

MSP
#8**CORRESPONDENCE EXAMINATION: The IRS's Correspondence Examination Procedures Burden Taxpayers and Are Not Effective in Educating the Taxpayer and Promoting Future Voluntary Compliance****RESPONSIBLE OFFICIALS**

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TAXPAYER RIGHTS IMPACTED¹

- *The Right to be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and be Heard*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Internal Revenue Code (IRC) § 7602(a) provides the IRS with the authority to conduct examinations for the purposes of determining whether a tax return is correct, creating a return where the taxpayer has not filed, and determining a taxpayer's tax liability. In fiscal year (FY) 2017, the IRS audited almost 1.1 million tax returns (including business and individual returns), approximately 0.5 percent of all returns received that year.² During FY 2017, the IRS conducted approximately 71 percent of all audits (business and individual) by correspondence.³ Proponents of correspondence examinations argue they are beneficial because they allow the IRS to audit many taxpayers without complex issues and minimize burden for them. However, in many cases, the issues deemed as "not complex" may involve complicated rules and procedures, or complicated fact situations, or both as in the case of the Earned Income Tax Credit (EITC). In addition, taxpayers audited by correspondence may suffer greater burden because of:

- The difficulty of sending and receiving correspondence (including having it considered at the right time);
- The lack of clarity in IRS correspondence; and
- The lack of a single employee assigned to the taxpayer's case.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 IRS Data Book, 2017, Publication 55B, 21 (Mar. 2018). This number does not include certain returns, such as those of tax exempt and government entities, nor does it include other compliance contacts that can be considered "unreal" audits, and which make the number much higher. See National Taxpayer Advocate 2017 Annual Report to Congress 49-63 (Most Serious Problem: *Audit Rates: The IRS Is Conducting Significant Types and Amounts of Compliance Activities that It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*).

3 IRS Data Book, 2017, Publication 55B, 22 (Mar. 2018).

For FY 2018 correspondence audits, the IRS took more than 65 days to respond to the majority of taxpayer replies in both EITC cases and non-EITC refundable credit cases.⁴ During FY 2018, the Small Business/Self-Employed Division (SB/SE) exam employees answered the exam phone line only about 35 percent of the time⁵ and, not surprisingly, SB/SE reported receiving only about 0.87 incoming calls per correspondence exam potentially because taxpayers could not get through.⁶ These problems are exacerbated when the audited taxpayer is low income, has limited English proficiency, or there are other impediments that hinder communication during the audit.

An examination is primarily an education vehicle, so the taxpayer learns the rules, corrects mistakes, and can comply in the future. The tax assessed from the examination is a byproduct of the exam, but it is not the purpose. In fact, the IRS gains about twice as much from the long-term effects of an audit than it does from the actual audit itself.⁷

The National Taxpayer Advocate is concerned that:

- Audit selection procedures may lead to complex cases being audited by correspondence and a disproportionate burden on low income taxpayers;
- Insufficient training on complex issues for correspondence examiners may prevent them from correctly determining the liability or knowing when to transfer a case to an employee with specific expertise;
- A substantial number of taxpayers audited by correspondence face barriers to understanding and effectively participating in the audit;
- The IRS's correspondence is often confusing and does not provide sufficient time for the taxpayer to respond; and
- The IRS metrics do not consider taxpayer needs and preferences when determining the effectiveness of its correspondence exam program, and the IRS prioritizes measures such as cycle time and closures, which ignore the impact on the taxpayer.

ANALYSIS OF PROBLEM

Background

In the past ten years, the percentage of overall audits (including businesses and individuals) conducted by correspondence has remained steady, around 80 percent. However, overall audits have decreased substantially, as shown in Figure 1.8.1.

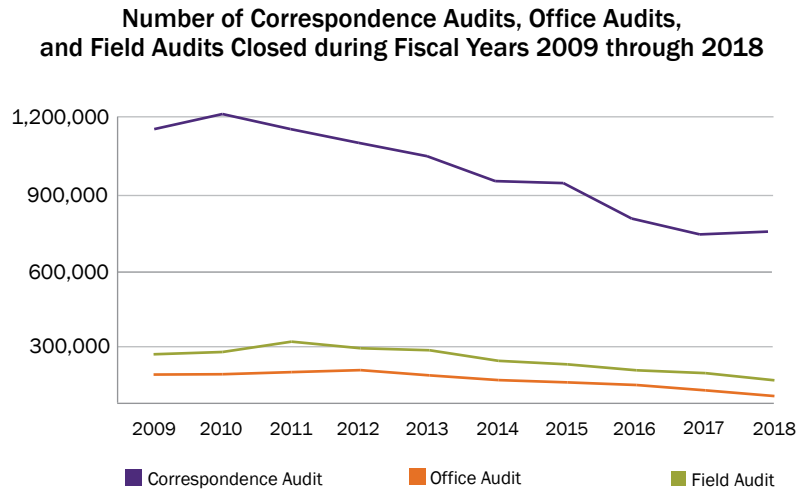
4 IRS, *W&I RICS Examination PAC 7F Reports* (Sept. 2018), combining correspondence statuses 55 and 57. See Internal Revenue Manual (IRM) 4.19.13.11, *Monitoring Overaged Replies* (Feb. 9, 2018) instruction to give either a 107 or a 150-day follow up expectation to taxpayers. For a discussion of the IRS's practice of mothballing overaged audit responses from taxpayers, see Case Advocacy section, *infra*.

5 IRS, Product Line Detail (Enterprise Performance) Snapshot report (week ending Sept. 30, 2018).

6 IRS response to TAS information request (Oct. 24, 2018).

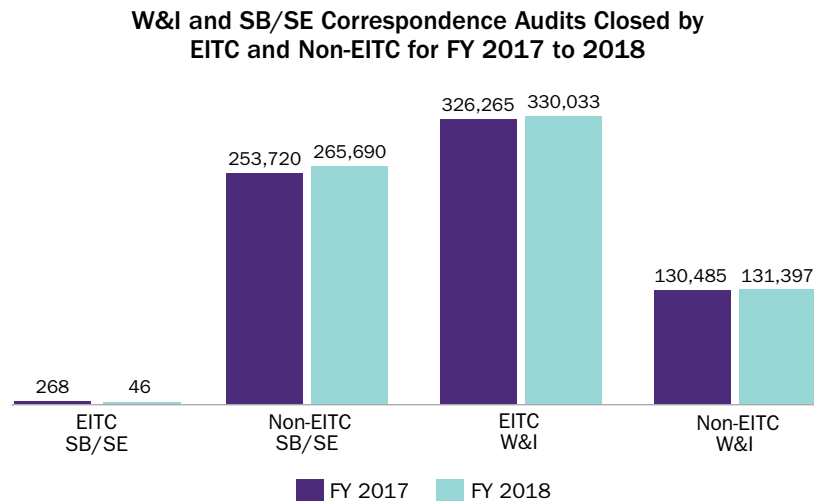
7 Jason DeBacker, Bradley T. Heim, Anh Tran, and Alexander Yuskavage, *Once Bitten, Twice Shy? The Lasting Impact of IRS Audits on Individual Tax Reporting* (Aug. 25, 2015) (working paper, Indiana University), <https://pdfs.semanticscholar.org/3833/61d62ea27f93deb89bf2c4b926bc5e96e14b.pdf>.

FIGURE 1.8.1⁸



As shown in Figure 1.8.2, in FY 2018, SB/SE closed about 266,000 correspondence exams,⁹ and Wage and Investment Division (W&I) closed about 461,000 correspondence exams, with EITC exams comprising about 72 percent of W&I’s exams.¹⁰

FIGURE 1.8.2¹¹



8 IRS response to TAS Fact Check (Dec. 20, 2018). For the purposes of this chart, correspondence audits include audits closed by campus tax examiners in the Wage and Investment Division (W&I) and Small Business/Self-Employed Division (SB/SE). Field audits include audits closed by revenue agents in SB/SE and Large Business and International (LB&I). Office audits include audits closed by tax compliance officers in SB/SE.

9 IRS response to TAS information request (Oct. 24, 2018).

10 *Id.*

11 IRS response to TAS fact check (Dec. 20, 2018). IRS response to TAS information request (Oct. 24, 2018).

SB/SE handles discretionary correspondence audits, including over 30 individual tax issues, such as nonrefundable credits, Schedule A and Schedule C expenses, and unreported income.¹² Of the nearly 447,000 Schedule C exams closed by SB/SE in the last two fiscal years, about 29 percent were conducted by correspondence. Schedule C correspondence exams represented about 38 percent of all correspondence exams conducted by SB/SE.¹³ The IRS has indicated that it may conduct correspondence exams for some issues related to the new deduction for qualified business income under IRC § 199A, but has not projected the volume.¹⁴

SB/SE uses a variety of sources to determine which cases to audit. To determine the exam work plan, SB/SE reports looking at the staffing/hours to work returns, projections for inventory already started or delivered to the various Exam functions, and the Exam Planning Scenario Tool (EPST), which determines the mix of inventory for Discriminant Index Function returns for Correspondence Exam Discretionary as well as Field Revenue Agents (RAs) and Tax Compliance Officers (TCOs).¹⁵ EPST provides scenarios of optimized mix by activity codes for Field (RA & TCO) and by project codes for Campus, based on historical business results.¹⁶ Activity codes describe the financial scope of the return and its complexity, which help determine the appropriate type of examiner.¹⁷ Project Codes identify a specific feature or item on a tax return that the IRS would like to monitor for compliance purposes, for example, Schedule A – Casualty Loss.¹⁸

Starting in FY 2016, W&I exclusively worked all new EITC correspondence exams.¹⁹ The majority of the inventory in the Refundable Credits Examination Operation (RCEO) is derived from the computer program known as the Dependent Database (DDb).²⁰ In FY 2014, DDb identified more than 77 percent of the closed EITC audits.²¹

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- 12 See IRM 4.19.15.1 through 4.19.15.43 (Dec. 1, 2017). SB/SE does not specifically audit Earned Income Tax Credit (EITC), but they will make automatic adjustments to EITC, the American Opportunity Tax Credit, and the Child Tax Credit when the Adjusted Gross Income changes due to other audit adjustments, including changes to Schedule C income.
- 13 IRS response to TAS fact check (Dec. 20, 2018).
- 14 The IRS anticipates a low volume of IRC § 199A exams during FY 2019 since most examinations efforts during that fiscal year will be tax year 2017 and earlier returns. IRS response to TAS information request (Oct. 24, 2018).
- 15 Discretionary exams are conducted by choice, as opposed to EITC exams that are driven by the Revenue Protection Strategy or the refundable credits exams identified by risk based scoring criteria. See IRM 4.19.15.1.3, *Roles and Responsibilities* (Dec. 1, 2017); IRM 4.19.14.1.1, *Background* (Dec. 7, 2017); IRM 4.19.14.1.4, *Program Management and Review* (Dec. 7, 2017).
- 16 IRS response to TAS information request (Apr. 27, 2018). The activity code identifies the type of return examined, e.g., Form 1040 in a specified income range and the project code identifies the examination issue(s), e.g., EITC. See Document 6036 (October 2017).
- 17 IRM Exhibit 4.4.1-1, *Reference Guide* (Apr. 15, 2016). An activity code would present a brief description of the return such as: Non-Farm Business with Schedule C or F where Total Gross Receipts are between \$XX and \$XX, and Total Positive Income is less than \$XX. IRS, Document 6036, *Examination Division Reporting System Codes Booklet 18-24* (Oct. 2017). The activity codes include the actual dollar range, which TAS redacted here. “In general, total positive income is the sum of all positive amounts shown for the various sources of income reported on the individual income tax return, and thus excludes losses.” IRS 2017 Databook, October 1, 2016 to September 30, 2017, 33, <https://www.irs.gov/pub/irs-soi/17databk.pdf>.
- 18 IRS, Project Code Listing (Oct. 16, 2018).
- 19 IRS response to TAS information request (Oct. 24, 2018).
- 20 IRS response to TAS information request (June 22, 2018).
- 21 Government Accountability Office (GAO), *Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened*, 16-103 (Dec. 2015). The IRS may not be using the Dependent Database (DDb) effectively because it concentrates its EITC audit resources on taxpayers with a noncompliance issue that is relatively minor (the relationship test), compared to an issue associated with 75 percent of all EITC qualifying child errors (the residency test). National Taxpayer Advocate 2015 Annual Report to Congress 248-260 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process As an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*).

FIGURE 1.8.3, Top 5 Project Codes Examined by W&I and SB/SE Correspondence Audit Programs in FY 2010 and FY 2018²²

Project Description	FY 2010	Project Description	FY 2018
First Time Homebuyer Credit (Pre-Refund case)	281,446	EITC DDb (Pre-Refund)	105,765
EITC DDb (Pre-Refund)	160,647	Employee Business Expense	71,429
Non-Filer Program	113,612	Schedule C Expenses	57,657
Employee Business Expense	69,106	EITC-DDb Post refund	47,903
EITC-DDb Post Refund	67,841	Non-Filer Program	37,791

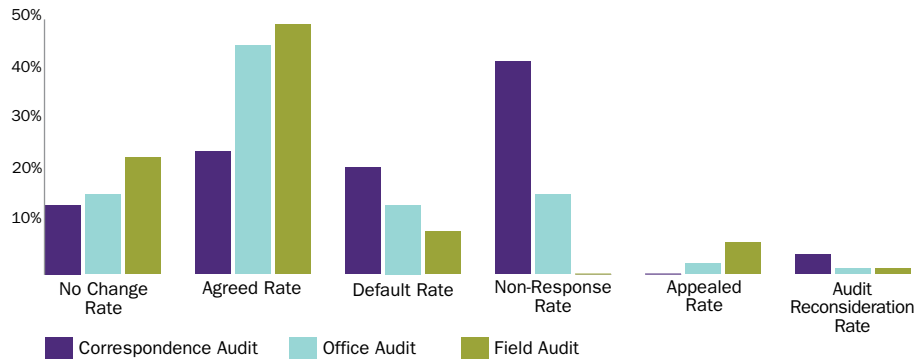
As shown in Figure 1.8.4, correspondence audits generally have lower no change rates, lower agreed rates, and significantly higher non-response rates. Appealed rates are surprisingly low for correspondence audits, given the low agreed rates, and may reflect taxpayers who are not receiving the correspondence or who have simply given up. On the other hand, audit reconsiderations are significantly higher for correspondence exams, which may reflect that taxpayers do not understand their appeal rights or do not realize what has happened until the IRS tries to collect from them.²³

22 IRS, Compliance Data Warehouse (CDW) Audit Information Management System (AIMS) fiscal year (FY) 2010 and FY 2018 (Dec. 2018), and IRS response to TAS fact check (Dec. 20, 2018). TAS chose project codes because they show why a return was selected and reflect the number of EITC adjustments. Issue codes reflect the adjustment line item on the tax return, e.g., the issue code for exemptions means that the exemptions were in question and the examiner classified that issue. However, issue codes do not include EITC in the top five because the EITC is an automatic adjustment, so the examiner does not classify it. For example, changing the number of dependents would automatically calculate an EITC adjustment, but EITC would not be reflected in the issue code.

23 IRS, CDW AIMS, Individual Master File (IMF), Business Master File (BMF) FY 2017 (Nov. 2018). Correspondence Audit includes SB/SE and W&I closures. IRM 4.4.12.5.49.1, *No Change Disposal Codes* (June 1, 2002) defines a no change as case closed by the examiner with no additional tax due (disposal code 1 and 2). In the IRS response to TAS fact check (Dec. 20, 2018), SB/SE notes disposal code 1 as an agreed closure. TAS does not agree with SB/SE's definition because these cases do not require agreement from the taxpayer since there is no additional tax liability (see, e.g., IRM 4.10.8.2.2, *No Change with Adjustments Report Not Impacting Other Tax Year(s)* (Sept. 12, 2014)) and the taxpayers agreement, or disagreement, with the adjustment(s) as it pertains to another's year's liability is not known. Treasury Inspector General for Tax Administration (TIGTA) Report 2018-30-069 concurs with TAS's definition. Additionally, SB/SE includes 'partially agreed' cases (in which a taxpayer executes an agreement to some, but not all, of the proposed adjustments) as agreed cases in their reporting. TAS excludes those cases since the final disposition of the case is unknown (see, e.g., IRM 4.4.12.2.6, *Final Disposition After Input of Partial Assessment* (Sept. 17, 2015), which indicates that cases closed as partial agreements must be updated to reflect either a later agreement or the issuance of a notice of deficiency). IRS response to TAS fact check (Dec. 20, 2018) did not disagree with TAS's definitions for no change or agreed closures.

FIGURE 1.8.4²⁴

Closing Rates, Appealed Rate, and Audit Reconsideration Rate for Correspondence Audit, Office Audit, and Field Audit Closed in FY 2017



Audit Selection Procedures May Lead to Complex Cases Being Audited by Correspondence and a Disproportionate Burden on Low Income Taxpayers

The IRS selects taxpayers for correspondence audit who have legally and factually complex issues, such as taxpayers claiming the EITC or Child Tax Credit (CTC) with differing relationships with the child claimed, complicated living situations where a child may not reside in one residence the entire year, and multiple sources of support for the child.²⁵ Taxpayers claiming the EITC with qualifying children must have a timely issued Social Security number (SSN) for the taxpayer and children; and there are three primary tests for each qualifying child:

- Age test: the child must be younger than the taxpayer and under 19 at the end of the calendar year (or under 24 if a full-time student, or any age if permanently and totally disabled).²⁶
- Relationship test: the child must be the taxpayer's son or daughter, stepchild, foster or adopted child, or a descendant of any of them (*e.g.*, a grandchild), or a child who is a sibling, stepsibling, or half-sibling of the taxpayer, or a descendant of any of them (*e.g.*, a nephew or grandnephew).²⁷
- Residence test: the child must live with the taxpayer for more than half the calendar year.²⁸

Taxpayers entering correspondence exams may be unfamiliar with these rules because they may have had little involvement in filing their returns due to using a paid preparer. For EITC returns filed for tax year 2017, over half were prepared by paid preparers.²⁹

24 IRS, CDW AIMS, IMF, BMF FY 2017 (Nov. 2018). FY 2017 will have a low audit reconsideration compared to older years due to the lack of time since the audit closing date. Correspondence Audit includes SB/SE and W&I closures. Field Audit includes SB/SE and LB&I closures.

25 GAO explains: "Verifying eligibility with residency and relationship requirements can be complicated and subject to interpretation," and the IRS itself acknowledges on its website: "EITC is complex and many special rules apply." GAO, *Comprehensive Compliance Strategy and Expanded Use of Data Could Strengthen IRS's Efforts to Address Noncompliance* 16-475 (May 2016); IRS, *Do I Qualify for the Earned Income Tax Credit?* (Jan. 2017), <https://www.irs.gov/newsroom/do-i-qualify-for-the-earned-income-tax-credit>.

26 IRC § 152(c)(3).

27 IRC § 152(c)(2).

28 IRC § 152(c)(1)(B).

29 IRS, CDW, IRTF tax year 2017. (Dec. 2018).

In addition to using correspondence exams for complex family status issues, the IRS is increasingly using them to audit Schedule C taxpayers. SB/SE increased its percentage of Schedule C exams conducted by correspondence from 18 percent in FY 2017 to 24 percent in FY 2018.³⁰ The National Taxpayer Advocate is concerned about the IRS's potential use of correspondence exams for the IRC § 199A qualified business deduction, which involves highly complex issues as evidenced by the almost 47-page proposed regulations.³¹

Insufficient Training on Complex Issues for Correspondence Examiners May Prevent Examiners From Correctly Determining the Liability or Knowing When to Transfer a Case to an Employee With Specific Expertise

Currently, tax examiners (who conduct correspondence audits for W&I and SB/SE) receive approximately 85 hours of basic income tax law training when they are hired. This training covers primarily items on the Form 1040, *U.S. Individual Income Tax Return*, but may be supplemented by training on additional deductions or specific issues.³² For example, a correspondence examiner may subsequently complete the six-hour course #17877, *Schedule C Travel, Meals & Entertainment*, the 18-hour course #17874, *Mortgage Interest*, or the 1.5 hour course, #17872, *Schedule C Exams: Legal and Professional Fees*.

However, unlike TCOs and RAs conducting office and field examinations, tax examiners do not receive the full spectrum of training on Form 1040 and related forms and schedules in one comprehensive training session. This presents difficulties for the IRS and the taxpayer if an exam item expands or evolves into an issue for which the correspondence examiner has not yet been trained. For example, a review of a taxpayer's travel, meals, and entertainment expenses may reveal that the claimed deduction is actually a car and truck expense. If the tax examiner has not yet completed the two-hour course #17876, *Car and Truck*, the taxpayer's *right to pay no more than the correct amount of tax* may be impaired.³³

A Substantial Number of Taxpayers Audited by Correspondence Face Barriers to Understanding and Effectively Participating in the Audit

Challenges for Low Income Taxpayers

Almost half of all correspondence exams conducted by W&I and SB/SE for individual taxpayers are EITC exams, which necessarily involve low income taxpayers.³⁴ Taxpayers with lower incomes and

30 IRS response to TAS fact check (Dec. 20, 2018).

31 Qualified Business Income Deduction, 83 Fed. Reg. 40884 (proposed Aug. 16, 2018) (to be codified at Treas. Reg. §§ 1.199A-1 through 1.199A-6).

32 IRS response to TAS information request (May 21, 2018); IRS response to TAS information request (June 6, 2018); IRS response to TAS fact check (Dec. 20, 2018).

33 IRS response to TAS information request (May 21, 2018). Examiners have the option to transfer a correspondence exam to an area office if the issue is deemed too complex for correspondence and they receive managerial approval. However, without adequate technical training, an examiner might not recognize the issue should be reassigned to an employee with more or different expertise. IRM 4.19.13.15.1, *Transfers to Area Office* (Jan. 1, 2016).

34 Approximately 46 percent of correspondence examinations (excluding partnership audits conducted under the partnership audit rules of the Tax Equity and Fiscal Responsibility Act (TEFRA)) closed by W&I or SB/SE during FYs 2017 and 2018 were EITC exams. IRS response to TAS information request (Oct. 24, 2018). IRS response to TAS information request (Oct. 25, 2018). Almost three quarters of W&I correspondence exams closed during FY 2018 were EITC exams. IRS response to TAS fact check (Dec. 20, 2018).

education levels may have more difficulty understanding the tax laws and may rely on incompetent or unscrupulous return preparers.³⁵

FIGURE 1.8.5, Individual Returns Closed by Correspondence Audit in FY 2010 and FY 2018 by Activity Code.³⁶

	FY 2010	FY 2018
Form 1040PR/1040SS	382	157
Form 1040, EITC present & TPI <\$200,000 and Schedule C/F TGR <\$25,000 or EITC with No Schedule C/F	539,318	350,820
Form 1040, EITC present & TPI <\$200,000 and Schedule C/F TGR >\$24,999	12,495	7,728
Form 1040, No EITC present – TPI <\$200,000 and No Schedule C, E, F, or Form 2106	327,621	119,450
Form 1040, No EITC present – TPI <\$200,000 and Schedule E or Form 2106 but No Schedule C or F	128,243	97,133
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR <\$25,000 and TPI <\$200,000	84,937	74,485
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR \$25,000 - \$99,999 and TPI <\$200,000	31,442	17,736
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR \$100,000 - \$199,999 and TPI <\$200,000	11,999	10,076
Form 1040, No EITC present - Non-farm Business with Schedule C/F TGR >\$199,999 and TPI <\$200,000	1,885	3,333
Form 1040, No EITC present - Farm Business Not Classified Elsewhere and TPI <\$200,000	2,752	2,218
Form 1040, No EITC present - No Schedule C or F and TPI >\$199,999 and <\$1,000,000	53,931	16,783
Form 1040, No EITC present - Schedule C or F present and TPI >\$199,999 and <\$1,000,000	19,079	13,871
Form 1040, No EITC present - TPI >\$999,999	9,369	3,210

Correspondence examinations may be especially challenging for taxpayers with a language barrier, who may benefit from a face-to-face conversation. A 2014 TAS survey found that 70 percent of Hispanic consumers who are representative of the general Hispanic population age 18 and older were below 250 percent of the federal poverty level, making them more likely to claim refundable credits designed for low income taxpayers, which are generally audited by correspondence.³⁷ Furthermore, despite the high number of low income taxpayers who use paid preparers, low income taxpayers audited by correspondence may not be represented during the actual audit. A 2007 TAS study found the vast majority of EITC taxpayers audited were unrepresented.³⁸ Unrepresented taxpayers may not understand

35 In 2014, 80 percent of students leaving high school (including those who graduated and those who did not) from families with income in the top quartile enrolled in college, compared with only 45 percent from families in the bottom quartile. The Pell Institute, *Indicators of Higher Education Equity in the United States: 2016 Historical Trend Report* 20, http://www.pellinstitute.org/downloads/publications-Indicators_of_Higher_Education_Equity_in_the_US_2016_Historical_Trend_Report.pdf.

36 IRS response to TAS fact check (Dec. 20, 2018).

37 Forrester Research, Inc., *The Taxpayer Advocate Service: Hispanic Underserved Analysis*, Q4 2014, 10 (Dec. 2014). See National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 101-110 (Research Study: *Understanding the Hispanic Underserved Population*).

38 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 94-116 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

the correspondence or how to respond correctly without being able to ask questions face-to-face.³⁹ In the 2007 TAS study, TAS found that represented taxpayers were twice as likely to retain EITC after the audit, and they retained almost twice as much EITC, as unrepresented taxpayers.⁴⁰

Difficulty in Receiving Mail and Having Correspondence Timely Reviewed

Compounding other issues is the fact that taxpayers do not always receive correspondence from the IRS. During the last two fiscal years, approximately eight percent of statutory notices of deficiency (SNODs) in EITC correspondence exams and four percent of SNODs in non-EITC exams conducted by W&I were undeliverable.⁴¹ Undeliverable mail rates for the SNODs in SB/SE correspondence exams were higher than W&I correspondence exams during FYs 2017 and 2018, indicating that small businesses and self-employed taxpayers may have more problems with receiving SNODs.⁴²

Even when mail is received and responded to, it may not be worked in time. Although SB/SE and W&I report associating exam correspondence to the taxpayer's file within one or two days, examiners may not review the correspondence until much later.⁴³ As shown in Figures 1.8.6 and 1.8.7, W&I was delinquent in reviewing and responding to responses for the majority of correspondence audits.⁴⁴

FIGURE 1.8.6, W&I Response Time for FY 2018 EITC Audits⁴⁵

	Cases	Percentage
Responses 65 days old or greater	55,318	83%
Responses less than 65 days old	11,508	17%

FIGURE 1.8.7, W&I Response Time for FY 2018 Non-EITC Refundable Credit Audits⁴⁶

	Cases	Percentage
Responses 65 days old or greater	22,487	79%
Responses less than 65 days old	5,881	21%

39 See Most Serious Problem: *Statutory Notices of Deficiency: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making it Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution*, *infra*.

40 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 94-116 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

41 TAS response to TAS information request (Oct. 25, 2018). See Most Serious Problem: *Statutory Notices of Deficiency: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making it Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution*, *infra*.

42 IRS response to TAS fact check (Dec. 20, 2018).

43 IRS response to TAS information request (Oct. 25, 2018). IRS response to TAS information request (Oct. 24, 2018).

44 IRS responses are considered delinquent when the case is in status 55 or 57, which requires at least 65 days to have elapsed since receiving the taxpayer's reply. IRM 4.19.13.11, *Monitoring Overaged Replies* (Feb. 9, 2018); IRS, *W&I RICS Examination PAC 7F Reports* (Sept. 2018) (combining correspondence statuses 55 and 57). For a discussion of the IRS's inadequate handling of overaged audit responses from taxpayers, see Case Advocacy section, *infra*.

45 IRS, *W&I RICS Examination PAC 7F Reports* (Sept. 2018).

46 *Id.*

During 2018, taxpayers received an IRS “Interim Letter” informing them of delays of four, five, or, in many cases, six months just for the IRS to review the taxpayer’s correspondence.⁴⁷ Because the IRS only provides taxpayers with 30 days to provide documentation in a correspondence exam, these delays may appear patently unfair to the taxpayer, harming trust in the tax system and negatively affecting voluntary compliance.⁴⁸

Since many correspondence exams are conducted pre-refund, taxpayers may not receive their refunds until the filing season of the next year.⁴⁹ TAS elevated the concern to W&I management, who attributed the long wait times to attrition losses and a heavy volume of mail receipts. The IRS waits at least 105 days after issuing the SNOD to allow for a taxpayer response before proceeding to assess the tax by default.⁵⁰ However, the SNOD may go out before the IRS considers the taxpayer’s examination response (including substantiating documents) because the system has advanced the case to the next stage and will not permit the employee to stop it.⁵¹

Inability To Reach the Employee Who Evaluates the Taxpayer’s Response

Even where the IRS receives the taxpayer’s correspondence and reviews it, taxpayers in correspondence exams may not be able to speak to an employee familiar with the case because the IRS does not assign a single employee to each taxpayer’s case, as directed by the IRS Restructuring and Reform Act of 1998 (RRA 98).⁵² The IRS will assign the case to a tax examiner if it determines a reply “needs technical assistance or evaluation of records sent by the taxpayer.”⁵³

Furthermore, because IRS correspondence does not include the contact information of the employee who reviewed the taxpayer’s reply, the taxpayer cannot ask questions of the person who made the decision.⁵⁴ Once a tax examiner reviews a taxpayer’s documentation, makes an evaluation, and creates a letter to the taxpayer explaining why the documentation is not sufficient, such a letter should include the employee’s name and contact information. RRA 98 states: “...any manually generated correspondence received by a taxpayer from the Internal Revenue Service shall include in a prominent manner the name, telephone number, and unique identifying number of an Internal Revenue Service employee the taxpayer may contact with respect to the correspondence.”⁵⁵ By not including this information, the IRS may be violating the law and is impairing the taxpayer’s *right to challenge the IRS’s position and be heard*.

47 Letter 3500, *Interim Letter to Correspondence from Taxpayer*. See Systemic Advocacy Management System (SAMS) issues 39961, 39948, 39794, 39786, 39779, 36457, 36121, 35726, and 34740 documenting use of Letter 3500 and chronic delays in responding to taxpayer correspondence.

48 For a discussion of how perceived fairness affects voluntary compliance, see Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, *Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. ECON. PSYCHOL. 218-219 (2008).

49 During 2018 through the end of October, the IRS sent out approximately 176,000 CP 75 *Exam Initial Contact Letter – EIC – Refund Frozen* to taxpayers, indicating that it was holding their refunds pending a correspondence examination. The average cycle time for a correspondence audit in W&I during the last two fiscal years was about 190 days and 229 for SB/SE. IRS response to TAS information request (Oct. 25, 2018); IRS response to TAS information request (Oct. 24, 2018).

50 IRM 4.19.10.1.5.2, *Standard Suspense Periods for Correspondence Examination* (Dec. 8, 2017).

51 See IRM 4.19.13.10.6, *Taxpayer Requests Additional Time to Respond*, 7-8 (Mar. 30, 2018).

52 Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998). See National Taxpayer Advocate 2014 Annual Report to Congress 134-144 (Most Serious Problem: *Correspondence Examination: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*).

53 IRM 4.19.13.10, *Taxpayer Replies* (Feb. 20, 2018).

54 See, e.g., Letter 525, *General 30 Day Letter* (Sept. 2014).

55 Pub. L. No. 105-206, § 3705(a) (1998).

The IRS may not know how many taxpayers are trying to reach the IRS about a correspondence exam because taxpayers cannot reach an employee at all. During FY 2018, the SB/SE exam phone line only had a 61 percent level of service, with only 35 percent of calls being answered by an exam employee, and about 17 percent routed to an automated message.⁵⁶ W&I reports receiving an average of only about 1.6 incoming calls per correspondence exam during the last two fiscal years, and SB/SE reports only about 0.8 incoming calls per correspondence exam.⁵⁷ A 2010 IRS analysis found that 62 percent of correspondence exam callers were repeat callers.⁵⁸

In many cases, there is no personal contact before closing a case. In FY 2018, about 42 percent of W&I and SB/SE correspondence audits were closed with no personal contact.⁵⁹ During FYs 2017 and 2018, W&I reported an average of 0.09 outgoing calls per correspondence exam—approximately one call for every 11 cases.⁶⁰ The IRM touts: “Because the ACE [Automated Correspondence Exam] system will automatically process the case through creation, statutory notice and closing, tax examiner (TE) involvement is eliminated entirely on no-reply cases. Once a taxpayer reply has been considered, the case can be reintroduced into ACE for automated Aging and Closing in most instances.”⁶¹ Because examinations are an opportunity for the taxpayer to show the IRS that it is wrong (or why the taxpayer believes the IRS is wrong), closing an exam with no personal contact means the IRS misses an opportunity to fix its filters or update its educational materials to clarify confusing issues. Further, TAS has found that outgoing contacts can increase the response rate for taxpayers, reduce the average cycle time of the exam, and increase the taxpayer agreed rate—which not only saves the IRS resources, but may mean the taxpayer better understood the exam and why the return was incorrect.⁶²

TAS has found that outgoing contacts can increase the response rate for taxpayers, reduce the average cycle time of the exam, and increase the taxpayer agreed rate—which not only saves the IRS resources, but may mean the taxpayer better understood the exam and why the return was incorrect.

56 IRS, Product Line Detail (Enterprise Performance) Snapshot report (week ending Sept. 30, 2018).

57 IRS response to TAS information request (Oct. 24, 2018); IRS response to TAS information request (Oct. 25, 2018).

58 Thirteen percent of correspondence exam callers called more than eight times. POP Team Recommendations, Solutions to Improve Taxpayer Satisfaction in Correspondence Examination Briefing Document (June 21, 2010).

59 IRS response to TAS fact check (Dec. 20, 2018).

60 *Id.*

61 IRM 4.19.20.2, *Automated Correspondence Exam Overview (ACE)* (Jan. 8, 2015).

62 The IRS selected 900 correspondence exam cases for a test group in which Exam telephoned the taxpayers ten days after the initial contact letter and again just prior to issuing the statutory notice of deficiency (cases were randomly selected from Project Codes 0261 and 0289 inventory via the DDb starting in cycle 2011-04 and continuing through cycle 2011-18). For those taxpayers successfully contacted, the response rate was 61 percent compared to 43 for the control group, the average cycle time was 21 days less than the control group, and the agreed rate was 30 percent compared to just 20 percent for the control group. TAS, *Earned Income Tax Credit (EITC) Enhanced Communication Test (CEECT)* White Paper (Nov. 2012).

The IRS's Correspondence Is Often Confusing and Does Not Provide Sufficient Time to Respond

A past TAS survey of taxpayers who were audited on the EITC found that more than 25 percent of them did not understand the IRS audit notice was telling them they were under audit, and about half didn't understand what they needed to do in response to the audit letter.⁶³ This lack of awareness is not limited to low income taxpayers claiming refundable credits. A study of self-employed taxpayers audited by correspondence between 2010 and 2015 found 39 percent of taxpayers did not recall they had been audited.⁶⁴

In a TAS study of enhanced communication during EITC correspondence audits, Exam forwarded almost 700 cases to TAS that were closed other than as “no change” or “agreed” and TAS was able to contact 37 percent of these taxpayers. In 44 percent of the cases, the taxpayers acknowledged they were ineligible for the EITC, but only two percent of these 44 percent said they understood they were ineligible prior to TAS's contact.⁶⁵ Taxpayers who understand what they did wrong may avoid making the same mistakes in the future. Further, this taxpayer education may promote voluntary compliance because multiple studies show that increasing knowledge of tax law results in a higher willingness of those taxpayers to comply.⁶⁶ However, when asked about procedures for educating audited taxpayers to avoid repeat mistakes, W&I stated: “The document request and publications included in the notices inform taxpayers of the tax law requirements and examples of documentation that can be provided to support the audit issues.”⁶⁷

The IRS correspondence and forms are clearly inadequate to inform and educate taxpayers. The CP 75, *Exam Initial Contact Letter – EIC – Refund Frozen*, one of the most common initial contact letters in correspondence exams, demonstrates why taxpayers may not understand what documentation is requested.⁶⁸ The CP 75 states at the top that the IRS is auditing the taxpayer's return, which may help alleviate confusion over whether the taxpayer is being audited. However, the CP 75 refers the taxpayer to Form 886-H-EIC to understand which documents a taxpayer must send in to prove EITC eligibility. As shown in Figure 1.8.8, this form is particularly confusing because it asks taxpayers to submit information to prove different residency requirements without clearly telling the taxpayer which documents may be submitted and which may fulfill some of or all of the different requirements.

63 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 103 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

64 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 163 (Matthias Kasper, Sebastian Beer, Erich Kirchler & Brian Erard, Research Study: *Audits, Identity Theft Investigations, and Taxpayer Attitudes: Evidence from a National Survey*).

65 TAS, *Earned Income Tax Credit (EITC) Enhanced Communication Test (CEEET) White Paper* (Nov. 2012).

66 *Id.*

67 IRS response to TAS information request (June 22, 2018).

68 In FY 2018 the volume of CP75 notices were: CP75, 181,342; CP75A, 48,573; CP75C, 107; and CP75D, 17,949. IRS, CDW, *Notice Delivery System (NDS) FY 2018* (Dec. 2018).

FIGURE 1.8.8, Excerpt of Question 1 from Form 886-H-EIC

Form 886-H-EIC (October 2018)			Department of the Treasury—Internal Revenue Service Documents You Need to Send to Claim the Earned Income Credit on the Basis of a Qualifying Child or Children for Tax Year 2018		
Taxpayer name		Taxpayer Identification Number		Tax year	
<p>To get Earned Income Credit (EIC), the child must have lived with you, be related to you and be a certain age. Para recibir el Crédito por Ingreso del Trabajo (EIC, por sus siglas en inglés), el niño tiene que haber convivido con usted, ser su pariente, y tener una edad específica. Visite IRS.gov/eitc para buscar la versión en español del Formulario 886-H-EIC (SP) (May. 18-2018) o llame al 1-800-829-3675. Visit IRS.gov/eitc to find out more about who qualifies for EIC.</p>					
<p>1. Each child that you claim must have lived with you for more than half of 2018* in the United States. The United States includes the 50 states and the District of Columbia. It doesn't include Puerto Rico or U.S. possessions such as Guam.</p> <p><small>*Certain times that you, or the child, is temporarily away from home due to special circumstances as long as the child lived with you. Examples include illness, college, business, vacation, military service or detention in a juvenile facility.</small></p>					
<p>To prove the child lived with you in the United States, the document(s) must have:</p> <ul style="list-style-type: none"> your U.S. address, your name, and the child's name. If you use a P.O. Box as your mailing address, you must send it registered mail, first-class, or by Air Application stamped by the Post Office. the dates in 2018 the child lived at the same address as you must cover more than half of 2018. if the document has the child's name and your address but not your name, you need to send in another document with your name showing the same address. 		<p>If you can send one or more of the following documents to prove the child lived with you for more than half of 2018:</p> <ul style="list-style-type: none"> school records (you may need to send one or more school records) medical records from doctors, hospital or medical clinic (communication records may not include all the necessary information) adoption or child placement documents court records 		<p>Or, send dated statements on letterhead from:</p> <ul style="list-style-type: none"> the child's school the child's childcare provider (not a relative) the child's health care provider, doctor, nurse or clinic a social service agency a placement agency official your employer an Indian tribal official your landlord or property manager a piece of mailing others. 	

A taxpayer reading this form may wonder: What kind of document is sufficient to prove residency in the United States? Can only the documents in the second column related to proving the child lived with the taxpayer be used to show residency in the United States? Are the documents in the third column alternatives for both the first and the second column? What information must be included on a dated statement? Would a school record issued at the end of the year demonstrate residency for more than half the year, or would two be required? These questions could go on and on but, unfortunately, a taxpayer has only 30 days to seek clarification from the IRS and provide the records. Although taxpayers can request an extension of time to provide information, it appears either not many EITC taxpayers take advantage of this or not many of these requests are granted. During the last two fiscal years, W&I granted approximately 2,100 of these requests for additional time to respond, compared to SB/SE, which granted approximately 27,000.⁶⁹

Furthermore, without an IRS employee being able to view the record a taxpayer is proposing to submit, the examiner may not know that such a record would be inadequate until after the taxpayer already mails it in.⁷⁰ Then, assuming the documentation is not accepted, instead of a conversation about how to remedy the problem, the taxpayer would receive a “30-day letter,” indicating how the IRS proposes to adjust the return and providing the taxpayer a 30-day window to provide further documentation before the IRS issues the SNOD.⁷¹ In some cases, the taxpayer may receive the 30-day letter at the initiation of the audit, where the IRS combines the initial contact letter and the preliminary report into

69 Approximately 72 percent of W&I correspondence exams are EITC exams. Starting in 2016, SB/SE started no new EITC correspondence audits. IRS response to TAS information request (Oct. 24, 2018); IRS response to TAS information request (Oct. 25, 2018). Neither operating division could provide the number of denied requests for additional time to provide documentation.

70 Virtual service delivery and other videoconferencing technology could mitigate this problem by allowing a taxpayer to show records to an IRS employee in real time. See National Taxpayer Advocate 2014 Annual Report to Congress 154-162 (Most Serious Problem: *Virtual Service Delivery: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services*).

71 IRC § 6213(a). Once a taxpayer receives the Statutory Notice of Deficiency (SNOD), the taxpayer may still provide documentation to the IRS, but the 90-day period for petitioning the U.S. Tax Court to challenge the liability before paying has begun.

a “combo-letter.” This letter confuses the taxpayer and sends a message that the IRS has already made a preliminary decision about the taxpayer’s case without even reviewing the taxpayer’s documentation.

The IRS Metrics Do Not Consider Taxpayer Needs and Preferences When Determining the Effectiveness of Its Correspondence Exam Program, and the IRS Prioritizes Measures Such as Cycle Time and Closures, Which Ignore the Impact on the Taxpayer

SB/SE points to the following metrics for measuring its examination program:

1. Full time employees
2. Closures and new starts by types of return
3. Inventory
4. Cycle time
5. Employee engagement index
6. Customer satisfaction
7. Reconsiderations
8. Quality score⁷²

W&I provided an even shorter list in response to TAS, highlighting only three metrics included in its FY 2017 final Business Performance Review:

1. Cycle time
2. No change rate
3. Accuracy rate⁷³

Although customer satisfaction may affect voluntary compliance, this measure fails to capture taxpayers who did not participate in the audit by not responding.⁷⁴ The IRS should measure response rates to determine how many taxpayers participated and use this information to tailor its correspondence or contacts for certain issues that resulted in low participation rates. Further, the metrics overall are inadequate to determine the effectiveness of the correspondence examination program in terms of choosing the best cases to audit, educating the taxpayer, and increasing voluntary compliance. In addition to customer satisfaction surveys, the IRS could use surveys to gauge how well taxpayers understand the audit. As discussed above, a 2007 TAS study found that more than 25 percent of EITC taxpayers audited were not even aware they were being audited.⁷⁵ A metric that captured an agreement rate would be more meaningful in determining effectiveness of compliance education than the summary “change” rate by which IRS computes its return on investment because it would suggest the taxpayer understands the error and will avoid making it again.

The IRS could also capture data regarding whether taxpayers understand the information they need to provide by surveying or conducting focus groups with taxpayers and looking at what types of documentation taxpayers frequently sent that were deemed insufficient. This could help the IRS better

72 IRS response to TAS information request (Apr. 27, 2018).

73 IRS response to TAS information request (June 22, 2018).

74 SB/SE Campus Exam Mail Customer Satisfaction Report, SB/SE Research TM20349 (Aug. 2018).

75 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 103 (Study: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*).

inform taxpayers about exactly what documentation is acceptable and may even provide an impetus for the IRS accepting additional forms of documentation as a result of what the surveys show.

Although SB/SE reports audit reconsideration numbers,⁷⁶ it does not do so in a meaningful way because it compares only the sheer number of audit reconsiderations for field audits and correspondence audits without looking at the percentage. Further, the IRS should measure how many correspondence audits result in in appeals conferences and the result of those conferences. Additionally, the IRS should track the number of appeals to the U.S. Tax Court, including what percentage resulted in a lower liability or a full concession by the IRS, to understand where greater communication or better employee training is needed.⁷⁷

Finally, neither W&I nor SB/SE measure how taxpayers perceive the IRS and how they feel about paying taxes after a correspondence audit.⁷⁸ A recent TAS study found that taxpayers audited by correspondence report a lower sense of fairness in the examination and are more likely to hold negative views towards the IRS than individuals audited in-person.⁷⁹

Analyzing how correspondence audits affect taxpayer attitudes towards the IRS, including filing and paying taxes, would go beyond just looking at whether a taxpayer was satisfied with the customer service received during the audit. The IRS could gather data to analyze filing and payment compliance in the years following an audit to determine the effect on future behavior.

CONCLUSION

The IRS's correspondence examination program burdens taxpayers and misses opportunities to educate the taxpayer. The IRS is ignoring important measures such as the resulting impact on voluntary compliance and taxpayer attitudes. Focusing on metrics like closures and cycle time has allowed the IRS to ignore the taxpayer perspective. Failing to assign an employee to a taxpayer's case, not allowing the taxpayer to speak with the examiner making decisions about the taxpayer's case, closing cases with little or no personal contact, and asking taxpayers to wait six months or more for the IRS to consider documentation directly undermine the taxpayer's *right to challenge the IRS's position and be heard*, and impair *the rights to be informed, to quality service, to pay no more than the correct amount of tax, and to a fair and just tax system*.

76 IRS response to TAS information request (Oct. 24, 2018).

77 A 2012 TAS study found taxpayers in EITC cases that were fully conceded by the IRS called the IRS on average five times after petitioning the U.S. Tax Court; yet, only one fifth of the cases were conceded due to the hazards of litigation. National Taxpayer Advocate 2012 Annual Report to Congress vol. 2 87.

78 SB/SE Campus Exam Mail Customer Satisfaction Report, SB/SE Research TM20349 (Aug. 2018). The taxpayer may add open-ended comments to the customer satisfaction survey, but the survey does not measure the taxpayer's perception of fairness.

79 See Brian Erard, Matthias Kasper, Erich Kirchler, and Jerome Olsen, Research Study: *What Influence do IRS Audits Have on Taxpayer Attitudes and Perceptions? Evidence from a National Survey*, *infra*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Require at least one personal contact between an IRS employee and the taxpayer (this can be satisfied by an outgoing or incoming phone call) before closing a correspondence examination.
2. Measure taxpayers' filing compliance (including filing a return, making an error on a return, and underreporting taxes on a return) following correspondence examinations and apply this data to guide audit selection based on the resulting impact on compliance.
3. Continue to assign a single employee for a correspondence examination when the IRS receives a response from the taxpayer either by phone or correspondence, and expand on this right by retaining this employee as the single point of contact throughout the remainder of the exam.
4. Per RRA 98 § 3705(a), place on outgoing taxpayer correspondence the name and telephone number of the tax examiner who reviewed the taxpayer's correspondence where a tax examiner has reviewed and made a determination regarding that specific documentation.
5. Conduct surveys of taxpayers following correspondence examinations to gauge their understanding of the examination process and their resulting attitudes towards the IRS and towards filing and paying taxes.
6. Collect data regarding which forms of documentation taxpayers sent in a correspondence examination that were deemed insufficient and revise existing correspondence examination letters to better explain documentation requirements.
7. End the practice of using the combination letter and provide taxpayers with an initial contact prior to issuing the preliminary audit report.