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# NATIONAL TAXPAYER ADVOCATE

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FISCAL YEAR 2015  
OBJECTIVES  
REPORT TO CONGRESS

VOLUME 2

IRS RESPONSES AND  
NATIONAL TAXPAYER  
ADVOCATE'S COMMENTS

REGARDING MOST SERIOUS  
PROBLEMS IDENTIFIED IN 2013  
ANNUAL REPORT TO CONGRESS





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## IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2013 Annual Report to Congress

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### PREFACE: NATIONAL TAXPAYER ADVOCATE'S INTRODUCTORY REMARKS

Honorable Members of Congress:

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the Most Serious Problems (MSPs) encountered by taxpayers. For 2013, the National Taxpayer Advocate identified, analyzed, and offered recommendations to assist the Internal Revenue Service (IRS) and Congress in resolving 25 such problems.<sup>1</sup>

Unlike previous Annual Reports, the 2013 document did not include IRS comments on the Most Serious Problem analyses and the National Taxpayer Advocate's response to those comments. In part, this change was necessary so we could issue the report as close as possible to the December 31 statutory deadline, given the 16-day government shutdown last fall, which hit at a particularly crucial time in the editing and review schedule.<sup>2</sup>

This change in approach, however, also brought us into conformity with the specific statutory language of IRC § 7803(c)(2)(B)(iii), which requires the National Taxpayer Advocate to submit her reports "directly" to the House Committee on Ways and Means and the Senate Committee on Finance "without any prior review or comment from the Commissioner, the Secretary of the Treasury, the Oversight Board, any other officer or employee of the Department of the Treasury, or the Office of Management and Budget."<sup>3</sup>

Congress provided the IRS with the ability to comment on and respond to the National Taxpayer Advocate's recommendations (in the Annual Reports and elsewhere) by requiring the Commissioner to "establish procedures requiring a formal response to all recommendations submitted to the Commissioner by the National Taxpayer Advocate within 3 months after submission to the Commissioner."<sup>4</sup> The IRS has fulfilled its statutory responsibility by preparing written responses to the recommendations in each of the 25 MSPs in the 2013 report.

Shortly after the National Taxpayer Advocate submitted her 2013 Annual Report to Congress, Commissioner Koskinen asked that she identify for his consideration select recommendations from the report that she believed could have a significant positive impact on tax administration and could be undertaken or at least explored with minimal resources. No prior commissioner had made such a request. I was pleased to provide a list of 12 recommendations, including adoption of a Taxpayer Bill of Rights, and also made recommendations regarding preparer standards in light of

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<sup>1</sup> Available at: <http://www.taxpayeradvocate.irs.gov/2013-Annual-Report>.

<sup>2</sup> IRC § 7803(c)(2)(B)(ii) requires the National Taxpayer Advocate to submit the Annual Report to the tax-writing committees of Congress not later than December 31 of each calendar year.

<sup>3</sup> IRC § 7803(c)(2)(B)(iii).

<sup>4</sup> IRC § 7803(c)(3). The IRS's 90-day responses to previous Annual Reports and the TAS comments on those responses are available in the "report cards" posted at <http://www.irs.gov/Advocate/Reports-to-Congress>.

the *Loving* decision.<sup>5</sup> I am pleased to report that the IRS has made substantial progress on five of these issues. The memorandum, dated January 22, 2014, is published immediately following this preface.

The IRS formal comments on our recommendations, together with the National Taxpayer Advocate's analysis of and responses to the comments, are presented here. In this way, we retain full transparency regarding the IRS's perspective on our recommendations to address the MSPs while still complying with the statutory protections.

The format for these responses is as follows:

- A one-page summary of each Most Serious Problem from the 2013 Annual Report, with a numbered list of the National Taxpayer Advocate's recommendations to the IRS for resolving the problem (for example, the first recommendation in MSP #3 would be 3.1).
- A similar numbered list of the IRS responses to the recommendations for each individual MSP, followed by the actions the IRS has committed to take (if any) to resolve the problem.
- The National Taxpayer Advocate's comments on the IRS responses, and her assessment of how they affect the objectives of our office for the coming (2015) fiscal year.

Nina E. Olson



National Taxpayer Advocate  
30 June 2014

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<sup>5</sup> Memorandum from Nina E. Olson, National Taxpayer Advocate, to John A. Koskinen, Commissioner of Internal Revenue, National Taxpayer Advocate Priority Recommendations (Jan. 22, 2014). *Infra*, p 3.



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

January 22, 2014

MEMORANDUM FOR JOHN A. KOSKINEN  
COMMISSIONER OF INTERNAL REVENUE

FROM: Nina E. Olson   
National Taxpayer Advocate

SUBJECT: National Taxpayer Advocate Priority

At your request, I am submitting for your consideration a summary of select recommendations from my recent Annual Report to Congress that I believe will have significant positive impact on tax administration and can be undertaken or explored with minimal resources. Each of these recommendations will enhance taxpayer rights and minimize taxpayer burden. Equally important from an enterprise perspective, I believe they will promote voluntary tax compliance and reduce IRS rework and the downstream use of unnecessary resources.

1. **Taxpayer Bill of Rights: Adopt a thematic, principle-based Taxpayer Bill of Rights (TBOR) and post it on IRS.gov** At Acting Commissioner Werfel's direction, NTA has taken the lead in developing a TBOR and coordinating the language with C&L (Terry Lemons) and Chief Counsel (Chris Sterner). TAS has just completed focus groups with taxpayers and preparers to test out the language we developed, and we plan to tweak the language in light of the feedback we received. Posting a TBOR has seemed noncontroversial because the intent is not to create new rights, but simply to organize the dozens of existing taxpayer rights into categories that taxpayers and IRS employees will more easily grasp and remember. The TBOR would serve as an organizing principle for the IRS in establishing agency goals, provide foundational principles to guide IRS employees in their dealings with taxpayers, and provide information to taxpayers to assist them in their dealings with the IRS. More specifically, we recommend that you direct C&L to work with the NTA to coordinate details of website posting and develop an education campaign. We also recommend the development of performance measures and individual commitments for managers and senior leaders regarding taxpayer rights. We further recommend that you direct IRS operating divisions to cooperate with TAS in revising IRM audit and collection provisions to incorporate more discussion of taxpayer rights. [NTA 2013 Report, Most Serious Problem #1, *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (pages 5-19).]

2. **Performance Measures: Adopt the suite of taxpayer-centric performance measures we set out in our annual report.** We proposed a set of performance measures geared specifically to gauge the IRS's effectiveness in protecting taxpayer rights and promoting voluntary tax compliance. [See NTA 2013 Report, Preface (especially pages xvi-xviii) and *National Taxpayer Advocate Report Card: Measuring the IRS's Protection of Taxpayer Rights and Promotion of Voluntary Compliance* (pages xxiv and xxv).]
3. **Identity Theft: Direct the Wage & Investment (W&I) Operating Division to collaborate with TAS to test the effectiveness of creating a meaningful "single point of contact" for taxpayers, at least for taxpayers with cases that require the involvement of multiple IRS functions.** For this test, we recommend that the IRS IPSU unit, using the TAS case management system and procedures, assign identity theft cases to specific IPSU employees, who would act as the sole person interfacing with the taxpayer, obtain from the taxpayer the information necessary to resolve the case and all issues in the case, forward that information to the appropriate IRS unit[s], and monitor and follow-up on the timeliness of requested actions. [NTA 2013 Report, Most Serious Problem #4, *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers* (pages 75-83).]
4. **Collection: With respect to IRS attempts to collect delinquent tax debts, instruct the Collection Governance Council to study and test TAS's recommendations to improve the collection of debts, particularly for employment taxes, while also maximizing future voluntary tax compliance.** The IRS typically prioritizes collection cases based on the dollar value of the debt (rather than the recency of the debt), uses its Automated Collection System (ACS) to serve levies and file liens by automation (rather than utilizing Revenue Officers to make personal contact), and emphasizes what we regard as the fairly heavy-handed use of levies and liens over more flexible collection approaches like installment agreements and offers-in-compromise. The NTA has long recommended that the IRS measure the effectiveness of its collection approach in terms of timely interventions, personal contact, and enhancing long-term voluntary tax compliance, particularly with respect to employment tax debts. [See NTA 2013 Report, Most Serious Problem #11, *Collection Strategy: The Automated Collection System's Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers and the Public Fisc* (pages 124-133); Most Serious Problem #12, *Collection Process: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue* (pages 134-146); Volume 2, Research Study, *A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies* (Vol. 2, pages 15-32).]
5. **EITC 2-Year Ban: Direct W&I to issue guidance regarding its application.** When the IRS makes a "final determination" that an individual improperly claimed the EITC due to "reckless or intentional disregard of rules and regulations", Section 32(k)(1)(B)(ii) of the Internal Revenue Code authorizes the IRS to ban the individual from receiving EITC benefits for the succeeding two years. This standard requires more than mere negligence on the part of the taxpayer. Yet the IRS has automatically applied the 2-year ban in many cases, which I believe is inconsistent with the statutory requirement of a "determination" that the improper claim was due to more than mere negligence (our MSP also cites Chief Counsel guidance to this effect) and which violates multiple provisions of the Internal Revenue Manual. I have discussed this issue with the



W&I commissioner; she expressed a willingness to work with TAS to resolve this issue. [NTA 2013 Report, Most Serious Problem #9, *Earned Income Tax Credit: The IRS Inappropriately Bans Many Taxpayers from Claiming EITC* (pages 103-115).]

6. **Civil Tax Penalties: Create a cross functional task force to review the rationale and application of the more than 130 penalties contained in the Internal Revenue Code** The primary objective of civil tax penalties is to promote voluntary compliance with the tax laws. In 1989, Congress recommended that the IRS “develop better information concerning the administration and effects of penalties.” Over the last 20 years, the IRS has increasingly applied penalties automatically. TAS research shows that taxpayers against whom automatic penalties have been applied show significantly lower levels of voluntary compliance after five years than those not subject to a penalty. We recommend the IRS conduct a review of its penalty policies to ensure it receives sufficient information from the taxpayer to make a determination as to whether the penalty actually applies and will enhance voluntary compliance, rather than being purely punitive. I have discussed this proposal with the SB/SE commissioner, and she expressed support for such a review. [See NTA 2013 Report, Volume 2, *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?* (Vol. 2, pages 1-14); see also Most Serious Problem #17, *Accuracy-Related Penalties: The IRS Assessed Penalties Improperly, Refused to Abate Them, and Still Assesses Penalties Automatically* (pages 182-187).]
7. **Exempt Organizations: Provide administrative review before automatically revoking an organization’s exempt status.** By law, the IRS is now required to revoke the exempt status of organizations that do not file returns for three consecutive years. The Exempt Organizations (EO) function ordinarily receives about 60,000 applications for exempt status each year, and the number of existing organizations whose exempt status was revoked and applied anew added about 50,000 cases to EO’s workload over the past three years. Some of those revocations were erroneous and others required needless rework. If the IRS sent a letter to exempt organizations at least 30 days before revoking their exempt status that provided them with an opportunity to correct the condition (e.g., by filing returns), the heavy burdens on the organizations and the IRS alike could be reduced. I have already discussed this proposal with the new TEGE commissioner, who has expressed interest in this approach as a way to minimize unnecessary reinstatements. [NTA 2013 Report, Most Serious Problem #15, *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status* (pages 165-172).]
8. **Offshore Accounts: Revamp the Offshore Voluntary Disclosure Program to reduce the disproportionate burden imposed on taxpayers who lacked willful intent or had reasonable cause for their mistakes** NTA proposed a three-tier penalty structure that would (1) provide full relief from FBAR penalties for taxpayers whose under-reporting falls below a threshold amount, (2) impose “non-willful” FBAR penalties on qualifying taxpayers, and (3) impose higher penalties on taxpayers who either acted willfully or lacked reasonable cause. I have met with the deputy commissioner of LB&I (Mike Danilack), who expressed general support for the approach of differentiating penalties. [NTA 2013 Report, Most Serious Problem #22, *Offshore Voluntary Disclosure: The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Make Honest Mistakes* (pages 228-237).]

9. **International Taxpayer Service: Explore the use of voice-over-Internet-protocol and other alternative methods of telephone services that will allow taxpayers to contact the IRS, or the IRS to contact taxpayers, without paying international call rates** Taxpayers living overseas generally do not have the option of calling IRS customer service representatives toll-free to seek help in complying with their U.S. tax obligations. This recommendation is designed to plug that hole. NTA has briefed the commissioner of W&I on a U.S. embassy contract in the United Kingdom that allows the U.S. Tax Attaché to make an unlimited number of international outbound calls for the same low rate. [NTA 2013 Report, Most Serious Problem #20, *International Taxpayer Service: The IRS Is Taking Important Steps to Improve International Taxpayer Service Initiatives, But Sustained Effort Will Be Required to Maintain Recent Gains* (pages 205-213).]
10. **Revenue Protection: Reinstate the cross-functional Pre-Refund Program Executive Steering Committee to coordinate the development of fraud-detection filters** Imprecise filters produce both underinclusive results (failing to catch refund fraud) and overinclusive results (substantially delaying and in some cases denying the payment of refunds to eligible taxpayers). A cross-functional group can help ensure that multiple perspectives are considered, allowing the IRS to target its filters more precisely. [NTA 2013 Report, Most Serious Problem #16, *Revenue Protection: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds* (pages 173-181).]
11. **Bitcoin: The IRS should issue guidance now to advise the growing number of Bitcoin users how the digital currency will be taxed.** The IRS has an obligation to be transparent and tell taxpayers up front what the tax treatment of common transactions will be. It should not wait in ambiguous areas to impose tax on audits after-the-fact. [NTA 2013 Report, Most Serious Problem #24, *Digital Currency: The IRS Should Issue Guidance to Assist Users of Digital Currency* (pages 249-255).]
12. **“Real Time” Tax System: Create a cross-functional task force to explore and make specific plans to transition to a system whereby the IRS matches tax returns against third-party information reports (e.g., Forms W-2 and 1099) before paying out refunds, and makes this information available in electronic form to taxpayers for assistance in preparing their returns** [NTA 2013 Report, Volume 2, *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments* (Vol. 2, pages 67-96).]

In addition, I made several recommendations in my annual report regarding steps to mitigate the impact of the *Loving* decision (assuming it is affirmed on appeal) and allow the IRS to do a better job of raising minimum competency and ethical standards in the return preparation industry. Some of these steps likely will require more than minimal resources, but they could be substantially accomplished using the resources currently allocated to the Return Preparer Office. Preparer oversight would protect taxpayers from unscrupulous preparers and, in my view, would be extremely cost effective in the long-term by improving return accuracy and helping to reduce improper payments.

Specifically, I recommended that the IRS take the following steps: (1) offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate; (2) restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn the certificate; (3) restrict the ability of unenrolled preparers who have not earned the certificate to be named as a third-party designee on Form 1040, *U.S. Individual Income Tax Return*; (4) mount a consumer protection campaign to educate taxpayers about the value of selecting a qualified preparer; (5) develop a research-driven and service-wide preparer compliance strategy similar in nature to the Earned Income Tax Credit preparer compliance strategy; and (6) recommend that Congress revise 31 U.S.C. § 330(a)(2) to expressly authorize the IRS to regulate unenrolled preparers. [NTA 2013 Report, Most Serious Problem #5, *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS is Enjoined from Continuing Its Efforts to Effectively Regulate Unenrolled Preparers* (pages 61-74).]

I have met with the Director of the Office of Professional Responsibility, the Director of the Return Preparer Program, and the Associate Chief Counsel for Procedure and Administration about the next steps for instituting voluntary testing and continuing education of unenrolled tax return preparers, and there appears to be general consensus about these recommendations.

I look forward to working with you on these issues and appreciate the opportunity to discuss them with you.

**MSP  
#1****TAXPAYER RIGHTS: The IRS Should Adopt a Taxpayer Bill Of Rights as a Framework for Effective Tax Administration**

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**PROBLEM**

The U.S. tax system is built on voluntary compliance. For the government, voluntary compliance is much cheaper than enforced compliance, because the government does not have to spend money to collect amounts that are voluntarily paid. Taxpayer rights are central to voluntary compliance. If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the tax system and be less likely to comply with the laws voluntarily. If taxpayers have confidence in the fairness and integrity of the tax system, they will be more likely to comply.

There are dozens of discrete taxpayer rights scattered throughout the Internal Revenue Code, but they are not organized or presented in a coherent way. Similarly, Congress in the past has enacted several bills with the name “Taxpayer Bill of Rights,” but they, too, create discrete rights and do not articulate broad principles. Not surprisingly, in response to a survey of U.S. taxpayers conducted for TAS in 2012, less than half said they believed they have rights before the IRS, and only 11 percent said they knew what those rights are.

A Taxpayer Bill of Rights (TBOR), modeled on the U.S. Constitution’s Bill of Rights, would provide a thematic list of core taxpayer rights, and a foundational framework for taxpayers and IRS employees alike. Its value can scarcely be overstated. A Taxpayer Bill of Rights provides organizing principles – a framework – for effective tax administration.

**ANALYSIS**

Many countries and states have adopted a Taxpayer Bill of Rights. Just as the U.S. Constitution’s Bill of Rights is organized and presented in a manner that U.S. citizens and the government itself can understand and respect, a Taxpayer Bill of Rights (TBOR) would serve the same function in the realm of taxation. A thematic, principle-based list of core taxpayer rights would serve as an organizing principle for tax administrators in establishing agency goals and performance measures, provide foundational principles to guide IRS employees in their dealings with taxpayers, and provide information to taxpayers to assist them in their dealings with the IRS.

The National Taxpayer Advocate views the tax system as an unwritten social contract between the government and its taxpayers; namely, taxpayers agree to report and pay the taxes they owe to enable their government to function, and the government agrees to provide the service and oversight necessary to ensure that taxpayers can and will do so. In recognition of this “two-way street,” the report recommends that the IRS adopt a Taxpayer Bill of Rights that contains ten taxpayer rights and five taxpayer responsibilities.

## TAS RECOMMENDATIONS AND IRS RESPONSES

[1-1] Adopt a Taxpayer Bill of Rights, including ten fundamental taxpayer rights and five taxpayer responsibilities.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS recognizes the importance of embracing and highlighting the Taxpayer Bill of Rights and using it as a reinforcing principle for all IRS employees as a way to improve taxpayer service and preserve the integrity of the tax system. The Taxpayer Bill of Rights offers a clear explanation of every person's fundamental rights, including when they pay taxes, receive refunds, or become involved in a tax dispute with the IRS. While taxpayer rights has been a cornerstone principle of the IRS following the Restructuring and Reform Act of 1998, the IRS recognizes it needs to do more in this area. The IRS fully embraces the revised language of the Taxpayer Bill of Rights and will continue to collaborate with the National Taxpayer Advocate to make this update visible to all taxpayers and employees. These rights include: *the right to be informed, the right to quality service, the right to pay no more than the correct amount of tax, the right to challenge the IRS's position and be heard, the right to appeal an IRS decision in an independent forum, the right to finality, the right to privacy, the right to confidentiality, the right to retain representation, and the right to a fair and just tax system.*
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will take the following actions in collaboration with the National Taxpayer Advocate:
  - Revise IRS Publication 1, *Your Rights as a Taxpayer*, to reflect revised language of the Taxpayer Bill of Rights. The first part of this publication will explain some of the most important rights as a taxpayer. The second part will explain the examination, appeal, collection, and refund processes. This publication will also be available in Spanish. Publication 1, *Your Rights as a Taxpayer*, was first published in 1988.
  - Engage in communications and discussions with IRS managers and employees about the Taxpayer Bill of Rights and demonstrate leadership support. This will include communicating with employees throughout the year about the importance of the Taxpayer Bill of Rights and its application to everyday work activities and taxpayers.
  - Inform external stakeholders about the Taxpayer Bill of Rights and the IRS's commitment to ensuring taxpayers are afforded those rights. This will include highlighting the Taxpayer Bill of Rights on the agency's public-facing website, IRS.gov, and include in materials delivered to taxpayers, the media, and tax professionals.
  - Determine the most efficient and cost-effective way of delivering materials on the Taxpayer Bill of Rights to all public-facing IRS sites so that they are in place as soon as possible.

[1-2] Prominently display a link on the IRS.gov homepage a link ("Know Your Rights as a Taxpayer") to a taxpayer rights page, which will further link to specific explanations of taxpayer rights and responsibilities.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As part of the effort to adopt the revised language of the Taxpayer Bill of Rights and communicate its importance to external stakeholders, the IRS is taking actions now to prominently feature the

Taxpayer Bill of Rights on the IRS.gov home page to ensure that online visitors can easily navigate to information about taxpayer rights. The IRS will also make any corollary updates to pages within the IRS.gov website when displaying information about taxpayer rights is appropriate and useful to online visitors.

- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will take the following actions in collaboration with the National Taxpayer Advocate:
  - Establish a reference landing page on the IRS.gov website to communicate official information about the Taxpayer Bill of Rights and its application to everyday interactions with the IRS.
  - Feature a link to the Taxpayer Bill of Rights landing page on the IRS.gov home page, consistent with strategies to increase the number of online visitors exposed to information about the Taxpayer Bill of Rights.

[1-3] In collaboration with the National Taxpayer Advocate, post taxpayer rights language on the business operating division pages of IRS.gov that refer to TAS, Low Income Taxpayer Clinics, and specific taxpayer rights and responsibilities and contains links to the U.S. Tax Court web page, where appropriate.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As part of the effort to adopt the revised language of the Taxpayer Bill of Rights and communicate its importance to external stakeholders, the IRS is taking actions now to collaborate with the National Taxpayer Advocate to update key pages of IRS.gov with information about the Taxpayer Bill of Rights. The external website, however, is not generally designed around IRS business units, rather around types of taxpayers.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will take the following actions in collaboration with the National Taxpayer Advocate:
  - Update information about the Taxpayer Bill of Rights on key pages within the IRS.gov website, where appropriate, to ensure that the official IRS.gov website provides accurate and up-to-date information to all online visitors.
  - For IRS employees, post information about the Taxpayer Bill of Rights on key Business Unit pages.

[1-4] Require all public- and taxpayer-facing IRS sites and offices to display a poster and brochures about the Taxpayer Bill of Rights, to be developed in collaboration with the National Taxpayer Advocate.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As part of the ongoing effort to communicate the importance of the Taxpayer Bill of Rights to external stakeholders, the IRS is taking actions now to assess the feasibility of printing and mailing materials to all public- and taxpayer-facing IRS sites and offices. Implementation of this recommendation is contingent on the budget. If the FY 2014 budget does not allow for the printing and mailing of posters and brochures to all public- and taxpayer-facing IRS sites

and offices, then the IRS will consider alternative options for effectively making the public aware of their fundamental rights as taxpayers.

- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will take the following actions in collaboration with the National Taxpayer Advocate:
  - Determine the most efficient and cost-effective way of delivering materials on the Taxpayer Bill of Rights to all public-facing IRS sites.
  - Ensure all materials are in place as soon as possible.

[1-5] Require all IRS operating divisions and functions when proposing initiatives, including budget initiatives, to include in their business case justifications an analysis of the proposed operation in terms of the Taxpayer Bill of Rights.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS's annual budget development process includes a requirement that all business units coordinate with the Taxpayer Advocate Service regarding the downstream program impact of any proposed initiatives. Historically, the purpose of this coordination has been for TAS to identify the additional staffing it may need to handle any increased TAS workload expected as a result of additional enforcement or taxpayer service activity. However, this existing process can also afford TAS an opportunity to provide feedback regarding the relationship between a proposed initiative and the Taxpayer Bill of Rights.
- **Actions the Internal Revenue Service Has Committed to Take:** Guidance on developing new initiatives will be expanded to instruct business unit owners to evaluate the impact of proposed initiatives on taxpayer rights and incorporate resources into their requests to ensure that taxpayer rights are appropriately considered. In addition, TAS will continue to have an opportunity to review proposed initiatives and identify additional resources that may be needed to ensure taxpayer rights are protected.

## TAXPAYER ADVOCATE SERVICE RESPONSE

In adopting the Taxpayer Bill of Rights, the IRS has taken a major leap forward in ensuring that every taxpayer and every IRS employee knows and understands the basis upon which effective tax administration rests in a democratic society. In its response, the IRS has committed to make a serious effort to educate taxpayers and its employees about these rights. The National Taxpayer Advocate is particularly pleased that the IRS has committed to revise its guidance regarding development of initiatives to instruct business owners “to evaluate the impact of proposed initiatives on taxpayer rights and incorporate resources into their requests to ensure that taxpayer rights are appropriately considered.” The Taxpayer Advocate Service appreciates the IRS's recognition and expectation that TAS will review these initiatives and raise any concerns about the negative impact on taxpayer rights.

Making the TBOR “real” to taxpayers will require a continuing commitment from the IRS and its employees, including informing taxpayers of existing remedies and identifying gaps where additional remedies may be required. The National Taxpayer Advocate commits to work with the IRS

and Congress to ensure taxpayers are able to avail themselves of these remedies and to recommend additional remedies so the TBOR's promises are, in fact, enforceable.

We note that the adoption of the TBOR took place after the IRS finalized the details of its strategic plan for fiscal years (FYs) 2014 through 2017.<sup>6</sup> That plan is notably deficient in references to taxpayer rights and a Taxpayer Bill of Rights.<sup>7</sup> Specifically, our review identifies only two mentions of taxpayer rights in a 40-page document. We expect the IRS will rectify this deficiency both in its next strategic plan and updates to the current plan, and also by undertaking the steps it commits to above.

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<sup>6</sup> IRS Pub. 3744, *Internal Revenue Service Strategic Plan FY 2014-2017* (Rev. 6-2014).

<sup>7</sup> IRS Strategic Plan FY 2014-2017, 11 & 13. The plan states, "The Taxpayer Advocate Service (TAS) offers free help to guide taxpayers" and "Taxpayer Advocates play an important role and are essential for the protection of taxpayer rights." Available at: <http://core.publish.no.irs.gov/pubs/pdf/31685f14.pdf>.



**MSP  
#2****IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance**

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**PROBLEM**

In fiscal terms, the mission of the IRS – to “[p]rovide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all” – trumps the missions of all other federal agencies. If the IRS lacks adequate funding to do its job effectively, the government will have fewer dollars to fund the military, social programs, and all other programs – or simply to reduce the deficit. Since fiscal year (FY) 2010, the IRS budget has been cut by nearly eight percent while inflation has risen by about six percent. As a result, the IRS is neither providing “top quality service” nor maintaining effective enforcement. In FY 2013, the IRS could only answer 61 percent of customer service calls, and respond timely to just 47 percent of taxpayers’ letters about changes to their accounts. The IRS also slashed its overall training budget by a staggering 87 percent, which means the IRS not only has fewer employees than four years ago, but those who remain are less equipped to perform their jobs and to understand and respect taxpayer rights.

**ANALYSIS**

The combination of more work and less funding predictably has impaired the IRS’s ability both to meet taxpayer needs and to improve tax compliance. The IRS is receiving significantly more individual and business tax returns today than ten years ago, which means it must answer more taxpayer phone calls, process the additional returns, conduct compliance checks, and sometimes conduct audits or take collection actions. The IRS is also receiving substantially more phone calls. In FY 2013, nearly 20 million calls to customer service representatives went unanswered because the IRS does not have enough employees to handle them. The IRS has also had to address a huge spike in tax-related identity theft and refund fraud. Also in FY 2013, the IRS assigned more than 3,000 employees to work identity theft. Because of the harm identity theft victims suffer, we believe that was the right decision, but the reassignment of so many employees meant that other work in crucial taxpayer service and enforcement areas simply could not be done.

Because the IRS is the federal government’s accounts receivable department and generates a substantially positive return on investment, it is self-defeating to treat the agency like a pure spending program in which a dollar spent is simply a dollar spent. With the IRS, a dollar spent generates many dollars in additional revenue, and a dollar not spent translates to a greater decrease in revenue collection, thereby adding to the budget deficit.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[2-1] Revise the budget rules so that the IRS is “fenced off” from otherwise applicable spending ceilings and is viewed more like an accounts receivable department. It should be funded at a level designed to maximize tax compliance, particularly voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is responsible for 92 percent of all federal receipts, through a combination of voluntary tax remittances and compliance activity. Since FY 2010, however, the IRS's budget has declined by more than \$850 million with a corresponding reduction of nearly 10,000 full-time equivalents (FTE). Recent fiscal events such as sequestration, the government shutdown, and multiple long-term continuing resolutions have affected the IRS's ability to strategically develop and implement plans for hiring, training, information systems development, and other critical business activities. We agree that the current IRS funding is insufficient to effectively serve taxpayers and increase voluntary compliance and will continue to work with Congress and seek its full support of our budget requests.

To the extent that Congress is supportive of recognizing the unique role of the IRS in the collection of federal revenues through an appropriations rule change, the Service would commit to working with the House and Senate, as well as other stakeholders, to find funding mechanisms that effectively balance the needs of taxpayer service, compliance, and support activities.

- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue to work with Congress and seek their full support of our budget requests. We remain prepared to implement Congressionally-enacted agency budgets.

[2-2] In allocating IRS resources, keep in mind that tax compliance requires a combination of high quality taxpayer service, outreach and education, and effective tax-law enforcement, and the IRS should continue to maintain a balanced approach toward that end. We are concerned that the program integrity cap adjustment procedures used in the past skew this important balance and should be avoided, but if cap adjustments continue to be used, we recommend they be written in a manner that applies to broadly defined compliance initiatives that include both taxpayer service (including outreach and education) and enforcement components.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is committed to striking an appropriate balance between voluntary compliance through effective taxpayer service, and enforcement efforts that ensure respect for both taxpayer rights and the law.

The cap adjustment is defined by the Office of Management and Budget (OMB) and is intended to be offset by the revenue generated. Any change to the definition would be made by Treasury and OMB.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

We recognize the IRS leadership fully appreciates the impact that reduced resources are having on the agency's ability to deliver on its mission of serving taxpayers and collecting tax.

However, we are disappointed that the IRS's response to our recommendation on the use of program integrity cap adjustments is simply to say that "the cap adjustment is defined by the Office of

Management and Budget (OMB).” As we understand it, OMB (in collaboration with the Congress) limits the use of cap adjustments to situations where the revenue generated by a proposed activity is projected to exceed its cost. But as long as a proposed initiative meets that requirement, we understand it may be considered for cap adjustment purposes without regard to whether the underlying activities are purely enforcement or a combination of (i) outreach and education and (ii) enforcement.

Our recommendation stated: “We are concerned that the program integrity cap adjustment procedures used in the past skew this important balance [between taxpayer service and enforcement] and should be avoided, but if cap adjustments continue to be used, we recommend they be written in a manner that applies to broadly defined compliance initiatives that include both taxpayer service (including outreach and education) and enforcement components.” We are not aware of any OMB definition that would preclude the use of cap adjustments for broadly defined compliance activities that include both taxpayer service and enforcement components – provided the combined effect is to produce a positive return-on-investment. We continue to urge that the IRS ensure – in its internal budget planning and in its collaboration with the Treasury Department and OMB – that its compliance activities reflect a reasonable balance between taxpayer service and enforcement.

**MSP  
#3****EMPLOYEE TRAINING: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission****PROBLEM**

To deal with a complex, constantly changing tax law and provide taxpayers with complete and accurate service, IRS employees must receive prompt and appropriate training and education. Since fiscal year (FY) 2009, budget cuts and sequestration have led the IRS to cut its training budget by over 85 percent. The IRS has reduced its training and education programs to a bare minimum without considering the types of training employees need to perform basic job functions, protect taxpayer rights, and prevent harm and undue burden for taxpayers. Lacking appropriate training and education, employees will be unable to fulfill their mission and taxpayer service will continue to erode. Delivering timely, appropriate education and training to employees is essential to the core function of the IRS.

**ANALYSIS**

The IRS drastically cut its training budget to meet its required overall reductions under the Budget Control Act of 2011. Even before the sequester, however, the IRS had sharply reduced the dollars it spent on training in response to a decrease in its total operating budget since FY 2010. In FY 2013, the IRS spent less than \$250 per employee on training, as compared with \$1,450 per employee in FY 2009, a decline of more than 83 percent. The IRS also created two review boards to review training requests for recommendation to the Deputy Commissioner (Operations Support), who declined to approve over 35 percent of proposed courses. Training hours delivered to employees in key job series have been reduced as much as 89 percent since FY 2009. In FY 2009, for example, Small Business/Self-Employed division revenue officers received over 700,000 total hours of training. In FY 2013, they were given just 76,000 hours – a reduction of almost 90 percent.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[3-1] Propose and Congress appropriate sufficient funding for the IRS to train its employees through the most effective means (in person, conference call, self-study, outside courses, etc.) about the subject matter they handle and protecting taxpayer rights.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS has implemented significant reductions in its non-labor spending. Since 2010, the IRS has limited employee travel and training to mission-critical projects. By our estimates, training costs have been reduced by 83 percent and training-related travel costs have been reduced by 87 percent since 2010. We have expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel. However, we have requested in our FY 2015 budget request that some of these funds be restored to ensure that IRS employees interacting with the public are properly trained and able to provide the answers and assistance expected.

- **Actions the Internal Revenue Service Has Committed to Take:** IRS FY 2015 Congressional Justification and Budget in Brief released March 10, 2014 requesting funding increase across the IRS by 10.5 percent.

[3-2] Prioritize funding for training employees in critical job skills; request Treasury Department authorization to approve training within the Office of Management and Budget's stated guidelines; and clearly define the review boards' criteria for approving training.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Current IRM 6.410.1 Policy. Business units (BU) are required to establish funding levels and determine work plans on an annual basis. As part of the process, BUs must include training in their work plans. Each year, the BUs develop Annual Training Plans based on a training needs assessment.

The Embedded Learning and Education (L&E) staff meet with their BU contacts to determine the annual training resource requirements and to submit the training plans to the HCO Learning, Education, and Delivery Services (LEADS) division. Embedded L&E periodically review the BU Annual Training Plan to determine the training that must be developed or revised each year.

Embedded L&E and the BU Finance Offices are responsible for:

- Allocating training funds to meet the training requirements of their BUs.
  - Distributing training funds in accordance with their BUs' training funding process.
  - Monitoring additions, changes, and deletions to training requirements and their impact on funding levels.
  - Ensuring training requirements are entered into the Annual Training Plan.
  - Preparing program guidance for managing training funds within their BUs.
  - Planning and funding delivery strategies.
- **Actions the Internal Revenue Service Has Committed to Take:** Training Oversight and Approval.

The delivery of training has been impacted by new approval requirements. Treasury Directive 12-70 (TD-12-70), issued November 28, 2012, requires Treasury approval of training and travel events costing more than \$50,000 and IRS Commissioner approval of all events costing more \$20,000.

The TRB provides recommendations to the IRS Commissioner regarding approvals for all training requests with costs greater than \$20,000. The TRB supports the IRS in meeting the requirements of TD-12-70 to minimize event-related costs and to ensure expenditures are properly reviewed, justifiable, and necessary to fulfill the vision and mission of the IRS.

These new approval requirements have resulted in much closer scrutiny of training requests and, therefore, reductions to training spending. However, IRS leadership worked with

the Treasury Department to relax some of the approval requirements related to TD-12-70. Effective April 4, 2014 certain IRS mission critical training and travel was exempted from the TD-12-70 approval process. Additionally, the purchase of Blanket Purchase Agreements (BPAs) for training services was exempted from the TD-12-70 approval process. This relaxation of approval requirements should result in increased training spending in the second half of FY 2014 and beyond.

[3-3] Request and obtain from the Department of Treasury authority to approve training within the OMB stated guidelines.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The Department of the Treasury did not agree with OMB's less restrictive guideline requiring that only proposed spending over \$100,000 for a single conference event to be reviewed at the level of the agency Deputy Secretary or equivalent. However, Treasury did agree to revise Treasury Directive 12-70 and increase the IRS Commissioner's approval threshold (from \$3,000 to \$20,000), Business Operating Division Commissioners' approval threshold (from under \$3,000 to \$10-\$20,000), First Level Executive (from \$0 to under \$10,000) and granted numerous exclusions (*e.g.*, online training that does not involve travel), thereby relieving some burden for obtaining approval of training events. The Deputy Commissioner, Operations Support (DCOS) has issued interim guidance incorporating revised provisions and approval requirement updates.
- **Actions the Internal Revenue Service Has Committed to Take:** The Department of the Treasury did not agree with OMB's less restrictive guideline requiring that only proposed spending over \$100,000 for a single conference event to be reviewed at the level of the agency Deputy Secretary or equivalent. However, Treasury did agree to revise Treasury Directive 12-70 and increase the IRS Commissioner's approval threshold (from \$3,000 to \$20,000), Business Operating Division Commissioners' approval threshold (from under \$3,000 to \$10-\$20,000), First Level Executive (from \$0 to under \$10,000) and granted numerous exclusions (*e.g.*, online training that does not involve travel), thereby relieving some burden for obtaining approval of training events. The DCOS has issued interim guidance incorporating revised provisions and approval requirement updates.

[3-4] Clearly define the criteria for TRB approval of training.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The Training Review Board (TRB) conducts high-level reviews of planned training events estimated to cost \$20,000 or greater to ensure training events are mission critical and delivered in the most cost effective manner (location, number of participants, lodging, and travel). The TRB recommendations have to be approved by the Commissioner of the Internal Revenue with events greater than \$49,999 routed to the Department of the Treasury for final approval. Efforts are underway to strengthen the role of the TRB to look at training needs and gaps across the IRS more strategically.
- **Actions the Internal Revenue Service Has Committed to Take:** The TRB's decision to shift its focus to a service-wide approach will result in the following actions:

- Servicewide alignment of training needs and budget that meet IRS goals;
- Categorization and prioritization of Service needs; and
- Measures to monitor the effectiveness of learning and education programs.

### **TAXPAYER ADVOCATE SERVICE RESPONSE**

The National Taxpayer Advocate appreciates the IRS's efforts in the face of shrinking budgets and increasing scrutiny. The National Taxpayer Advocate is pleased that the IRS requested increased funding for FY 2015, and fully supports additional funding to ensure that the IRS is able to better serve taxpayers. We are particularly pleased that the IRS recognizes the need for face-to-face training of employees in taxpayer-facing occupations.

The exclusions and relaxation of spending limits the IRS has obtained in later FY 2014 from the Department of Treasury are encouraging. The National Taxpayer Advocate looks forward to continuing to work with the IRS to ensure that it delivers training, particularly to employees in mission critical public-facing jobs, in a timely and appropriate manner. We will also continue to advocate that the Treasury Department further expand the Commissioner's approval authority over training so that it aligns with OMB guidance.

## **MSP #4 TAXPAYER RIGHTS: Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights**

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### **PROBLEM**

While the Internal Revenue Code guarantees certain rights to taxpayers, many taxpayers are unaware of their rights, and IRS employees do not always communicate them to taxpayers at the right times. The IRS should provide employees with an overarching, comprehensive education about taxpayer rights as well as training and guidance about how those rights apply in specific situations.

### **ANALYSIS**

Training for many IRS employees contains only minimal instruction on taxpayer rights. For example, the 575-page training guide for newly hired tax examiners contains only six paragraphs that address discussing taxpayer rights and the audit process with taxpayers. The FY 2013 continuing education schedule for the Office of Appeals includes ten Customer Satisfaction courses, nine of which are from an outside vendor and focused on customer relationships in the private sector, along with one internal course on Cultural Competence and Effective Communication. While the courses may encourage effective communication, they do not discuss taxpayer rights at all. The Internal Revenue Manual (IRM) sometimes instructs employees to ensure that they have taken a specific action to protect taxpayer rights. Often, however, the manual does not explain how an item or action, such as a statutory notice of deficiency in an audit, affects taxpayers' rights. In addition, the IRS does not adequately include taxpayer rights in its measures, such as critical job elements and case quality scores.

### **TAS RECOMMENDATIONS AND IRS RESPONSES**

[4-1] Require all future updates of training modules to include a significant segment on taxpayer rights.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is committed to the fair and equitable treatment of taxpayers in all situations, from interacting with a taxpayer to responding to an inquiry or resolving a compliance issue. The U.S. taxation system is dependent upon the belief of taxpayers that the tax laws they follow apply to everyone, and the IRS will respect and protect their rights under the law. To ensure this is accomplished, we provide our employees the necessary training using a wide variety of training materials and job aids. We already provide information on taxpayer rights to new hires and our ongoing training curriculum addresses taxpayer rights as they relate to specific customer situations, including privacy, disclosure, third-party representation, collection and exam processes, as well as courteous and professional service. We embed taxpayer rights in our Internal Revenue Manual (IRM) procedures, training modules, workshops, team meeting discussions, job aids, and automated systems. Additionally, all IRS personnel designated



as 1204 employees are subject to the retention standard, “The Fair and Equitable Treatment of Taxpayers” (IRM 1.5.3.6). This standard ensures that employee performance focuses on providing quality service to taxpayers. Employees receive biennial training on Section 1204 of the Restructuring and Reform Act of 1998 (RRA ‘98) as a mandatory briefing. When an employee’s performance does not meet this standard, he or she is rated unsuccessful and action is taken to provide an improvement period, reassess, and, if warranted, remove the employee. In egregious cases, removal is immediate. We do not agree that future updates of training modules require significant revision to address taxpayer rights.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[4-2] Require all training modules that will not be updated in the next year to include the independent taxpayer rights training module to be developed by TAS.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As stated in the IRS response to 4-1, IRS believes adequate training is currently provided on taxpayer rights.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[4-3] Require all IRS employees to take the TAS Roadmap to a Tax Controversy Level One training.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS does not agree that all employees should receive training on the TAS Roadmap to a Tax Controversy Level One training. This TAS-developed training provides a high-level overview of the legal issues related to return filing, examinations, collections, appeals, and judicial review. It includes three roadmaps: Litigation and Assessment, Pre-Litigation Administrative Procedures and Collection. Given the technical nature of the content, it is not training that would be appropriate for all IRS employees. Moreover, given limited resources, it would not be appropriate to divert all employees from their core work to complete this training.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[4-4] Require all operating divisions to include in their Business Performance Reviews an analysis of how employees were trained on taxpayer rights issues and what actions the operating divisions took to incorporate the TBOR into their programs.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS recognizes the importance of publicizing the Taxpayer Bill of Rights and using it as an organizing principle for all IRS employees as a way to improve taxpayer service and preserve the integrity of the tax system over the long term. This will include communicating with employees throughout the year about the importance of the Taxpayer Bill of Rights and its application to everyday work activities.

Business Performance Reviews (BPRs), which occur on a quarterly basis, detail high-level organizational performance information to the IRS Commissioner and the Deputy Commissioners. The reviews are vital components of the Service’s strategic planning and budgeting process and provide a framework for measuring, reporting, and reviewing performance, goals, initiatives, and collaborative programs and processes. BPRs also provide

the opportunity to share evolving concerns with the IRS leadership. As such, it would be expected that issues or concerns involving the Taxpayer Bill of Rights be addressed at the BPRs to the extent necessary and appropriate. As a corrective action, we propose to reinforce this expectation with those IRS officials involved in producing the BPR materials and participating in the related discussions.

- **Actions the Internal Revenue Service Has Committed to Take:** Advise the Business Operating Division Commissioners and Chiefs reporting to the Deputy Commissioner for Services and Enforcement that issues arising relative to the Taxpayer Bill of Rights warranting the attention of IRS leadership from an enterprise, unit, and major program perspective should be included in the Business Performance Review materials and discussions.

[4-5] Require operating divisions to update their case quality attributes to measure whether the employee informed the taxpayer of his or her rights beyond just requiring the mailing of a publication or notice.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS believes this recommendation has already been implemented. In the Examination area, case quality attribute number 617 “TP/POA Rights and Notification” measures if the taxpayer representative was advised of all rights and kept informed throughout the examination process. See IRM Exhibit 4.8.3-1. During IRS collection activities, case quality attribute number 610 “Identified/Provided Taxpayer Rights or Statutory Letters” measures whether IRS employees “followed the regulatory/statutory guidelines to ensure that taxpayer rights are protected during the collection process. This includes...the explanation of additional appeal rights that may arise during the case. As case circumstances warrant, the revenue officer must advise the taxpayer of appeal rights under CAP and CDP, as well as the right to appeal certain decision such as....” See IRM 5.13.2.6.4. Finally, CAP program managers are instructed that employees must, among other things, know and observe the rights of taxpayers. See IRM 1.4.20.14. While this recommendation has already been implemented, the response to Recommendation 4-8 below—the IRS will be reviewing the IRM for updates needed relative to the Taxpayer Bill of Rights—will include IRM sections involving employees’ responsibilities for informing taxpayers of their rights.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[4-6] Update the IRS’s guidance for developing CJE’s to include a focus on taxpayer rights.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Taxpayer Rights are incorporated in every manager and employee annual performance expectation meeting and appraisal discussion. RRA 98 § 1204(b) requires employees to be evaluated using the fair and equitable treatment of taxpayers as a performance standard. The IRS established the retention standard to ensure that employee performance is focused on providing quality service to taxpayers instead of on achieving enforcement results. The retention standard requires employees to:

- Administer the tax laws fairly and equitably;
- Protect taxpayers’ rights; and

- Treat each taxpayer ethically with honesty, integrity, and respect.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will take the following actions:
  - Review the IRM with the aim of identifying areas which need updates as a result of the Taxpayer Bill of Rights.
  - Update the IRM as appropriate.

[4-7] Distribute taxpayer rights posters to managers and require all employee offices to place them where the maximum number of employees will see them.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS will ensure IRS employees are made aware of the publication through appropriate placement, managerial discussions and through traditional internal communication channels.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[4-8] Update all IRM sections identified by TAS with language provided by TAS to incorporate the TBOR into the IRM.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** With the assistance of TAS, the IRS will review the IRM. The IRS will update the IRM as necessitated by the Taxpayer Bill of Rights. The IRS does not agree to update the IRM with the specific language provided by TAS; rather, the final Taxpayer Bill of Rights, as included in IRS Publication 1, *Your Rights as a Taxpayer* (Catalog Number 64731W) will dictate the language that is properly included in any revisions to the IRM.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will take the following actions in collaboration with the National Taxpayer Advocate:
  - Review the IRM with the aim of identifying areas which need updates as a result of the Taxpayer Bill of Rights.
  - Update the IRM as appropriate.

[4-9] The IRS will review the IRM to determine if any updates are needed regarding providing Pub 1 and TBOR.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As the IRS does its periodic updates of the IRM, we will review to determine if any updates are needed regarding providing Pub 1 and TBOR.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[4-10] Update all IRM sections identified by TAS to include requirements for employees to provide either Publication 1 or separate publications that explain the application of taxpayer rights in particular contexts, such as examination (Publication 1-E), collection (Publication 1-C), and appeals (Publication 1-A). Update all notices identified by TAS to include Publication 1, Publication 1-E, Publication 1-A, or Publication 1-C as a staffer.

- Internal Revenue Service Response to the National Taxpayer Advocate: N/A.
- Actions the Internal Revenue Service Has Committed to Take: N/A.

## TAXPAYER ADVOCATE RESPONSE

The National Taxpayer Advocate is deeply disappointed by the IRS's response, which seems to be in direct conflict with the IRS's response to the first Most Serious Problem, in which it commits to specific actions following its adoption of the Taxpayer Bill of Rights. The IRS's insistence that it already provides adequate training on taxpayer rights, despite multiple examples TAS has raised, calls into question the IRS's commitment to the Taxpayer Bill of Rights.

The new Taxpayer Bill of Rights provides the IRS with an opportunity to integrate rights awareness at a very practical and day-to-day level. The IRS points to examples like the biennial training employees receive on § 1204 of RRA 98, but the Fair and Equitable Treatment of Taxpayers retention standard, which is mandated by statute, addresses only one of the ten core taxpayer rights. The IRS needs to incorporate all ten of these rights throughout all of its training.

It is surprising that the IRS is opposed to showing all employees the Roadmap to a Tax Controversy Level One training. TAS has offered this training to all of its employees, including administrative assistants and headquarters analysts. Employees from across the organization commented that they found it important and helpful. TAS has even offered to revise or edit the training to make it more accessible. The IRS's response states that this training would divert employees from their core work. Understanding taxpayer rights and how they apply during the controversy process is a necessary part of every employee's core work. In refusing to accept this recommendation, the IRS has not taken the time to consider which occupations the Roadmap training may be appropriate for, nor how the training could be altered to fit the needs of different types of employees. The IRS could offer the training to examination and collection employees, so they would understand what comes after cases pass through their particular work areas, thus creating a broader understanding of taxpayer rights and tax administration.

The National Taxpayer Advocate is disappointed that the IRS does not agree to update the IRM with specific language provided by TAS to incorporate taxpayer rights. The National Taxpayer Advocate hopes the IRS is truly committed to a meaningful collaboration with the TAS in reviewing and updating the manual, which means working with TAS on the exact language to be inserted.

The National Taxpayer Advocate is pleased that the IRS plans to include issues related to the Taxpayer Bill of Rights in business performance reviews. Taxpayer rights should be an integral part of any process the IRS uses to review performance, goals, initiatives, programs, and processes.

**MSP  
#5****REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS is Enjoined from Continuing Its Efforts to Effectively Regulate Unenrolled Preparers****PROBLEM**

In tax year 2011, unregulated tax return preparers prepared over 42 million individual returns, or more than half of all the returns handled by preparers. As preparers play a critical role in tax administration, it is essential that the IRS ensure they are competent, visible, and accountable. The IRS had instituted a program to impose minimum competency requirements, but a U.S. District Court in *Loving v. Internal Revenue Service* enjoined the IRS from enforcing the testing and continuing education elements of the program. Unless this ruling is overturned on appeal, taxpayers will continue to find themselves without meaningful IRS oversight of preparers in a world where anyone can hang out a shingle as a “tax return preparer” with no knowledge or experience needed.

**ANALYSIS**

Since 2002, the National Taxpayer Advocate has recommended adoption of a system to regulate return preparers. The Taxpayer Advocate Service has witnessed widespread problems in the tax preparation industry. Problems with return accuracy and ethical standards were substantiated by “shopping visits” the Government Accountability Office and the Treasury Inspector General for Tax Administration conducted, where auditors posed as taxpayers and visited tax preparation businesses. The National Taxpayer Advocate believes minimum competency standards are essential to protect taxpayers and improve return accuracy. Filing a tax return is not merely a ministerial act. The taxpayer is taking a position before the federal government regarding items of income, expenses, and eligibility for government benefits that are administered by the IRS. Taxpayers pay preparers for their knowledge and skills because they are uncomfortable navigating the complexity of the tax laws by themselves. Taxpayers often suffer significant consequences when a preparer is incompetent or unethical.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[5-1] Offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Following the *Loving* court decision preventing the IRS from mandating testing and continuing education for paid tax return preparers, the IRS remains concerned about protecting taxpayers and ensuring they receive quality assistance in tax return preparation. The President’s FY 2015 budget includes a proposal to explicitly authorize the IRS to regulate all paid tax return preparers. IRS Commissioner Koskinen has urged Congress to quickly enact the proposal.

Meanwhile, the IRS is taking a close look at the possibility of an interim step involving a program of voluntary continuing education.

- **Actions the Internal Revenue Service Has Committed to Take:** A voluntary program is under consideration because the IRS believes it is important to maintain the momentum for positive engagement of unregulated preparers that has built up over the last five years, and to lessen the risks to taxpayers resulting from the lack of federal education requirements. Before moving forward on this idea, however, we will solicit feedback from a wide range of stakeholders as to whether such an interim step would be useful and appropriate. This is an interim step while simultaneously working to get clear legislative authority for regulating paid preparers.

[5-2] Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn the voluntary examination and continuing education certificate.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The Office of Professional Responsibility (OPR) is working with Counsel to revise the rules restricting unenrolled preparers' representation rights so that an unenrolled return preparer may represent taxpayers only if the preparer has obtained, on a voluntary basis, annual certification that requires passing a course that includes a test and completing continuing education as prescribed in published guidance.
- **Actions the Internal Revenue Service Has Committed to Take:** It is anticipated that the revised guidance on representation restrictions will be introduced during the summer of 2014 with phased-in rollout through 2016.

[5-3] Restrict the ability to name an unenrolled preparer as a Third Party Designee on Form 1040.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is exploring the complications/impact of restricting use of the check-the-box on p.1, Form 1040 by unenrolled tax return preparers.
- **Actions the Internal Revenue Service Has Committed to Take:** Implementation is dependent upon the complications/impact identified and the time needed to revise the tax form and instructions.

[5-4] Mount a consumer protection campaign to educate taxpayers about the need to select competent preparers who can demonstrate competency.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Return preparers play a key role in increasing taxpayer compliance and strengthening the integrity of the U.S. tax system. The IRS believes it is critical to ensure a basic competency level for tax return preparers and to focus our enforcement efforts on identifying and stopping unscrupulous preparers. The IRS's efforts also include extensive outreach and education directed to return preparers and taxpayers. This includes dedicating resources to educate taxpayers about the need to select preparers who can demonstrate competency.

- **Actions the Internal Revenue Service Has Committed to Take:** Develop a communication plan to promote increased taxpayer awareness of the need to select return preparers who can demonstrate competency.
  - Implement the communication plan as part of the overall effort to prepare tax preparers and taxpayers for the next filing season in 2015.

[5-5] Develop a research driven and Servicewide preparer compliance strategy similar in nature to the EITC preparer compliance strategy.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is still analyzing the results of the Earned Income Tax Credit (EITC) preparer initiative to determine the effectiveness of the different treatments (*e.g.*, due diligence visits, knock-and-talk visits, undercover shopping). At this time, it is premature to develop a similar preparer compliance strategy without knowing whether the benefits of such a strategy would outweigh the associated costs of implementing the strategy.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[5-6] Recommend that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate unenrolled preparers.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS proposed and Treasury accepted a legislative recommendation for the Green Book. The Commissioner and the National Taxpayer Advocate have testified on the need for legislation at a Senate Finance Committee hearing. The IRS has submitted proposed language to Senate Finance and Treasury Office of Tax Policy (OTP).
- **Actions the Internal Revenue Service Has Committed to Take:** Legislation is the best solution.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate agrees that legislation is the best solution and will continue to recommend that Congress provide the IRS with the necessary authority to impose testing and continuing education requirements on unenrolled preparers. In the meantime, we believe a voluntary certificate is an appropriate interim measure.

However, the National Taxpayer Advocate believes the voluntary certificate program should have both testing and continuing education components to establish minimum competency. We understand that testing a smaller population of preparers may involve higher user fees than charged for the exam in the past, but the IRS should not discard this option until it solicits bids with a Request For Proposal (RFP). In addition, although not as effective as a proctored exam, the IRS should also evaluate the feasibility of offering an online exam, similar to the one offered through the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs.<sup>8</sup>

<sup>8</sup> For more information on VITA/TCE Link & Learn courses and tests, see <http://apps.irs.gov/app/vita/>.

Unenrolled preparers will be more inclined to take the time and bear the cost associated with a voluntary certificate if the IRS restricts representation rights. We commend the IRS for moving forward with plans to condition the authority for an unenrolled preparer to represent his or her preparation-clients in audits on the preparer earning the voluntary certificate. We are also pleased that the IRS will further consider prohibiting taxpayers from designating unenrolled preparers as the Third Party Designees unless they earn the voluntary certificate.

To educate taxpayers on the various preparer designations available, it is crucial that the IRS take a proactive role in a public awareness campaign. This campaign should include the development and marketing of a publicly accessible and searchable preparer database. The database should list all preparers who have obtained valid Personal Tax Identification Numbers (PTINs) with their basic information such as location, contact information, and credentials or qualifications. The database should also allow the user to scroll over and obtain a basic description of each preparer credential or qualification along with any associated limitations in representation, such as the inability to represent taxpayers in Collection or Appeals.

Finally, we believe the IRS should evaluate and share the results to date of its EITC preparer strategy. Considering the high percentage of EITC returns prepared by unenrolled preparers,<sup>9</sup> the IRS can minimize burden to this low income taxpayer population if it evaluates the results as soon as the data is available and makes timely revisions to its strategy.

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<sup>9</sup> For tax year (TY) 2012, approximately 76 percent of EITC returns prepared by a paid preparer were prepared by unenrolled preparers. IRS, Compliance Data Warehouse, Individual Returns Transaction File; IRS, Individual Master File (net of transactions 764, 765, and 768); IRS, Return Preparers and Providers Database (through Nov. 2013).



**MSP  
#6****IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden on Such Taxpayers****PROBLEM**

In general, tax-related identity theft occurs when someone uses another individual's personal identifying information to file a false tax return to obtain an unauthorized refund. For the victims, the impact can be devastating and traumatic. The IRS takes much too long to fully unwind the harm suffered by victims and issue refunds to the legitimate taxpayers. Moreover, the IRS's specialized approach to resolving identity theft requires victims to interact with multiple IRS units.

**ANALYSIS**

Identity theft is a devastating crime that can have a traumatic emotional impact on the victim. A person's identity is core to his or her being – when someone steals and uses your identity, it is an invasion of your person. The IRS's approach to assisting the victims ignores this important fact, and in many ways treats the victim as someone experiencing a minor inconvenience instead of a frightening personal disaster. Identity theft victims also will not receive the tax refunds they are entitled to receive until the IRS completes its handling of the case; thus, victims may suffer financial hardships when cases are not resolved quickly. The IRS should set up a centralized identity theft unit, similar to the centralized innocent spouse unit that assists taxpayers who may have been victims of domestic abuse. If the IRS believes the most efficient way to resolve identity theft issues is to involve more than 20 different units, this back-end process should be invisible to the taxpayer. As far as victims are concerned, there should be *one* IRS employee who interacts with the taxpayer. That one employee should maintain control of the taxpayer's case, including all peripheral issues stemming from the identity theft.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[6-1] Designate the Identity Protection Specialized Unit (IPSU) as the centralized function that assigns a single employee to work with identity theft victims until all related issues are resolved.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Critical to the IRS's efforts to assist identity theft victims is our Identity Protection Specialized Unit. IPSU provides taxpayers with a single point of contact at the IRS via a specialized toll-free telephone line. Budgetary constraints do not allow for a single employee to be assigned as an individual point of contact for each victim of identity theft from receipt of the claim through determination and/or account resolution. The specialized teams throughout the enterprise acknowledge identity theft claims and provide contact information. The point of contact may be an individual or group of individuals trained and able to provide the information on the victim's case.

In March 2013, an IPSU Reengineering, in partnership with the Taxpayer Advocate Service,

involved those identity theft victims with unresolved issues in multiple organizations. A multi-function criterion was established and included in Internal Revenue Manual (IRM) 21.9.2.43, *Multiple Function Criteria (MFC) – IDTX*. The latest revision of this IRM section is March 7, 2014 and includes the procedures for multiple function criteria. Those cases meeting MFC have a single point of contact (individual) in IPSU. The IRS continues to explore opportunities to improve the victim experience and is currently exploring opportunities and options to better serve victims of identity theft and the time it takes to resolve their case.

Since then, we have proposed a major step to centralize identity theft victim casework in W&I. The proposal, titled the W&I-SB/SE Compliance Realignment Initiative was issued in May of 2014. All IRS employees have been invited to comment on the proposal. The IRS also welcomes TAS input on the proposal. With the adoption of the proposal, as modified through the comment period, W&I would be wholly responsible for all identity theft victims' assistance work. By centralizing this function, it is anticipated that victims of identity theft will receive better service from the IRS. While budgetary and resource constraints prohibit a single point of contact, we believe the centralized W&I process will serve victims more timely and completely.

We recognize the emotional impact identity theft victims experience and provide guidance to those employees who may work with these individuals. The Identity Theft Training and Awareness Briefing, taken annually by over 40,000 IRS employees with the potential of working with identity theft victims, has a section dedicated to the sensitivity of this issue and how to work with taxpayers. In addition, our IRMs include information on the need to be aware of the impact of these victims and how to handle the contact with an additional level of sensitivity and understanding.

The IRS continues to recognize the importance and urgency of combating identity theft and providing victim assistance. Fighting identity theft is an ongoing battle for the IRS and remains a top priority. Identity thieves continue to find new ways to steal taxpayer's personal information and use it for their gain, such as refund fraud. Although we cannot stop all identity theft, we continually review our policies and procedures to ensure we are doing everything we can to curb further instances of identity theft, help those who have become victims, and detect and prosecute those who perpetrate refund fraud. The IRS is committed to helping identity theft victims and continues to improve on past accomplishments. In calendar year 2013, the IRS worked with victims to resolve and close approximately 963,000 cases and the time for resolving these cases is decreasing. This past fiscal year, taxpayers who became identity theft victims had their situations resolved in roughly 120 days, far more quickly than in previous years. The IRS will continue to build on these improvements and take the necessary steps to meet new challenges going forward.

We believe the report has omitted important factors when comparing TAS cycle time with that of cases worked under normal IRS procedures. A very high percentage of TAS identity theft casework involve TAS criteria 1-4 (economic hardship), which get high priority

treatment when referred to an IRS function via an Operations Assistance Request (OAR). In these instances, the TAS caseworker sets the response time and the functions know they could be the recipient of a Taxpayer Assistance Order if they do not respond and take action timely. The priority TAS cases receive when sent to the functions via OARs and Identity Theft Assistance Requests (ITARs) could very well explain, at least in part, the difference in how long it takes TAS to resolve a case versus how long it takes IRS. In fact, the IRS plays an important role in this aspect of working a TAS case and a victory in reducing cycle time should be shared.

We believe the information contained in the report citing results from past TIGTA reports paints an inaccurate picture of how the IRS currently works identity theft cases, as well as current cycle time and timeliness. The May 2012 TIGTA report used a non-statistical, judgmental sample of only 17 cases closed prior to 2012, the results of which cannot be used to project to the entire population. Additionally, the September 2013 TIGTA report evaluated cases closed August 1, 2011, through July 31, 2012. While some specialized groups began operating in early 2012, they were not mandated to start processing cases until October 1, 2012. Therefore, it is suspect whether any of the cases worked by the specialized groups were included in either TIGTA sample.

Each function's IRM contains guidance on resolving issues in the most efficient manner through the use of proper workload management and time utilization techniques. Timeliness is measured from the taxpayer's perspective; however, case processing timeframes are dependent upon case issues and complexities. Identity theft cases worked in Accounts Management (AM) generally differ in complexity from cases worked in Exam and Collection that might require additional documentation or analysis; therefore, setting the same timeliness measures across functions would not necessarily be reflective of the time needed to resolve cases in each function. We believe allowing each specialized group to adhere to its current timeliness measures represents the best possible service we can provide to all taxpayers who contact the IRS with identity theft issues.

We acknowledge there was significant room for improvement in how we serviced identity theft victims and their cases in FY 2011 and FY 2012. However, the process improvements and additional staffing implemented for the 2013 filing season, as well as processes we have improved or added since that time, have improved timeliness and cycle time. The average number of days to close identity theft cases varied from 2009 to 2013; however, this past fiscal year taxpayers who became victims of identity theft had their situation resolved in roughly 120 days. The IRS has taken numerous steps to quickly identify and streamline its identity theft processes through a variety of reengineering initiatives. New procedures are in place to identify the legitimate taxpayer's return, correct taxpayer account data and initiate refunds to identity theft victims more quickly. One such procedure added the use of Electronic Fraud Detection System (EFDS) data as a tool to determine the true SSN owner, thus eliminating numerous research steps and improving efficiencies. Additionally, the IRS implemented new programming to identify returns with identity theft documentation attached. Cases are now generated directly to the specialized groups, reducing the amount of cases that pass through several areas. Also, new procedures requiring the IPSU to control

and monitor cases crossing multiple functions were implemented to ensure these cases are worked more efficiently and to completion. As more review and analysis occurs, the IRS Privacy, Governmental Liaison, and Disclosure (PGLD) office will work with the other IRS functions to update and incorporate new procedures as necessary to further reduce the time it takes to work an identity theft case.

The IRS appreciates the acknowledgement in the report of the enhancements to the Identity Protection PIN (IP PIN) program. The IP PIN is issued to select identity theft victims whose identities have been validated by the IRS. This allows legitimate returns to be processed and prevents processing of fraudulent returns, thereby mitigating processing delays in identity theft victims' federal tax return processing. This past year, in addition to increasing the number of taxpayers receiving the IP PIN via the legacy process, the IRS began testing new online applications. Also, this filing season the IRS began allowing taxpayers who have lost, misplaced, or never received their assigned IP PIN to retrieve their original IP PIN using an online application and eAuthentication process, which allowed them to file their returns without additional delays. The legacy IP PIN replacement process remained in effect for those taxpayers who were unable or unwilling to use the online application. The IRS will continue to look for ways to expand the use of this technology to assist victims of identity theft and protect those at highest risk.

- **Actions the Internal Revenue Service Has Committed to Take:** The IPSU provides taxpayers with a single point of contact at the IRS via a specialized toll-free telephone line. The specialized teams throughout the enterprise acknowledge identity theft claims and provide contact information. The point of contact may be an individual or group of individuals trained and able to provide the information on the victim's case.

The IRS proposed a major step to centralize identity theft victim casework in W&I. The proposal, titled the W&I-SB/SE Compliance Realignment Initiative was issued in May of 2014. All IRS employees have been invited to comment on the proposal and the IRS welcomes TAS input.

[6-2] Develop a method of tracking cycle time from the perspective of the victim.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** IRS functions currently calculate cycle time that reflects the taxpayer's perspective. AM captures the IRS received date of the second (valid) tax return and uses this date as the start date for calculating cycle time, whereas compliance functions generally use the receipt date of the identity theft affidavit or documentation as the start date for calculating cycle time. In addition, cases sent to another function are worked by IRS received date, not the date received in that unit. As such, we think current procedures do provide a holistic approach to casework and coincide with the victim's expectation of how their case should be worked. In addition, as noted above, there is a proposal to further centralize identity theft victims' work at the IRS. If the proposal is adopted, the IRS will be reviewing its processes from beginning to end to ensure that the needs of victims of identity theft are being met appropriately.
- **Actions the Internal Revenue Service Has Committed to Take:** AM captures the IRS received date of the second (valid) tax return and uses this date as the start date for calculating

cycle time, and compliance functions generally use the receipt date of the identity theft affidavit or documentation as the start date for calculating cycle time. In addition, cases sent to another function are worked by IRS received date, not the date received in that unit. If the proposal to further centralize identity theft victim work is adopted, the IRS will be reviewing its processes from beginning to end to ensure that the needs of victims of identity theft are being met appropriately.

[6-3] Implement “timeliness” measures to ensure identity theft cases do not languish.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Each functional IRM contains guidance on resolving an issue in the most efficient manner through the use of proper workload management and time utilization techniques. Timeliness is measured from the taxpayer’s perspective; however, case processing timeframes are dependent upon case issues and complexities. Identity theft cases worked in AM generally differ in complexity from cases worked in Exam and Collection that might require additional documentation or analysis and setting timeliness measures across functions would not necessarily be reflective of the time needed to resolve cases in each function. We believe allowing each specialized unit to adhere to its current timeliness measures represents the best possible service we can provide to all taxpayers who contact the IRS with identity theft issues. However, the proposal to centralize victim assistance casework in W&I will include a revision of the related processes and measures.
- **Actions the Internal Revenue Service Has Committed to Take:** The proposal to centralize victim assistance casework in W&I will include a revision of the related processes and measures.

[6-4] Develop an identity theft database or system accessible to all functions working on identity theft cases.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS acknowledges that creating a service-wide platform for tracking and monitoring identity theft cases would assist in assessing inventory and measuring cycle time, as well as make it easier to share information across functions. The idea of an identity theft database has been discussed for several years. Current systems are diverse and designed specifically for the type of work performed by that function; therefore, a new identity theft database designed to exchange information with multiple, existing databases would be complex. However, currently IRS employees can use the IDRS system to determine if there is ID theft activity.

The IRS will continue to use our current systems and explore ways to better control and track our inventory. In addition, the proposal to centralize victim assistance casework in W&I provides an opportunity to explore managing the caseload through a single system.

- **Actions the Internal Revenue Service Has Committed to Take:** IRS employees can use the IDRS system to determine if there is ID theft activity.

As IRS considers the proposal to centralize victim assistance casework in W&I, it will explore options for managing the caseload through a single system.

## TAXPAYER ADVOCATE SERVICE RESPONSE

We recognize and appreciate the efforts by the IRS to work through its inventory of ID theft cases. Reducing the cycle time for ID theft cases in Accounts Management (AM) to 120 days is commendable, but does not paint a complete picture of the victim's experience. From our years of working ID theft cases, we know that many ID theft cases involve multiple issues. While TAS cases are not necessarily representative of overall IRS cases, we suspect that a significant percentage of the IRS's identity theft cases involve multiple issues. Having AM complete its portion of the ID theft case in 120 days may be a noteworthy improvement over prior years, but it does not mean the taxpayer's case is fully resolved in 120 days. Until the IRS can provide a cycle time that represents the taxpayer's experience in resolving all identity theft-related tax issues, the cycle time data the IRS provides based on AM cases should be viewed in the context of its limitations. It forces us to rely on third-party reports such as those issued by TIGTA, as imperfect as they may be.

The IRS correctly notes that because TAS cases receive priority consideration, it is not fair to compare identity theft cases worked by TAS to those cases worked under normal IRS procedures. However, its statement that all criteria 1 to 4 cases receive "high priority" treatment is incorrect. According to the Service Level Agreement between the National Taxpayer Advocate and the W&I Commissioner, only OARs that are marked "expedite" receive high priority treatment. The decision to mark an OAR "expedite" is made on an OAR-by-OAR basis according to the facts and circumstances of the case.

The National Taxpayer Advocate does not tout TAS's cycle time for ID theft cases for mere puffery. We recognize that these cases would not be resolved without the cooperation of the IRS functions that treat these cases as a priority. We note, however, that these cases would not be in TAS but for the fact that the IRS's own identity theft processes have failed the taxpayer. We believe the TAS approach – assigning a case advocate to "own" the case and providing a date certain for which various IRS functions must take action – can be replicated by the IRS. We are pleased to learn of the IRS's plan to reorganize and centralize its ID theft victim assistance within W&I. We hope that this new approach will mirror TAS's approach to handling cases, and we will continue to advocate on this point.

From inception, the National Taxpayer Advocate had envisioned the IPSU as operating similarly to TAS – with a sole contact person who shepherds the case through complete resolution. The IPSU reengineering effort in 2013 cited in the IRS response did not reflect the perspective voiced by TAS's representatives. As implemented, the IPSU serves as a single point of entry for ID theft victims but not a sole contact. Even in cases with a single issue worked by AM, we have seen instances where the victim has been transferred to multiple assistors within AM. The IRS cites budgetary constraints as a barrier to adopt the recommendation to assign a single employee to an ID theft victim's case. Our reply is that the IRS has no idea how many resources are tied up in duplicative efforts with its current approach.

The National Taxpayer Advocate has offered (and W&I has accepted) to pull a representative sample of ID theft cases to see how many actually involve multiple issues and the average number of contacts with the taxpayer. We will also determine the time required for the IRS to work a case, both in AM and in other functions. Ultimately, we plan to quantify the total time necessary

to resolve all identity theft-related issues, the number of affected modules, and the time to process any refunds, from the taxpayer perspective. This research can guide the development of an approach under which AM would conduct a global account review upon case receipt (and closure) and handle true single-issue identity theft cases, while cases that involve multiple issues would be assigned to a single employee within the IPSU unit who would serve as a coordinator for the case and the sole contact for the taxpayer.

**MSP  
#7****HARDSHIP LEVIES: Four Years After the Tax Court's Holding in *Vinatieri v. Commissioner*, the IRS Continues to Levy on Taxpayers it Acknowledges Are in Economic Hardship and Then Fails to Release the Levies****PROBLEM**

The IRS is required by law to release a levy that it knows is causing an economic hardship due to the financial condition of the taxpayer, and according to *Vinatieri v. Commissioner*, 133 T.C. 392 (2009), the fact that the taxpayer has unfiled returns does not justify proceeding with the levy. In 2011, despite *Vinatieri*, the IRS levied on the Social Security (SSA) and Railroad Retirement Board (RRB) benefits of nearly 67,000 taxpayers presumed to be experiencing economic hardship – taxpayers whose incomes were less than 250 percent of the federal poverty level. The IRS declined to spare accounts of almost 41,000 of these taxpayers – more than half – from the automated levy program because the taxpayers had unfiled returns. The median income of taxpayers subject to levies on their SSA or RRB in 2011 was at most about \$17,500.

**ANALYSIS**

The IRS's own research shows that it levied on the Social Security payments of taxpayers it presumed were low income solely because they had unfiled returns. The IRS changed some Internal Revenue Manual provisions that pertain to how employees handle cases involving unfiled returns, but training materials, job aids, and quality standards still need adjusting. The IRS can determine from its own and third-party databases whether a taxpayer is likely in economic hardship before it issues a levy.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[7-1] Establish quality review procedures that measure whether employees identified and considered the possibility that a taxpayer was in economic hardship before levying.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** IRS procedures require the taxpayer to document and verify that a levy will cause economic hardship if issued. If the taxpayer verifies that the levy will cause economic hardship, the levy should not be issued. Both field and campus quality review programs currently monitor and measure whether our employees considered and verified the documentation provided by the taxpayer to establish that the levy would cause economic hardship.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[7-2] Establish quality review procedures that measure whether, in cases in which the employee identified economic hardship, the employee adhered to the *Vinatieri* decision by placing the account in Currently Not Collectible status rather than levying.



- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS currently monitors and measures the quality of our ability to pay determinations and CNC case dispositions. Internal Revenue Manual (IRM) 5.16.1.2.9(9) for field collection and IRM 5.19.1.7.1.3 and 5.19.4.4.10 for campus collection emphasize that an account can be reported CNC-Hardship even if there is an unfiled return and that a levy cannot be issued or left in place to persuade a taxpayer to file unfiled returns in an economic hardship situation. Compliance with these IRM sections is monitored and measured currently.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[7-3] Develop and publish IRM guidelines for how collection employees, on the basis of information in IRS and third-party databases, should consider the possibility a taxpayer is in economic hardship before issuing a levy.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS will not levy when a taxpayer has verified that the levy would cause an economic hardship. Additionally, the IRS's Currently Not Collectible models already rely on information in IRS databases to exclude certain cases from levy. However, we do not agree that the determination of economic hardship always can be based solely on information available in IRS and third-party databases. Rather, we believe that the information existing in IRS and third-party databases is insufficient to verify economic hardship generally and that the taxpayer must provide additional documentation before the economic hardship can be verified. The requirement that the taxpayer provide documentation is consistent with the statute and the regulations. However, the IRS is revising IRM 5.11.1 for Field Collection employees, clarifying the pre-levy considerations for taxpayers who document and verify economic hardship.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS is revising IRM 5.11.1 for Field Collection employees, clarifying the pre-levy considerations for taxpayers who document and verify economic hardship.

[7-4] Adjust the FPLP low income filter to include accounts with unfiled returns.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The low income filter (LIF) is not determinative of economic hardship or inability to pay. If an economic hardship determination is made, the employee will follow the procedures established based on the *Vinatieri* decision. To ensure that only the most accurate and up-to-date information is used when an FPLP analysis is performed, we do not apply the analysis to cases in which the taxpayer has delinquent tax returns. While the IRS does not agree that accounts with unfiled returns should be included in the LIF generally, we will request a Unified Work Order (UWR) adjusting the LIF to include certain taxpayers over age 65 or who are receiving SSI payments.
- **Actions the Internal Revenue Service Has Committed to Take:** We will submit a UWR requesting an adjustment to the LIF to include certain taxpayers over age 65 or who are receiving SSI payments.

[7-5] Inform collection employees of procedural changes described above by issuing a separate alert and a memorandum.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is revising IRM 5.11.1 for Field Collection employees to clarify the pre-levy considerations for taxpayers who document and verify economic hardship. When the revised IRM is published, a cover sheet identifying the material changes to the IRM also will be published.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will publish a material change cover sheet with the release of the revision to IRM 5.11.1.

[7-6] Update training materials and job aids to reflect the *Vinatieri* decision and the 2013 changes to IRM 5.19 and 5.11.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS delivered training to address economic hardship reflecting the determinations made in the *Vinatieri* decision to Field Collection and ACS employees during the FY 2011 Continuing Professional Education. As per our current practice to update/develop Field Collection and Campus Collection training and eGuides to reflect changes to the Internal Revenue Manual, we will reflect any changes to the IRM in future training material.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

Taxpayers have the right to a fair and just tax system.<sup>10</sup> That is, taxpayers have the right to expect the system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Thus, the National Taxpayer Advocate is pleased that the IRS, working with TAS, is revising IRM 5.11.1 pertaining to pre-levy considerations. Clarifying that levy determinations are made on a case-by-case basis, and that Revenue Officers (ROs) must exercise good judgment in making the determination to levy, will be important elements of the revised IRM provision. Moreover, we will advocate that the revised IRM provision clarify that if the RO can verify from the information available that the levy will cause an economic hardship, the levy will not be issued, because if there is economic hardship, the levy must be released under IRC § 6343(a)(1)(B). We continue to believe the IRM should also require ROs to place an account in Currently Not Collectible (CNC) status once they have determined that a taxpayer is experiencing economic hardship, because that is the logical next step.

However, the National Taxpayer Advocate is troubled by the IRS's assertion that "the low income filter is not determinative of economic hardship or inability to pay" because it is inaccurate. The LIF *is* determinative of economic hardship. It was established on the basis of a research study that applied the IRS's formula for economic hardship to a representative sample of taxpayers in the Social Security FPLP population. The LIF is the result of that study. It was implemented because the IRS Deputy Commissioner of Services and Enforcement accepted the LIF as the proxy for economic hardship.

The IRS's comment that it will adjust the LIF "to include certain taxpayers who are over age 65 or who are receiving SSI payments" is also troubling because it 1. implies that Supplementary

<sup>10</sup> Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.

Security Income (SSI) payments are subject to FPLP;<sup>11</sup> and 2. does not reflect the Commissioner's commitment to the National Taxpayer Advocate to include in the LIF taxpayers receiving Social Security disability payments,<sup>12</sup> provided they can be identified. The National Taxpayer Advocate is ascertaining whether the Social Security Administration can extract those who receive Social Security disability payments from its list of benefit recipients. The National Taxpayer Advocate urged the IRS to reconsider its response pertaining to the LIF, noting these inaccuracies and inconsistencies, but the response remained unchanged.<sup>13</sup> TAS was disturbed by the response and confirmed that the IRS is not levying on SSI payments, but the response indicates an incomplete grasp on the IRS's part of how it administers the FPLP and which taxpayers are affected by it and which are excluded. The National Taxpayer Advocate does not find this reassuring.

Finally, the National Taxpayer Advocate finds the IRS's commitment to adjust future training material only to the extent it revises the IRM disappointing. The IRS last trained its collection employees on the *Vinatieri* holding in 2011. Collection employees hired in the past three years do not necessarily know of the existence of the *Vinatieri* case or its implications. TAS and Low Income Taxpayer Clinic cases continually demonstrate that IRS collection employees disregard the holding in *Vinatieri* and require filing of returns before releasing levies. The IRS should offer the training on a regular basis. In addition, we recommend that training for collection employees include a video TAS is planning to produce in FY 2015 about economic hardship and the difficulty low income taxpayers and other special populations face in dealing with the IRS.

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11 IRC § 6334(a)(11) exempts from levy "Any amount payable to an individual as a recipient of public assistance under...(A) title IV or title XVI (relating to supplemental security income for the aged, blind, and disabled) of the Social Security Act."

12 See IRM 5.11.7.2.1.1 (Aug. 28, 2012), IRS/FMS Interagency Agreement - Federal Payments Subject to the FPLP, including on the list of federal payment subject to the FPLP "Social Security Administration (SSA) benefit payments under Title II of the Social Security Act, aka Federal Old Age, Survivors and Disability Insurance (OASDI) benefits. ...Note: Supplemental Security Income (SSI) payments are not subject to the FPLP."

13 June 2, 2014 comment from the National Taxpayer Advocate to IRS operating divisions on their responses to the 2013 Annual Report to Congress recommendations.

**MSP  
#8****RETURN PREPARER FRAUD: The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds****PROBLEM**

Unscrupulous preparers sometimes alter taxpayers' returns by inflating income, deductions, credits, or withholding without their clients' knowledge or consent, and pocket all or a portion of the inflated refund. Even though the taxpayer receives no financial gain from the fraudulent filing, he or she must still deal with the IRS in the aftermath. Return preparer misconduct is similar to identity theft, but the IRS treats victims of preparer fraud differently. When a taxpayer is victimized by identity theft, the IRS will "back out" the return filed by the perpetrator, process the true return, and pay out the refund claim. In preparer misconduct cases, the IRS has declined not provide full relief to victims, contending it would be inappropriate to issue a "second refund."

**ANALYSIS**

The IRS has developed interim procedures to deem a falsified return a nullity and to process the true return. However, this guidance falls short of instructing employees to issue refunds to victims of preparer fraud, which from the victim's perspective is likely the most important aspect of case resolution. Instead, the IRS tells employees to suspend action on such cases pending further guidance. The National Taxpayer Advocate believes the IRS has the legal authority to issue refunds to victims of preparer misconduct. The IRS should make these vulnerable taxpayers whole once it is established that they were not complicit in the crime, just as identity theft victims are not complicit.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[8-1] Develop comprehensive guidance providing full relief to victims of return preparer fraud, including the issuance of a refund.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS acknowledges that the perpetration of fraud by a tax return preparer is a very serious issue, and one that presents unique challenges for the IRS to address. The IRS agrees that comprehensive guidance is necessary to provide relief to taxpayers. Because each return preparer fraud case is fact-specific and there are numerous scenarios, a one-size-fits-all solution cannot work. The IRS has discussed with the National Taxpayer Advocate an approach that is being considered.

The IRS is working through legal issues regarding financial accounting to inform comprehensive guidance associated with providing relief in some of these scenarios. Therefore, it is premature to develop the guidance at this time as we are still exploring policy options. In addition, the IRS is attempting to strike a balance between relief for taxpayers in appropriate situations and its role as a steward of federal tax dollars. To ensure that federal

tax dollars are used appropriately, the Government Accountability Office performs audits of the IRS's financial statements. In developing guidance, the IRS is cognizant that its financial statements reflecting payments to make taxpayers whole must withstand an audit by the GAO. Until the IRS is able to finalize the appropriate accounting policies and internal accounting procedures, the IRS is not in a position to develop the comprehensive guidance requested.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[8-2] Direct TAS, W&I, Criminal Investigation, Chief Counsel, the Return Preparer Office, and the Office of Professional Responsibility to develop referral procedures for and establish a liaison to national tax preparation firms, to seek recovery of refunds for taxpayers defrauded by their employees or agents.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As noted in response to recommendation 8-1 above, the IRS takes tax return preparer fraud very seriously and is committed to determining whether, and under what circumstances, the IRS can legally reissue refunds to victims of preparer fraud. The IRS does not believe that a blanket, one-size-fits-all solution, *i.e.*, providing full refunds to any taxpayer claiming to having been victimized, is appropriate given the multi-faceted nature of this problem. Rather, careful thought and consideration must be given to facts and to these situations to determine the appropriate IRS policy, and the IRS has discussed with the National Taxpayer Advocate an approach that is being considered. Given that the IRS policy is still under consideration, we cannot agree to this recommendation. We will keep this recommendation in mind as we move forward.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate disagrees with the IRS assertion that there are outstanding policy and legal concerns to be addressed. On March 14, 2014, the Commissioner decided that the IRS will issue refunds to victims of preparer fraud who can provide to the IRS a copy of a police report (in addition to the other documentation previously required). He preferred this bright-line approach over a more comprehensive facts-and-circumstances approach. The Office of Chief Counsel has reiterated that there is no legal impediment to the IRS issuing such refunds. The Chief Financial Officer has raised some questions about how to account for these refunds in a way that would not be considered a material weakness by the GAO, but these concerns can be addressed. In no way should they hold up the process of developing guidance to W&I employees to adopt the approach endorsed by the Commissioner.

The National Taxpayer Advocate notes that some of these victims are awaiting refunds associated with their 2008 tax returns. It is unconscionable that the IRS has not developed procedures to issue such refunds, when there are no outstanding legal or policy issues. The National Taxpayer Advocate encourages the IRS to have procedures in place to begin issuing refunds to victims of preparer fraud by October 1, 2014. TAS is willing to work with W&I to develop interim guidance. The IRS's failure to commence issuance of refunds to taxpayers by October 1, 2014 will result in her issuing a Taxpayer Assistance Order in every eligible TAS return preparer refund fraud case.

**MSP  
#9****EARNED INCOME TAX CREDIT: THE IRS Inappropriately Bans Many Taxpayers from Claiming EITC**

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**PROBLEM**

Section 32(k) of the tax code authorizes the IRS to ban a taxpayer from claiming the earned income tax credit (EITC) for two years if the IRS determines the taxpayer claimed the credit improperly due to reckless or intentional disregard of rules and regulations. This standard requires more than mere negligence on the part of the taxpayer and requires a determination of the taxpayer's state of mind. In 2011, the IRS imposed the ban on more than 5,000 taxpayers and did so contrary to IRS Chief Counsel guidance almost 40 percent of the time by banning taxpayers who simply did not respond to requests for substantiation of their claims. In a random sample of two-year ban cases, TAS found the IRS imposed the ban *automatically* 15 percent of the time, meaning no determination was made. The National Taxpayer Advocate does not support the Administration's proposal to permit the IRS to use math error authority in the context of these bans until the IRS improves its procedures to ensure its auditors impose the ban consistently with the statute. Moreover, Congress should clarify that IRS bears the burden of proving the taxpayer acted intentionally or recklessly with respect to his or her EITC claim.

**ANALYSIS**

IRS auditors must explain and document in their work papers the reason for imposing the two-year ban, but in almost all of the cases in TAS' sample (90 percent), the papers do not contain an adequate explanation. Managerial approval of the two-year ban is also required, but in more than two-thirds of the cases (69 percent), no managerial approval was obtained. In 62 cases in the sample (19 percent), the examiner imposed the ban solely because EITC had been disallowed in a previous year. In only ten percent of the cases were taxpayer-submitted documents clearly insufficient to prove eligibility, raising only the *possibility* that the taxpayer had the requisite state of mind to justify the two-year ban. The two-year ban is authorized only if the IRS determines the taxpayer's state of mind meets statutory criteria, but IRS procedures do not take into account that the unique challenges low income taxpayers face in substantiating claimed EITC may be relevant to these taxpayers' state of mind. In fact, some IRM provisions result in the IRS punishing EITC taxpayers while they are learning these complex rules. Other IRM provisions lead to inappropriate imposition of the ban.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[9-1] Immediately suspend the application of IRM provisions (*e.g.*, IRM 4.19.14.6.1.5) that permit automatic imposition of the two-year EITC ban or require the taxpayer to show why the ban should not be imposed.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is carefully looking at our processes to ensure we are applying the EITC ban in appropriate circumstances.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS is working with the Office of Chief Counsel to ensure we are applying the EITC ban in appropriate circumstances.

[9-2] In collaboration and consultation with the National Taxpayer Advocate, include on the Treasury Guidance Priority List regulations that explain when the IRS should impose EITC bans.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS will suggest that, as part of the process for developing the Priority Guidance Plan, Treasury and the IRS consider whether additional guidance should be issued on the meaning of “reckless or intentional disregard of rules and regulations.”
- **Actions the Internal Revenue Service Has Committed to Take:** The Office of Chief Counsel will work with Treasury during the development of the FY2015 Priority Guidance Plan to determine whether additional guidance is appropriate.

[9-3] Revise, in consultation with the National Taxpayer Advocate, the IRM provisions on the two year ban to take into account what is reasonable to expect of taxpayers who claim EITC. At a minimum, before imposing the two-year ban, examiners should be required to:

- Attempt to speak with the taxpayer;
- Determine whether the substantiation the taxpayer submitted is probative of the EITC claim or shows a sincere effort to prove the elements of EITC, even if the documentation is not listed in the IRM as acceptable substantiation or the documentation is insufficient, and
- Consider the role, if any, of a paid preparer in claiming disallowed EITC

Conduct quality reviews of every case in which the IRS proposes to impose the two-year ban. One hundred percent quality reviews should continue for at least three years and until the IRS’s failure to adhere to the terms of the statute and the IRM is corrected.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS currently corresponds with every taxpayer on which the ban is proposed. Also, IRM 4.19.13 already includes several references about contacting a taxpayer when additional information is needed, if a number has been provided. We agree to review and improve our IRMs as necessary. We will ensure two-year ban training is provided during annual CPE training to all examiners as well as penalty requirement training for the managers.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will review and make any appropriate changes in FY 2015 to the IRM with the goal of identifying areas of improvement and clarifying procedures.
- The IRS will provide necessary training to examiners and managers. The IRS will review and make any appropriate changes to the FY 2015 examiner CPE training module on

two-year bans and ensure the training is provided to all examiners. The IRS will provide Penalty Requirement Training to managers.

[9-4] Conduct quality reviews of every case in which the IRS proposes to impose the two-year ban. One hundred percent quality reviews should continue for at least three years and until the IRS's failure to adhere to the terms of the statute and the IRM is corrected.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Managerial approval is required for two-year ban cases as stated in IRM 20.1.5.1.6, *Managerial Approval of Penalties*, and IRM 4.19.13.5.2 *Managerial Approval of Penalties* (this does not include a requirement to approve systemically imposed bans on cases with no responses). Therefore, the managers are already expected to conduct reviews of every case in which the IRS proposes to impose the two-year ban. We agree with the National Taxpayer Advocate that procedures were not followed correctly and consistently on each case. Therefore we will:
  - Issue a Servicewide Electronic Research Program (SERP) Alert reinforcing that all two-year bans must have managerial approval on all manual cases and on systemically imposed two-year ban cases if correspondence is received.
  - Review a sample of all two-year ban closed cases bi-annually to ensure the managerial approval is present on manual cases and systemic cases that include a taxpayer response.
  - The IRS will take immediate action to ensure that examiners and managers are reminded of existing IRM procedures that require appropriate documentation and managerial approval for manual application of the ban. The IRS will also include annual refresher training for examiners and managers and will implement a process to monitor adherence to procedures.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will develop a SERP Alert regarding the two year ban process and the requirement to obtain managerial approval prior to asserting the two-year ban penalty. The SERP alert will also serve to remind examiners and managers of existing Internal Revenue Manual (IRM) procedures that require appropriate documentation and managerial approval for manual application of the ban.

The IRS will review a sample of all two-year ban closed cases bi-annually to ensure the managerial approval is present on manual cases and systemic cases that include a taxpayer response and will ensure that any issues identified are addressed and corrected.

The IRS will also include annual refresher training for examiners and managers and will implement a process to monitor adherence to procedures.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate welcomes the IRS's commitment to review its processes to ensure that the two-year ban is properly applied, but regrets that the IRS declines to suspend automatic imposition of the ban pending such review, in light of the findings from our analysis of a random



sample of two-year ban cases. The National Taxpayer Advocate already suggested that the IRS and Treasury include on the 2014-2015 Guidance Priority Plan (GPP) new guidance that provides a non-exclusive list of facts and circumstances to be taken into account in determining whether EITC was claimed in “reckless or intentional disregard of rules and regulations” for purposes of IRC § 32(k)(1)(B)(ii).<sup>14</sup> She is pleased to learn the IRS also intends to suggest inclusion of this issue on the GPP.

The IRS agrees to review and improve its IRMs “as necessary,” but prefaces this commitment with the observation that it already “corresponds” with every taxpayer on whom the two-year ban is proposed. Our review of actual two-year ban cases shows that while the IRS sends letters to taxpayers, it often receives no response. This is not the appropriate level of “correspondence” in these cases. The IRS also notes the IRM refers to contacting taxpayers when additional information is needed, if a number has been provided. However, there is still no requirement that examiners attempt to speak to a taxpayer before imposing the two-year ban. Thus, we reserve judgment on any IRM changes that result from the IRS’s review until it becomes clear what the IRS deems “necessary.”

The National Taxpayer Advocate is troubled by the IRS’s response concerning managerial review. IRM 4.19.14.6.1 (January 1, 2013) is captioned, “EITC 2/10 Year Ban - Correspondence Guidelines for Examination Technicians (CET).” It says, “(4) Managerial approval is required for *all* 2/10 year ban cases (emphasis added).” The provision does not distinguish between bans systemically imposed and those not systemically imposed.<sup>15</sup> However, the IRS in its response draws this distinction. The IRS agrees to reinforce the rule requiring managerial approval, and to sample cases to insure approval is present, but only when the ban was manually imposed. The safeguard of managerial approval will therefore be absent in the very cases in which it is most needed – where there has been no communication from the taxpayer. With this approach, the IRS sanctions a procedure in which a computer will draw an inference about a taxpayer’s state of mind, and the IRS will impose the two-year ban without any human intervention. The National Taxpayer Advocate remains convinced that this approach is inconsistent with Congress’s intent when it authorized the IRS to impose the two-year ban.

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14 Such factors could include the taxpayer’s: Level of education; English language proficiency; Reliance on a tax return preparer in claiming the disallowed EITC; and Submission of probative substantiation of the claimed EITC that was rejected because it is not listed in the IRM as acceptable documentation. The guidance should also provide examples of situations in which imposing the ban would not be appropriate. For example, it should be clarified that disallowance of the taxpayer’s claimed EITC in a previous year, without more, is insufficient to support imposing the ban.

15 We note that IRC § 6751(b), which requires managerial approval of certain penalties, makes an exception for “any other penalty automatically calculated through electronic means.” Perhaps the IRS is analogizing to this provision. The two-year ban does not appear to be a “penalty” within the meaning of the statute (see subsection(c)), but even if it were, it does not require a “calculation” and thus would not appear to fall within the exception to the requirement of managerial approval.

**MSP  
#10****INDIAN TRIBAL TAXPAYERS: Inadequate Consideration Of Their Unique Needs Causes Burdens**

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**PROBLEM**

In filing season 2013, the IRS wrongly flagged tax returns filed by Indian tribal members as fraudulent because they shared characteristics that the IRS has identified as indicators of fraud. Although the National Taxpayer Advocate's 2008 Annual Report to Congress applauded IRS outreach to Indian Nations as exemplary, it is unclear if all IRS functions are responsive to their needs. In certain cases, IRS operating divisions (ODs) remain unaware of particular characteristics and needs of Indian taxpayers, which can lead to unnecessary contact with the IRS and unwarranted audits, tax assessments, or penalties.

**ANALYSIS**

Indian tribes have a unique status in federal tax law. Indian taxpayers may confront IRS misunderstandings and delays relating to issues such as:

- Improper treatment of tribal distributions;
- Presumed frivolous positions;
- Misunderstanding of Native American family structure;
- Ignorance of tribal sovereignty; and
- Delays in processing certain settlement awards.

While the IRS recently issued various pieces of guidance helpful to Indian individuals, major projects remain outstanding, especially those applicable to tribal entities. The resulting uncertainty can chill tribal enterprise, distorting the tribes' economic opportunities.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[10-1] Train all compliance employees about the culture and needs of Native American taxpayers, rendering assistance as required by this population, after consulting with and referring taxpayers to TAS when necessary.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is in the process of creating a cross-functional working group on issues of Indian individuals, parallel to the ITG function on tribal entities. This working group will develop training for appropriate campus and field compliance employees.

- **Actions the Internal Revenue Service Has Committed to Take:** Establish a cross-functional working group on issues of Indian individuals.
- Develop training for appropriate campus and field compliance employees.

[10-2] Establish a cross-functional working group on issues of Indian individuals, parallel to the ITG function that focuses on tribal entities.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Consistent with the 2013 Annual Report to Congress, the IRS is in the process of creating a cross-functional working group to handle Indian individual issues.
- **Actions the Internal Revenue Service Has Committed to Take:** Establish a cross-functional working group on issues of Indian individuals.

[10-3] Consult with the ITG function before implementing filters or similar programs (such as those operated by Wage & Investment Pre-Refund, AUR, ASFR, Correspondence Exam; Field Exam) that could have the effect of erroneously targeting Indian taxpayers.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is respectful of the nation's many diverse backgrounds and strives to develop compliance filters that do not create bias against particular segments of the population. TPP filters are constantly evaluated on both current and historic data to prove that selected samples do not arbitrarily select compliant taxpayers. With respect to this testing, special attention is paid that no group is chosen based on individual characteristics. Additionally, processes have recently been implemented that any changes to existing filters or development of new filters requires managerial and executive approval.

With respect to the Examination Program, all Individual Master File returns are filtered through the Dependent Database (DDb) application and scored during pipeline processing. The DDb is a 'Rules Based' selection application that is designed to identify potentially non-compliant returns during return processing. DDb uses data from Department of Health and Human Services, Social Security Administration and internal data. Returns filed by Native American taxpayers are subject to the same selection criteria and filters as all other returns. In order to assist Native Americans selected for audit, the Examination Program provides additional guidance to the Native American population. Indian Tribal Government (ITG) ZIP codes are utilized to facilitate the inclusion of the Form 13588 (Native Americans and Earned Income Credit) with audit notices sent to taxpayers. The Form advises the Native American taxpayers of the alternative documentation they can provide to support audit issues. In FY 2013, approximately 2,500 returns were identified by correspondence examination as Native American returns. In addition, once it is established, we will coordinate with the cross-functional working group created to handle Indian individual issues.

- **Actions the Internal Revenue Service Has Committed to Take:** TPP filters are constantly evaluated on both current and historic data to prove that selected samples do not arbitrarily select compliant taxpayers.

Processes are already in place that requires managerial and executive approval prior to modifying filters.

We will continue to consult with the ITG functions.

In addition, once it is established we will coordinate with the cross-functional group that is created by ITG to handle Indian individual issues.

[10-4] Correct procedures that result in routine failure to comply with ITG directives.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is in the process of creating a cross-functional working group on issues of Indian individuals, parallel to the ITG function on tribal entities. This working group will develop training for appropriate campus and field compliance employees.
- **Actions the Internal Revenue Service Has Committed to Take:** Establish a cross-functional working group on issues of Indian individuals.

[10-5] Finalize guidance on tribal documentation of qualifying children, frivolous claim penalties, integral parts of governments including tribal corporations, general welfare exclusion of tribal distributions, and other questions as they arise.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** With respect to tribal documentation of qualifying children, the IRS issued a SERP alert that should be incorporated into the IRM under normal procedures. With respect to frivolous-claim penalties as they apply to Indian-tribe members asserting sovereignty arguments, the IRS has not initiated any guidance. The IRS Office of Chief Counsel has an ongoing regulations project (number 45 on the priority guidance plan) for providing criteria for treating an entity as an integral part of a state, local, or tribal government; Chief Counsel is also working on regulations providing criteria for what constitutes a governmental plan under section 414(d), which will provide information to consider in working on the integral part regulations project. The IRS and Treasury published a notice and proposed revenue procedure requesting comments on tribal government programs that provide benefits to tribal members, and will publish a final revenue procedure to establish safe harbors deeming benefits identified in the revenue procedure to be based on need and, in some cases, not to be treated as compensation for services. On March 10, 2014, the IRS and Treasury Department issued interim guidance regarding per capita distributions made to members of Indian tribes from funds held in trust by the Secretary of the Interior.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS and the Office of Chief Counsel have completed some actions with respect to TA MSP Recommendations. The actions include (1) a SERP Alert issued by the IRS on documentation of qualifying children, (2) a Revenue Procedure providing safe harbors under which the IRS will conclusively presume that the individual need requirement of the general welfare exclusion is met for benefits provided under Indian tribal governmental programs, and (3) a Notice providing interim guidance regarding per capita distributions. With respect to the Integral Part project, the Office of Chief Counsel has released an Advance Notice of Proposed Rulemaking

(ANPRM) seeking comment on governmental plans under section 414(d) that will provide information to consider on the integral part regulations project. We will continue to consider whether separate, narrower guidance on tribally chartered corporations can be provided. The IRS has not initiated any guidance on frivolous claims penalties.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate applauds the IRS for establishing a cross-functional working group to handle Indian individual tax issues as suggested by TAS in the 2013 Annual Report to Congress.<sup>16</sup> It is our understanding that when the team is formed TAS will be invited to participate. TAS is encouraged that the group will develop training materials on the unique culture and needs of Indian taxpayers. TAS suggests the working group use the online course jointly developed by federal agencies, “*Working Effectively with Tribal Governments*,” as a guide for the training materials.<sup>17</sup> The National Taxpayer Advocate urges that development of this training be a top priority of the working group so the IRS can deliver it to employees as soon as possible. TAS further recommends that, in addition to developing training for campus and field compliance employees on the culture and needs of Indian taxpayers, the cross-functional group oversee its implementation.

The National Taxpayer Advocate is pleased that the IRS now requires any changes to existing filters or development of new filters to receive managerial and executive approval via the *TPP Filter Change Request Form*. Nevertheless, ITG should also be involved in this evaluation and approval process to lessen the negative impact of such filters on groups of compliant taxpayers, such as Indian taxpayers.

TAS encourages the IRS to provide guidance to employees with respect to frivolous return penalties as they apply to Indian-tribe members asserting sovereignty arguments. Guidance should advise employees regarding the culturally sensitive use of the words “sovereign,” “sovereignty,” or other unique words/terms for Indian tribal governments and Indian taxpayers. The IRS should clarify that not all statements about sovereignty justify assertion of a frivolous return penalty, and a tribal member’s reference to sovereignty may not reflect a desire to delay or impede the administration of federal tax laws within the meaning of IRC § 6702.

The National Taxpayer Advocate commends the IRS for distributing Form 13588, *Native American and Earned Income Credit*, which notifies Native Americans of the alternative documentation they can provide to support the claimed credit. Although the IRS uses Indian Tribal Government ZIP codes to facilitate the inclusion of this form with audit notices to taxpayers, many qualifying Native Americans do not live on reservations and would not receive the Form 13588 through the ZIP code search. Therefore, these Native American taxpayers may not be notified of the alternative documentation they can provide to support an EITC claim. TAS recommends that, at the onset of an audit of Native Americans, the taxpayer or representative be asked if they are aware of acceptable alternative documentation for the EITC and be given Form 13588 if necessary. TAS is pleased that guidance regarding alternative documentation for Native Americans is contained in the Internal

<sup>16</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 116-123.

<sup>17</sup> See “*Working Effectively with Tribal Governments*” available at <http://tribal.golearnportal.org/return.php>.

Revenue Manual, but recommends it also include procedures pertaining to alternative documentation guidelines to Native Americans who do not receive such information through the ZIP code search discussed above.<sup>18</sup>

The National Taxpayer Advocate appreciates that the IRS and Treasury Department issued interim guidance regarding per capita distributions made to members of Indian tribes from funds held in trust by the Secretary of the Interior.<sup>19</sup> This guidance, along with recently issued Rev. Proc. 2014-35, which establishes safe harbors for benefits provided under certain housing, educational, elder and disabled, cultural and religious, and other qualifying assistance programs of Indian tribal governments, highlights the IRS's commitment to properly address Indian tribal issues.<sup>20</sup> TAS looks forward to working with the IRS in this ongoing effort to ensure that all IRS operating divisions consistently apply the appropriate cultural sensitivity and relevant tax guidance.

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18 See IRM 4.19.14.3, *Program Description* (01/01/2014); IRM 4.19.14.4, *RPS Casework Procedures* (01/01/2014).

19 See Notice 2014-17, (Mar. 10, 2014), <http://www.irs.gov/pub/irs-drop/n-14-17.pdf>.

20 Rev. Proc. 2014-35, (June 3, 2014), <http://www.irs.gov/pub/irs-drop/rp-14-35.pdf>.

**MSP  
#11****COLLECTION STRATEGY: The Automated Collection System's Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers****PROBLEM**

The Automated Collection System (ACS) is a computerized inventory system that manually and systemically sends notices to taxpayers, issues liens and levies, and answers calls in an effort to resolve balance due accounts. ACS collects tax largely by offsetting taxpayers' refunds and eliminates much of its inventory by passing cases to other parts of the IRS. ACS's failure to resolve cases can be attributed in part to its counterproductive approach to working cases and the types of cases it is assigned. Rather than applying the appropriate type of contact for each taxpayer, ACS generally relies on notices of intent to levy or systemically generated levies, which are often not effective. ACS should first attempt to talk to the taxpayer by making an outgoing call or sending a notice, and then consider a levy. This strategy would reduce the risk of placing the taxpayer in economic hardship, prevent the liability from becoming too big to be resolved, and reduce the need for more extreme collection measures.

**ANALYSIS**

In fiscal year (FY) 2013, ACS collected \$5.4 billion on delinquent accounts, but about 47 percent of this came through automatic refund offsets, not from ACS employees' direct efforts. ACS transferred approximately three times what it collected – \$16.1 billion – in unresolved tax liabilities to other IRS collection operations. Although ACS issued 46 percent fewer levies in FY 2013 than in FY 2012, its overall collections actually increased slightly. This result is not surprising based on a TAS review of ACS cases that found about 75 percent of levies were unproductive. In addition, an IRS study showed taxpayers' rate of response to a letter was nearly three times greater than the response to a levy. Further, some types of cases are more suitable to ACS treatment than others.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[11-1] Better identify groups of taxpayers that would more likely respond best to a particular collection action or communication.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** With its scarce resources, the IRS already uses filters to identify inventory with various characteristics and routes them appropriately based on these characteristics. Using this method, we are able to best prioritize the workload and better match the priority inventory to the correct work stream. Given the different work streams require a different level of effort and skill of employee, ensuring our most expensive work streams are concentrating on the highest priority and most complex work is essential for effective resource management. The IRS is, however, looking broadly at collection activities, and if research indicates that this

recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[11-2] In an attempt to establish contact with the taxpayer, include a soft notice in its systemic procedures that would discuss payment options up front.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS currently sends taxpayers with accounts in the Automated Collection System (ACS) pipeline notices of payment options. Additionally, Publication 594 is enclosed with the Final Notice that is sent to the taxpayer before enforcement action is taken. Publication 594 clearly identifies ways to make payment, including options if the taxpayer cannot pay, in plain language. Also, the IRS webpage provides taxpayers with information on the payment options available and the Office of Taxpayer Correspondence (OTC) is currently updating all IRS written correspondence to direct the taxpayer to the webpage for information on payment options. This OTC initiative should reduce the cost of mailing including postage and paper. The IRS is, however, looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[11-3] Send out a monthly (or no less than quarterly) notice to taxpayers whose cases are in the Queue that informs them of the tax owed and penalty and interest accruals as well as payment options.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Taxpayers currently are provided with 2-4 notices when they have a balance due, including the Collection Due Process (CDP), before routing their case to the Inventory Delivery System and subsequent assignment to ACS or the queue. Additionally, reminder notices are sent yearly. There is no data to suggest that sending more notices would produce better results. The 2-4 notices we send are within the statutory requirements and there is no evidence that the cost of issuing more notices would be offset by increased collection revenue from those notices. Thus, we believe the current process for ensuring taxpayers are aware of their payment liabilities is sufficient and is in conformance with applicable statutes. Additionally, given our limited resources, the recommendation to provide monthly or quarterly notices to taxpayers is cost prohibitive. The IRS is, however, looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[11-4] Create and properly train a core ACS unit that can work and resolve small business cases when the field cannot take on more assignments.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** SB/SE ACS currently works small business cases in its regular work streams. ACS expanded the small



business cases from one SB/SE call site to the top priority in all SB/SE call sites several years ago. All SB/SE ACS employees are trained to work these accounts and small business cases are the top priority in the SBSE ACS hierarchy of accounts. The IRS is, however, looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[11-5] Expand the guidance under IRM 5.19.1, Liability Collection, Balance Due, to require ACS assistants to present all collection alternatives to the taxpayer upfront in all cases.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** All ACS Collection Representatives are trained to discuss payment options with the taxpayer. Once the ACS employee has identified the issue with the taxpayer, the employee is trained to discuss payment options with the taxpayer. Offering collection alternatives before the issue and facts of the case can mislead taxpayers. They may think an option is appropriate for them only to find out later that not all taxpayer situations allow the taxpayer to qualify for all payment options. The IRS is, however looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The IRS response implies that its collection strategy is adequate and limited resources prevent it from doing anything beyond the status quo. The National Taxpayer Advocate finds this position unconvincing and profoundly disappointing. Although the IRS's budget is not what we would want it to be, IRS resources are hardly "scarce." A reconsideration of its collection approach may produce more revenue along with better resolutions for taxpayers, and thus convince Appropriators that the IRS will effectively utilize additional collection resources. However the IRS has yet to make any commitment to alter its existing collection practices. An approach that places less emphasis on levies, identifies which taxpayers would best respond to other collection approaches, and initiates them early in the life of the debt would yield effective contacts and better case resolutions, potentially resulting in more revenue collected. Alternatively, holding steadfast to ACS's current collection approach (*i.e.*, its tendency to rely on levies or move cases to the Queue) unnecessarily harms taxpayers and creates needless work for the IRS, as well as being ineffective at collecting revenue.

Although taxpayer accounts placed in ACS have received notices regarding payment options through the IRS notice process, ACS itself often moves quickly to enforcement action and sends out Letter 11, *Final Notice, Notice of Intent to Levy and Your Notice of a Right to a Hearing*, followed by a levy. This rush to enforcement action is troubling, because months may have elapsed since the last notice and assignment to ACS. A soft notice providing information on a variety of payment options would afford taxpayers another opportunity to resolve their tax issues before the IRS starts enforcement actions.

Obviously, there is no data on the effectiveness of monthly or quarterly reminder notices to taxpayers regarding their amount due, because the IRS has never tested or piloted monthly or quarterly notices to find out if they bring in dollars. However, the practice of not sending a bill after sending two to four notices is out of line with the private sector's bill-collecting techniques (*i.e.*, credit card companies send monthly bill statements). Further, a research study in the National Taxpayer Advocate's 2013 Annual Report to Congress found most employment tax payments received while the accounts were in queue status were received within about 35 days of being placed in the queue, suggesting that some resulted from a prior notice. This further supports the recommendation that the IRS consider sending additional notices to taxpayers assigned to the queue, particularly notices that emphasize payment alternatives and the impact of late payment penalties and daily compounded interest.<sup>21</sup>

The National Taxpayer Advocate does not understand why the IRS insists on placing small business cases involving trust fund taxes in the SB/SE ACS group. They would clearly be worked more efficiently in the Collection Field function, which is better equipped to work these cases (*i.e.*, it has more authorities and greater latitude to resolve these cases than ACS).<sup>22</sup> Because the field is better equipped to work these cases, it achieves better results.<sup>23</sup>

The National Taxpayer Advocate is not suggesting that ACS assistors do not obtain all the facts of the taxpayer's situation. However, rather than pushing for full payment, ACS assistors should be permitted to discuss *all* collection options early on in their discussion with the taxpayer, including the possibility of an installment agreement. Insisting on full payment is not realistic in many situations, and, as the ACS data illustrate, it has not yielded and will not yield effective tax collection.

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21 National Taxpayer Advocate 2013 Annual Report to Congress, volume II (*A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*) 26.

22 IRS response to TAS information request (Sept. 13, 2012). ACS employees are not trained or authorized to enter into non-streamlined IAs for accounts involving business taxes.

23 SB/SE ACS employees are not authorized to consider a business taxpayer's complex financial statements, such as cash flow and profit and loss statements, nor are they trained to complete a financial analysis of business cases. Further, ACS employees are limited to granting in-business trust fund express installment agreements (IBTFE) for business accounts with a balance due of \$25,000 or less. This means that business taxpayers who call ACS after receiving a notice (potentially a levy notice) will speak with an ACS assistor who has limited authority to agree to an IA. See National Taxpayer Advocate 2013 Annual Report to Congress, volume II, 16 (*A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*).

**MSP  
#12****COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue****PROBLEM**

The withholding and payment of trust fund taxes are vital components of the voluntary compliance system. Trust fund tax delinquencies can quickly become unmanageable for business taxpayers; yet the IRS provides inadequate attention and service for emerging trust fund collection cases. The IRS persists in assigning these cases to employees who are not fully equipped to resolve them. Consequently, important collection options (*e.g.*, installment agreements and offers in compromise), are exceptionally rare and are frequently not available to business taxpayers until their debts become uncollectible. The National Taxpayer Advocate is troubled by the high percentage of business taxpayers who cannot resolve their tax problems in response to IRS collection notices or contacts with the Automated Collection System (ACS) and believes the IRS could resolve many of these accounts through a more proactive, service-oriented approach.

**ANALYSIS**

In FY 2013, 85 percent of the employment-related trust fund taxes included in collection “final” notices were not resolved in the notice process, and 78 percent of the delinquent trust fund dollars that passed through the ACS left as unresolved cases. As a result, resolutions for these collection accounts are unnecessarily delayed, increasing the risk that these taxpayers may never pay what they owe or return to compliance. At the conclusion of FY 2013, 75 percent of the trust fund cases in the IRS’s collection inventory involved more than one tax delinquency. From FY 2010 through FY 2013, the IRS has reported as uncollectible an average of \$4.2 billion per year in trust fund tax debts – or roughly 1 ½ times the amount the IRS managed to collect on these accounts, including refund offsets and installment agreements.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[12-1] Reconcile case assignment practices involving In-Business Trust Fund (IBTF) tax delinquencies with the authorities delegated to employees assigned to work these accounts. Trust fund tax delinquencies should not be assigned to employees who are not fully empowered to resolve them. Current IRS practices create undue burden on taxpayers and contribute to significant delays in case resolution.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is committed to providing the highest levels of taxpayer service. We are contacting business taxpayers who may not have made their required Federal tax Deposits (FTDs) either in-person or through correspondence. Our assignment practices (including the decision of whether to reach out in-person or through correspondence) are based on a comprehensive analysis of accounts to determine the priority/complexity of the case. Contacts made through

correspondence are worked by SB/SE ACS employees. All S/BSE ACS employees are trained to work IBTF cases. Trust Fund Tax Delinquencies cases are a top priority in SB/SE ACS case hierarchy. And, beginning in March 2014, certain business taxpayers with liabilities of \$25,000 (combined taxes, penalties, and interest) or less can establish an installment agreement through the on-line payment agreement toolkit. The IRS is, however, looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[12-2] Develop and test a new “second” notice for business taxpayers with trust fund tax debts, with an expanded focus on the availability of collection payment options. The notice should proactively invite taxpayers who have not acted since receiving the first notice or who are experiencing financial difficulties to contact the IRS to discuss payment options and should provide more information about the options that may be available. This information should be on the front page of the notice.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Currently, business taxpayers receive a Final Balance Due Notice. All taxpayers that have outstanding balances also receive Letter 3228, Annual Reminder Notice, reminding them of their outstanding liability and we recently started sending certain taxpayers with outstanding balances a “soft” notice after completing a successful pilot. The Final Balance Due Notice provides basic collection information, contact information and some payment alternatives. Publication 594, which is enclosed with many of our notices, includes an extensive discussion of payment options and the Letter 3228 provides taxpayers with a contact number if they disagree with the balance or would like to self-correct through other collection options. Current budgetary constraints prevent the IRS from developing or testing additional collection notices at this time, but we will review our existing notices to determine if more should be done to provide available payment options.
- **Actions the Internal Revenue Service Has Committed to Take:** Initiate a review of existing Collection notices to determine whether more information about available payment options should be included.

[12-3] Develop and implement an initiative to test the benefits that may be obtained through continued efforts to reach out to IBTF taxpayers whose accounts have been assigned to the Collection Queue. Through regularly issued “reminder” notices, similar to the new notice described in Recommendation 2 above, the IRS may encourage taxpayers to self-correct delinquencies on accounts that would otherwise sit inactive in the Queue.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As your recommendation acknowledges, there is more inventory in the Collection queue than the IRS has resources to work each week. However, the risk levels of the cases in the queue are reset each week, helping our employees to prioritize the cases selected to be worked. All business taxpayers who have a case in the queue have received a statutory notice of deficiency and a Final Balance Due Notice. The Final Balance Due Notice provides basic collection information, contact information and some alternatives, such as installment agreements.

Additionally, all taxpayers that have outstanding balances receive Letter 3228, *Annual Reminder Notice*, reminding them of their outstanding liability and providing them with a contact number if they disagree with the balance or would like to self-correct through other collection options. Current budgetary constraints prevent the IRS from developing or testing additional collection notices at this time. The IRS is, however, looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[12-4] Allow “conditional IAs” for business taxpayers with trust fund tax debts. These IA procedures would allow ACS, CSCO, and AM to set up IAs for taxpayers’ unfiled returns, with a requirement to file the returns included as a condition of finalizing the agreement within a reasonable period.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** A taxpayer is not prevented from making voluntary payments while they prepare and file delinquent returns. The taxpayer can designate these voluntary payments to their maximum benefit. However, granting a “Conditional IA” is not workable. First, without knowing the total extent of the trust fund liability, ACS, CSCO, and AM cannot determine if the case meets their criteria for working an IBTF case, whether the taxpayer qualifies for IBTF Express treatment, or whether a TFRP determination needs to be made. AM and CSCO are not well suited for working cases that require follow-up actions. Additionally, if we grant the IA, conditional or otherwise, we cannot default it if the taxpayer fails to file the delinquent returns as promised. The IRS is, however, looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[12-5] Revise the collection procedures detailed in IRM 5.7.2.2, *Issuance of Letter 903*, and expand the use of the L-903 process to serve as a delinquency prevention tool. This practice would allow the IRS to clearly identify high-risk, repeat delinquents, and expedite these cases to Revenue Officers for appropriate attention.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS has recently expanded the early intervention program using the soft letter notice in an effort to contact taxpayers earlier in the delinquency process and educate the taxpayer on the deposit requirements before the accounts become actual field Federal Tax Deposit (FTD) Alerts. The results of the soft letter notice indicate that taxpayers who do not receive a soft letter notice consistently had a higher percentage of late filed returns than those to whom the letter is sent. When a taxpayer is issued a Letter 903, an “L” indicator is listed on the account. When additional modules generate that have an “L” indicator, it bypasses the collection queue and goes directly to the Group Manager’s (GM) hold file for assignment. If the account is already assigned to a Revenue Officer (RO) or in the GM hold file, the additional module will be accelerated to attach with the other modules. Currently, ROs have numerous priority cases in their inventory. Increasing the number of case prioritizations would not necessarily

increase the efficiency or quality of the casework when faced with limited resources due to budgetary limitations. The IRS is, however, looking broadly at collection activities, and if research indicates that this recommendation would be helpful, the IRS will incorporate the recommendation into any redesign of collection processes.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

One common theme running through the IRS response is that current budgetary constraints have limited the resources Collection has available to develop and implement new approaches to providing effective treatments on collection accounts. Consequently, the IRS seems to be taking the position that the processes in place to address employment tax delinquencies are adequate – despite the considerable data and analysis in this report that indicate these treatments are clearly ineffective.

The IRS response indicates an increased emphasis in the use of FTD Alerts to intervene earlier in employment tax delinquencies. In fact, IRS research has revealed that for every dollar spent on revenue officers working FTD Alerts, future FTD non-compliance decreased by \$69. Yet, IRS data indicate that in FY 2013, the IRS devoted only a minute percentage of its CFF resources to FTD Alerts. The IRS response acknowledges that the recommendation to increase use of the L-903 process would indeed expedite cases involving taxpayers with multiple episodes of employment tax delinquencies to revenue officers, but astonishingly seems to question the relative priority these high-risk cases should have in collection strategy. Yet, the IRS response also notes that the Accounts Management, Compliance Services Collection Operation, and Automated Collection System operations have limited criteria for working these cases, and “AM and CSCO are not well suited for working cases that require follow-up actions.”

The IRS seems to recognize the need to provide business taxpayers better access to installment agreements, and indicates that it has recently modified the online payment agreement (OPA) application accordingly. However, through May 2014, the IRS reports only a few IAs involving business-related taxes have been issued via the OPA, while overall business-related IAs have declined by 22 percent from the same time in FY 2013.

The National Taxpayer Advocate is keenly aware of the budgetary constraints imposed on the IRS, and has addressed inadequate funding for the IRS as a most serious problem in the 2013 Annual Report to Congress. However, the reality of limited resources intensifies the need for the IRS to examine its case assignment practices, policies, and procedures to ensure that existing resources deliver the maximum benefits to the government and its taxpayers. The employment tax program is a vital component of the nation’s system, and the current IRS strategy to collect delinquent employment taxes is not effective. The recommendations in this report are actionable and remain valid. The National Taxpayer Advocate encourages the IRS to make the necessary improvements in this key aspect of its collection program.

**MSP  
#13****COLLECTION STATUTE EXPIRATION DATES: The IRS Lacks a Plan to Resolve Taxpayer Accounts with Extensions Exceeding its Current Policy Limits****PROBLEM**

As of December 31, 2013, 2,371 taxpayers remain subject to IRS collection action because of waivers of the applicable statutory period for collection of tax liabilities, which violate the IRS policy limit of five years. On October 30, 1991, the IRS set a limit of five years on collection statute extensions entered in connection with installment agreements (IAs) that allowed taxpayers to pay their debts over time. Before January 1, 2000 (the effective date of the IRS Restructuring and Reform Act of 1998 (RRA 98)), however, IRS collection personnel commonly solicited extensions of any collection statute beyond five years when it did not appear the taxpayer could pay before the collection statute expiration date (CSED). In connection with a directive from the National Taxpayer Advocate, the IRS and TAS worked together to investigate these CSED extensions. The majority of these lengthy CSED cases burden taxpayers, who do not appear able to pay or resolve their debts through collection alternatives. The National Taxpayer Advocate's chief concern is the IRS's failure to cancel these unreasonable CSED extensions that do not comply with current policies. The IRS has already spent over four years trying to fix this problem, and no resolution is in sight.

**ANALYSIS**

RRA 98 restricted CSED waivers but did not apply to waivers entered in connection with IAs. The IRS does not plan to collect almost 82 percent of taxpayers' accounts (1,939 accounts) in which it inappropriately extended the CSED beyond five years, and has placed them in currently not collectible (CNC) status or in the collection queue. TAS analysis of these accounts reveals that 309 taxpayers affected by these CSEDs are deceased. More than half of the taxpayers subject to these CSED extensions owe more than \$50,000, of which almost 76 percent is attributable to accrued penalties and interest. Further, over 93 percent of these taxpayers defaulted on the installment agreement entered in connection with his or her CSED waiver.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[13-1] By April 15, 2014, cease collection of payments on all accounts where the collection period was extended in violation of the IRS 1991 waiver policy.

[13-2] By June 30, 2014, abate all such extended CSED accounts under the authority vested in the Commissioner under the Internal Revenue Code

- **Internal Revenue Service Response to Taxpayer Advocate [13-1 and 13-2]:** Although these pre-1999 extensions of the collection period are valid under the law and regulations, the IRS is working collaboratively with TAS and the Office of Chief Counsel to explore alternatives to address these accounts. These efforts include performing a cost/benefit analysis to

determine if the cost of collecting amounts on these accounts exceeds the monetary benefits achieved.

- **Actions the Internal Revenue Service Has Committed to Take [13-1 and 13-2]:** Present IRS leadership with options for addressing the approximately 3,900 open accounts in which the taxpayer and the IRS entered into a valid agreement prior to 1999 to extend the collection period.

## **TAXPAYER ADVOCATE SERVICE RESPONSE**

On May 6, 2014, the National Taxpayer Advocate met with IRS leaders regarding the status of the taxpayers who remain subject to IRS collection action because of waivers for the applicable collection period for tax liabilities that violate the IRS policy limit of five years. During this meeting, the National Taxpayer Advocate and IRS leaders discussed a possible approach to resolving these cases (*i.e.*, stop collection and clear the remaining liabilities on the accounts). In the next month or so, the National Taxpayer Advocate and the Commissioners of W&I and SB/SE will present this approach to the IRS Commissioner for final decision. We are hopeful that the IRS has a workable solution to this long-festering problem.



**MSP  
#14****COLLECTION DUE PROCESS HEARINGS: Current Procedures Allow Undue Deference to Collection Function and Do Not Provide the Taxpayer a Fair and Impartial Hearing****PROBLEM**

IRS procedures for Collection Due Process (CDP) hearings deprive taxpayers of a fair and independent review of IRS collection actions. A CDP Hearing Officer must verify that the IRS followed the law and administrative procedures, and consider whether the collection action balances the need for efficient tax collection with the taxpayer's concern that the action be no more intrusive than necessary. However, Hearing Officers may overlook this balancing test and rely too heavily on the determination made by the Collection function.

**ANALYSIS**

Taxpayers often do not have an opportunity to work with Collection prior to a CDP hearing. Neither the Automated Collection System (ACS) nor Field Collection tracks how often employees contact taxpayers by phone or mail prior to sending CDP notices. If taxpayers do work with Collection, they often must waive their rights to a CDP hearing when accepting collection alternatives such as installment agreements for payment. IRS Office of Appeals employees does not appear to understand the purpose of CDP, and there are legitimate concerns about Appeals' independence from Collection. Among other things, Appeals lacks its own Internal Revenue Manual (IRM) guidance for CDP cases and must use the Collection IRM to evaluate collection alternatives and conduct the balancing test unique to CDP cases. Appeals does not consider the hazards of litigation in CDP cases even though the rationale for judicial review of collection actions is to provide guidance regarding when IRS actions constitute abuse of discretion. If the IRS ignores that guidance, it will harm taxpayers.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[14-1] Require Collection to attempt to contact the taxpayer, preferably by phone, before issuing a CDP notice.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS does attempt to contact the taxpayer prior to issuing a CDP notice. Often this is done by issuing collection notices or the IRS may attempt direct contact with the taxpayer by phone or in person. If the taxpayer responds to these contact attempts, the IRS can assist him or her in resolving the account. If the taxpayer does not respond to these attempts to contact, the IRS must initiate the next most cost-effective action. Direct contact by phone is not always the most effective next action, in addition, the current budget environment does not provide sufficient resources to make individual contact. As noted in the report, the IRS issued over 3.6 million CDP notices in FY 2012. Issuance of a CDP notice is also an attempt to contact the taxpayer. Some taxpayers will respond to the notice and resolve their account without

requesting a CDP hearing. Few taxpayers request a CDP hearing. As noted in the report only 1.3 percent of taxpayers issued a CDP notice in FY 2012 requested a CDP hearing.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[14-2] Direct the taxpayer to send his or her CDP request to Appeals instead of Collection. If this is not done, require Collection to send cases to Appeals immediately upon receipt of the CDP request.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS believes taxpayers sending their appeals directly to the Office of Appeals is not appropriate because it would cause the CDP appeal process to be different than the longstanding appeals process for all other types of cases Appeals considers. This would set a precedent that Appeals is the starting point for taxpayer interaction with the IRS rather than the traditional role of Appeals entering the process to resolve a dispute, which is contrary to Appeals' mission of resolving tax controversies. Taxpayers state on their CDP hearing request the resolution they are seeking. When the resolution is routine, *e.g.*, an installment agreement, Collection employees can explain the requirements to the taxpayer and address such issues more quickly than if the taxpayers are required to go first to Appeals. If the parties enter into a satisfactory resolution, there is no dispute at issue, and the taxpayer should not be required to include Appeals in the process.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[14-3] Consider untimely CDP requests as requests for an equivalent hearing if they qualify. Notify the taxpayer by letter and attach a list of questions and answers about equivalent hearings.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The CDP regulations were amended in 2006 to require taxpayers to specifically request an EH, if a CDP hearing request is not timely. To ensure taxpayer rights, language was also added to paragraph (c)(2), Q&A-C7 stating that the Service would notify the taxpayer his/her CDP hearing request was untimely and offer the taxpayer an equivalent hearing. IRM Part 5 requires contact with the taxpayer, verbally or in writing, to determine the taxpayer's interest in an EH in such cases. To make it simple for the taxpayer, the IRS does not require the taxpayer to submit a second written request for a hearing. The 2006 amendment to the regulations was intended to address the large number of no-response equivalent hearings in Appeals. Once many taxpayers discovered that they were only entitled to an equivalent hearing and not a CDP hearing, they did not want an equivalent hearing and would not respond to efforts by Appeals to conduct a hearing. Publication 594 and Form 12153, sent with all CDP notices, provide the taxpayer with information about the nature of an EH. When a contact is made with a taxpayer who would qualify for, but does not request an EH, Collection informs the taxpayer that a CDP hearing and an EH are substantially the same, except that the taxpayer generally has no right to judicial review with an EH. Mailing an additional publication with EH Q/A's in such instances would be redundant, costly, confusing, and unnecessary.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[14-4] If a taxpayer reaches an agreement with Collection, do not ask the taxpayer to waive the right to a CDP hearing. Require Appeals to retain jurisdiction of the hearing when a taxpayer reaches an

agreement with Collection, meaning Appeals and not Collection enters into the agreement with the taxpayer and conducts the other tasks required in CDP hearings.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** When the taxpayer reaches an agreement with Collection, Collection advises the taxpayer of the option to voluntarily withdraw the CDP hearing request and explains the effect of the withdrawal. Denying taxpayers the right to withdraw a CDP hearing request after they have successfully resolved their tax matters with Compliance would harm taxpayers for several reasons, including: 1) causing confusion; 2) causing taxpayers to unnecessarily incur higher penalty and interest charges by delaying implementation of an agreed upon collection alternative; and 3) causing represented taxpayers to pay additional fees to meet with Appeals when the highly-probable result would be the same resolution. Implementing this recommendation would prioritize preserving appeal and judicial review rights over allowing taxpayers to resolve their tax matters at the earliest stage possible and at the lowest cost of time and money.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[14-5] Require Appeals to suspend a CDP hearing when a taxpayer raises a liability issue for a non-CDP year that would be included in collection alternatives covered by the CDP hearing. Allow the taxpayer to resolve these related liability issues with the appropriate IRS function.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** CDP was created to allow taxpayers an opportunity for a timely appeal of certain collection actions. The statutory rights and requirements apply to the taxable period for which the collection action relates. Currently, the statute does not contemplate that collection actions for the years covered by the CDP will be suspended while issues related to liabilities for other tax years are resolved. Such a system would be impractical to implement as the underlying liability should be determined by Compliance not by Appeals and issues exists in attempting to keep an action suspended in Appeals for a potentially significant time. Other avenues exist for a taxpayer to dispute a liability with Compliance (*e.g.*, amended return, audit reconsideration, claim, etc.).
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[14-6] Provide further guidance and examples of when the issuance of an Appeals Referral Investigation is appropriate, and limit the use of ARIs to obtaining additional documentation or facts, not analysis.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Appeals has been working on ARI guidance relative to new AJAC requirements for several months. An interim guidance memo containing substantial ARI guidance was issued for clearance on March 4, 2014. Appeals anticipates release of this guidance soon.
- **Actions the Internal Revenue Service Has Committed to Take:** An interim guidance memo containing substantial ARI guidance was issued for clearance on March 4, 2014. Appeals anticipates release of this guidance soon.

14-7] Update the Appeals IRM to provide significant guidance on CDP hearings, including reviewing the collection action, conducting the balancing test, and considering collection alternatives.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** IRM Part 8 includes significant guidance on CDP hearings and includes the issues mentioned. IRM Part 8 has eight sections and 300 pages of guidance for Appeals employees considering CDP appeals. Over 100 of those pages are dedicated to verifying that the requirements of law and administrative procedures were met, considering collection alternatives, and determining whether the proposed collection action balances the need for the efficient collection of taxes with the legitimate concern that the collection action be no more intrusive than necessary. This recommendation is premised on the view that CDP does not provide taxpayers with a meaningful hearing. Tax Court decisions indicate the opposite is true. Page 376 in the Most Litigated Issues section of the National Taxpayer Advocate's 2013 Annual Report shows the IRS fully prevailed in over 90 percent of the CDP decisions from 2003-2013, which strongly indicates taxpayers are receiving meaningful hearings.
- **Actions the Internal Revenue Service Has Committed to Take:** IRM 8.22 already contains the recommended guidance.

[14-8] Require all Appeals Officers, Settlement Officers, and Appeals Account Resolution Specialists to take updated training on conducting the balancing test and applying the hazards of litigation.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Appeals has offered ongoing and comprehensive training on all aspects of CDP since IRC §§ 6320 and 6330 became effective. This includes training on verifying that the requirements of law and administrative procedures were met, considering collection alternatives, and determining whether the proposed collection action balances the need for the efficient collection of taxes with the legitimate concern that the collection action be no more intrusive than necessary. Assessing hazards of litigation applies to a small percentage of cases. The Conference Committee Report states that the court's *de novo* review applies only when the validity of the liability is properly at issue, and an abuse of discretion standard is applied in all other instances. Appeals officers who are well trained in assessing litigating hazards consider liability disputes in CDP cases. Non-liability issues raised under CDP require factual rather than legal determinations, in which case hazards of litigation do not apply.
- **Actions the Internal Revenue Service Has Committed to Take:** Appeals already trained its employees on the recommended topics.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate is disappointed by the IRS's response, which fails to recognize that the CDP process is a unique Appeals process created by statute. In creating CDP hearings, Congress specifically required the IRS to provide an independent hearing officer in Appeals and specifically laid out what the hearing officer must consider. Sending CDP requests to Collection undermines the independence of the entire CDP process.

The National Taxpayer Advocate agrees that Appeals should not be the first contact for the taxpayer, and thus her recommendation to send CDP requests directly to Appeals does not relieve Collection of the need to meaningfully contact the taxpayer and try to work towards a solution *before* issuing the CDP notice. Although the IRS does attempt to contact taxpayers before issuing a CDP notice, it rarely does so in a way that provides a meaningful opportunity to work with Collection. Simply sending a balance due notice does not educate taxpayers about the possibility of working with Collection on alternatives such as an offer in compromise. The IRS has a chance to have meaningful contacts with the taxpayer before issuance of the CDP notice, but it declines to do so. The IRS's practice of issuing the CDP notice so early in the notice stream is what sets up Appeals to be the first meaningful contact. This practice creates an endless cycle where Appeals receives a CDP case and then sends it back to Collection in order to not be the first meaningful contact.

The National Taxpayer Advocate's recommendation to send the CDP request to Appeals also does not prevent Collection from working with the taxpayer after the request has been sent. The letter notifying the taxpayer that he or she is eligible for a CDP hearing could state that if the taxpayer has not worked with Collection, then Collection will attempt to work with the taxpayer unless the taxpayer objects. If the taxpayer and Collection agree on a solution, Appeals still must be involved because it must verify that the IRS followed the applicable law and procedures, and conduct the balancing test.

The IRS's response regarding asking taxpayers to withdraw CDP requests when they have come to an agreement with Collection misses the point of our recommendation. The response states that Collection "advises the taxpayer of the option to voluntarily withdraw," while the IRM says the Revenue Officer "should solicit a withdrawal of the hearing request." Even if the IRS in practice only informs the taxpayer of the right to withdraw, withdrawing the CDP request takes away the responsibility of Appeals to ensure transparency and accountability in the collection process. The IRS response expresses a concern about resources, but the Appeals review to determine whether Collection followed the applicable law and procedures could be done quickly and efficiently, so it would not add significant cost or time for the taxpayer. Appeals could be simultaneously working on the review to determine whether Collection followed procedures and at the same time be ready for the referral back from Collection. Appeals would act as a "quality review" of the decision.

The IRS response focuses solely on represented taxpayers, ignoring unrepresented and low income taxpayers who would not receive the benefit of a review by Appeals. Some taxpayers may have no debt at all if the assessment statute has expired or the statutory notice of deficiency was not sent to the last known address, but the taxpayer would end up paying the liability because he or she did not receive an independent review. Furthermore, because the request to withdraw is coming from Collection, taxpayers may feel coerced into withdrawing due to a fear that the IRS will take enforced collection actions if they do not agree to withdraw. A solution would be for Appeals to send the letter to the taxpayer, asking him or her to withdraw, and clearly explaining what the taxpayer would give up by doing so.

The National Taxpayer Advocate is pleased that Appeals has been working on further guidance clarifying when employees should issue an Appeals Referral Investigation. However, she remains concerned that Appeals does not have proper IRM guidance on conducting the balancing test,

which is fundamental to a CDP hearing. Although the IRS prevailed in the majority of CDP cases in Tax Court during the last year, the abuse of discretion standard applied to the government's actions in CDP cases is a very high standard, which makes it unsurprising that the IRS would often prevail. The National Taxpayer Advocate believes Appeals should fully conduct the balancing test in all CDP cases, based on the available evidence. CDP hearings are an opportunity to ensure that the Collection function is acting appropriately.

The National Taxpayer Advocate is disturbed by the IRS's refusal to take into account the hazards of litigation in non-liability cases. Where there is judicial review and the Court has issued opinions and rulings on non-liability issues, there are hazards of litigation that the IRS should consider when deciding whether to settle a taxpayer's case.

**MSP  
#15****EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status****PROBLEM**

The IRS Exempt Organizations (EO) function receives about 60,000 applications for exempt status each year. In addition, EO receives applications for reinstatement from organizations whose exempt status was automatically revoked for failing to file returns or Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt EOs Not Required to File Form 990 or 990-EZ*, for three consecutive years. Its inventory backlog now stands at about 66,000 cases, more than the number of routine applications it usually receives in an entire year, four times the 2010 level, and more than triple the 2011 level. EO also erroneously treated thousands of organizations as no longer exempt, and programming conditions will cause more erroneous revocations in the future. Organizations affected by delays in obtaining recognition of exempt status include those that deliver human services such as food and shelter. Of public charities that report to the IRS, there are more in this category than in any other. Increased need for their assistance coincides with reductions in the amount of government funds to meet the need, especially at the state and local levels.

**ANALYSIS**

Since 2009, EO has notified more than half a million organizations they are no longer exempt. About 9,000 of these revocations were erroneous. Some erroneous revocations were caused by IRS programming, which calculates the three-year non-filing period that triggers automatic revocation by reference to the date the organization obtained its Employer Identification Number (EIN), rather than by reference to the effective date of its exempt status. EO intends to retain the practice of measuring the nonfiling period with reference to the EIN date. It does not inform organizations how the practice may affect them or provide for administrative review of automatic revocations.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[15-1] Issue a letter informing the organization when the IRS proposes to treat it as having had its exempt status automatically revoked and providing an opportunity to correct the condition that caused the proposed automatic revocation within 30 days. The letter should specify the availability of administrative review for organizations raising concerns that the IRS is proceeding in error.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As noted in the report, the IRS sends Notice 259A (“You didn’t file a Form 990/990-EZ or Form 990-N”) each year an organization fails to file. In addition to informing an organization that it has not filed, the Notice 259A also advises the organization about the consequences of failing to file for three consecutive years. Approximately eight percent of Notices 259A are returned by the Postal Service as undeliverable, an indication that the organization may not have updated its address. After multiple Notices, the effectiveness of yet another letter thirty days

before automatic revocation would be unclear.

The statute does not provide for administrative review of automatic revocation. Once an organization has failed to file the third required return, it is revoked by operation of law. In addition to its existing efforts, the IRS will consider further steps to advise organizations of their filing obligation, particularly by reviewing the content of Notice 259A and Notice CP 575E (“We assigned you an Employer Identification Number”), which is generally received at inception, and revising them as appropriate.

- **Actions the Internal Revenue Service Has Committed to Take:** Review form letters for clarity.

[15-2] When notifying organizations that they did not submit a required return or e-Postcard, inform them that EO calculates the three-year non-filing period using the date the organization obtained its EIN. Advise them to contact EO if its use of the EIN date may result in an erroneous revocation.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The report describes the considerations of accuracy and convenience underlying the business decision to compute the three-year period from the date of assignment of an EIN. The IRS agrees that a revision to Notice 259A would clarify the use of this date. Moreover, the EO function will consider a programming change to allow manual input of an alternate establishment date if the organization presents evidence of that alternate date in the course of an application for exemption (or reinstatement).
- **Actions the Internal Revenue Service Has Committed to Take:** Revise form letter and request a UWR for programming change to input alternate establishment date.

[15-3] Do not include in the three-year non-filing period for purposes of automatic revocations any period for which an organization could not submit an e-Postcard without contacting the IRS.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The report relates how the statutory requirement of electronic filing by small exempt organizations has created a gap for those not legally required to notify the IRS of their claim of tax-exempt status. At the current time, the IRS system cannot accept an e-filing from an organization which has not given prior notice of its existence and filing requirement. The IRS has addressed this issue by enabling e-filing by an organization once it makes a toll-free call as noted in the report. Because the organization has to call the IRS before it can e-file, the recommendation to toll the three-year period until the organization calls would result in organizations not complying with their statutory filing requirement without any consequence. Nevertheless, the current cumbersome effect on both organizations and the IRS would justify exploration of programming changes to facilitate e-filing in this case. As anticipated, the IRS will allow e-filing by an organization that indicated, when obtaining an EIN, that it was a non-profit.
- **Actions the Internal Revenue Service Has Committed to Take:** Facilitate e-filing by non-profits.



## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate is pleased that the IRS is addressing the difficulty some exempt organizations face due to the IRS's computing the three-year nonfiling period from the date the EIN is assigned. Adjustments to Notice 259A and Notice CP 575E, as well as a programming change to allow manual input of an alternative establishment date, will be welcome developments. Additional adjustments to allow e-filing by nonprofits without the need to contact the IRS will also be welcome.

However, the National Taxpayer Advocate is disappointed in the IRS's position with respect to administrative review. Even if exempt status is automatically revoked by operation of law when an organization fails to file returns for three consecutive years, administrative review is not prohibited by statute. Nothing requires the IRS to immediately remove an organization it believes is no longer exempt from the list of organizations to which deductible contributions may be made – a measure which may be fatal to the organization. The IRS already adjusts its records, and the list the public relies on, *after* it erroneously lists organizations as no longer exempt, a procedure that takes time and can be prolonged lack of funding for a valid exempt organization. Effective tax administration would allow organizations to show the IRS is in error beforehand, and would minimize damage and rework. Moreover, the IRS's position on this issue is inconsistent with its adoption, on June 9, 2014, of the Taxpayer Bill of Rights, which includes *the right to appeal IRS decisions in an independent forum* (such as the Appeals office or the Taxpayer Advocate Service).<sup>24</sup>

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24 See *IRS adopts "Taxpayer Bill of Rights,"* available at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;-10-Provisions-to-be-Highlighted-on-IRSGov,-in-Publication-1>.

**MSP  
#16****REVENUE PROTECTION: Ongoing Problems with IRS Return Integrity Programs Harm Taxpayers by Delaying Valid Refunds**

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**PROBLEM**

The National Taxpayer Advocate identified problems as early as 2005 with IRS return integrity programs, which detect and prevent civil fraud in tax returns before the IRS issues refunds to the taxpayers. Despite improvements, problems within the IRS's return integrity strategies persist and continue to harm taxpayers. The continued failure to address these problems burdens taxpayers who file legitimate returns and are wrongly ensnared by the myriad of fraud detection filters put in place by several IRS units. The failure of these units to coordinate may result in duplicate, over-inclusive, and unnecessary filters that are not routinely reviewed for accuracy or continued necessity. With the elimination of the IRS's return integrity steering committee, problems associated with fraud detection filters will not be discussed at a servicewide level and may create additional burden.

**ANALYSIS**

The return integrity process is complex and multifaceted. A tax return must travel a long path with many potential roadblocks before the IRS accepts it as filed. The main goal of Integrity Verification and Operation (IVO) is to stop fraudulent refunds before they are issued by identifying potentially false returns, usually via wages or withholding reported on the return. Returns are flagged as potentially fraudulent when a computer program automatically checks to see if the return "breaks" filters put in place by the IRS to attempt to identify activity often associated with fraud. These filters resulted in more than 300,000 refunds being delayed due to false positives for fraudulent activity in filing season 2013. TAS has seen a continued increase in cases involving taxpayers caught in fraud filters, with receipts of IVO cases increasing over 45 percent from FY 2012 to FY 2013. Problems were compounded in FY 2012 when the IRS eliminated the Pre-Refund Program Executive Steering Committee, leaving no over-arching governance of the implementation or design of revenue protection strategies or filters, inhibiting an integrated approach, and resulting in potentially duplicative or over-inclusive filters. Additional IRS programs, such as the External Leads Program, which is responsible for receiving and processing informational leads and questionable funds returned by partner financial institutions and various other sources, leave taxpayers uninformed about the status of their refunds.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[16-1] Reinstate the Pre-refund Executive Steering Committee or form a new, similar committee with TAS as a charter voting member.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The FY 2013 Return Integrity and Correspondence Services (RICS) reorganization established a centralized structure for the refund fraud program, and eliminated the need for an Executive

Steering Committee (ESC). RICS has made it a priority to continue regular and frequent collaboration and coordination with all impacted functions, including PGLD, CI, TAS, and SB/SE.

- **Actions the Internal Revenue Service Has Committed to Take:** RICS collaborates with various IRS business units to review refund fraud, patterns, and emerging schemes.

[16-2] Perform regular global reviews and updates of all return integrity filters.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS strives to identify fraudulent refunds while minimizing the delay of refunds due to legitimate taxpayers. A robust fraud detection program unfortunately means that some taxpayers' returns will be subjected to additional scrutiny and refunds delayed. Data driven models are used to identify fraudulent claims for refund, including fraud caused by identity theft. These models are continuously monitored for improvement. The Cross Industry Standard Process for Data Mining is applied when creating the Models. For 2014, we have implemented the use of Historical Characteristics Exclusionary rules to further increase the accuracy of the selections.
- **Actions the Internal Revenue Service Has Committed to Take:** Weekly review of filters and models are completed with various stakeholders.
- For 2014, we have implemented the use of Historical Characteristics Exclusionary rules to further increase the accuracy of the selections.

[16-3] Introduce a computer code to indicate that a refund is under investigation through the bank leads program.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS has existing codes in place that identify if a refund is under review through the bank leads program. IRS employees open IDRS control bases to identify ongoing action on the account under review. If a taxpayer contacts the IRS about a refund, a Customer Service Representative (CSR) is able to identify that the case is being reviewed based on a bank lead. Once the review is complete, the refund is either released to the taxpayer or the account is referred to the appropriate civil treatment stream. If referred, the bank lead portion of the review is over and normal revenue protection procedures begin.

In addition, some financial institutions participate in a program to reject direct deposit refunds for specific account discrepancy reasons. Direct deposit refunds that are rejected by the financial institution are rejected using codes R17, R18, or R19 to send to RICS for a review identical to the review conducted above. When the refund posts back to the taxpayer's account, the taxpayer is issued a CP53A, CP53B, or CP53C according to the reject code R17, R18, or R19 respectively. The CP53 informs the taxpayer that their refund was rejected by the financial institution and is under review and they do not need to take action until the review is completed. Once the review is complete, the refund is either released to the taxpayer or the account is referred to the appropriate civil treatment stream. If referred, the bank lead portion of the review is over and normal revenue protection procedures begin.

- **Actions the Internal Revenue Service Has Committed to Take:** The IRS has existing codes in place to identify if a refund is under review through the bank leads program and we have specific notices to inform the taxpayers of rejected direct deposits that also assist tax examiners in identifying returned refunds.

[16-4] Reclassify the letters intended to inform taxpayers of the status of a refund caught by filters from “just destroy” to “perform further research” when they are returned as undeliverable.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is discovering that returns identified by refund fraud programs are due to identity theft. Notices sent to addresses on these returns have historically low response rates because in most cases the true taxpayer did not file the return. As a result, a process that requires further research would not be appropriate.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

While the National Taxpayer Advocate agrees that RICS has kept open lines of communication with TAS and presumably the other operating divisions (ODs) and functions, the IRS seems to have missed the point of the recommendation to reinstate the Executive Steering Committee. Individual communication with the ODs and functions is of course important; however, it is not a substitute for an overarching body composed of all impacted ODs and functions. Without an executive committee, the individual ODs and functions may never realize that their efforts are duplicative, have gaps, or are contradictory. The National Taxpayer Advocate strongly urges the IRS to reconsider and reinstate the Executive Steering Committee.

The National Taxpayer Advocate remains concerned about mail returned to the IRS as undeliverable and its impact on taxpayer rights. It is notable that the IRS has found that many returns stopped by revenue protection strategies are the result of identity theft. If this is the case, what is the IRS doing to notify the actual taxpayer that his Social Security number may have been compromised? Further research would allow the IRS to identify correct taxpayer addresses on returns with a simple typographical error in the address, or to identify a real address for a taxpayer who may be a victim of identity theft. By not conducting additional research, the IRS is assuming that all undelivered mail is a result of ID theft and harms taxpayers who may have made a simple error, those who have moved and not updated the IRS, and those who may be actual victims of identity theft and be unaware that a problem might exist.

Revenue protection is a pressing concern for the IRS, but its revenue protection programs must not harm innocent taxpayers. The National Taxpayer Advocate believes reinstating the Pre-refund Executive Steering Committee would be a step toward reducing taxpayer burden by allowing all impacted ODs and functions to come together to identify common problems, program overlaps, and program gaps. Further, performing additional research on undelivered mail will assist innocent taxpayers in resolving potential IRS problems.

**MSP  
#17****ACCURACY-RELATED PENALTIES: The IRS Assessed Penalties Improperly, Refused to Abate Them, and Still Assesses Penalties Automatically****PROBLEM**

In 2012, in a reversal of prior advice, the IRS Office of Chief Counsel determined that the IRS was not legally authorized to impose the accuracy-related penalty under IRC § 6662 against taxpayers who claimed refundable credits that it had frozen (*i.e.*, not actually paid or accepted). The IRS abated almost \$143 million in penalties that it imposed against 108,774 taxpayers after June 1, 2012. Yet it declined to abate more than \$40 million in penalties that it imposed improperly against more than 46,000 taxpayers earlier, and it is still trying to collect over \$20 million of these penalties from more than 23,000 taxpayers. The IRS's failure to abate inapplicable penalties signals disrespect for the law and a disregard for taxpayer rights.

**ANALYSIS**

The IRS's decision not to abate inapplicable penalties illustrates its resource-driven approach to them. As we have described in prior reports, the IRS too often proposes accuracy-related penalties automatically when they might potentially apply – before performing a careful analysis of the relevant facts and circumstances – and then burdens taxpayers by requiring them to prove the penalties do not apply. For example, as part of its automated under-reporter (AUR) matching program, the IRS in 2012 sent over 93,000 letters (the CP 2000) that proposed nearly \$100 million in accuracy-related penalties without first calling (or writing) the taxpayers to determine whether there was a reason for the apparent mismatches. Moreover, the IRS abated about 20 percent of the tax it assessed through AUR in FY 2012. The National Taxpayer Advocate is concerned the IRS may use the same approach to administer the new penalty applicable to erroneous claims for refund under IRC § 6676. Unlike many other penalties, this new penalty may apply even if a taxpayer has “reasonable cause” for the error. If the IRS automatically applies the new penalty to all refundable credit claims that might be erroneous (*i.e.*, before investigating), it will place a disproportionate burden on unsophisticated taxpayers who have difficulty communicating with the IRS or do not understand the relevant facts and legal rules – precisely those individuals to whom Congress frequently targets the benefits of refundable tax credits. Thus, IRC § 6676 could turn refundable credits into traps for the unwary.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[17-1] Identify and abate (or refund) all accuracy-related penalties on frozen refundable credit claims for all open years.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** In the second quarter of FY 2014, the Commissioners of W&I and SB/SE approved penalty abatements on frozen refund cases closed after November 20, 2009, the date the Office of Chief Counsel

issued an opinion on this subject. The affected cases for the two and a half years are being analyzed to insure abatement is appropriate and abatements have commenced on those confirmed.

- **Actions the Internal Revenue Service Has Committed to Take:** Abate penalties on affected cases closed between November 20, 2009 and May 29, 2012. Penalties on cases closed May 30, 2012 and forward have already been abated.

[17-2] If a court determines that accuracy-related penalties do not apply to refundable credit claims that the IRS has paid, and the IRS does not appeal, then identify and abate (or refund) all such penalties on open years.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As per our normal processes, the IRS carefully considers court decisions and takes appropriate administrative actions as warranted.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[17-3] In the meantime, the IRS should direct attorneys handling refundable credit cases involving IRC § 6662 penalties to notify the court and opposing counsel (or *pro se* petitioner) if the IRS is pursuing a larger penalty than would apply under the Tax Court's recent analysis in *Rand*.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Ethical rules applicable to practice in the Tax Court already make clear a lawyer's duty to advise the court of adverse authority; therefore, there is no need to specifically direct attorneys as per the recommendation. The issue decided in *Rand v. Commissioner*, 141 T.C. No. 12 (2013), is being raised appropriately by the Office of Chief Counsel attorneys during the pendency of docketed Tax Court cases.
- **Actions the Internal Revenue Service Has Committed to Take:** Corrective actions addressed and implemented.

[17-4] Avoid proposing the new penalty under IRC § 6676 automatically (*i.e.*, before contacting the taxpayer, considering the facts, and determining that it actually applies).

- **Internal Revenue Service Response to the National Taxpayer Advocate:** In a TIGTA audit report, #2013-40-123 (*The Law Which Penalizes Erroneous Refund and Credit Claims Was Not Properly Implemented*), TIGTA pointed out that if the erroneous refund penalty is not assessed when applicable, there is nothing to deter taxpayers from repeatedly filing excessive erroneous credit claims. As a result, individuals will continue to make questionable claims on their tax returns, burdening IRS resources and increasing the cost of addressing taxpayers' noncompliance. These are the individuals that the law was intended to penalize. As a result of TIGTA's recommendation, the IRS has already established a cross functional team to assess the feasibility and cost of assessing the IRC § 6676 penalty in the campus environment. The assessment process will be determined based on this team's analysis and findings. In addition, the IRS will consider performing a penalty study to determine if penalties are counterproductive.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[17-5] Work with the Treasury Department to seek an amendment to IRC § 6676 to provide a reasonable cause exception, as previously recommended by the National Taxpayer Advocate.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** In March 2008 and again in 2011, the Office of Associate Chief Counsel (Procedure & Administration) recommended that Treasury seek legislation to include a reasonable cause exception to the § 6676 penalty.
- **Actions Internal Revenue Service Has Committed to Take:** N/A.

### TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate is pleased the IRS has now agreed to abate penalties that it improperly assessed. She is also pleased that the IRS worked with the Treasury Department in 2008 and 2011 to propose a reasonable cause exception to the penalty under IRC § 6676. The IRS should continue its advocacy in this area. A reasonable cause exception to this penalty is particularly important, given the possibility that the IRS will begin to impose it against those claiming the child tax credit (CTC).

In the meantime, the IRS should use its existing authority to abate the IRC § 6676 penalty where the taxpayer had a “reasonable basis” for claiming a credit. Existing guidance defining that term generally addresses what would be a reasonable basis for a taxpayer to claim the benefit of an aggressive transaction (*e.g.*, a tax shelter).<sup>25</sup> However, it does not necessarily address what constitutes a “reasonable basis” for a taxpayer to claim the CTC. The National Taxpayer Advocate will ask the IRS Chief Counsel’s Office to provide guidance to expand the definition of “reasonable basis” to cover CTC claims.

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<sup>25</sup> Treas. Reg. § 1.6662-3(b)(3).

**MSP  
#18****ONLINE SERVICES: The IRS's Sudden Discontinuance of the Disclosure Authorization and Electronic Account Resolution Applications in E-Services Left Practitioners Without Adequate Alternatives****PROBLEM**

The IRS has a strategic goal of expanding electronic service options for its tax partners, including practitioners, who can interact with the IRS through an e-Services suite of web-based products. In early 2013, the IRS discontinued the Disclosure Authorization (DA) and Electronic Account Resolution (EAR) applications without discussing the matter with the practitioner community in advance. DA enabled practitioners to submit power of attorney and tax information authorization forms (Forms 2848 and 8821) electronically, while EAR allowed practitioners to work with the IRS electronically on account-related issues. The IRS cited low usage and increased operating costs as reasons for ending the programs. However, almost immediately after the IRS announced the decision, practitioners expressed significant concerns. The National Taxpayer Advocate believes the decision process lacked strategic planning and stakeholder engagement, and increased burden on taxpayers and their representatives.

**ANALYSIS**

The IRS discontinued the e-Services applications without providing practitioners with acceptable online options, despite practitioners' clear demand for more electronic services and the IRS Strategic Plan's objective to expand e-Services. Once the IRS retired the two programs, practitioners who used DA reverted to mailing or faxing their paper disclosure authorization forms to the Centralized Authorization File (CAF), which has a record of long processing times due its outdated systems. Those who used EAR must now contact the IRS through the Practitioner Priority Service (PPS). Practitioners who used PPS in fiscal year 2013 had to wait almost 20 minutes to reach a live assistor. It also is unclear whether the IRS considered the additional long-term costs of moving customers away from online services to paper and phone-based systems.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[18-1] Consult with and solicit comments from impacted stakeholders, *i.e.*, the practitioner community, before deciding whether to retire applications.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Online Services (OLS) routinely solicits comments from the Business Operating Divisions (BODs), Information Technology (IT), and impacted stakeholders in the process of deciding applications to be retired.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue to solicit comments before deciding to retire applications.



[18-2] Establish a strategic plan to identify develop, and promote viable electronic alternatives to discontinued applications prior to discontinuance.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS Strategic Plan depends on sufficient resources to implement. We often identify strategies and initiatives that are a priority but for which we lack funding. OLS routinely works with the BODs and IT to include viable electronic alternatives to discontinued applications prior to their discontinuance where appropriate.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue working to include viable electronic alternatives to discontinued applications prior to their discontinuance.

[18-3] For online practitioner applications experiencing low usage, solicit comments from the users on how to improve the applications to boost usage to acceptable levels.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** OLS routinely solicits comments from the BODs, IT, and users of low-usage practitioner applications to boost uses as a collaborative effort.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue to solicit comments on low-usage practitioner applications to boost usage.

[18-4] Solicit suggestions from practitioners on marketing strategies and potentially develop a joint marketing initiative, leveraging stakeholders' ability to communicate with their members.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** OLS routinely solicits comments and suggestions from the BODs, IT, and the practitioners on marketing strategies as a collaborative effort.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue to solicit comments and suggestions on marketing strategies.

[18-5] Evaluate potential electronic alternatives to the retired e-services applications.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Previous electronic services for tax professionals were discontinued due to resource constraints. The IRS agrees with the recommendation and will work with the BODs and IT to evaluate potential electronic alternatives to retired e-services applications.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue working to evaluate potential electronic alternatives to retired e-services applications.

## TAXPAYER ADVOCATE SERVICE RESPONSE

We appreciate the commitment of OLS to solicit comments from both internal and external stakeholders before retiring applications. However, in this particular case, the IRS discontinued the Disclosure Authorization and Electronic Account Resolution applications without discussing the matter with the practitioner community in advance. Furthermore, the National Taxpayer

Advocate, an internal stakeholder, was not informed beforehand. In fact, she learned about it after the fact from the practitioner community. In the future, we request that OLS solicit comments from the National Taxpayer Advocate as well as other impacted internal and external stakeholders before making any final decisions. Soliciting comments after a final decision has been made is not conducive to trust or ongoing dialogue.

**MSP  
#19****IRS WORKER CLASSIFICATION PROGRAM: Current Procedures Cause Delays and Hardships for Businesses and Workers by Failing to Provide Determinations Timely and Not Affording Independent Review to Adverse Decisions****PROBLEM**

The classification of workers as employees or independent contractors has significant tax consequences for businesses and individuals, ranging from the allowance of expenses derived from a “trade or business” to eligibility for employee benefit or pension plans. The National Taxpayer Advocate has repeatedly called for the IRS to simplify its worker classification criteria and develop online self-help tools, but the IRS has taken little action. In addition, applicants who receive adverse classification determinations from the IRS may not automatically receive administrative appeal options, and those who do may not be afforded all the remedies offered in internal guidelines.

**ANALYSIS**

Firms and workers may file Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, to ask the IRS whether a worker is an employee or an independent contractor. The SS-8 unit has been beset with a backlog of cases, with “overage” inventory reaching 80 percent and applicants having to wait for up to a year for a decision. The development of an electronic tool to determine classification would reduce inventory. The IRS has tried to address the backlog by streamlining procedures, but problems remain. The unit is using subjective case screening criteria that may lead to rejection of legitimate applications. And in contrast to applicants under audit, those who receive adverse SS-8 determinations may not automatically receive administrative appeal options, and those who do may not be afforded remedies like Alternative Dispute Resolution.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[19-1] Adopt the National Taxpayer Advocate’s previous recommendation to develop an electronic self-help tool for employers or workers to determine employment status.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Multiple factors must be considered when making a determination of a worker’s status as employee or independent contractor. The determination depends on the unique facts and circumstances of each case, some factors will carry more weight than others depending upon the situation. Because worker relationships are unique and fact intensive, creation of an automated program would carry risk that some factors are not considered or are not given proper weight. Also, Section 530 prohibits the IRS from issuing guidance. Making an automated program that standardizes certain factors may be in conflict with this provision of Section 530. Further, an automated program might create 530 relief with regard to the results provided by the program to taxpayers who use it, even if such taxpayers manipulate or use the program improperly; and the IRS would likely have a very hard time demonstrating that such

taxpayers manipulated or used the program improperly. In addition, notwithstanding the aforementioned concerns, budget constraints and lack of information technology resources prevent us from considering this as an option. The Treasury Department has included a proposal in the Greenbook to issue generally applicable guidance on the proper classification of workers under common law standards, and the IRS agrees some guidance for taxpayers would be helpful.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[19-2] Allow applicants the right to an independent administrative appeals review of adverse determinations by the SS-8 unit.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** This issue was discussed extensively with TAS and the Office of Chief Counsel. Current procedures were shared with TAS with the understanding we would work on the process further. Currently, if the requestor contacts the SS-8 program and voices disagreement with the adverse determination, the requestor shall be advised of the reconsideration procedures, and also require the requestor to provide information not previously considered. Form 14430 and a letter explaining the reconsideration are sent to the requestor. To improve this process, a notice is being written that will provide specific information on how to request a reconsideration along with the documentation that is needed and will be published. This notice will be included in with the determination letter. Procedures currently in IRM 7.50.1.5.10 will be rewritten to say that the reconsideration is to be worked by an independent reviewer. The rewrite of the IRM will be shared with TAS when Counsel has approved the new process and the actions are complete.

- **Actions the Internal Revenue Service Has Committed to Take:** We will begin discussions with Appeals to determine the feasibility of their providing a review of the adverse determinations.

[19-3] Increase staffing to address the existing backlog and prevent future accumulation of worker classification requests.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS conducted an analysis of receipt patterns and verified that we have appropriate staffing to handle workload. Prior to 2012, all documents were accepted into the program (*e.g.*, Form 1099 reporting issues). A first read screening process identifies cases that are not worker classification issues and refers the taxpayer to the toll-free assistance line for resolution of their non-worker classification issues.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[19-4] Provide applicants an opportunity to cure perceived deficiencies in their initial filings rather than rejecting the applications outright through an initial screening process.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Workers or firms submitting an SS-8 for worker classification issues have the opportunity to cure the request. The incomplete document is returned with Letter 4949 explaining the defects. If

returned and the document is still not perfected, then an examiner calls to obtain the missing information. This guidance is provided in IRM 7.50.1.3.1 and contact procedures are in 7.50.1.3.1(8).

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate continues to believe that both taxpayers and the IRS would benefit from an electronic self-help tool to determine employment status. The National Taxpayer Advocate will consult the Office of Chief Counsel about whether the development of such a tool would violate Section 530. If Counsel opines that it would not, we encourage the IRS to seek advice from HMRC on how its system balances the many factors that go into similar determinations in the United Kingdom.

While the IRS states that workers and firms have the ability to cure requests, we remain concerned that the procedures impose unnecessary burden. The IRS first returns the incomplete document back with a Letter 4949 explaining the deficiencies. Upon return, if the document is still not perfected, the IRS states that it calls the requester. However, nothing in the IRM states that the IRS must call. IRM 7.50.1.3.1(8) merely says the IRS will “contact” the requester, which can mean a variety of methods and not necessarily a phone call. We recommend the IRS revise the IRM to specifically state that the contact must be by phone. The IRM should direct the IRS employee to attempt to contact the requester by telephone before sending the document back the first time. The use of the telephone upfront could significantly reduce response time.

Finally, we commend the IRS for its willingness to consider inserting two opportunities for independent review in the determination process. First, assigning a reconsideration to an independent reviewer will ensure that the determination receives a fresh look and is not sent back to the same group that made the original determination. Second, the IRS has indicated that it will begin discussions with Appeals to determine the feasibility of their providing a review of adverse determinations. Because an incorrect IRS decision has significant consequences for income and employment tax liabilities, providing applicants with the right to an independent, administrative appeals review of adverse determinations would improve the process significantly.

**MSP  
#20****INTERNATIONAL TAXPAYER SERVICE: The IRS Is Taking Important Steps to Improve International Taxpayer Service Initiatives, But Sustained Effort Will Be Required to Maintain Recent Gains****PROBLEM**

U.S. citizens or resident aliens are subject to tax on their worldwide incomes and have the same general tax reporting requirements whether they live in the United States or abroad. However, the tax requirements have become so confusing and the compliance burden so great that taxpayers are giving up their U.S. citizenship in record numbers. The IRS emphasizes service to international taxpayers via IRS.gov webpages, but taxpayers still call the IRS for assistance with account-related matters because online options remain limited. The IRS is planning improvements to online service delivery, but in view of the unique communication challenges international taxpayers encounter, the IRS needs to prioritize initiatives that affect this population.

**ANALYSIS**

The IRS focuses on improving online services rather than telephone service for taxpayers overseas, but the persistent lack of online options means taxpayers frequently call the international call site, a *toll* number. The customer service level of service for that number declined from 78 percent to 72 percent from FY 2011 to FY 2012. The IRS.gov landing page for international taxpayers received about a quarter million unique visitors in a recent 12-month period. There were more than 145,000 unique visitors to the Individual Taxpayer Identification Number (ITIN) page on average each *month*. At the same time, several basic tax forms, including both the ITIN application and Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, cannot be filed electronically. The International Individual Tax Assistance Team (IITA), created to develop international taxpayer service initiatives, has yet to be made permanent, which means there is still no ongoing IRS commitment to improve service to international taxpayers. Important details about how U.S. taxpayers living abroad can meet their obligations under the Affordable Care Act remain undeveloped.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[20-1] Make the IITA a permanent initiative with reporting responsibilities.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS continues to recognize the importance of a team focused on international taxpayers and welcomes the opportunity to continue working with the National Taxpayer Advocate. In June 2012, a cross-functional International Individual Taxpayer Assistance Team (IITA) was formed to better coordinate and develop international taxpayer service initiatives. This team consists of LB&I, W&I, ACCI, TAS, and Online Services. In June 2013, a permanent IITA manager was selected to coordinate this collaborative effort. The IRS recognizes the need and importance of enhancing taxpayer service to international taxpayers operating in a complex global

tax environment. Enhancements to the international taxpayer webpage and tax map have been made to improve the international taxpayer experience. The current IITA is still in the pilot stage, and its effectiveness will need to continue to be evaluated and measured. After the completion of this evaluation, the IRS will consider whether the IITA should become permanent with a formal charter.

- **Actions the Internal Revenue Service Has Committed to Take:** The IITA Team continued its work in 2014 by redesigning the international taxpayer landing page to make it more useful to the taxpayer. The team organized the various international pages into one of six categories (Taxpayers Living Abroad, Resident Aliens, Nonresident Aliens, Foreign Students and Scholars, Territory Residents, and Other). The international taxpayer landing page will show these six categories. Each category links to a separate landing page with relevant categories (such as Filing Requirements, Income, Deductions, Nonresident Aliens with a U.S. Trade or Business, Forms, or Resources) that link to separate pages with information on a specific topic. The International Taxpayer pages were posted in June 2014 and are live.

[20-2] Develop and implement free electronic filing of Forms 1040NR and W-7.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is committed to balancing the needs of customers, complying with statutory regulations, and protecting taxpayers from potential fraud and ID theft. As such, the IRS does not plan to pursue electronic filing of the ITIN application. Form W-7, *Application for IRS Individual Taxpayer Identification Number (ITIN)*, is not a candidate form for electronic filing for the following reasons:
  - Modernized e-File (MeF) is unable to accept both the W-7 and associated tax return(s) in the same transaction. Taxpayers are required to include their original, valid tax return(s) for which the ITIN is needed.
  - MeF requires a valid Taxpayer Identification Number (TIN) at the time the return is submitted for processing. The tax returns submitted with the W-7 applications do not have a TIN when the return is submitted to IRS.
  - Taxpayers must also submit documentation that supports the information provided on the Form W-7. The applicant can submit original documents or certified copies from the issuing agency. Attaching a .pdf version of the supporting documentation will not allow IRS to authenticate the documents per IRM 3.21.263.
  - Form 1040-NR is included in the list of forms to be sequenced and has been identified as a Business Operating Division (BOD) priority form. Form 1040-NR is tentatively planned for processing year (PY) 2016 deployment. Our ability to deliver in this timeframe is dependent on budget and resource availability and considered in the context of other agency priorities. There are currently no plans for the IRS to develop and offer a free version of the 1040-NR. The IRS will engage the Free File Incorporated to consider offering a free version once the form is deployed on the MeF platform.
- **Actions the Internal Revenue Service Has Committed to Take:** Form 1040-NR is included in the list of forms to be sequenced and has been identified as a Business Operating Division

(BOD) priority form. The IRS will engage Free File Incorporated to consider offering a free version once the form is deployed on the MeF platform. Form 1040-NR is tentatively planned for PY 2016 deployment. Our ability to deliver in this timeframe is dependent on budget and resource availability and considered in the context of other agency priorities.

[20-3] Prioritize the delivery of online services to the overseas population of international taxpayers, given their special circumstances and communication barriers, by including them in the first group of pilot projects the IRS launches.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** As part of the IRS's online service delivery strategy, the IRS will consider options for international taxpayers. The IRS already includes the overseas population of taxpayers in online service projects, whenever possible. Resources are not available to prioritize online services to the overseas population. Other guidance and recommendations concerning online services require that the delivery of online services to the entire taxpayer population needs to be prioritized, with resources directed toward addressing other online challenges. The IRS is updating the IRS.gov landing page for international taxpayers to improve the taxpayer's web experience. The IRS has an online tool scheduled for release in May 2014 – the FATCA FFI look-up tool. The IRS will continue to investigate and prioritize services as resources become available. The IRS welcomes the opportunity to work with TAS to determine what specific pilots TAS is interested in and the order of priorities.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[20-4] Improve the CSR level of service for international taxpayers who call the international call site.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** We are committed to providing the best level of service possible to the international taxpayer segment within the overarching need to balance the use of our declining resources to best meet the service needs of all taxpayers.
- As noted in the Most Serious Problem, the level of service provided to international taxpayers for FY 2012 was 72 percent. The same level of service (72 percent) was provided in FY 2013. The level of service provided to international taxpayers is higher than what the IRS provides to non-international taxpayers. Maintaining the level of service was significant in light of recent budget constraints that have caused the IRS to make difficult decisions concerning services provided.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[20-5] Explore the use of voice-over-Internet-protocol and other alternative methods of telephone services that will allow the IRS to contact taxpayers, and taxpayers to contact the IRS, without paying international call rates.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS has looked at this issue in the past. Each service requires subscriber-to-subscriber connection. The IRS is not a subscriber and cannot endorse the use of one service over another without a competitive procurement action. We also do not know if it would be possible to queue



such callers, as connection to the Public Switched Telephone Network is required for queuing. As part of the IRS's online service delivery strategy, this is an area that will be explored.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[20-6] Open more foreign tax attaché offices, and locate a Local Taxpayer Advocate at each site.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS does not believe that such expansion is appropriate at this time. We do not believe that the magnitude of the overseas service challenge can be adequately addressed by incurring the substantial costs of placing single individuals in overseas offices to answer the telephone or handle walk-in assistance requests. Especially given limited budgets, our efforts will be focused on delivery channels that will benefit taxpayers on a broader basis.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[20-7] Develop dedicated FAQs that ultimately become formal published guidance about how U.S. citizens abroad who are subject to the reporting requirements of the Affordable Care Act (ACA) can meet their obligations, and provide links to this guidance on the ACA webpage from the international taxpayer webpage.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** ACA has primary responsibility for all issues relating to the ACA. LB&I will work with ACA to identify useful links to add to the international taxpayer webpage. The ACA pages currently include FAQs that focus on the international taxpayer.
- **Actions the Internal Revenue Service Has Committed to Take:** The ACA office and LB&I have been collaborating with the Dept. of Health and Human Services and the Dept. of State (DOS) to address concerns raised by U.S. citizens living abroad and will continue efforts in this regard. LB&I elevated several international issues to the ACA office, which has since added relevant information to numerous ACA webpages on the IRS.gov website. Information applicable to international taxpayers is included on the main pages, as well as embedded as FAQs linked to these main pages, and specifically address aspects of Shared Responsibility, Premium Tax, Additional Medicare Tax, and other related segments of the vast ACA provisions. In addition to posting all available information on the IRS website, we have partnered with the Department of State (DOS) to distribute information to U.S. embassies worldwide for further dissemination to Americans overseas. We continue to elevate questions and feedback received from taxpayers overseas through our foreign posts and DOS colleagues, and the ACA office continues to develop more content for wide distribution through IRS and DOS channels.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate congratulates the IRS on the new IRS.gov pages directed at international taxpayers, which are tailored to specific audiences and are easier to navigate. The release of the FATCA FFI look-up tool is also a welcome development. The National Taxpayer Advocate is pleased that the IRS continues to collaborate with TAS in providing better service to international taxpayers - its willingness to explore alternative telephone services that do not carry international

call rates is one example. Thus, we are surprised and disappointed in the IRS's unwillingness to make the IITA permanent. The IITA, formed in 2012, now has a track record to evaluate. The population of international taxpayers is growing, and the IRS should signal its commitment to meeting the needs of this important taxpayer base. Making IITA permanent, with a charter and a strategic plan, would also signal that the IRS is not concerned only with enforcement initiatives with respect to international taxpayers.

The National Taxpayer Advocate welcomes the availability of electronic filing for Form 1040-NR in 2016, even though it will not be free initially. Once it is included in Free File, it needs to be in the Free Fillable Forms portion of Free File so that international taxpayers who do not meet Free File income requirements will have access to it. However, she is disappointed that the IRS, by not allowing electronic filing of Form W-7, relies on circular reasoning. Taxpayers are required to submit Form W-7, the application for an ITIN, with their returns, but the IRS cannot accept an electronically filed return that does not already have an ITIN – which means it also cannot accept electronic Forms W-7. The IRS could eliminate this problem by allowing taxpayers to file Form W-7 before the filing season and by building a separate application to accept electronic Forms W-7, which would accommodate documentation. As we have discussed elsewhere, the IRS should also change its rules that require taxpayers to submit original documents.

The National Taxpayer Advocate applauds the IRS for maintaining its level of service from FY 2012 to FY 2013. She also welcomes the IRS's willingness to explore the use of voice-over-Internet-protocol and other alternative methods of telephone services. With respect to opening more foreign attaches, we propose staffing them with Local Taxpayer Advocates (not general IRS employees) whose job would be threefold:

1. To ensure that the rights of taxpayers within that office's geographic area are protected;
2. To conduct outreach; and
3. To identify problems specific to that population.

By proposing minimal staff, with the casework done in domestic U.S. TAS offices, we have taken cost concerns into consideration.

The National Taxpayer Advocate supports IRS efforts to provide information regarding the ACA on its website. Currently, taxpayers searching for information about how the ACA affects them are directed to a home page that is then branched out by taxpayer (*e.g.*, Individuals and Families, Employer) or provision (*e.g.*, Premium Tax Credit or Individual Shared Responsibility) with no further menu subcategories. A taxpayer living abroad is then left in the confusing situation of finding essential information piecemeal. An ACA page dedicated to overseas taxpayers would provide a single point of service to this growing group of taxpayers and alleviate their burden in researching this material.

**MSP  
#21****INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS: ITIN  
Application Procedures Burden Taxpayers and Create a Barrier  
to Return Filing****PROBLEM**

In November 2012, the IRS announced permanent changes to its application procedures for Individual Taxpayer Identification Numbers (ITINs), which taxpayers who are ineligible for Social Security numbers must use to meet their filing obligations. Dependent ITIN applicants now face a substantial burden because they can no longer use a certifying acceptance agent (CAA) to certify their documents. Dependents must mail original documents or copies certified by the issuing agency, or have the documents certified at an IRS taxpayer assistance center (TAC) or at one of just four U.S. tax attaché offices overseas.

**ANALYSIS**

From January through October 2013, applicants filed only one million ITIN applications with returns, compared to 1.8 million during the same period in 2012. During this period, ITIN applications and accompanying returns declined nearly 50 percent, while the percentage of applications rejected by the IRS soared to 50.2 percent. One explanation for these numbers is the burden caused by the new ITIN procedures. ITIN applicants report problems, including a lack of communication about why the IRS suspended or rejected an application, an inability to speak with IRS employees, a lack of notice about the status of the application, the rejection of applications with legitimate supporting documents, and lost original documents. The IRS's policy of generally accepting ITIN applications only during the filing season forces the IRS to process applications under short timelines and does not provide sufficient time to review them for potential fraud.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[21-1] Allow filing of ITIN applications throughout the year if submitted with proof of taxable income or a filing requirement.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The requirement to file a valid tax return with the Form W-7 application was established to ensure the ITIN assigned is used for proper tax administration purposes. Associating the issuance of the ITIN with the filing of a tax return is the only reliable method for the IRS to verify the number is being requested and properly used for tax administration purposes.
- **Actions the Internal Revenue Service Has Committed to Take:** The Internal Revenue Service has provided one response to all six recommendations –

The IRS is working on the approach and will incorporate feedback and comments from external stakeholders. The IRS will address the feasibility and options for notification to taxpayers.

[21-2] Allow ITIN applications to be filed electronically.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS does not plan to pursue electronic filing of the ITIN application. The Form W-7, *Application for IRS Individual Taxpayer Identification Number (ITIN)*, is not a suitable candidate for electronic filing for several reasons. In order to strengthen the ITIN program, when requesting an ITIN taxpayers are required to submit documentation that supports the information provided on the Form W-7. The applicant can submit original documents or certified copies from the issuing agency. The attachment of an electronic copy of the documents, such as a .pdf version of the supporting documentation, will not allow IRS to authenticate the documents as outlined in IRM 3.21.263. In addition, taxpayers are required to submit their original tax return(s) for which the ITIN is needed with the W-7 attached. The Modernized e-File (MeF) system is not able to accept both the W-7 and associated tax return(s) in the same transaction. MeF also requires a valid Taxpayer Identification Number (TIN) at the time the return is submitted for processing. The tax returns submitted with the W-7 applications do not have a TIN when the return is submitted to IRS. The return is processed after the ITIN is assigned.
- **Actions the Internal Revenue Service Has Committed to Take:** See [21-1].

[21-3] Allow CAAs to certify copies of dependents' documentation instead of requiring original documents or copies certified by the issuing agency.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** To protect the integrity of the ITIN program and refund process, it was determined that specifically trained IRS employees in Austin, TX, designated TACs, and tax attaches need to review the identification documents of dependents. The IRS trained employees to authenticate identification documents, including those submitted for dependents, submitted with Form W-7 ITIN applications. The techniques and training materials used were provided by the Department of Homeland Security. The IRS trained employees from Submission Processing (SP) ITIN, located in Austin, Texas, Field Assistance TACs located throughout the United States, and United States tax attaches around the world. This training expanded service options to ITIN applicants and an alternative to surrendering original identification documents or mailing them to the SP ITIN Unit. In FY 2014, the IRS expanded this valuable service to assist more customers at 188 TACs compared to 100 TACs trained to authenticate ITIN documents in FY 2013.
- **Actions the Internal Revenue Service Has Committed to Take:** See [21-1].

[21-4] Allow TAC employees to certify all identity documents (beyond passports and national identity cards) that ITIN examiners currently accept for primary, secondary, and dependent applicants.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS determined certain identity documents could be certified by a Taxpayer Assistance Center (TAC) based on historical data. TACs are limited to face-to-face authentication of documents with relatively little variance in format which have a lesser chance for alterations and potential fraud. Variance in format and content among alternate documents originating in foreign countries would prevent the TAC employees from becoming proficient in authentication

without extensive training and specialized tools. The criteria for document certification, including documents that can be certified at a TAC are listed on IRS.gov.

- **Actions the Internal Revenue Service Has Committed to Take:** See [21-1].

[21-5] Require training with a knowledge check or test on the ITIN real time system for employees answering the toll-free lines and update the IRM to advise toll-free assistors of the capability to transfer calls to the ITIN unit and update the IRM to advise toll-free assistors of the capability to transfer calls to the ITIN unit.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is committed to providing toll free assistors with the necessary skill sets to effectively address customer ITIN inquiries. We train employees who work Application 20/21 (individual account inquiries), Priority Practitioner Services, International Accounts and National Taxpayer Advocate applications. Employees take three ELMs courses that address Real-Time System (RTS) and ITIN Topics. Two courses include a knowledge check (test). In addition, managers assess the sufficiency of RTS and ITIN training through regular evaluative managerial reviews of employee performance.

The IRS toll-free assistors have full access to RTS and can answer questions involving filing and dependent issues as well as post-filing questions and the current status of the application. This minimizes any need to transfer customers and create additional burden for them such as wait time. If there is an issue toll free assistors cannot resolve, the IRM instructs them to fax or refer (via Form 4442) the issue to the ITIN unit on the customer's behalf. A call can be transferred from toll free product lines to a local line by selecting "outside line" on the teleset and dialing the local number. Upon receiving an answer, the assistor hits the transfer button. The problem with this procedure is it ties up two lines on the Automated Call Distributor, one inbound and one outbound. This transfer could also impair our service to other taxpayers as it will tie up an inbound line and an outbound line, which would limit the number of taxpayers that can reach an assistor. Therefore, we do not publish the transfer capability in the IRM for toll free assistors to transfer directly to the ITIN unit.

- **Actions the Internal Revenue Service Has Committed to Take:** See [21-1].

[21-6] Require notification to a taxpayer before an ITIN expires and allow the taxpayer time to apply for and obtain a new ITIN before the expiration of the old number.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is working on the approach for deactivation of ITINS. This approach incorporates feedback and comments, including from external stakeholders such as practitioners and community based organizations. The approach will incorporate feedback and comments from external stakeholders and will also address the feasibility and options for notification to the taxpayer.
- **Actions the Internal Revenue Service Has Committed to Take:** See [21-1].

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate is disappointed by the IRS's response regarding ITINs. The blanket statement that filing an ITIN application with a paper return is the *only* reliable method of verifying that an ITIN is being requested and used properly shows the IRS is unwilling to consider alternatives, even ones that it already uses. The IRS allows applicants to provide copies of pay stubs with year-to-date information to verify that the applicant earned income if a Form W-7 and Form W-2 do not match. The IRS is ignoring its own practice, which provides a clear example of an acceptable way for an applicant to prove a filing requirement without filing a return.

Regarding the IRS's statement that Form W-7 is not an applicant for electronic filing, it is the IRS's own rules, such as the requirement to submit Form W-7 with a return, that prevent the Modernized e-File system from being able to process a Form W-7 and the accompanying return in the same transaction. The IRS could eliminate this problem and the associated bottlenecks if it allowed taxpayers to apply for an ITIN throughout the year with proof of taxable income or a filing requirement.

The IRS's continuing policy of not allowing CAAs to certify dependents' supporting documents will only continue to harm taxpayers who cannot give up their documents for extended periods or may not have access to a TAC. It is surprising that the IRS is touting the increased number of TACs that certify ITIN documents as a solution, given the recent decrease in overall service at TACs and the long lines caused by certifying ITINs. While we applaud the expansion of ITIN processing in TACs, TACs are simply not a substitute for CAAs.

The National Taxpayer Advocate is pleased that IRS toll-free assistors have full access to the Real-Time System, so there is no technical bar to their looking up ITIN information for taxpayers. However, because many taxpayers have reported that the assistors have not accessed RTS when they called, there is a concern that the assistors are not actually using RTS. If in practice employees do not use RTS and cannot answer basic questions about a caller's ITIN application, it is apparent that the RTS training is inadequate. Furthermore, it is of little benefit to applicants if toll-free assistors can transfer calls to the ITIN unit, but do not know how because the IRM does not provide this information.

The National Taxpayer Advocate hopes the IRS will seriously consider the importance of notifying taxpayers that their ITINs will expire before they do. Failure to notify taxpayers violates their right to be informed and will only lead to more work for the IRS in having to match already filed returns with new ITIN applications.

**MSP  
#22****OFFSHORE VOLUNTARY DISCLOSURE: The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Made Honest Mistakes****PROBLEM**

Since 2009, the IRS has generally required individuals who failed to report offshore income and file one or more related information returns (*e.g.*, the *Report of Foreign Bank and Financial Accounts* (FBAR)) to enter into increasingly punitive offshore voluntary disclosure (OVD) settlement programs. It generally requires “benign actors” to apply to OVD and then “opt out” before it will consider a lesser penalty. Those who opt out are subjected to audits. Because those opting out face prolonged uncertainty and the risk of even more severe penalties, some agree to pay more than they should. Moreover, IRS resources devoted to auditing and disproportionately penalizing those who come forward to correct honest mistakes are not available to address noncompliance by others who do not come forward.

**ANALYSIS**

In the 2009 OVD program, the median offshore penalty paid by those with the smallest accounts (\$87,145 or less) was nearly six times the tax on their unreported income. Among unrepresented taxpayers with small accounts it was nearly eight times the unpaid tax. The penalty was also disproportionately greater than the amount paid by those with the largest accounts (more than \$4.2 million) who paid a median of about three times their unreported tax. When the IRS audited taxpayers who opted out (or were removed), on average, it assessed smaller, but still severe, penalties of nearly 70 percent of the unpaid tax and interest. Given the harsh treatment the IRS applied to benign actors, others have made quiet disclosures by correcting old returns or by complying in future years without subjecting themselves to the lengthy and seemingly-unfair OVD process. Still others have not addressed FBAR compliance problems, and the IRS has not done enough to help them comply. While the IRS initiated a less punitive “streamlined” program to encourage certain nonresidents to self-correct, no similar program is available to U.S. residents. Moreover, the IRS has imposed new duplicative reporting requirements.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[22-1] Expand and clarify the streamlined program to encourage all benign actors (including U.S. residents) to correct past noncompliance using less burdensome and punitive procedures (*e.g.*, expand and clarify who qualifies). Alternatively, adopt the three-category approach (described above), which does not require benign actors to opt out of the OVD program(s). As with other changes to OVD programs, the IRS should allow those who previously applied (even if they have signed closing agreements) to take advantage of the new approach.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS is re-examining the OVDP and the Streamlined Filing Compliance Procedures (Streamlined) in

light of the IRS's experience with the programs and feedback from external stakeholders indicating that the penalty structure of OVDP and the terms of Streamlined are not well suited for all taxpayers who have failed to report all offshore financial accounts and income. The IRS is considering modifications to both OVDP and Streamlined to better use limited IRS examination resources and to better address the needs of taxpayers with offshore non-compliance issues. In light of ongoing offshore enforcement efforts by the Service and the implementation of FATCA, the OVDP and Streamlined procedures continue to be important programs for the IRS and taxpayers.

■ **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[22-2] Educate persons likely to have foreign accounts (*e.g.*, recent immigrants and U.S. citizens residing overseas) about the information reporting requirements. For example, consider working with other agencies such as the U.S. State Department and the Department of Homeland Security to provide information about the requirements to those who apply for an ITIN, visa, or residency status.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS recognizes that heightened public awareness is critical to reporting compliance. A number of steps have been taken by IRS to educate persons with foreign accounts about their filing obligations. For example, information is posted to [irs.gov](http://irs.gov) outlining filing obligations and fact sheets and public announcements outlining filing requirements have been issued. This information is published through multiple channels including IRS Twitter account, communications by the IRS Tax Attachés located in U.S. consulates and embassies with assistance from the State Department, and National Public Liaison's practitioner email distribution list. Additionally, the IRS has established a team to explore efforts, which can increase taxpayer assistance and awareness for international taxpayers and taxpayers facing international issues. The FY 2014 FBAR Communication Strategy includes efforts to reach U.S. citizens residing abroad via Internet, social media, and collaboration with the State Department. The IRS has begun discussion with the State Department on issues impacting both agencies.
- **Actions the Internal Revenue Service Has Committed to Take:** A number of steps have been taken by IRS to educate persons with foreign accounts regarding their filing obligations. Educating taxpayers is an ongoing process. Specific actions are addressed below.
  - The IRS established a team to explore efforts, which can increase taxpayer assistance and awareness for international taxpayers and taxpayers facing international issues (IITA). As a result of the team's efforts, a more useful and effective international individual [irs.gov](http://irs.gov) landing page was completed. Offshore Voluntary Disclosure Program information was shared with the IITA team. Coordination with the team on identified items will continue in order to refine taxpayer services for international taxpayers.
  - The IRS began discussions with the State Department on issues impacting both agencies and will continue to reach out to other government agencies. Also, as a result of sharing information with the FBAR Communication Strategy, the following actions have been completed: FBAR reference guide was posted to [irs.gov](http://irs.gov); an FBAR webinar was completed; COSS, Stakeholder Liaison Headquarters will be using an



FBAR drop-in article to reach out to first-generation U.S. citizen professional groups; Stakeholder Liaison Headquarters facilitated dissemination of the drop-in article and publicized the webinar by requesting the National Public Liaison Office use its extensive e-mail distribution list to reach tax professional groups, IRPAC and IRSAC; Communications will share the drop-in article with other Federal agencies such as Department of State to reach U.S. citizens abroad, and the Department of Homeland Security, U.S. Immigration and Customs Enforcement to reach immigrants; information was shared with LB&I tax attaches for dissemination within their foreign posts; Communication specialists have helped make extensive use of IRS's Twitter account.

[22-3] Issue guidance about what, if any, information reporting applies to AFOREs (*i.e.*, privatized social security accounts held by those who have worked in Mexico).

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The Mexico/US IGA addresses information reporting for AFOREs for purposes of foreign financial reporting under FATCA. The IRS will continue to explore whether additional guidance is needed.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[22-4] Incorporate all OVD FAQs and the streamlined program into a Revenue Procedure (or similar guidance published in the Internal Revenue Bulletin) that incorporates comments from internal and external stakeholders.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS has provided instructions to taxpayers for both programs through irs.gov. Feedback has been obtained from both internal and external stakeholders. Multiple meetings with internal and external stakeholders have been held and feedback has been considered. The IRS does not plan to implement this recommendation of incorporating the programs into a Revenue Procedure or similar guidance. We will continue to review other available guidance to determine if additional clarification is necessary.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[22-5] Reduce the duplicative reporting required on both Form 8938, Statement of Foreign Financial Assets and the FBAR.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Congress enacted both the Title 31 and the Title 26 provisions regarding the reporting requirements of the FBAR (formerly Form TD F 90-2-1, Report of Foreign Bank and Financial Accounts, now FinCEN Form 114) and Form 8938 (Statement of Specified Foreign Financial Assets). Reporting on the FBAR is required for law enforcement purposes under the Bank Secrecy Act, as well as for purposes of tax administration. As a consequence, different policy considerations apply to Form 8938 and FBAR reporting. These are reflected in the different categories of persons required to file Form 8938 and the FBAR, the different filing thresholds for Form 8938 and FBAR reporting, and the different assets (and accompanying information) required to be reported on each form. Although certain information may be reported on both Form 8938 and the FBAR, the information required by the forms is not identical in all cases, and reflects the different rules, key definitions (for example, "financial account"), and

reporting requirements applicable to Form 8938 and FBAR reporting.

These differing policy considerations were recognized by Congress during the passage of the HIRE Act and the enactment of Section 6038D. Congress's intention to retain FBAR reporting requirements, notwithstanding the enactment of section 6038D, was specifically noted in the Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the "Hiring Incentives To Restore Employment Act," Under Consideration by the Senate (Staff of the Joint Committee on Taxation, JCX-4-10 (February 23, 2010))(Technical Explanation) accompanying the HIRE Act. The Technical Explanation states that "[n]othing in this provision [section 511 of the HIRE Act enacting new section 6038D] is intended as a substitute for compliance with the FBAR reporting requirements, which are unchanged by this provision." (Technical Explanation at p. 60.) Against this background, reporting on the Form 8938 and on the FBAR is not duplicative and both forms must be filed, if required.

The IRS is committed to minimizing taxpayer reporting burdens to the extent consistent with the effective implementation of FATCA, and this commitment is incorporated in the regulations implementing new Section 6038D. For example, the statute excludes from the definition of "specified foreign financial assets" that must be reported on Form 8938 any financial accounts of taxpayers maintained by financial institutions that are U.S. entities (or U.S. territory entities). Thus, taxpayers holding foreign securities in U.S. brokerage accounts are not required to report the foreign securities held in such accounts on a Form 8938. The regulations importantly extend this reporting relief to financial accounts of U.S. taxpayers maintained by controlled foreign corporation subsidiaries of U.S. financial institutions, a particularly important burden reduction for U.S. taxpayers living abroad. This exclusion is fully consistent with the goals of FATCA, because these foreign financial institutions, like their affiliated U.S. financial institutions, have annual 1099 reporting obligations with respect to such accounts under Chapter 61, greatly reducing the potential for offshore tax evasion by their account holders.

The section 6038D regulations carefully tailor the new reporting requirements to compliance risks in additional ways. Most significantly, the regulations attempt to strike an appropriate balance between reporting burdens and compliance benefits by limiting filing requirements to those individuals with specified foreign financial assets totaling above stated minimum dollar thresholds (*e.g.*, \$50,000 for single taxpayers resident in the U.S.). Recognizing that an individual residing outside the United States can reasonably be expected to have a greater amount of specified foreign financial assets for reasons unrelated to the policies underlying section 6038D, the regulations substantially increase the reporting thresholds for U.S. persons residing abroad.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate commends the IRS for modifying the OVD and Streamlined programs to address many of the National Taxpayer Advocate's concerns.<sup>26</sup> She is also pleased that LB&I offered her an opportunity to review and comment on some of the changes before they were implemented.

However, one significant unaddressed concern is with the quality and transparency of the IRS's FAQ interpretations, which the public has viewed as arbitrary and one-sided. TAS and other stakeholders have encountered many cases where the IRS's interpretation of the FAQs appears inconsistent with their plain language.<sup>27</sup>

To make matters worse, counterintuitive interpretations are not subject to an appeal. Rather, when questions arise about how to interpret the FAQs, revenue agents consult with technical advisors or SB/SE counsel attorneys in the field who sometimes consult with each other or the OVD program manager. Because the taxpayer is not allowed to speak with these employees, the IRS does not have to explain their counter-intuitive interpretations, and the taxpayer cannot be sure these employees have considered all of the pertinent facts or are applying the rules consistently. As a result, taxpayers – who have come forward voluntarily to correct a problem – often believe they are being singled out for arbitrary and unfair treatment. Some seek help from TAS.

The National Taxpayer Advocate and other stakeholders have recommended the IRS address these transparency concerns by issuing OVD guidance as a revenue procedure, which could be interpreted by attorneys in a single branch of the National Office of Chief Counsel. Interpretive memos (and even emails to the field) would be subject to disclosure and available to the public. Another option would be for the IRS to publish the technical advisors' clarifying interpretations of the FAQs that they issue to the field in the same way that it publishes CCAs. Alternatively, the IRS could regularly clarify the FAQ in areas where the technical advisors have received questions.<sup>28</sup> Such public clarifications would save resources by reducing the number of questions received by IRS technical advisors and SB/SE attorneys, while increasing public confidence that the IRS is processing cases consistently. In FY 2015, TAS will evaluate the OVD program changes and continue to advocate for more transparency in the IRS's interpretation of its OVD program guidance.

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26 IRS, IR-2014-73, *IRS Makes Changes to Offshore Programs; Revisions Ease Burden and Help More Taxpayers Come into Compliance* (June 18, 2014); IRS, *Options Available For U.S. Taxpayers with Undisclosed Foreign Financial Assets* (June 18, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Options-Available-For-U-S--Taxpayers-with-Undisclosed-Foreign-Financial-Assets>.

27 See, e.g., Letter from New York State Bar Association Tax Section to Commissioner, IRS, Chief Counsel, IRS, and Acting Assistant Secretary (Tax Policy) Department of the Treasury, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, reprinted as, *NYSBA Tax Section Comments on FAQ for 2011 Offshore Voluntary Disclosure Initiative*, 2011 TNT 153-13 (Aug. 9, 2011) (hereinafter "NYSBA Letter") (identifying inconsistencies and recommending "FAQs be incorporated into some type of more permanent guidance such as a Revenue Procedure and that such guidance be subject to public comments.").

28 This need not result in excessive expansion of the FAQs. For example, each FAQ could be linked to all of the clarifying interpretations which could be visible only in an expanded view.

**MSP  
#23****REPORTING REQUIREMENTS: The Foreign Account Tax Compliance Act Has the Potential to Be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights****PROBLEM**

The Foreign Account Tax Compliance Act (FATCA), which Congress enacted in 2010, fundamentally changes the reporting of foreign assets. FATCA tries to reduce revenue loss by imposing a broad range of additional reporting obligations, along with potential sanctions on U.S. taxpayers and residents, foreign entities, and withholding agents. One goal of FATCA is international data sharing with global information transparency. Questions remain, however, regarding whether such a course is advisable, whether the information being compiled is necessary and will be effectively used, whether the enforcement benefits of FATCA justify the compliance burdens and economic hardships it imposes, and whether the due process rights of taxpayers will be preserved in the process.

**ANALYSIS**

The IRS has not spelled out reasonable cause defenses or other relief procedures to distinguish between bad actors and benign non-filers. This lack of guidance exposes good faith non-filers to FATCA's severe penalties. Similarly, errors in collecting and reporting information on account holders by foreign financial institutions (FFIs) could cause significant difficulties for taxpayers unless the IRS develops a timely and effective mechanism for addressing such inaccurate information reporting. Additionally, although the IRS has been responsive to some comments and suggestions throughout the development of the FATCA regime, it has failed to act on advice from other well-informed stakeholders.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[23-1] Undertake proactive steps to preserve the due process rights of taxpayers, by issuing FATCA-specific guidance for reasonable cause or similar relief, which adopts a measured approach to the imposition of penalties with respect to benign non-filers.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Certain individuals holding an interest in a foreign bank account or another specified foreign financial asset are required under IRC § 6038D to report information about such accounts and assets to the IRS annually. Reporting is required on Form 8938, which must be attached to the taxpayer's federal income tax return filed for the year. In developing the regulations for section 6038D, the IRS sought to balance the reporting burdens on taxpayers against the tax compliance goals of Congress in enacting the new reporting and penalty provisions. The regulations provide significant relief from reporting burdens up front by removing many individuals from the reporting requirements altogether, by providing exceptions that relieve taxpayers from reporting certain assets, and by incorporating special rules to ease valuation methods

for certain assets. (See further discussion of burden reduction in the response to MSP 22-5). Although failure to file a Form 8938 if required to do so may result in penalties, section 6038D contains a “reasonable cause” exception to application of the penalty. Under this exception, no penalty will be imposed on any failure to report if it can be shown that such failure is due to reasonable cause and not due to willful neglect. The regulations explain that all pertinent facts and circumstances will be taken into account in determining the applicability of the statutory reasonable cause exception. See section 1.6038D-8T(e) of the regulations.

There are clear general standards in the IRM addressing the approach that IRS employees must take whenever considering the applicability of a reasonable cause exception to a civil penalty. The general reasonable cause standards are set out in the IRS’s “Penalty Handbook,” which is included in the IRM at section 20.1. The Handbook sets forth general policy and procedural requirements for assessing and abating penalties, as well as the criteria for relief from certain penalties.

The reasonable cause instructions set forth in the Penalty Handbook provide a sound foundation for fair and uniform application of the new FATCA-related penalties. The IRS will consider options for providing more certainty to taxpayers affected by the new FATCA requirements and potential new FATCA penalties as more data is collected on specific factors that should be considered in reasonable cause determinations under FATCA.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[23-2] Ensure that U.S. taxpayers and non-residents have at their disposal a timely and effective mechanism for addressing information reporting errors of FFIs.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS will follow current procedures when a U.S. taxpayer or non-resident provides information that contradicts information received from another source. In addition, U.S. taxpayers and non-residents should contact the FFI immediately upon notification that information provided by the FFI is in error to try and rectify the situation.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[23-3] Act responsively and expeditiously to implement recommendations of stakeholders that have particular expertise on the effective implementation of FATCA.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Guidance: At every stage of FATCA implementation since its enactment in 2010, the IRS has actively sought out the input of affected parties. In the development of guidance, the FATCA team within the Office of Chief Counsel, working closely with Large Business and International (LBI) division and the Treasury Department, has requested and received extensive written comments from hundreds of individuals, financial institutions, and their representatives over several iterative cycles of guidance development. In addition, Chief Counsel and LBI representatives have participated in dozens of conferences and meetings throughout the process in order to continually exchange views with those impacted by the new legislation,

their advisors, and other knowledgeable stakeholders. All views submitted have been carefully considered, and dozens of changes have been incorporated to reflect valuable suggestions for reducing taxpayer burdens and addressing industry concerns consistent with the compliance objectives of FATCA as envisioned by Congress. Guidance has been provided as expeditiously as feasible consistent with effective implementation of the law, including (i) three detailed notices issued between 2010 and 2011; (ii) comprehensive proposed regulations in February 2012; (iii) final regulations in January 2013; (iv) correcting amendments in September 2013; (v) a draft financial institution agreement and highlights of upcoming changes in October 2013; (vi) a final financial institution agreement in January 2014; (vii) extensive regulations, with additions and clarifications to the previously issued final regulations as well as guidance to coordinate FATCA with preexisting account due diligence, reporting, and withholding requirements under other provisions in the Internal Revenue Code, released in February 2014.

The last substantial package of regulations, issued on February 20, 2014, contains over 50 discrete amendments and clarifications to the 2013 final regulations that address concerns raised by stakeholders. For example, the amendments/clarifications include those relating to (i) the accommodation of direct reporting to the IRS, rather than to withholding agents, by certain entities regarding their substantial U.S. owners; (ii) the treatment of certain special-purpose debt securitization vehicles; (iii) the treatment of disregarded entities as branches of foreign financial institutions; (iv) the definition of an expanded affiliated group; and (v) transitional rules for collateral arrangements prior to 2017.

**Forms and publications:** The IRS has worked consistently with the Information Reporting Program Advisory Committee (IRPAC), as well as other commentators, to incorporate their suggestions into new forms and instructions and existing forms and instructions needing revisions to reflect FATCA. In addition, in response to inquiries from stakeholders IRS posted alerts and notes to IRS.GOV to provide information about new FATCA forms for Tax Year 2014.

**FFI registration:** The IRS, recognizing the logistical complexities that FFIs may face in registering and obtaining a Global Intermediary Identification Number (GIIN), has developed a process through which stakeholders may submit their FATCA questions via the IRS's FATCA web page. Submitted questions are reviewed by a cross-divisional team of IRS subject-matter experts. Questions that are asked frequently and/or address significant issues are routed to the appropriate business/functional unit (IT, LBI, etc.) for further consideration. To the extent that available resources allow, answers are developed, reviewed, and posted to the IRS's FATCA webpage so that all stakeholders that may have similar questions may benefit from guidance.

In addition, the IRS has incorporated FFI stakeholder input in the design of the registration process and FFI registration portal. Specifically, feedback from internal and external stakeholders was used in the design of current and future portal functionality, including but not limited to input screens, FFI list search and download tool, and FFI message board status

and description of required actions.

Form 8938 filer issues and feedback: Since 2012, the IRS has monitored communications with taxpayers concerning Form 8938 filing issues, and updated and enhanced communications channels, such as Frequently Asked Questions (FAQs) and self-help documents on the [irs.gov](http://irs.gov), to address emerging taxpayer issues and problems. For example, IRS staff have listened to recordings of taxpayer calls to Accounts Management assistants and evaluated email and other electronic feedback to the IRS, to identify and address emerging issues concerning Form 8938. Further, the IRS has specifically attempted to address the concerns and issues received by U.S. embassies from U.S. taxpayers and others concerning FATCA. Additionally, in-person meetings with tax and financial industry representatives have been held with IRS executives from the FATCA program and other IRS organizations to discuss taxpayer concerns.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[23-4] Take immediate steps to eliminate or reduce duplication between the Form 8938 and the FBAR form.

- **Internal Revenue Service Response to the Taxpayer Advocate:** At this time, no steps are planned to modify the Form 8938, although the form will continue to evolve as experience accumulates under the new FATCA reporting provisions (both those applicable to taxpayers and to third-party financial institutions). As indicated above in the response to MSP 22-5, when Congress enacted the new Section 6038D reporting requirements to address offshore tax evasion, it intended these requirements to be in addition to the FBAR reporting requirements. Understanding the potential applicability of two reporting regimes for some taxpayers, great care was taken to draft the regulations under Section 6038D so as to minimize taxpayer reporting burdens in every way possible consistent with achieving the offshore tax compliance objectives of Congress. It will continue to be a high priority of the IRS to ensure that taxpayer reporting burdens are appropriately balanced against tax administration needs as experience is gained under FATCA.

With respect to the FBAR, while FinCEN has delegated substantial enforcement responsibilities to the IRS, IRS authority does not extend to rulemaking. FinCEN retains sole authority to amend the Title 31 regulations implementing the FBAR filing regime and setting out many of the key filing requirements. Moreover, FinCEN now controls the new FBAR form and its instructions, and FinCEN solely manages the electronic filing process for FBARs. Also see IRS Response to MSP 22-5, *Reduce the Duplicative Reporting Required on Both Form 8938, Statement of Foreign Financial Assets, and the FBAR*.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate commends the IRS for its efforts to implement and enforce the FATCA regime enacted by Congress. We recognize that the IRS has been confronted with the challenging task of balancing the reporting and administrative burdens of taxpayers, withholding

agents, and FFIs against the tax compliance goals of Congress in establishing the new information reporting and penalty provisions of FATCA. TAS applauds the IRS for its willingness to solicit input and consider the views of multiple stakeholders as part of this iterative process.

The National Taxpayer Advocate, along with a range of stakeholders, raised concerns regarding the time constraints and resource demands to which FATCA subjects withholding agents and FFIs.<sup>29</sup> As a response to this input, the IRS published Notice 2014-33 which, among other things, promulgates certain extensions and modifications to existing regulations and allows a “soft” enforcement transition period (2014 and 2015) for withholding agents and FFIs.<sup>30</sup>

While the National Taxpayer Advocate acknowledges the IRS’s openness to dialogue as FATCA implementation remains ongoing, she remains concerned about voices and perspectives of individual taxpayers not being heard, especially given the unintended consequences of new FATCA rules for foreign financial institutions, which make it harder for U.S. taxpayers living abroad to open and maintain legitimate bank accounts overseas. During recent meetings with TAS, organizations of U.S. citizens abroad reiterated their concerns and proposed several changes to IRS regulations.

In response to these concerns and to further recommendations in the Annual Report to Congress, the National Taxpayer Advocate recently followed up with a recommendation for published guidance. It proposes specific regulatory changes to eliminate duplicative reporting of assets on the FATCA Form 8938 if the asset is reported or reflected on the FBAR (FinCEN Report 114), and to exclude financial accounts maintained by a financial institution in the country of which the U.S. person is a *bona fide* resident from FATCA reporting.<sup>31</sup> This step would mitigate concerns regarding collateral consequences of FATCA raised by U.S. non-residents, alleviate reporting burdens faced by FFIs, and allow the IRS to focus enforcement efforts on identifying and addressing willful attempts to evade the payment of U.S. taxation through the use of foreign accounts.<sup>32</sup>

Similarly, the National Taxpayer Advocate remains unconvinced of the need for duplicative reporting of assets on Form 8938 when an asset is also reported or reflected on a timely-filed FinCEN Report 114. Accordingly, the National Taxpayer Advocate has recommended that Temp. Reg. § 1.6038D-7T(a) be amended to eliminate this double reporting under FATCA when the assets have already been reported to FinCEN.<sup>33</sup>

Despite the IRS’s publication of educational materials and the availability of reasonable cause relief, benign taxpayers may still be unable to navigate complex FATCA requirements and as a result may become subject to disproportionately high penalties. In the event that FFIs inaccurately

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29 National Taxpayer Advocate 2013 Annual Report to Congress 238-248.

30 See IRS Notice 2014-33, I.R.B. 2014-21 (May 19, 2014).

31 See National Taxpayer Advocate Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 24, 2014) for inclusion in the 2014-2015 U.S. Department of the Treasury and IRS Priority Guidance Plan.

32 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. 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); TAS meeting with Democrats Abroad Task Force on FATCA (Mar. 4, 2014).

33 See National Taxpayer Advocate Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 24, 2014) for inclusion in the 2014-2015 U.S. Department of the Treasury and IRS Priority Guidance Plan. See also Taxpayer Advocate response to Internal Revenue Service Response to 2013 MSP #22 *supra*.



report account information to the IRS, affected taxpayers will experience additional burdens in proving their compliance. Thus, the IRS needs FATCA-specific reasonable cause formal and informal guidance to alleviate burdens for taxpayers who may fall victim to the reporting errors of FFIs.

The National Taxpayer Advocate recognizes that the FATCA regime is in its infancy, yet it is important for the IRS to act preemptively to address potential systemic issues with FATCA reporting at an early stage. TAS is looking forward to collaborating with the IRS on FATCA-related issues in the future.<sup>34</sup>

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<sup>34</sup> The National Taxpayer Advocate is a member of the FATCA Executive Steering Committee, at which she provides the taxpayers' perspective to FATCA implementation.

**MSP  
#24****DIGITAL CURRENCY: The IRS Should Issue Guidance to Assist Users of Digital Currency**

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**PROBLEM**

The use of digital currencies, such as bitcoin, is growing. In the four months between July and December 2013, Bitcoin usage has increased by over 75 percent – from about 1,700 transactions per hour to over 3,000. Over the same period, the market value of bitcoins in circulation increased more ten-fold from about \$1.1 billion to \$12.6 billion. However, the IRS has yet to issue specific guidance addressing the tax treatment or reporting requirements applicable to digital currency transactions. People who are trying to comply with these rules have complained that they are unsure about them. Thus, IRS-issued guidance would promote tax compliance, particularly among those who want to report digital currency transactions properly, and it would reduce the risk that users of digital currencies will face tax consequences that they did not anticipate.

**ANALYSIS**

Following a 2008 recommendation by the National Taxpayer Advocate to issue guidance on the tax treatment of the transfer of “virtual” items and currency, the IRS created a webpage that suggests existing guidance covers these transactions. However, it did not explain when the transactions are sufficiently analogous to be covered by existing rules. Unanswered questions may include:

1. When will receiving or using digital currency trigger gains and losses?
2. When will these gains and losses be taxed as ordinary income or capital gains?
3. What information reporting, withholding, backup withholding, and recordkeeping requirements apply to digital currency transactions?
4. When should digital currency holdings be reported on a *Report of Foreign Bank and Financial Accounts* (FBAR), or Form 8938, *Statement of Specified Foreign Financial Assets*?

To fill the void left by the IRS’s lack of specific guidance, taxpayers are speculating on the Internet about the answers to these questions. Some of this speculation is incorrect, incomplete, or misleading. It is the government’s responsibility to inform taxpayers about the rules they are required to follow. Moreover, the lack of clear answers to basic questions probably encourages tax avoidance.

**TAS RECOMMENDATIONS AND IRS RESPONSES**

[24-1] Issue guidance that answers the following questions:

- When will receiving or using digital currency trigger gains and losses?
- When will these gains and losses be taxed as ordinary income or capital gains?
- What information reporting, withholding, backup withholding, and recordkeeping requirements apply to digital currency transactions?

- When should digital currency holdings be reported on an FBAR or Form 8938, Statement of Specified Foreign Financial Assets?
- **Internal Revenue Service Response to Taxpayer Advocate Service**

[24-1] Notice 2014-21, released on March 25, 2014, provides guidance in a Q&A format on how existing general tax principles apply to transactions using virtual currency. Notice 2014-21 identifies virtual currency as property and not currency for federal tax purposes; explains how to determine gains and losses, and the character of the gains and losses, from transactions using virtual currency; addresses certain employment tax consequences of payments using virtual currency; and addresses certain information reporting and backup withholding requirements that can apply. Guidance necessary to implement FATCA, as well as other potentially applicable reporting and withholding rules, must be prioritized; guidance related to the reporting of virtual currency will be considered at the appropriate time during the phased implementation of FATCA and other compliance rules.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate commends the IRS for issuing a notice to address many of the unanswered questions about digital currency, and for asking for public comments about other related areas in need of guidance. In a webinar following release of the notice, the IRS also reportedly clarified that information reporting applicable of digital currency is not currently required on Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR).<sup>35</sup> The newly-issued guidance should help digital currency users comply with the rules while also enabling IRS employees to enforce them. If TAS becomes aware of any other major gaps in these rules, it will advocate for further guidance in FY 2015.

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<sup>35</sup> Jaime Arora, Virtual Currency May Be Reportable On FBAR In Future, 2014 TNT 108-2 (June 5, 2014).

**MSP  
#25****DEFENSE OF MARRIAGE ACT: IRS, Domestic Partners, and Same-Sex Couples Need Additional Guidance**

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**PROBLEM**

The recent Supreme Court case *United States v. Windsor* held unconstitutional the Defense of Marriage Act of 1996, which effectively had precluded federal recognition of same-sex marriage. Subsequent IRS guidance resolved certain questions for same-sex spouses anticipated by the National Taxpayer Advocate's 2012 Annual Report to Congress. While the decision and guidance resolve fundamental issues, various questions of implementation remain, while questions about the tax status of unmarried domestic or civil union partners persist.

**ANALYSIS**

Because of the difference between federal and state law, same-sex spouses may have to file tax returns as single at one level but as married at the other. Before *Windsor*, spouses whose state recognized their marriage would file singly for federal but jointly for state tax purposes. After *Windsor*, spouses whose state does not recognize their marriage need to file as married with the IRS while continuing to file singly with the state. IRS systems for processing amended and new returns hold potential for rejecting unusual but legitimate claims, putting them in the limbo of refund fraud processes. Meanwhile, same-sex partners in three states that ban same-sex marriage but allow domestic partnerships or civil unions still need answers to questions like the following. Is alimony after dissolution of a civil union includible by the recipient and deductible by the payer? Is community property created upon partnering with an individual of the same sex a taxable gift?

**RECOMMENDATIONS**

[25-1] The IRS should issue formal and informal guidance for same-sex spouses as questions continue to arise.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Since the Supreme Court's decision in *Windsor*, the IRS and Treasury Department quickly issued both formal and informal guidance. Revenue Ruling 2013-17 clarified the definitions of "marriage," "spouse," "husband," and "wife" for Federal tax purposes. More particular published guidance has addressed the application of *Windsor* and the revenue ruling to employment taxes, qualified retirement plans, cafeteria plans and Flexible Spending Arrangements, and portability elections. In addition, the IRS web page contains comprehensive sets of Frequently Asked Questions regarding both same-sex marriages and civil unions, which are updated as new issues are identified. The IRS will continue to issue both formal and informal guidance as new issues arise.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue to issue formal and informal guidance as issues arise. The 2013-2014 Guidance Priority List includes guidance on *Windsor* issues. The FAQs on IRS.gov will continue to be updated.

[25-2] The IRS should issue formal and informal guidance for same- and opposite-sex partners who have marital attributes under civil union or similar state law.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** Since the Supreme Court's decision in *Windsor*, the IRS and Treasury Department have quickly issued both formal and informal guidance to taxpayers. Revenue Ruling 2013-17 clarified the definitions of "marriage," "spouse," "husband," and "wife" for all Federal tax purposes. More particular published guidance has addressed the application of *Windsor* and the revenue ruling to employment taxes, qualified retirement plans, cafeteria plans and Flexible Spending Arrangements, and portability elections. In addition, the IRS web page contains comprehensive sets of Frequently Asked Questions regarding both same-sex marriages and civil unions, which are updated as new issues are identified. The IRS will continue to issue both formal and informal guidance as issues arise.
- **Actions the Internal Revenue Service Has Committed to Take:** The IRS will continue to issue formal and informal guidance as issues arise. The 2013-2014 Guidance Priority List includes guidance on *Windsor* issues. The FAQs on IRS.gov will continue to be updated.

[25-3] The IRS should issue formal and informal guidance for IRS employees to promptly process the foregoing returns and related claims.

- **Internal Revenue Service Response to the National Taxpayer Advocate:** The IRS has responded in a timely and proactive manner to both external and internal stakeholder concerns regarding the *Windsor* decision. Internal guidance was issued via timely SERP alerts to frontline employees with specific processing procedures. Processing guidance was updated as formal published guidance was issued. Guidance covered both individual (IMF) and employment tax (BMF) related issues.
- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

[25-4] The IRS should review identity theft and revenue protection filters in light of common filing scenarios by same-sex spouses to ensure that the IRS does not freeze and delay refunds to legitimately married taxpayers.

- **Internal Revenue Service Response to the Taxpayer Advocate:** Form 1040X claims received based on the *Windsor* decision were promptly processed through the normal pipeline process and were subject to the same timeframes as other amended claims.
- The IRS Taxpayer Protection filters team takes specific actions to prevent bias against particular segments of the population during the development of filters. Sophisticated algorithmic filters are designed to address specific identity theft schemes, as those schemes are identified. In addition, filters are constantly evaluated on both current and historic data to prove that selected samples do not arbitrarily select compliant taxpayers. With respect to this testing, special attention is paid that no group is chosen based on individual characteristics, such as filing type or sexual orientation.
- This guidance has been shared with all employees involved in identity theft and revenue protection filters. Additionally, processes have recently been implemented that any changes

to existing filters or development of new filters requires managerial and IRS executive approval.

- **Actions the Internal Revenue Service Has Committed to Take:** N/A.

## TAXPAYER ADVOCATE SERVICE RESPONSE

The National Taxpayer Advocate is pleased that the IRS has issued Revenue Ruling 2013-17, effective as of September 16, 2013, to implement the Supreme Court's decision in *Windsor*. The Revenue Ruling adopted a general rule recognizing a marriage of same-sex individuals that were lawfully married under state law for all federal tax purposes including income, estate and gift, and employment taxes. The IRS followed up with Answers to Frequently Asked Questions posted on its website<sup>36</sup> and released Notice 2014-19, which addressed procedures for employers to seek refunds of Social Security and Medicare taxes paid to the extent of employer-provided health coverage to the employee's same-sex spouse and dependents and for employees to amend returns to reduce gross income.<sup>37</sup> The IRS should monitor issues that arise and promptly update its informal guidance to remove obsolete and misleading information.

The National Taxpayer Advocate remains concerned that the IRS has been slow to address various issues about the tax status of unmarried domestic or civil union partners. As various state laws on same-sex marriage, civil unions, and registered domestic partnerships evolve, some same-sex couples may remain uncertain as to whether they are married for state and federal tax purposes.<sup>38</sup> The IRS's website seems to conflate civil unions with registered domestic partnerships and does not address distinctions by jurisdiction.<sup>39</sup> Such one-size-fits-all guidance to registered domestic partners and individuals in civil unions of various jurisdictions may exacerbate confusion and provide ambiguous or misleading advice to taxpayers.<sup>40</sup> These Q&As will be further outdated by June 30, 2014, when thousands of registered domestic partners will be deemed married under the laws of Washington, blurring the seemingly easy distinction between marriage on the one hand and registered domestic partnerships and civil unions on the other.<sup>41</sup>

The IRS should carefully analyze the attributes of formal relationships that are not marriages under state law and tailor its advice to the needs of taxpayers in various jurisdictions. As the law in domestic and foreign jurisdictions continues to evolve, the IRS should work closely with TAS and all affected stakeholders. It should issue timely and substantive updates to formal and informal guidance to help taxpayers meet their tax obligations and help IRS employees to promptly process returns and claims related to this dynamic social issue.

36 IRS, Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married Under State Law, at <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples> (last revised Mar. 7, 2014).

37 See Notice 2013-61, 2013-44 I.R.B. 432 (setting forth guidance for employers and employees to make refund claims or adjustments of payroll tax withholding for some benefits provided and monies paid to same-sex spouses).

38 For example, Washington State passed a law automatically converting certain state registered domestic partnerships into marriages as of June 30, 2014. See Wash. Rev. Code § 26.60.100 (2012).

39 IRS, Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions, at <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions> (last revised Sept. 19, 2013).

40 See National Taxpayer Advocate 2013 Annual Report to Congress 260 (where the IRS advised that opposite-sex Illinois civil union couples could file married jointly).

41 See Wash. Rev. Code § 26.60.100 (2012). See also <https://www.sos.wa.gov/corps/domesticpartnerships/>.





[www.TaxpayerAdvocate.irs.gov/2015ObjectivesReport](http://www.TaxpayerAdvocate.irs.gov/2015ObjectivesReport)

