

MSP
#17**NOTICES: Refund Disallowance Notices Do Not Provide Adequate Explanations****RESPONSIBLE OFFICIALS**

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DEFINITION OF PROBLEM

The IRS is not providing taxpayers with adequate explanations as to why it is disallowing their refunds as required by the IRS Restructuring and Reform Act of 1998 (RRA 98).¹ Some IRS notices include an explanation that is too short or too vague for the taxpayer to learn the specific reasons for the disallowance.² Other explanations are not written in language that the taxpayer can easily understand.³ Some letters provide no explanation or reason at all, other than stating there is no basis for the IRS to allow the claim or that another notice explaining the disallowance is forthcoming.

In its report on RRA 98, the Joint Committee on Taxation (JCT) stated: “Congress believed that taxpayers are entitled to an explanation of the reason for the disallowance or partial disallowance of a refund claim so that the taxpayer may appropriately respond to the IRS.”⁴ A taxpayer’s *right to challenge the IRS’s position and be heard* means taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions.⁵ Without an adequate explanation of its actions, taxpayers cannot respond appropriately to the IRS and challenge the disallowance. Taxpayers also have *the right to be informed*, which means the IRS should clearly explain its decisions and the outcomes of its actions. This right is impaired when the IRS disallows a refund without providing a clear, easily understandable explanation to taxpayers. Moreover, vague or inadequate explanations create additional work for the IRS when taxpayers must call or write for clarification.

ANALYSIS OF PROBLEM**Background***Legislative History and Implementation*

Section 3505 of RRA 98 states, “In the case of a disallowance of a claim for refund, the Secretary shall provide the taxpayer with an explanation for such disallowance.”⁶ The legislative history for section 3505 shows Congress intended the IRS to go beyond just a general explanation. In this regard, the

- 1 Section 3505(a) of RRA 98, codified initially at Internal Revenue Code (IRC) § 6402(j) (and then subsequently redesignated as IRC § 6402(l)), states: “In the case of a disallowance of a claim for refund, the Secretary shall provide the taxpayer with an explanation for such disallowance.” Pub. L. No. 105-206, 112 Stat. 685, 771 (1998).
- 2 For example, one 105C letter stated as the explanation: “The information received relating to the case did not change our determination and the case is now closed” (letter on file with TAS).
- 3 The Treasury Inspector General for Tax Administration (TIGTA) reviewed a statistically valid sample of recently revised IRS letters and notices, and found that half of the letters and almost two thirds of the notices were not written clearly or did not provide sufficient information. See TIGTA, Ref. No. 2014-40-076, *Processes Are Needed to Ensure That Letters and Notices Are Written in Compliance with the Plain Writing Act 7* (Sept. 12, 2014).
- 4 JCT, General Explanation of Tax Legislation Enacted in 1998, JCS-6-98, 117 (Nov. 24, 1998).
- 5 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.
- 6 Pub. L. No. 105-206, 112 Stat. 685, 771 (1998).

Senate report states that Section 3505 “requires the IRS to notify the taxpayer of the *specific reasons* for the disallowance (or partial disallowance) of the refund claim” (emphasis added).⁷ The legislative history also shows Congress meant for the IRS to provide information “so that the taxpayer may appropriately respond to the IRS.”⁸

RRA 98 does not require the IRS to explain the claim disallowance on any specific letter or notice, in any specific format, or at any specific time.⁹ However, the Internal Revenue Manual (IRM) reflects that the IRS uses notices of claim disallowance to meet the Section 3505 requirement.¹⁰ When RRA 98 was enacted, the IRS issued multiple memos to employees, reinforcing the requirement to explain a claim disallowance.¹¹ The IRS revised two publications, including Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, to reflect that the IRS must send the taxpayer an explanation if it disallows a claim for refund.¹² It also updated IRM Part 21, *Customer Account Services*, to require an explanation. The IRM states, “Letters must contain the specific reason for the claim disallowance. An IRC section, if provided by Examination, should be cited.”¹³

Types of Refund Disallowance Notices

The IRS uses different types of notices, some of which are required by statute, to tell taxpayers their claims are disallowed. If the IRS disallows any portion of a claim for refund or credit of an overpayment, IRC § 6532(a) requires it to mail to the taxpayer, by certified or registered mail, a notice of claim disallowance in order to commence the two-year statute of limitations on filing suit to challenge the disallowance in a United States District Court or the Court of Federal Claims.¹⁴ Notices mailed pursuant to IRC § 6532(a), known as “statutory notices of claim disallowance,” can be stand-alone notices¹⁵ or be combined with another notice.¹⁶ In situations where a taxpayer’s claim for refund is pending during an examination and a statutory notice of deficiency has not been issued, the IRS will issue a combined

7 S. Rep. No. 105-174, at 97 (Apr. 22, 1998).

8 JCT, General Explanation of Tax Legislation Enacted in 1998, JCS-6-98, 117 (Nov. 24, 1998).

9 There are no regulations or official guidance from Counsel that specifies when and in what form the IRS has to provide the explanation required by IRC § 6402(l).

10 See IRM 4.71.8.6.3, *Processing a Claim When Taxpayer Contact Is Made* (July 29, 2014) (discussing the IRC § 6402(l) requirement in a section regarding Letter 569-A, *Claim Disallowance Notification Letter*). See also IRM 8.7.7.2.4, *Periods of Limitation in Claim and Overassessment Cases* (Oct. 16, 2014) (stating that per IRC § 6402(l), the statutory notice of claim disallowance must include an explanation of the reason for the disallowance); IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures* (Dec. 20, 2010) (noting that disallowance letters must contain the specific reason for the disallowance).

11 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-13244, AT-2009-13244, AT-2009-13246 (retrieved May 28, 2014). The IRS uses LATIS to track all provisions, actions, and status of enacted legislation that impacts the IRS. The Action Plan lists Action Items and is used to record and track relevant contacts and activities as they occur, covering the time frame from passage of the legislation to full implementation.

12 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-13241 (retrieved May 28, 2014). See IRS, Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund* 16 (Sept. 2013).

13 IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures* (Dec. 20, 2010).

14 IRC § 6532(a)(1) provides, “No suit or proceeding under section 7422 (a) for the recovery of any internal revenue tax, penalty, or other sum, shall be begun before the expiration of 6 months from the date of filing the claim required under such section unless the Secretary renders a decision thereon within that time, nor after the expiration of 2 years from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of the part of the claim to which the suit or proceeding relates.”

15 See, e.g., Letter 105C.

16 See, e.g., Letter 3219.

In its report on the IRS Restructuring and Reform Act of 1998, the Joint Committee on Taxation stated: “Congress believed that taxpayers are entitled to an explanation of the reason for the disallowance or partial disallowance of a refund claim so that the taxpayer may appropriately respond to the IRS.”

statutory notice of claim disallowance and statutory notice of deficiency.¹⁷

Taxpayers receiving the combined statutory notice can contest the disallowance in a United States District Court, the Court of Federal Claims, or the United States Tax Court.¹⁸ In this Most Serious Problem, we also look at notices disallowing claims for innocent spouse relief¹⁹ under the category of statutory notices of claim disallowance, although these notices provide a different time period and venue for challenging the disallowance.²⁰

There is a second category of claim disallowance notices that are not mailed by certified or registered mail, and do not start the running of the statute of limitations for filing a refund suit. These notices, hereinafter referred to as “non-statutory notices of claim disallowance,” formally communicate to the taxpayer that his or her claim is denied, but have no effect on the statute of limitations for filing a refund suit. The IRS sometimes sends these letters after a statutory notice of claim disallowance, such as when Appeals issues a non-statutory notice of claim disallowance after Exam has issued a statutory notice of claim disallowance. In other cases, the non-statutory notice is followed by the statutory notice of claim disallowance. In still other cases, when the taxpayer waives the right to the statutory notice of claim disallowance, the taxpayer will only receive the non-statutory notice. Under the regulations, if a taxpayer waives the right to receive the statutory notice of claim disallowance, the filing of the waiver will begin the running of the two-year statute of limitations to file suit.²¹

In addition to these two categories, we also discuss “No Consideration” letters. These letters are not technically claim disallowance notices because the IRS is not disallowing the claim; it is saying the claim cannot be processed because the IRS does not have enough information. If the taxpayer does not respond to the “No Consideration letter,” the IRS does not follow the letter with another communication nor does

17 See IRM 4.8.9.15.2, *Disallowed Claims for Refund and Examination Results in Deficiency* (July 9, 2013). The IRM provides that the statutory notice of deficiency will include immediately after the summary of the tax liability, or as an attachment, a paragraph informing the taxpayer that the claim has been disallowed and he or she may file suit within two years of the date of mailing on the notice in a United States district court or the Court of Federal Claims. The IRM also instructs the employee to provide an explanation of any additional deductions or reductions in income that were requested in the claim and are disallowed.

18 See, e.g., *McCormack v. Commissioner*, No. 1773-13 (T.C. Oct. 24, 2014) (order discharging the prior order to show cause as to why the case should not be dismissed for lack of jurisdiction). Where the IRS issued a statutory notice of deficiency that also clearly stated that the taxpayer’s claim for refund was being disallowed, the court found “IRC § 6512 contemplates treating the disallowed claim for a refund as a claim under our overpayment jurisdiction, so there is no problem with our jurisdiction.”

19 IRC § 6013(d)(3) provides that married taxpayers who file a joint return under section 6013 will be jointly and severally liable for the income tax arising from that joint return. By requesting innocent spouse relief under IRC § 6015, in certain circumstances, one spouse may be relieved of the joint and several liability imposed by IRC § 6013(d)(3).

20 IRC § 6015(e)(1)(A) provides a taxpayer requesting innocent spouse relief may petition the Tax Court to determine the appropriate relief available. The petition must be filed no later than 90 days after the IRS mails, by certified or registered mail, the notice of the IRS’s final determination of relief available to the individual. IRC § 6015(e)(3) provides that if a refund suit is brought under IRC § 6532, the Tax Court shall lose jurisdiction of the individual’s action under IRC § 6015 to whatever extent jurisdiction is acquired by the district court or the Court of Federal Claims over the taxable years that are the subject of the suit for refund, and the court acquiring jurisdiction shall have jurisdiction over the petition filed under IRC § 6015(e).

21 Treas. Reg. § 301.6532-1(c). The waiver form must include: the type of tax and the taxable period covered by the taxpayer’s claim for refund, the amount of the claim, the amount of the claim disallowed, and a statement that the taxpayer agrees the filing of the waiver will commence the running of the two-year statute of limitations to file suit. The limitation restricting the taxpayer from filing suit until six months after the date the claim for refund was filed still applies even if the waiver is filed within this six month period. *Id.* The IRS typically uses Form 2297, *Waiver of Statutory Notice of Claim Disallowance*, for this purpose.

it issue a statutory notice of claim disallowance. “No Consideration” letters are different from refund hold notices,²² because with a refund hold notice, the taxpayer eventually receives a statutory notice of claim disallowance in most circumstances.²³ Therefore, for purposes of this MSP, we have not analyzed refund hold notices.

TAS’s Analysis of Certain Refund Disallowance Notices Finds They Do Not Satisfy the Intent of RRA 98.

To determine whether the IRS meets the requirement of providing an explanation of the reason for disallowance, TAS identified over 50 notices of claim disallowance the IRS uses to deny different types of claims. Some letters, such as 105C, *Claim Disallowed* and 106C, *Claim Partially Disallowed*, are used by multiple IRS functions to deny multiple types of claims; others are sent to deny specific types of claims.²⁴ To identify the most common letters and analyze the explanations received most frequently by taxpayers, TAS attempted to find the volume for each letter²⁵ and the frequency of different standard paragraphs used.²⁶ Although the IRS can track the volume for many of its notices and letters, it has no way of tracking what standard paragraphs are inserted into letters generated by the Correspondex system.²⁷ Furthermore, once notices are sent, employees face difficulty obtaining a copy of the actual letter sent to see the specific language.²⁸ This makes it challenging for employees to answer taxpayers’ questions arising from the notices.

For our analysis, we chose to look at what we identified as the main letters sent out in the context of examination, general claims for refund (often filed on an original or amended return), appeals, and innocent spouse claims. We included No Consideration letters, even though these are not technically notices of claim disallowance, because if taxpayers do not respond to these letters or submit new claims, their claims are effectively disallowed.

22 The notice the IRS sends to inform a taxpayer that his or her refund is being held or frozen is referred to as a refund hold notice for the purpose of this Most Serious Problem.

23 In some circumstances, such as in certain cases of identity theft, the IRS issues neither a refund hold notice nor a statutory notice of claim disallowance because it considers the returns to be nullities. See IRS Office of Chief Counsel Memorandum, *Identity Theft Returns and Disclosures Under Section 6103*, PMTA 2009-024 (June 8, 2008), available at www.irs.gov/pub/lanoa/pmta2009-024.pdf.

24 Examples of specific letters are Letter 4878, *Notice of FICA Refund – Allowed/Disallowed Claims*, and Letter 5088C, *Requesting Spouse Final Determination Letter on Disallowed Innocent Spouse Claims* (Dec. 2012).

25 We were unable to find the volume for any of the Appeals letters because Appeals does not track this information. IRS Response to TAS Information Request (Oct. 10, 2014). The IRS does track volume for Correspondex letters, known as “C” letters”, which are computer generated. There are almost 800 “C-letters.” See IRS intranet, Correspondex Letters.

26 Each C letter gives the employee the ability to choose from a number of standard paragraphs to include in the letter. IRM 2.4.6.1, *Welcome to Correspondex* (Dec. 5, 2014).

27 Email from the IRS Office of Taxpayer Correspondence to TAS (Oct. 28, 2014) (on file with TAS).

28 The Office of Taxpayer Correspondence does not maintain copies of C-Letters once they are sent. Email from Office of Taxpayer Correspondence to TAS (Oct. 28, 2014) (on file with TAS). Statutory notices of claim disallowance, which are sent by certified or registered mail, are available on an internal database. See IRMs 21.5.3.4.6.2, *Appeals and Responses to Letter 105C and 106C* (May 30, 2014) and 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures* (Dec. 20, 2010) (stating that once the letters are sent to the centralized print site, they will not be returned to be associated with the taxpayer’s file and will only be available on an internal database if needed at a later date). However, not all employees have access to the internal database, and locating an individual letter can be challenging. Furthermore, employees may not be able to help taxpayers when they call about a refund disallowance notice because there is a delay from when an employee requests a copy of the letter from the database to when he or she receives it.

FIGURE 1.17.1, Refund Disallowance Notices Analyzed by TAS²⁹

Letter	Title	Revision Date	Description	Volume for FY 2014
Statutory Notices of Claim Disallowance				
Letter 105C	Claim Disallowed	Nov. 2012	Used by multiple functions for claim disallowance.	564,008
Letter 106C	Claim Partially Disallowed	Jan. 2014	Used by multiple functions to notify the taxpayer that their claim is partially disallowed.	40,339
Letter 1364	Appeals Full Disallowance of Claim - Certified Letter	Mar. 2009	Generated by Appeals and represents the taxpayer's legal notice of the full disallowance of the taxpayer's claim for refund.	Unavailable
Letter 1363	Appeals Partial Disallowance of Claim - Certified Letter	Apr. 2008	Generated by Appeals and represents the taxpayer's legal notice of the partial disallowance of the taxpayer's claim for refund.	Unavailable
Letter 5088C	Requesting Spouse Final Determination Letter on Disallowed Innocent Spouse Claims	Dec. 2012	Letter 5088C is used to notify the requesting spouse that the IRS is disallowing relief in full and to inform the taxpayer of his or her right to appeal the determination in the Tax Court.	3,152
Letter 5087C	Requesting Spouse Final Determination Letter on Partially Allowed Innocent Spouse Claims	Dec. 2012	Letter 5087C is used to notify the requesting spouse that the IRS is granting partial relief and to inform the taxpayer of his or her right to appeal the determination in the Tax Court.	2,402
Non-statutory Notices of Claim Disallowance				
Letter 569	Letter of Claim Disallowance	Aug. 2009	Used by Examination to advise the taxpayer when a claim is disallowed/allowed or partially allowed with reason for disallowance.	8,197
Letter 2681	Appeals Full Disallowance After Previous Claim Disallowance	Nov. 2006	Generated by Appeals to notify the taxpayer of the full disallowance of a claim where the IRS previously mailed a statutory notice of claim disallowance or the taxpayer waived his or her right to receive the statutory notification.	Unavailable
Letter 2683	Appeals Partial Disallowance After Previous Claim Disallowance	Nov. 2006	Generated by Appeals to notify the taxpayer of the partial disallowance of a claim where the IRS previously mailed a statutory notice of claim disallowance letter or the taxpayer waived his or her right to receive the statutory notice.	Unavailable
No Consideration Letters				
Letter 916C	Claim Incomplete for Processing; No Consideration	Mar. 2014	Used to notify the taxpayer that the IRS is unable to process his or her claim for refund.	28,196
Letter 3657C	No Consideration Innocent Spouse Claim Letter	Dec. 2012	Letter 3657C is used to notify the requesting spouse that he/she does not meet basic eligibility requirements and their claim will be closed as specified in this letter.	8,800

29 IRS Compliance Data Warehouse (data retrieved Nov. 10, 2014). The IRS Office of Appeals does not track letter volume data for Letters 1363, 1364, 2681, or 2683. IRS Response to TAS Information Request (Oct. 10, 2014).

Analysis of Statutory Notices of Claim Disallowance

The IRS Fails to Ensure Statutory Claim Disallowance Letters 105C and 106C Provide Sufficient Explanations of Disallowances.

Letters 105C and 106C are statutory notices of claim disallowance³⁰ that multiple IRS functions use to fully or partially deny claims for refund.³¹ Employees generate these letters by inserting standard paragraphs that they customize slightly by entering specific information into fields, such as a dependent's name. However, there seems to be little oversight or accountability for what the letters actually say. From a sample of 18 Letters 105C and ten Letters 106C, TAS found two letters did not list any reason at all under the heading "WHY WE CANNOT ALLOW YOUR CLAIM" or "WHY WE PARTIALLY DISALLOWED YOUR CLAIM," a clear violation of Section 3505. The letters varied in terms of content; some letters included the amount of the claim and some did not. Two of the ten 106C letters stated the claim was only partially allowed, but the amount allowed was the same as the amount of the claim, meaning either that one of these amounts was incorrect, or the claim was not partially disallowed and the IRS sent the wrong notice.

One 105C letter listed the amount of the claim as ".00." Although it stated the refund was disallowed due to the expiration of the refund statute of limitations, the letter advised the taxpayer "You can submit for our consideration a statement telling us why you're not eligible for Medicare health coverage, Part A or B." If the taxpayer called the IRS to discuss this letter, the customer service representative on the phone would not be able to view the letter to clarify the reason for the disallowance.³² However, if the employee were able to easily locate a copy of the letter, the IRS could verify the mistake and issue another notice of claim disallowance, although this notice would not provide a new time period to appeal the disallowance administratively or in federal court.³³

TAS pulled a sample of 100 Letters 105C and determined that 92 of them did not provide adequate explanations that would satisfy the purpose of Section 3505.³⁴ Specifically, 30 letters included language that was not clear and written in plain language,³⁵ 58 did not sufficiently explain the specific reasons for the disallowance, and 65 did not provide the taxpayer with the information needed to respond to the IRS. TAS pulled a smaller sample of ten 106C letters that use similar standard paragraphs. One letter 106C included this confusing explanation:

We partially disallowed your claim because We [sic] have allowed only the Earned Income Tax Credit for [name redacted]. As you did not provide proof of support, we did not allow

30 These notices are mailed by certified or registered mail and therefore start the running of the two year statute of limitations for filing a refund suit. See IRC § 6532(a)

31 Submission Processing generally uses Letter 105C to initially deny a claim for refund if the refund is the only issue, and Letter 106C to initially deny a claim for refund when there are other issues. See IRM 3.11.6.9.3, *Correspondence for Disallowing a Claim (105C and 106C Letters)* (July 24, 2014). Examination also uses Letters 105C and 106C. See IRM 4.19.16.1.4.2, *Claims Contact Responses* (Nov. 4, 2011).

32 See footnote 28, *supra*.

33 If the IRS were to issue another notice of claim disallowance with the correct information, that subsequent notice would not operate to extend the period for filing a refund suit. See IRC § 6532(a)(4). Letter 105C notifies taxpayers of their right to appeal the disallowance administratively, and states "If we do not hear from you within 30 days from the date of this letter, we will process your case without further action."

34 Letters were deemed to satisfy the purpose of Section 3505 if reviewers answered "Yes" for the following three questions: Does the letter provide the specific reason the refund claim was disallowed? Was the description of the reason for the disallowance written in clear and plain language that an average taxpayer would understand? If you were the taxpayer and you disagreed with the disallowance, based on the information on this notice would you understand what you need to do in order to dispute the disallowance?

35 See Plain Writing Act of 2010, Pub. L. No. 111-274, 124 Stat. 2861 (2010).

the dependent exemptions, Child Tax credit, Additional Child Tax Credit or the Head of Household Filing Status.

This explanation is incomplete, confusing, and could lead to an interpretation that is an incorrect statement of the law. The use of the word “or” when listing the different exemptions, credits, and filing status is confusing because the taxpayer does not know if the IRS is denying all four items, some of them, or just one. The first sentence makes it appear as though the IRS is allowing the Earned Income Tax Credit (EITC) for one child, but not others. However, the second sentence makes it seem that the taxpayer cannot include any children for dependent exemptions for the purpose of Head of Household Filing Status, which would likely mean no children would be eligible for the EITC.³⁶ In addition, if the second sentence is interpreted to require the taxpayer to prove that he or she provided support to the child claimed, it gives an inaccurate statement of the law. Under IRC § 152(c), a qualifying child can be claimed as an exemption and qualify an individual for Head of Household filing status under IRC § 2(b)(1) if, among other requirements, the child did not provide over one-half of his or her own support for the calendar year in which the taxable year of the taxpayer begins. There is no requirement that the taxpayer must have provided support to the child.³⁷ Furthermore, even if the taxpayer can identify which items are disallowed, to which children the letter refers, and who must prove support, the letter does nothing to explain how the taxpayer can prove someone other than the child provided over half of his or her support. The sheer complexity of the underlying law cries out for clearer explanations so the taxpayer can understand the error and respond appropriately, if at all.

Some 105C letters offered even less information. A similar letter provided more specific details by naming which child was disallowed, but nonetheless failed to state what was disallowed, *e.g.*, EITC, child tax credit, etc.³⁸ Another letter simply stated, “You were claimed as a dependent on another taxpayer’s return,” without stating the consequences of this situation. Given the high improper payment rate for EITC claims,³⁹ providing clear and easily understandable explanations of why a taxpayer did not qualify is especially important to educate taxpayers and prevent future erroneous EITC claims.

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- 36 IRC § 32(c)(3) defines “qualifying child” for the EITC by referring to the definition of “qualifying child” in IRC § 152(c), which defines it for the purpose of claiming a child as a dependent, except that the requirement that the child must provide no more than one-half of his/her own support for the calendar year in which the taxable year of the taxpayer begins is not applicable, and the special rules for divorced parents under IRC § 152(e) do not apply. IRC § 32(c)(3)(C) further requires the qualifying child for the EITC to have his or her principal place of abode in the United States and IRC § 32(m) requires the child to have a Social Security number. Thus, children who are qualifying children under IRC § 32 for the purpose of the EITC can also be claimed as dependents under IRC § 152 for the purpose of Head of Household filing status so long as they also meet the support test under IRC § 152(c)(1)(D) and the rules regarding divorced parents under IRC § 152(e).
- 37 However, if the child did not meet the other requirements to be considered a qualifying child and the taxpayer were to claim an exemption for the child as a qualifying relative, the taxpayer would need to have provided over one-half of the child’s support for the calendar year in which the taxable year began. See IRC § 152(d)(1)(C). Also, if the taxpayer was married during the year and lived apart from his or her spouse, in order to claim head of household filing status he or she must meet the requirements under IRC § 7703(b). This section requires the taxpayer to: file a separate return; maintain as his or her home a household which constitutes for more than one-half of the taxable year the principal place of abode of the child who can be claimed as a dependent; and furnish over one-half of the cost of maintaining such household during the taxable year. In addition, under IRC § 7703(b), the taxpayer’s spouse cannot be a member of the household during the last six months of the taxable year.
- 38 This letter only stated: “We disallowed [name redacted] because you did not verify she was related and lived with you more than 6 months. The school records only verified an approximate 3 months.”
- 39 The improper payment rate for FY 2012 attributable to EITC is 22.8 percent (or \$12.6 billion). Fiscal Year 2013 Agency Financial Report – Department of the Treasury 210 (Dec. 13, 2013). The \$12.6 billion amount is the midpoint between Treasury’s lower and upper estimate. This is based on estimates of dollars ultimately incorrectly issued (taxpayer overclaims are net of amounts the IRS prevents or recovers). IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 6 (Feb. 12, 2014) (unpublished).

TAS pulled a sample of 100 Letters 105C (Statutory Notice of Claim Disallowance) and determined that 92 of them did not provide adequate explanations that would satisfy the purpose of Section 3505. Specifically, 30 letters included language that was not clear and written in plain language, 58 did not sufficiently explain the specific reasons for the disallowance, and 65 did not provide the taxpayer with the information needed to respond to the IRS.

Letters denying the EITC due to problems with wages reported on Form W-2, which made up about half of the 100 105C letters in our sample,⁴⁰ stated exactly *why* the refund was disallowed, but were not specific enough for the taxpayer to know *what* was incorrect. These notices stated “We have information that the Form(s) W-2, Wage and Tax Statement, attached to your return for the tax period shown above misrepresented your correct income and/or federal tax withheld and have been removed. The following credit(s) have been eliminated based on the removal of the wages (earned income): The Earned Income Tax Credit.” Missing from these letters was key information such as which Form W-2 was incorrect (an issue for taxpayers with multiple employers), whether it was the wages or withholding that was incorrect, and why the IRS determined these numbers were not correct. A taxpayer would not know how to respond or what steps to take without calling the IRS to find out which numbers were wrong.⁴¹ The failure to provide specific reasons causes more work for not only the taxpayer, but also the IRS.

The second most common type of notice from our sample of 100 105C letters, those that denied the claim due to the expiration of the refund statute of limitations,⁴² also did not provide enough information. Only two of the 31 notices in this group included helpful information such as the following: “The postmark date on your tax return’s envelope is May 23, 2014. The expiration date for filing a claim for tax year 2008 was Apr. 15, 2012. We couldn’t allow your claim because it was not postmarked on or before the deadline.” The

other 29 notices included a date of the claim at the top of the letter and a complicated description of the refund statute rules, but never said in plain language exactly what day the claim was due and what day the IRS deemed the return to be filed. Without this information, a taxpayer whose return had been filed on time may not know he or she can challenge the disallowance. In fact, in certain instances, the IRS incorrectly calculates the date the claim is received. TAS pulled a sample of 50 of its cases from fiscal year 2014 where the primary or secondary issue was the refund statute expiration date. In over half of these cases, the taxpayer was entitled to a refund, but a manual review was required to verify the IRS received date. In these instances, the IRS’s failure to provide an explanation impairs the taxpayer’s *right to challenge the IRS and be heard*.

Statutory Innocent Spouse Letters Provide Good Examples of Explanations.

The two final determination letters issued by the Innocent Spouse unit to deny a claim for refund are Letter 5087C, *Requesting Spouse Final Determination Letter on Partially Allowed Innocent Spouse Claims*, and Letter 5088C, *Requesting Spouse Final Determination Letter on Disallowed Innocent Spouse Claims*.⁴³

40 Forty-seven out of the 100 105C letters disallowed an EITC refund because income on Form W-2 appears to have been misreported.

41 Calling the IRS to find the reason may be problematic. For the first four months of FY 2014, the level of service on the phones was 62.5 percent, meaning over a third of calls to the IRS were not answered. See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 157.

42 These notices made up 31 of the sample of 100 105C letters. IRC § 6511(a) provides the general statute of limitations on filing a refund claim—the later of three years from the date the return was filed, or two years from the date the tax was paid.

43 The Innocent Spouse unit also uses preliminary determination letters. We did not analyze these letters because, in some cases, the determination may change after the preliminary letter if the taxpayer submits additional documentation.

These letters provide excellent examples of thorough explanations for disallowing a taxpayer's claim for refund and should serve as a model for other IRS letters.⁴⁴

Letter 5087C states, "We reviewed your claim stating the joint return for tax year(s) [blank] is/are invalid. It appears you intended to file a joint return. We determined it is valid for the reason(s) listed below."⁴⁵ While many IRS letters would stop here, at the general explanation of what disqualifies a person for innocent spouse relief, this letter goes on to give a specific reason why the joint return was valid. For example, the letter might state the taxpayer signed the refund check or had a history of filing joint returns. This letter includes detailed paragraphs about how to file a petition in the Tax Court to challenge the determination, including the address to send the petition and the Tax Court's website. A taxpayer who receives this letter is empowered with the information needed to understand why he or she is not receiving a refund and what to do if he or she does not agree.

Analysis of Non-statutory Notices of Disallowances

Use of Letter 569 (SC) with the Request to Waive the Statutory Notice of Claim Disallowance Infringes Taxpayer Rights and Does Not Provide All Taxpayers with a Sufficient Explanation for the Disallowance.

The Examination function uses Letter 569 (SC), a non-statutory notice of claim disallowance, to initially notify the taxpayer of the partial or full disallowance of a claim for refund.⁴⁶ Exam sends this letter with a form asking the taxpayer to waive the right to a statutory notice of claim disallowance.⁴⁷ If the taxpayer agrees, then this may be the only refund disallowance notice he or she will receive, unless the taxpayer receives the combination statutory notice of deficiency and notice of claim disallowance on a single letter ("combination letter"), a letter that easily gives rise to confusion.⁴⁸ If the taxpayer does not agree, the taxpayer will receive a statutory notice of claim disallowance in the form of Letter 105C or Letter 106C.⁴⁹

Allowing the taxpayer to waive the right to receive the statutory notice of claim disallowance can save the IRS resources by not requiring an additional notice be sent by certified or registered mail. However, the current use of Letter 569 (SC) to request the waiver infringes upon a taxpayer's *right to be informed* and *right to appeal an IRS decision in an independent forum*. The letter does not explain the significance of waiving the statutory notice, nor does it even imply the taxpayer has a choice if he or she agrees with the adjustment. The letter states, "If you agree with our findings, please sign, date, and return: [check box] Form 2297, Waiver of Statutory Notification of Claim Disallowance."⁵⁰ Letter 569 (SC) does not explain that the taxpayer can choose not to sign this form and receive the statutory notice. Nor does it explain that the two-year period to file suit in a United States District Court or the Court of Federal Claims

44 Not all Innocent Spouse determination letters are refund disallowance letters because in some cases, the taxpayer or taxpayers may not have paid the tax before submitting the request for innocent spouse relief and thus are not claiming a refund.

45 As the basis for a request for innocent spouse relief, a taxpayer may argue that the joint return is not valid and therefore the taxpayer should not be held jointly or severally liable for the liability.

46 See IRM 4.19.16.1.4.1, *Claims Contact Procedures* (Nov. 4, 2011).

47 See Form 2297, *Waiver of Statutory Notice of Claim Disallowance* (Mar. 1982).

48 See, e.g., *McCormack v. Commissioner*, No. 1773-13 (T.C. Oct. 24, 2014) (order discharging the prior order to show cause as to why the case should not be dismissed for lack of jurisdiction) (professing that the notice of deficiency stating that it was a disallowance of refund "puzzled the Court because it had never before seen such a notice, and thinking this might not be a deficiency case at all it issued an order to the parties to show cause why the case shouldn't be dismissed for lack of jurisdiction.").

49 IRM 4.19.16.1.4.2, *Claims Contact Responses* (Nov. 4, 2011). Letters 105C and 106C are used by all functions (except TAS, which has no authority to disallow a claim for credit or refund) to notify a taxpayer that his or her claim is fully or partially disallowed.

50 Letter 569 (SC) (Aug. 2009).

otherwise would not begin until the IRS sends the taxpayer the statutory notice. While Form 2297 itself states, “I understand that the filing of this waiver is irrevocable and it will begin the 2-year period for filing suit for refund of the claims disallowed as if the notice of disallowance had been sent by certified or registered mail,” it does not identify the court where the taxpayer may file suit. It also fails to explain that this is the taxpayer’s *only* opportunity to challenge the disallowance in court.

One notice states, “We are unable to process your claim for the tax period(s) shown above because your supporting information was not complete. If you have more information you did not send with this claim, you may file another claim and attach your information.” This clearly does not provide specific reasons for the claim disallowance or explain what supporting information was incomplete or lacking, nor does it tell the taxpayer how to fix the issue or respond.

Of 7,962 taxpayers who received Letter 569 during fiscal year (FY) 2014, only a little over half (4,294) subsequently received Letter 105C or 106C.⁵¹ Although some of these taxpayers who did not receive Letter 105C or 106C may have eventually had their claims allowed or received a lesser used statutory notice of claim disallowance, this figure suggests a large number of taxpayers may have had to rely only on Letter 569 or to explain the disallowance.⁵²

Letter 569 (SC) does not provide an explanation of the refund disallowance on the actual letter, and instead refers the taxpayer to the attached Form 886-A, *Explanation of Items*. Forms 886-A vary greatly in terms of their explanations. Some provide thorough explanations with sufficient details for the taxpayer to know exactly what was disallowed, what documentation would have been required to prove the item claimed, and why the taxpayer’s documentation fell short. However, TAS pulled a sample of ten Forms 886-A and found two included completely unacceptable explanations for the refund disallowance such as “Since you did not establish that you are entitled to the exemption(s), it/they is/are being disallowed.” The IRS could disallow the exemptions for numerous reasons, such as the person claimed did not bear the correct relationship to the taxpayer or the person claimed had income that was too high.⁵³ Without providing the specific reasons for the disallowance, Form 886-A attached to Letter 569 (SC) does not comply with Section 3505 of RRA 98.

Some Letters Used by Appeals Do Not Contain Explanations of Why the Claim Was Disallowed.

The Office of Appeals uses two sets of letters to disallow refunds, depending on whether the taxpayer has already received a statutory notice of claim disallowance or waived his or her right to receive one. When the taxpayer has previously received a statutory notice of claim disallowance or waived the right to one, Appeals uses Letters 2681 and 2683—neither of which explains the disallowance.

Letter 2681 states: “Based on the information submitted, there is no basis to allow any part of your claim.” Although one could argue that this letter does not need to include the reason for the disallowance

51 IRS Compliance Data Warehouse (data retrieved Nov. 10, 2014). Of the 46 percent who did not subsequently receive Letter 105C or 106C, it is unknown how many waived their right to receive the statutory notice of claim disallowance, how many received a combination letter or other statutory notice of claim disallowance, or how many had claims which were allowed before the Letter 105C or 106C could be issued.

52 Although 7,962 different taxpayers received Letter 569 during FY 2014, as indicated in the preceding table, 8,197 Letters 569 were actually issued as some taxpayers receive more than one letter.

53 See IRC §§ 151 and 152 for the specific requirements for claiming personal exemptions and who may be claimed as a dependent.

because the taxpayer has already received a notice from Examination,⁵⁴ Appeals may have based the disallowance on different reasons than Examination. Appeals may have looked at other factors such as case law, credibility of witnesses, and hazards of litigation. The *right to be informed* and the *right to challenge the IRS's position and be heard* mean the taxpayer needs to know why the IRS took the action it did; otherwise, the IRS action could be arbitrary and capricious. Moreover, taxpayers have the *right to appeal an IRS decision in an independent forum*. If a taxpayer receives no explanation as to why that independent forum (the IRS Office of Appeals) made a decision, the taxpayer will have no faith that he or she received “a fair and impartial administrative appeal.”⁵⁵

Letter 2683, used for a partial disallowance, states:

Based on the information you submitted, I am pleased to tell you that we are allowing [blank] of your claim. However, the rest of the claim is not allowed. After your claim has been processed, the [blank] will send you a notice explaining any changes that we have made to your tax account.

Although Section 3505 of RRA 98 does not require the IRS to provide an explanation on every notice, it is appropriate for the IRS to provide the explanation at the time when a determination is made to disallow or partially disallow a refund, even if the determination is sustaining a prior determination. The taxpayer needs to be able to respond to *this* notice, which means it should explain why the refund was not allowed.

No Consideration Letters

Many “No Consideration” Letters Lack Explanations, Except for Those Related to Innocent Spouse Claims.

In addition to the letters that formally notify the taxpayer that it disallowed his or her claim for refund, the IRS uses letters that notify the taxpayer that it cannot even consider the claim. These “No Consideration” letters do not specifically state a refund is being disallowed, but say something like “We are unable to process your claim,”⁵⁶ or “You didn’t meet the basic eligibility requirements because ...”⁵⁷

Although these letters do not state that the refund is disallowed and do not start the running of the statute of limitations to file suit, the refund is effectively disallowed unless the taxpayer provides additional documentation or submits a new claim. A paragraph on Letter 916C states, “We are unable to process your claim for the tax period(s) shown above because your supporting information was not complete. If you have more information you did not send with this claim, you may file another claim and attach your information.” This clearly does not provide specific reasons for the claim disallowance or explain what supporting information was incomplete or lacking, nor does it tell the taxpayer how to fix the issue or respond.

54 In its response to TAS’s information request, the Office of Appeals stated “Letters 2681 and 2683 are issued by Appeals after the IRS issued the statutory notice of claim disallowance letter, so the requirements of IRC 6402(l) do not apply to these two letters.” IRS Response to TAS Information Request (Oct. 10, 2014).

55 See IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014) (“Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals’ decision. Taxpayers generally have the right to take their cases to court.”).

56 Letter 916C, *Claim Incomplete for Processing; No Consideration* (Mar. 2014).

57 Letter 3657C, *No Consideration Innocent Spouse Claim* (Dec. 2012).

Conversely, Letter 3657C, the “No Consideration” letter for innocent spouse claims, includes helpful explanations. For example, for a taxpayer who submitted an innocent spouse claim⁵⁸ when he or she should have submitted an injured spouse claim,⁵⁹ the letter states:

Our records show you may qualify for injured spouse relief instead of innocent spouse relief. When a joint return is filed and the refund is used to pay one spouse’s past-due child support, spousal support (or other federal non-tax debt), student loans, federal or state taxes, the other spouse may be considered an injured spouse.

The letter goes on to explain how to file a claim for Injured Spouse relief, including the name of the form, and a phone number to use if the taxpayer has any questions. This letter not only explains why the Innocent Spouse claim is disallowed, but gives the taxpayer the information to respond. It is unclear why the IRS cannot use the Innocent Spouse letters as a model for providing clear, specific, and complete explanations to taxpayers.

CONCLUSION

RRA 98 requires IRS notices to go beyond just stating that a refund is disallowed. Notices must provide the taxpayer with specific reasons for the disallowance and give the taxpayer the information he or she needs to respond. Many of the notices the IRS uses are deficient in both regards. These notices violate a taxpayer’s *right to be informed* because the taxpayer cannot find out why a claim is denied. These notices also violate a taxpayer’s *right to challenge the IRS’s position and be heard* because the taxpayer needs certain information to challenge the IRS—specifically what on the return or claim was disallowed and what documents the taxpayer can submit to challenge the disallowance or cure the claim. Finally, some of the notices impair a taxpayer’s *right to appeal an IRS decision in an independent forum* by soliciting a waiver of the statutory notice of claim disallowance without explaining where to file suit or the consequences for failing to timely file suit. For these reasons, the IRS must follow the directive of Congress and revise its refund disallowance letters as well as the process for generating them.

58 See Form 8857, *Request for Innocent Spouse Relief*.

59 See Form 8379, *Injured Spouse Allocation*. Form 8379 is filed by one spouse (the injured spouse) on a jointly filed tax return when the joint overpayment was (or is expected to be) applied (offset) to a past-due obligation of the other spouse. By filing Form 8379, the injured spouse may be able to get back his or her share of the joint refund.

RECOMMENDATIONS

To honor a taxpayer's right to receive an explanation for the disallowance of a refund claim, the National Taxpayer Advocate recommends that the IRS:

1. Issue a stand-alone statutory notice of claim disallowance in all cases where the taxpayer does not waive the right to receive one.
2. Maintain copies of all refund disallowance notices on an electronic database that employees can easily access when working inquiries related to the letters.
3. Revise Letter 569 (SC) to clearly explain a taxpayer's right to challenge the claim disallowance in court and the consequences of waiving the right to receive the statutory notice of claim disallowance.
4. Revise Form 2297 to include further information about the taxpayer's right to appeal, including the court where the taxpayer may file suit, and a statement that this is the taxpayer's only opportunity to challenge the disallowance in court.
5. Require all letters or notices stating that a claim for refund is being partially or fully disallowed, regardless of whether they start the running of the statute of limitations on filing suit, to explain the specific reasons for the disallowance. This explanation can be included on an attachment, such as Form 886-A attached to Letter 569 (SC).
6. Provide training to all employees who create notices of claim disallowance and "No Consideration" letters to reinforce the requirement to provide an explanation of the specific reasons for the disallowance, with detailed guidance on explaining the most common reasons for disallowance, such as the expiration of the refund statute.
7. Require all notices of claim disallowance and "No Consideration" letters to include the amount of the claim.
8. Require all notices of claim disallowance where the reason for disallowance is the expiration of the refund statute of limitations to include the date the return was deemed filed, how the IRS calculated that date, and the date the claim was due.
9. Require "No Consideration" letters to include an explanation of the specific reason for the disallowance, and if supporting documentation was not accepted, an explanation of why and what the taxpayer can do to cure the claim.
10. For notices of disallowance where the taxpayer can challenge the refund disallowance in court, provide details similar to those in Letter 5087C, including where to find more information about filing refund suits.