

NATIONAL TAXPAYER ADVOCATE

# ANNUAL REPORT TO CONGRESS

Volume 1

2014



*This report is dedicated*

*to*

*The Honorable Dave Camp,*

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*Upon his retirement from Congress,*

*In recognition of*

*And appreciation for*

*His tireless work*

*To advance the cause*

*of*

*Comprehensive tax reform.*



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## PREFACE: Introductory Remarks by the National Taxpayer Advocate

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### HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate's 2014 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

In this year's report, I attempt to make the case for four major points:

- First, the budget environment of the last five years has brought about a devastating erosion of taxpayer service, harming taxpayers individually and collectively;
- Second, the lack of effective administrative and congressional oversight, in conjunction with the failure to pass Taxpayer Rights legislation, has eroded taxpayer protections enacted 16 or more years ago;
- Third, the combined effect of these trends is reshaping U.S. tax administration in ways that are not positive for future tax compliance or for public trust in the fairness of the tax system; and
- Fourth, this downward slide can be addressed if Congress makes an investment in the IRS and holds it accountable for how it applies that investment.

Moreover, I believe we need fundamental tax reform, sooner rather than later, so the entire system does not implode.<sup>1</sup> Although this year's report does not focus on tax reform, I have recommended tax reform in my reports and congressional testimony for many years.<sup>2</sup>

### **The devastating erosion of taxpayer service harms taxpayers individually and collectively.**

As the nation's advocate for taxpayers, I feel compelled to speak up about the degradation of service provided by the IRS in all aspects of its work, primarily in its pre-filing and filing activities but also in its

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1 For a discussion of the role the IRS could play in addressing the complexity of the tax code, see *Most Serious Problems: COMPLEXITY: The IRS Does Not Report on Tax Complexity as Required by Law; and COMPLEXITY: The IRS Has No Process to Ensure Front-Line Technical Experts Discuss Legislation with the Tax Writing Committees, as Requested by Congress, infra*.

2 See National Taxpayer Advocate 2012 Annual Report to Congress 3-23 (Most Serious Problem: *The Complexity of the Tax Code*); Testimony of Nina E. Olson, National Taxpayer Advocate, at *Hearing on Fundamental Tax Reform Before H. Comm. On Ways and Means*, 112th Cong. (2011), at <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=219701>; National Taxpayer Advocate 2010 Annual Report to Congress 3-14 (Most Serious Problem: *The Time for Tax Reform Is Now*); National Taxpayer Advocate 2010 Annual Report to Congress 365-72 (Legislative Recommendation: *Enact Tax Reform Now*); National Taxpayer Advocate 2005 Annual Report to Congress 375-80 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*); Presentation of Nina E. Olson, National Taxpayer Advocate, at Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) at <http://www.taxreformpanel.gov/meetings/meeting-03032005.shtml>. Over the past decade, the National Taxpayer Advocate's annual reports have contained dozens of additional proposals to simplify particular sections or areas of the tax code.

enforcement activities. We outline this sad state of affairs in the first five Most Serious Problems discussed herein, which cover in detail the crisis in taxpayer service and its effects on taxpayers of all ilk.<sup>3</sup>

As we note in Most Serious Problem #1, *TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, the IRS's inflation-adjusted budget has declined by about 17 percent between Fiscal Years (FYs) 2010 and 2015. Yet during this period, the number of taxpayers (individual and business) has increased significantly, along with the scope and complexity of the tax system and the duties assigned to the IRS. The sheer size of the IRS's annual workload can be demonstrated by just a few statistics for FY 2014:

- Nearly 160 million individual and business returns filed;<sup>4</sup>
- More than 100 million phone calls received;<sup>5</sup>
- Nearly 10 million pieces of correspondence received about taxpayer account issues;<sup>6</sup> and
- More than 5 million taxpayer visits to IRS walk-in sites.<sup>7</sup>

Similarly, the decay in taxpayer service can also be summed up by a few FY 2014 statistics:

- 35.6 percent of phone calls went unanswered by customer service representatives;
- 50 percent of pieces of correspondence were not handled timely;
- Virtually zero tax returns were prepared by IRS walk-in sites;
- Only about 6 percent of the outreach and education budget of the Wage and Investment Division, which is responsible for helping approximately 126 million individuals understand and comply with their tax obligations, is devoted to activities that involve face-to-face contact with taxpayers. Thus, localized outreach and education have nearly disappeared.
- In 13 states, no outreach and education employees were focused on the 65 million small business and self-employed taxpayers served by the Small Business/Self-Employed Division.<sup>8</sup>

When the IRS does not answer the calls its taxpayers are making to it, and when it does not timely read and respond to the letters its taxpayers are sending it, the tax system goes into a downward spiral. Taxpayers do not get answers to their questions, so they must either pay for advice they would otherwise obtain for free, or they proceed without any advice at all, leading to future compliance problems (and

3 The first five most serious problems are: *TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*; *TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions*; *IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*; *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*; and *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*.

4 IRS Publication 6292, Fiscal Year Return Projections for the United States 2014-2021, at 4 (Fall 2014).

5 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of FY 2014).

6 IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2014).

7 IRS Wage & Investment Division, *Business Performance Review 7* (4th Quarter – FY 2014, Nov. 6, 2014).

8 IRS, Individual Returns Transaction File, IRS Compliance Data Warehouse (TY 2013 returns filed through Oct. 2014); IRS HRRC, Report of SBSE Job Series 0526, Stakeholder Liaison Field Employees as of November 1, 2014 (Nov. 19, 2014) (13 states include Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, Wyoming); National Taxpayer Advocate 2012 Annual Report to Congress 319 (Most Serious Problem: *The IRS is Substantially Reducing Both the Amount and Scope of Its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of Its Remaining Outreach Activities, Thereby Risking Increased Noncompliance*).

more burden for the taxpayer and more work for the IRS). Taxpayers are unable to provide the IRS with information that would resolve a problem with a return or an audit issue. And taxpayers are unable to talk with an IRS employee about how they can pay their past tax debts using collection alternatives available under the tax laws.

Most people understand that the Taxpayer Services budget category includes the IRS phone system and the correspondence system. But few people understand that what is covered by IRS phone and paper activity touches just about every taxpayer in some aspect of his, her, or its interaction with the tax system. To wit:

- Taxpayer Services annually involves the acceptance and processing of all returns for individuals, businesses (including payroll tax), and information reporting (including W-2s, 1099s, and new forms required under the Affordable Care Act).
- Taxpayer Services includes issuing refunds, depositing tax payments and other remittances, resolving errors or issues identified in the processing of returns, including refund fraud and identity theft, and processing amended returns.
- Taxpayer Services includes handling taxpayer calls and processing taxpayer responses to IRS notices about math error adjustments, penalty abatements, automated substitutes for returns, and automated underreporter adjustments, as well as statutory notices of deficiency.
- Taxpayer Services includes answering phone calls from taxpayers requesting installment agreements and other payment arrangements, including those seeking currently not collectible (CNC) status because of economic hardship.

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**For every phone call or piece of correspondence that goes unanswered, there is a great likelihood problems will arise that will require more IRS resources and impose more burden on taxpayers to later resolve. The correspondence inventory backlogs will spill over into the next filing season, further reducing the IRS's ability to deliver a satisfactory filing season in years to come.**

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For FY 2015, the IRS originally projected it would achieve a 54 percent level of service (LOS) on the phones, meaning that almost half of the taxpayers wanting to speak with a live assistior would not get through.<sup>9</sup> It also projected that about half its correspondence would be over-aged (meaning that, on average, about half of the correspondence would not be processed within 45 days of receipt). However, with the receipt of the final FY 2015 appropriation, the state of affairs for taxpayers is much worse.

Specifically, the IRS projects that, depending on when the IRS releases its seasonal workers, the level of service on the phones could be as low as 43 percent (on average, which means that on any given day the LOS could be truly abysmal) and it may be unable to handle up to 1.9 million fewer pieces of correspondence as compared with FY 2014.<sup>10</sup> Thus, potentially millions of taxpayers will not be able to reach the IRS when they need to, and their written communications will go unanswered or unaddressed. Taxpayers will not get their math error notices corrected or penalties abated, leading to incorrect assessments and expensive downstream dispute resolution activities, including audit reconsideration, appeals, and litigation. Taxpayers will be unable to talk with IRS employees about making payment arrangements, resulting in automated and unnecessary liens and levies and leading to expensive downstream activities like levy releases and lien releases and withdrawals. For every phone call or piece of correspondence that goes unanswered, there

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9 Wage & Investment Business Performance Review Fourth Quarter (Nov. 6,), 2014) at 4.

10 IRS Senior Executive Team discussion (Dec. 23, 2014) (information on file with the National Taxpayer Advocate).

is a great likelihood problems will arise that will require more IRS resources and impose more burden on taxpayers to later resolve. The correspondence inventory backlogs will spill over into the next filing season, further reducing the IRS's ability to deliver a satisfactory filing season in years to come.

Why would anyone want to go this route? The answer, I think, is that no one really wants to go this way, but everyone is in collective denial about what inadequate funding for the IRS means to taxpayers.

This denial must stop. We have to face up to the fact that we have an incredibly complex tax system that, by virtue of its complexity, creates burden, confusion, and unfairness. It is a challenge for any tax agency to properly administer a system such as the one we have. But it is *impossible* for an underfunded tax agency to do so. The victims of this underfunding are not the IRS and its employees—the victims are U.S. taxpayers.

### **Congress must act to ensure existing taxpayer rights protections are properly implemented and new protections are put in place.**

On June 10, 2014, the IRS formally adopted the Taxpayer Bill of Rights (TBOR) that I have long recommended and advocated for.<sup>11</sup> I have followed the TBOR as the North Star for this Report. In the Report's major sections—the Most Serious Problems Encountered by Taxpayers, Legislative Recommendations, and Most Litigated Issues—in almost every case, we have linked each of the issues discussed to one or more of the foundational rights taxpayers have under our TBOR. We do so in order to demonstrate that the TBOR can and should guide our every action in tax administration.

Between 1988 and 1998, Congress passed three landmark pieces of legislation establishing taxpayer rights protections and providing remedies for violations of those protections.<sup>12</sup> As we identify in *each* of the 23 Most Serious Problems of taxpayers discussed in this report, these protections have not been implemented as envisioned. There are many reasons for the IRS's failure to adequately implement the provisions. In some cases, legal interpretation has diluted the original legislative goal.<sup>13</sup> In other instances, the tax system itself has changed so much that provisions enacted nearly three decades ago no longer fit today's administrative processes.<sup>14</sup> Sometimes, implementation has been delayed or cannot be achieved because of the design of the IRS's existing technology systems.<sup>15</sup> In all instances, we make recommendations for how the IRS can improve its administration of these provisions so they provide substantive protection to U.S. taxpayers.

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11 Internal Revenue Service, News Release IR-2014-72, *IRS Adopts "Taxpayer Bill of Rights;" 10 Provisions to be Highlighted on IRS.gov, in Publication 1* (June 10, 2014), at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;10-Provisions-to-be-Highlighted-on-IRSGov,-in-Publication-1>.

12 See Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the "Omnibus Taxpayer Bill of Rights," also known as TBOR 1); Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998) (Title III is known as "Taxpayer Bill of Rights 3" or TBOR 3).

13 See, e.g., the following most serious problems discussed *infra*: AUDIT NOTICES: The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability; CORRESPONDENCE EXAMINATION: The IRS has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers; STATUTORY NOTICES OF DEFICIENCY: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notices; and MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98.

14 See, e.g., Most Serious Problem: ACCESS TO THE IRS: Taxpayers are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues, *infra*.

15 See, e.g., 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, *infra*.

**The erosion of taxpayer trust is an even more serious matter than the erosion of taxpayer service, because with the provision of adequate funding, declines in taxpayer service can be reversed. Not so with declines in trust—once lost, trust takes a very long time to be regained. For a taxpayer whose trust has been shaken, each IRS failure to meet basic expectations (e.g., answer the phone ...) confirms the belief that the IRS is not to be trusted.**

But the work toward creating a vital system of taxpayer rights with enforceable remedies for violations of those rights is not yet done. Over the last year, my office has identified areas where taxpayer rights protections are weak or nonexistent under current law, and other areas where the IRS has resisted Congress's direction in past legislation.

Thus, my number one Legislative Recommendation is that Congress enact landmark taxpayer rights legislation this year, which would include codification of the Taxpayer Bill of Rights and adoption of the taxpayer rights legislative recommendations my office and others have made since 1998. For everyone's convenience, we summarize those legislative proposals, aligned with the rights they protect.<sup>16</sup>

Passage of a taxpayer rights bill will accomplish several things that are desperately needed in today's environment. First, it will create a vehicle for a meaningful discussion about taxpayer rights, the role they play in promoting voluntary compliance, and what mechanisms exist to instill the protection of taxpayer rights into every nook and cranny of tax administration. Second, by codification of the TBOR and enforceable remedies for violations of rights enunciated in the TBOR, the United States will become the model for the world in the protection of taxpayer rights. Third, and most importantly, this combination of rights and remedies will begin to restore the U.S. taxpayers' trust in the tax system.

#### **The emerging shape of U.S. tax administration is not encouraging for future tax compliance or taxpayers' trust in the fairness of tax administration.**

For the last five years or so, the Office of the Taxpayer Advocate has undertaken some of the most important studies conducted to date about the factors influencing taxpayers' compliance behavior.<sup>17</sup> In a study of sole proprietors, who IRS research data show are responsible for the largest portion of the tax gap, we found that trust in the government, in the IRS, and in the fairness of the tax system is the greatest corollary to tax compliance behavior. Specifically, the factors that appear to have the greatest influence on whether a taxpayer is compliant or noncompliant are the norms of the taxpayer's community and the provision of taxpayer service.

As noted above, the IRS is not providing adequate taxpayer service these days. Per our studies, this does not bode well for the future compliance behavior of taxpayers. But the erosion of taxpayer trust is an even more serious matter than the erosion of taxpayer service, because with the provision of adequate funding, declines in taxpayer service can be reversed. Not so with declines in trust. Once lost, trust takes a very long time to be regained. For a taxpayer whose trust has been shaken, each IRS failure to meet basic expectations (e.g., answer the phone, listen carefully, consider the specific facts and circumstances, provide alternatives, take the extra step to help) confirms the belief that the IRS is not to be trusted.

16 See Legislative Recommendation: *TAXPAYER RIGHTS: Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections, infra*.

17 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 60-61 (*Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*). See also National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-50 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

The IRS will never be a beloved federal agency, because it is the face of the government's power to tax and collect. But it should be a *respected* agency. When there are accusations of bias or heavy-handed actions by the tax agency, these reinforce the already deep concerns the U.S. taxpayer bears toward taxes, such concerns going back to the nation's founding. But casting the entire agency and all its employees as an out-of-control agency in response to the actions of a few, no matter how deplorable those actions may be, is harmful to taxpayers and to tax compliance.<sup>18</sup> We need to recognize that the IRS and its employees play a vital role in the economic welfare of this country. And we need to find a way to support the agency even as we hold it accountable for what is often a thankless task.

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**Congress must simultaneously make an investment in the IRS and hold it accountable for how it applies that investment.**

I have spent my entire professional life protecting the rights of taxpayers, individually and collectively, and advocating for systemic changes in the tax system. I firmly believe that the best way to improve the IRS is to have active, consistent oversight of and support for the agency by both the Administration and Congress.

On the Administration's part, this means (1) proposing budgets that recognize and fund the important role taxpayer service plays in promoting voluntary compliance; (2) establishing administrative remedies to protect taxpayer rights; (3) establishing performance measures that promote taxpayer rights; and (4) holding IRS officials accountable for violations of taxpayer rights. In order to measure the IRS's performance in fulfilling the promise of the Taxpayer Bill of Rights, we present, as an appendix to this Preface, an assessment of taxpayer rights performance measures that lists specific data under each of the ten rights. In future reports, we will develop this assessment and fill in any data gaps.

As discussed earlier, Congress can both support the IRS and hold it accountable by funding the IRS adequately to conduct the task of administering the complex system Congress has enacted. It can, and should, enact taxpayer rights legislation, including TBOR codification. But on an ongoing basis, Congress should exercise its oversight authority by holding regular hearings on IRS activity—not just on the issue *du jour* but on all the routine work the IRS does. Focusing on current tax administration challenges, these hearings could address the following questions:

- With respect to taxpayer service, what data did the IRS rely on to decide to limit the scope of tax-law questions on the phones or in person, or eliminate tax return preparation in the Taxpayer Assistance Centers?<sup>19</sup>

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<sup>18</sup> In this Report, I make substantive legislative proposals to address one source of taxpayers' distrust of the IRS, e.g., its handling of political campaign activities by IRC § 501(c)(4) social welfare organizations. See Legislative Recommendation: Section 501(c)(4) Political Campaign Activity: Enact an Optional "Safe Harbor" Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity, and Legislative Recommendation: EO Judicial and Administrative Review: Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status, *infra*.

<sup>19</sup> See Most Serious Problem: TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions, *infra*.

- Is the IRS effectively utilizing its existing resources to collect past-due tax liabilities, or does it, as I believe, need to completely revise its approach to collection?<sup>20</sup>
- Does the IRS's approach to penalty administration promote voluntary compliance, or is it confirming taxpayers' belief that the system is stacked against them and thus increasing noncompliant behavior?<sup>21</sup>
- Do IRS employees have the appropriate education and skills to deal with such diverse populations as those subject to the offshore account reporting regimes and those eligible for the Earned Income Tax Credit (EITC)?<sup>22</sup>
- Is the future vision of the IRS going to leave low income taxpayers—who constitute over 40 percent of the U.S. population—behind, as the IRS moves away from person-to-person communication and toward online information?<sup>23</sup>
- What is the impact on taxpayer attitudes and voluntary compliance if the only time a taxpayer has direct contact with an IRS employee is when that employee is taking an enforcement action (*i.e.*, conducting an audit or imposing a penalty, lien, or levy)?<sup>24</sup>

These are profound issues for the future of our tax system, which annually touches more people in the U.S. than any other federal government agency. Bipartisan, dispassionate congressional hearings on these issues, with testimony not just from IRS personnel, GAO, and TIGTA, but also from academics and other experts, tax professional groups, and low income taxpayer clinics, would help create a framework for what the IRS needs and how it should operate in order to gain the trust of U.S. taxpayers in the twenty-first century. Along the way, taxpayers can begin to be educated about the daily work of the IRS and the reasons for its actions.

- 20 See Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure, infra*, and Most Serious Problem: *COLLECTION DUE PROCESS: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections, infra*.
- 21 See Most Serious Problem: *PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others, infra*; Most Serious Problem: *OFFSHORE VOLUNTARY DISCLOSURE (OVD): The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights, infra*; *FOREIGN ACCOUNT REPORTING: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure, infra*; and Legislative Recommendation: *ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit "Reasonable Cause" Relief, infra*.
- 22 See Most Serious Problem: *Workload Selection: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy, infra*.
- 23 See U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, Age and Sex of All People, Family Members and Unrelated Individuals Iterated by Income-to-Poverty Ratio and Race, Below 250% of Poverty, (2013 and 2007 poverty data, available at <http://www.census.gov/hhes/www/poverty/data/incpovhlth/2013/index.html>). From tax year 2013 returns and based on the HHS 2013 poverty levels, the percent of taxpayers at or below 250 percent of poverty level is about 45 percent. Individual Returns Transaction File on IRS Compliance Data Warehouse. IRC § 7526 adopts 250 percent of federal poverty guidelines published by the Department of Health and Human Services as the general income eligibility level for Low Income Taxpayer Clinic assistance. Other IRS programs, including waivers of user fees for Offers in Compromise and exclusion from the Federal Payment Levy Program, adopt this definition. See Most Serious Problem: *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design of the Grant Structure is Not Adequately Based on Specific Needs of Served Taxpayer Populations, infra*; Legislative Recommendation: *RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery, infra*; and Volume Two Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics, infra*.
- 24 See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance, infra*; Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State, infra*; and Volume 2 Research Study: *Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Results, infra*.

Finally, Congress must do its part to ensure that taxpayers have the *right to a fair and just tax system* by enacting fundamental tax reform—a reform that brings sanity and clarity for all taxpayers. That would be good for our country, for our taxpayers, and for the IRS.

The increasing workload the IRS faces, the erosion of public trust occasioned by the IRS's highly publicized use of terms like “tea party” in screening organizations applying for tax-exempt status and related management issues, and the sharp reduction in funding have created a “perfect storm” of trouble for effective tax administration. Taxpayers who need help are not getting it, and tax compliance is likely to suffer over the longer term if these problems are not quickly and decisively addressed.

Now more than ever, Congressional involvement is needed to repair the damage and place tax administration on a better path forward. In the short term, I urge Congress to take the following steps:

- Enact a true Taxpayer Bill of Rights along the lines I describe in this report in order to protect taxpayers and help restore their trust in the fairness of the system;
- Conduct meaningful oversight hearings into the nuts and bolts of tax administration that haven’t captured public attention in the same way as certain other issues but shape the experiences of millions of taxpayers in critical ways every day; and
- Along with proper oversight, provide the IRS with the additional funding it needs to answer taxpayer phone calls and otherwise do its job well.

Over the long term, I urge Congress to enact comprehensive tax reform, with simplification as a key goal.

I look forward to working with Congress on these important issues in the coming year, and I remain hopeful that we can provide U.S. taxpayers with the quality tax system they both need and deserve.

Respectfully submitted,



Nina E. Olson  
National Taxpayer Advocate  
31 December 2014

## TAXPAYER RIGHTS ASSESSMENT: IRS Performance Measures and Data Relating to Taxpayer Rights

In the 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that would “...provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance.”<sup>1</sup>

On June 10, 2014, the IRS adopted a Taxpayer Bill of Rights (TBOR), a list of ten rights that the National Taxpayer Advocate recommended to help taxpayers and IRS employees alike gain a better understanding of the dozens of discrete taxpayer rights spread throughout the multi-million word Internal Revenue Code.<sup>2</sup> While this was a significant achievement for increasing taxpayers’ awareness of their rights, and an important first step in integrating taxpayer rights into all aspects of tax administration, more can be done. The *Taxpayer Rights Assessment* contains selected performance measures and data organized by the ten taxpayer rights and is another important step toward integrating taxpayer rights into tax administration.

This *Taxpayer Rights Assessment* is a work in progress. The following measures provide insights into IRS performance; but they are by no means comprehensive. In some instances, data is not readily available. In other instances, we may not yet have sufficient measures in place to evaluate adherence to specific taxpayer rights. And, despite what the numbers may show, we must pay particular attention to the needs of taxpayers who lack access to quality service even if overall performance metrics are improving. This *Taxpayer Rights Assessment* will grow and evolve over time as data becomes available and new concerns emerge.

- 1. THE RIGHT TO BE INFORMED** – Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

Measure/Indicator	FY 2014
Individual Correspondence Volume (adjustments) <sup>a</sup>	5,700,132
Average Days in Inventory <sup>b</sup>	57.6 days
Inventory Overage <sup>c</sup>	63.6%
Business Correspondence Volume (adjustments) <sup>d</sup>	3,471,571
Average Days in Inventory <sup>e</sup>	39 days
Inventory Overage <sup>f</sup>	17.5%
Total Correspondence (all types)	TBD
Quality of IRS Forms & Publications	TBD
IRS.gov Web Page Ease of Use	TBD
IRS Outreach	TBD

a IRS, Joint Operations Center, Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2008 through FY 2014).

b IRS, Joint Operations Center, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014.

c *Id.*

d IRS, Joint Operations Center, Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2008 through FY 2014).

e IRS, Joint Operations Center, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014

f *Id.*

1 See National Taxpayer Advocate 2013 Annual Report to Congress, Preface, xvii-xviii (*Taxpayer Service Is Not an Isolated Function but Must Be Incorporated throughout All IRS Activities, Including Enforcement*).

2 IRS Press Release IR-2014-72, June 10, 2014 (*IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be highlighted on IRS.gov, in Publication 1*).

**2. THE RIGHT TO QUALITY SERVICE** – Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

Measure/Indicator	FY 2014
Number of Returns Filed (projected, all types) <sup>a</sup>	243,077,800
Total Individual Income Tax Returns <sup>b</sup>	147,812,000
E-file Receipts (Received by 11/21/14) <sup>c</sup>	125,821,000
E-file: Tax Professional <sup>d</sup>	62%
E-file: Self Prepared <sup>e</sup>	38%
<b>Returns Prepared by:</b>	
VITA/TCE/AARP <sup>f</sup>	3,322,582
Free File Consortium <sup>g</sup>	2,406,465
Fillable Forms <sup>h</sup>	478,501
IRS Taxpayer Assistance Centers (TACs) <sup>i</sup>	376
Number of Taxpayer Assistance (“Walk-In”) Centers <sup>j</sup>	382
Number of TAC Contacts <sup>k</sup>	5,477,279
Total Calls to IRS (Enterprise) <sup>l</sup>	100,667,411
Number of Attempted Calls to IRS Accounts Management (AM – formerly Customer Service) Lines <sup>m</sup>	86,171,857
Toll Free: Percentage of calls answered <sup>n</sup> (LOS)	64.4%
Toll Free: Average Speed of Answer <sup>o</sup>	19.6 minutes
NTA Toll Free: Percentage of calls answered (LOS)	68.9%
NTA Toll Free: Average Speed of Answer <sup>p</sup>	7.0 minutes
Practitioner Priority: Percentage of calls answered (LOS)	70.4%
Practitioner Priority: Average Speed of Answer <sup>q</sup>	27.4 minutes
Tax Exempt/Government Entities Percentage of calls answered <sup>r</sup> (LOS)	67.6%
Tax Exempt/Government Entities: Average Speed of Answer <sup>s</sup>	18.7 minutes
Awareness of Service (or utilization)	TBD
IRS Issue Resolution – Percentage of taxpayers who had their issue resolved as a result of the service they received	TBD
Taxpayer Issue Resolution – Percentage of taxpayers who reported their issue was resolved after receiving service	TBD

a IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014).

b *Id.*

c IRS, Filing Season Statistics, IRS Newsroom <http://www.irs.gov/uac/Newsroom/Nov-21-2014> (last viewed Nov. 26, 2014).

d *Id.*

e *Id.*

f *Id.* Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), and AARP Tax-Aide programs.

g IRS Compliance Data Warehouse (CDW), Electronic Tax Administration Marketing Database (ETA MDB), frequency table.

h *Id.*

i IRS, E-File Reports, Field Assistance Report, Current Year Accepted, Jan – Sept. 30, 2014.

j Information received from Senior Advisor, Wage and Investment (Dec. 23, 2104). Three hundred eighty-nine Taxpayer Assistance Centers were open during the filing season and 382 were open at the end of the fiscal year.

k Wage & Investment Division, Business Performance Review, 4th Quarter, FY2014. Dashboard, p.7.

l IRS, Joint Operations Center, Snapshot Reports: Enterprise Snapshot, week ending Sept. 30, 2014 (report generated Oct. 16, 2014).

m *Id.* Number of calls to Accounts Management (formerly Customer Services) - Sum of 30 lines (0217, 1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 1778, 9887, 9982, 2942, 4184, 7388, 0452, 0352, 7451, 9946, 5215, 3536, 2050, 4017, 2060, 4778, 4259, 8482, 8775, 5500 and 4490). The IRS determines its level of service based on calls to Accounts Management, not total calls.

n *Id.* Calls answered include reaching live assist or selecting options to hear automated information messages.

o *Id.*

p *Id.*

q *Id.*

r *Id.*

s *Id.*

**3. THE RIGHT TO PAY NO MORE THAN THE CORRECT AMOUNT OF TAX** – Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

Measure/Indicator	FY 2014
Toll-Free Tax Law Accuracy <sup>a</sup>	95.0%
Toll-Free Accounts Accuracy <sup>b</sup>	96.2%
Scope of Tax Law Questions Answered	TBD
<b>Correspondence Examinations</b>	
No change rate <sup>c</sup>	17.3%
Agreed rate <sup>d</sup>	17.2%
Non-response rate <sup>e</sup>	44.4%
Percentage of cases appealed	TBD
<b>Field Examinations</b>	
No change rate <sup>f</sup>	15.5%
Agreed rate <sup>g</sup>	46.6%
Non-response rate <sup>h</sup>	0.3%
Percentage of cases appealed	TBD
<b>Office Examinations</b>	
No change rate <sup>i</sup>	13.7%
Agreed rate <sup>j</sup>	45.0%
Non-response rate <sup>k</sup>	19.0%
Percentage of cases appealed	TBD
Math Error Adjustments	TBD
Math Error Abatements	TBD
Number of Statutory Notices of Deficiency Issued	TBD
Number of Statutory Notices of DeficiencyAppealed	TBD
Number of Collection Appeals Program Conferences	TBD
Number of Collection Appeals Program Conferences Reversing IRS position	TBD
Number of Collection Due Process Conferences	TBD
Number of Collection Due Process Conferences Reversing IRS position	TBD
Percentage of taxpayers subject to IRS burden (e.g., received a notice from math error, AUR, ASFR, audit, collection, or had a refund delayed) who were (or may have been) compliant (i.e., those whose math error, AUR, or ASFR resulted in no net increase in tax, those with delayed refunds that were ultimately paid, those who appeared to have delinquencies but where nothing was ultimately collected)	TBD

a IRS Wage & Investment Division, Business Performance Review, 4th Quarter, FY2014 (Nov. 6, 2014) at 4.

b *Id.*

c IRS, Audit Information Management System, Closed Case Database. Includes disposal codes 1 and 2.

d *Id.* Includes disposal codes 3, 4, and 9.

e *Id.* Includes disposal code 13 or disposal code 10 in combination with technique codes 6 or 7.

f *Id.* Includes disposal codes 1 and 2.

g *Id.* Includes disposal codes 3, 4, and 9.

h *Id.* Includes disposal code 13 or disposal code 10 in combination with technique codes 6 or 7.

i *Id.* Includes disposal codes 1 and 2.

j *Id.* Includes disposal codes 3, 4, and 9.

k *Id.* Includes disposal code 13 or disposal code 10 in combination with technique codes 6 or 7.

**4. THE RIGHT TO CHALLENGE THE IRS'S POSITION AND BE HEARD** – Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

Measure/Indicator	FY 2014
Individual Correspondence Volume (adjustments) <sup>a</sup>	5,700,132
Average Days in Inventory <sup>b</sup>	57.6 days
Inventory Overage <sup>c</sup>	63.6%
Business Correspondence Volume <sup>d</sup>	3,471,571
Average Days in Inventory <sup>e</sup>	39 days
Inventory Overage <sup>f</sup>	17.5%
Percentage of Math Error Adjustments Abated	TBD
Percentage of Statutory Notices of DeficiencyAppealed to Tax Court	TBD
Number of Collection Appeal Program Conferences Requested by Taxpayers <sup>g</sup>	TBD
Percentage of CAP Conferences that Reversed the IRS Position	TBD
Number of Collection Due Process Hearings Requested by Taxpayers <sup>h</sup>	TBD
Percentage of Collection Due Process Hearings that Reversed the IRS Position	TBD

a IRS, Joint Operations Center, Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2008 through FY 2014).

b IRS, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014.

c *Id.*

d IRS, Joint Operations Center, Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2008 through FY 2014).

e IRS, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014.

f *Id.*

g Taxpayers may request a Collection Appeals Process (CAP) review as the result of IRS actions such filing a Notice of Federal Tax Lien, an IRS levy or seizure of property, and termination, rejection, or modification of an installment agreement. See, IRS Pub. 1660, *Collection Appeal Rights*.

h Taxpayers may request a Collection Due Process (CDP) review when the IRS plans to take actions such as filing a federal tax lien or levy. See, IRS Pub. 1660, *Collection Appeal Rights*.

**5. THE RIGHT TO APPEAL AN IRS DECISION IN AN INDEPENDENT FORUM** – Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court.

Measure/Indicator	FY 2014
Number of CasesAppealed <sup>a</sup>	113,608
Appeals Staffing (On-rolls) <sup>b</sup>	1,704
Number of States without an Appeals or Settlement Officer <sup>c</sup>	12
Customer Satisfaction of service in Appeals	TBD
Average Days in Appeals to Resolution	TBD
Percentage of cases appealed	TBD
Percentage of Statutory Notices of DeficiencyAppealed to Tax Court	TBD

a IRS Appeals Business Performance Review, 4th Quarter FY2014 (Nov. 10, 2014), at 9.

b *Id.*

c IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014). This map does not include Puerto Rico, which also has no Appeals presence.

- 6. THE RIGHT TO FINALITY** – Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

Measure/Indicator	FY 2014
Average Days to Complete Correspondence Examination (non-EITC) <sup>a</sup>	225 days
Average Days to Complete Correspondence Examination (EITC) <sup>b</sup>	243 days
Average Days to Reach Determination on Applications for Exempt Status <sup>c</sup>	237 days
Average Days for Exempt Organization Function to Respond to Correspondence <sup>d</sup>	66 days
Percentage of calls/letters/issues resolve in a single 2-way communication (single call, single meeting, or single exchange of correspondence)	TBD

a IRS, Wage & Investment Division, Business Performance Review, 4th Quarter, FY2014 (Nov. 6, 2014), at 8.  
b *Id.*  
c *Id.* at 16.  
d *Id.*

- 7. THE RIGHT TO PRIVACY** – The right to privacy goes to the right to be free from unreasonable searches and seizures and that IRS actions would be no more intrusive than necessary. Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

Measure/Indicator	FY 2014
Number (or percentage) of Collection Due Process cases where IRS cited for Abuse of Discretion	TBD
Number of Offers in Compromise Submitted using 'Effective Tax Administration' as Basis <sup>a</sup>	1,468
Percentage of Offers in Compromise Accepted that used 'Effective Tax Administration' as Basis <sup>b</sup>	2.1%
Number of cases where taxpayer received repayment of attorney fees as result of final judgment.	TBD

a IRS response to TAS fact check (Nov. 26, 2014).  
b *Id.*

- 8. THE RIGHT TO CONFIDENTIALITY** – Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

Measure/Indicator	FY 2014
Number of Unauthorized Access of Taxpayer Account (UNAX) Violations	TBD
Percentage of UNAX Violations Determined to be Inadvertent	TBD
Percentage of UNAX Violations Determined that Resulted in Discipline or Removal	TBD

**9. THE RIGHT TO RETAIN REPRESENTATION** – Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

Measure/Indicator	FY 2014
Average Days for IRS to Process Power of Attorney Requests (Form 2848) <sup>a</sup>	3 Days
Percentage of Power of Attorney Requests Overage (as of Sept. 30, 2014) <sup>b</sup>	0%
Number of Low Income Taxpayer Clinics Funded <sup>c</sup>	131
Funds Appropriated for Low Income Taxpayer Clinics <sup>d</sup>	\$10 million
Number of States and other jurisdictions with a Low Income Taxpayer Clinic <sup>e</sup>	48
Number of Low Income Taxpayer Clinic Volunteer Hours <sup>f</sup>	60,229

a IRS, Joint Operations Center, Customer Account Services, Accounts Management Paper Inventory Reports FY 2014.

b *Id.*

c IRS Pub. 5066, *Low Income Taxpayer Clinics Program Report* (Dec. 2014).

d Consolidated Appropriations Act, Pub. L. No. 113-76, enacted Jan. 17, 2014.

e Forty-seven states and the District of Columbia have at least one Low Income Taxpayer Clinic. IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2014).

f IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2014).

**10. THE RIGHT TO A FAIR AND JUST TAX SYSTEM** – Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

Measure/Indicator	FY 2014
Offer in Compromise: Number of Offers Submitted <sup>a</sup>	67,935
Offer in Compromise: Percentage of Offers Accepted <sup>b</sup>	41.9%
Installment Agreements: Number of Individual & Business IAs <sup>c</sup>	3,011,636
Streamlined Installment Agreements (ACS): Number of Individual & Business IAs <sup>d</sup>	2,857,043
Installment Agreements (CFF): Number of Individual & Business IAs <sup>e</sup>	52,619
Streamlined Installment Agreements (CFF): Number of Individual & Business IAs <sup>f</sup>	10,680
Number of OICs Accepted per Revenue Officer <sup>g</sup>	6.7
Number of IAs Accepted per Revenue Officer <sup>h</sup>	13.1
Percentage of Cases in the Queue (Taxpayers) <sup>i</sup>	15.6%
Percentage of Cases in the Queue (Modules) <sup>j</sup>	25.0%
Percentage of TDAs reported Currently Not Collectible – Surveyed <sup>k</sup>	18.2%
Age of Delinquencies in the Queue <sup>l</sup>	4.4 years
Percentage of Modules in Queue from TY 2010 and Prior <sup>m</sup>	80.2%
Percentage of cases where the taxpayer is fully compliant upon closure	TBD
Percentage of cases where the taxpayer is fully compliant after five years	42% <sup>n</sup>

a Collection Activity Report 5000-108 FY 2014 (Sep. 29, 2014).

b *Id.*

c Collection Activity Report 5000-6 FY 2014 (Sep. 29, 2014).

d *Id.*

e *Id.*

f *Id.*

g Collection Activity Report 5000-6 FY 2014 (Sep. 29, 2014); see also IRS Human Resources Reporting Center – number of revenue office s in SB/SE as of the end of FY 2014 (pay period 19).

h *Id.*

i Collection Activity Report 5000-2 FY 2014 (Sep. 29, 2014).

j Collection Activity Report 5000-6 FY 2014 (Sep. 29, 2014).

k Collection Activity Report 5000-2 FY 2014 (Sep. 29, 2014).

l Individual Master File Accounts Receivable Dollar Inventory as of the end of FY 2014 (cycle 201438).

m Collection Activity Report 5000-2 FY 2014 (Sep. 29, 2014).

n Calculation by TAS Research. Percentage of taxpayers with TDAs in 2009 who have no new delinquencies (TDAs or TDIs) five yeas later. IRS, Individual Master File.

## THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS: Introduction

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2014, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 23 such problems.

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

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

### METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. In many years, the National Taxpayer Advocate identifies a theme for the report that is reflected in the selection of issues. For example, this year the theme is *what the IRS must do to enhance the remedies available to taxpayers under the Taxpayer Bill of Rights*.

The 23 issues in this year’s report are ranked according to the following criteria:

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

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

### TAXPAYER ADVOCATE MANAGEMENT INFORMATION SYSTEM (TAMIS) LIST

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC, but TAS’s integrated approach to advocacy—using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2014, a period spanning October 1, 2013, through September 30, 2014.

## USE OF EXAMPLES

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

**MSP  
#1****TAXPAYER SERVICE: Taxpayer Service Has Reached  
Unacceptably Low Levels and Is Getting Worse, Creating  
Compliance Barriers and Significant Inconvenience for Millions  
of Taxpayers****DEFINITION OF PROBLEM**

The most serious problem facing U.S. taxpayers is the declining quality of service provided to them by the IRS when they seek to comply with their federal tax filing and payment obligations. The deficiencies in taxpayer service have been on our “Most Serious Problems” list for several years. As we begin 2015, the widening imbalance between the IRS’s increasing workload and its shrinking resources leads us to designate it the #1 problem for taxpayers.

More than 100 million taxpayers attempt to reach the IRS by telephone each year. For fiscal year (FY) 2015, the IRS is projecting it will only be able to answer about 50 percent of the calls it receives from taxpayers seeking to speak with a telephone assistor, and it projects that those taxpayers who manage to get through “could easily wait 30 minutes or more for limited service.”<sup>1</sup> If these projections prove accurate, taxpayers in 2015 will receive the worst levels of service since the IRS implemented its current performance measures in 2001.<sup>2</sup> For comparison, the IRS’s best year was 2004, when it answered 87 percent of its calls, and taxpayers had to wait only about 2½ minutes on hold.<sup>3</sup> To make matters worse, the IRS last year decided it would answer only what it terms “basic” questions, declaring “more complex” questions that it previously answered “out of scope.”<sup>4</sup> Therefore, even when a taxpayer manages to get through to a telephone assistor with a question, the assistor may not be able to provide an answer.

Millions more taxpayers visit the IRS’s walk-in sites every year. The same limitations on the scope of tax-law questions imposed on the phone lines were also imposed at the walk-in sites.<sup>5</sup> In addition, the IRS last year discontinued its long-time practice of preparing tax returns for hundreds of thousands of low income, elderly, and disabled taxpayers who sought assistance.<sup>6</sup> Overall, the IRS is providing more limited services to fewer taxpayers who face increasing difficulty obtaining those services, compared to just two years ago.

The lack of adequate taxpayer service stands in marked contrast to congressional directives and the IRS’s own stated goal. In 1998, Congress directed the IRS to revise its mission statement, which at that time emphasized revenue collection, “to place a greater emphasis on serving the public and meeting taxpayers’ needs.”<sup>7</sup> In response, the IRS adopted a new mission statement, stating that the IRS’s mission is to

1 Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014).

2 For data going back to FY 2001, see in combination IRS, FY 2013 Enforcement and Service Results 9, at <http://www.irs.gov/PUP/newsroom/FY%202013%20Enforcement%20and%20Service%20Results%20-%20WEB.pdf>, and IRS, FY 2006 Enforcement and Service Results 10, at [http://www.irs.gov/pub/newsroom/11-06\\_enforcement\\_stats.pdf](http://www.irs.gov/pub/newsroom/11-06_enforcement_stats.pdf).

3 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2004).

4 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

5 *Id.*

6 *Id.*

7 Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 1002, 112 Stat. 685, 690 (1998).

“provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.”<sup>8</sup>

In the National Taxpayer Advocate’s 2007, 2011, and 2013 reports to Congress, we recommended that Congress strengthen taxpayer rights protections by adopting an overarching, principles-based Taxpayer Bill of Rights.<sup>9</sup> We reiterate and expand on that recommendation in this report.<sup>10</sup> Among the rights we recommended for adoption in 2007 and 2011 was “The Right to Be Assisted,” which in our 2013 report we retitled “*The Right to Quality Service*.” In July 2013, the House of Representatives—with bipartisan support, on a voice vote, and without opposition—approved verbatim the Taxpayer Bill of Rights we recommended in 2011, including “The Right to Be Assisted.”<sup>11</sup> The Senate did not pass companion legislation, but in 2014, the IRS administratively adopted a slightly modified version of the Taxpayer Bill of Rights.<sup>12</sup> It included “*The Right to Quality Service*.”

As we enter 2015, we are deeply concerned that taxpayers are receiving markedly less assistance from the IRS now than at any time in recent history. IRS support is critical for millions of taxpayers, and its absence imposes significant burdens on taxpayers who cannot obtain timely assistance from their government. Without adequate support, many taxpayers will be frustrated, some will make potentially costly mistakes, others will incur higher compliance costs when forced to seek information and assistance from tax professionals that the IRS previously provided for free, and still others will simply give up and not file returns at all.

## ANALYSIS OF PROBLEM

### Overview

The IRS interacts with more Americans every year than any other federal government agency.<sup>13</sup> In fiscal year (FY) 2014, individuals filed nearly *150 million income tax returns*.<sup>14</sup> Even that figure understates the number of people interacting with the IRS because about 50 million returns were joint returns, and many claimed additional dependents. Business entities filed more than *10 million income tax returns*.<sup>15</sup>

<sup>8</sup> IRS News Release IR-98-59, *New IRS Mission Statement Emphasizes Taxpayer Service* (Sept. 24, 1998), at <http://www.irs.gov/pub/irs-news/ir-98-59.pdf>.

<sup>9</sup> National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2007 Annual Report to Congress 478-89 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payments*). We recommended that Congress take the multiple, existing taxpayer rights scattered throughout the Internal Revenue Code and group them into ten broad categories, modeled on the U.S. Constitution’s Bill of Rights, that would be easier for taxpayers to understand and invoke.

<sup>10</sup> See Legislative Recommendation, *TAXPAYER RIGHTS: Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections, infra*.

<sup>11</sup> Taxpayer Bill of Rights Act of 2013, H.R. 2768, 113th Cong. (sponsored by Representative Roskam and passed by the House on July 31, 2013). In addition to stating the ten core rights, the bill would have clarified that the Commissioner has a duty to ensure IRS employees are familiar with and act in accordance with those rights.

<sup>12</sup> IRS News Release IR-2014-72, *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov, in Publication 1* (June 10, 2014), at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;-10-Provisions-to-be-Highlighted-on-IRSGov-in-Publication-1>.

<sup>13</sup> By comparison, 59 million Americans received Social Security benefits in 2014. See <http://www.ssa.gov/news/press/basic-fact.html>.

<sup>14</sup> IRS Publication 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014). About 50 million are joint returns, so the number of taxpayers is nearly 200 million. IRS Compliance Data Warehouse, *Individual Returns Transaction File* (Tax Year 2013) (showing 51.5 million joint returns filed through October 2014).

<sup>15</sup> *Id.*

Because of the complexity of the tax code, many taxpayers or their preparers contact the IRS with questions. In addition, IRS compliance functions initiate contact with taxpayers throughout the year—usually through correspondence—and taxpayers often contact the IRS in response. All told, the IRS has received:

- More than *one hundred million telephone calls* from taxpayers in every year since 2008.<sup>16</sup>
- More than *ten million letters* a year, on average, from taxpayers responding to proposed adjustments and other notices.<sup>17</sup>
- More than *five million visits from taxpayers in the IRS's walk-in sites* each year who seek to obtain forms, ask questions, or conduct other business.<sup>18</sup>

Given that U.S. taxpayers pay the federal government's bills—and collectively paid more than \$3 trillion in taxes last year<sup>19</sup>—the National Taxpayer Advocate believes the government has a moral and practical imperative to make the tax compliance process as painless as possible. Today, we are far from that goal, and we are moving in the wrong direction.

As mentioned above, the IRS is projecting it will be able to answer only about 50 percent of the telephone calls it receives from taxpayers seeking to speak with a telephone assist in FY 2015, and it projects that taxpayers who get through will face wait times of 30 minutes or more for limited service.<sup>20</sup>

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**The National Taxpayer Advocate believes the government has a moral and practical imperative to make the tax compliance process as painless as possible. Today, we are far from that goal, and we are moving in the wrong direction.**

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For taxpayers who turn to practitioners for help, the news is even grimmer. The IRS maintains a “Practitioner Priority Service” (PPS) telephone line for tax professionals calling the IRS to assist their clients with account-related issues such as audits, yet the term “priority” has become an object of derision among practitioners. Prior to the enactment of the FY 2015 budget cuts, the IRS was projecting wait times averaging more than 41 minutes on the PPS phone line.<sup>21</sup> Not only is this extraordinarily inconvenient for the hundreds of thousands of Certified Public Accountants, Enrolled Agents, and attorneys who must wait on hold, but these professionals often charge their taxpayer-clients for some or all of this time, increasing the cost of tax compliance.

The IRS’s ability to meet taxpayer needs has been deteriorating for the past decade as the agency’s workload has increased and its budget has declined. While no metric is perfect, the following graph illustrates these trends, using the number of returns the IRS receives as a proxy for work and the percentage of

16 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2008 through FY 2014).

17 IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2008 through FY 2014).

18 IRS Wage & Investment Division, *Business Performance Review 7* (4th Quarter – FY 2014, Nov. 6, 2014).

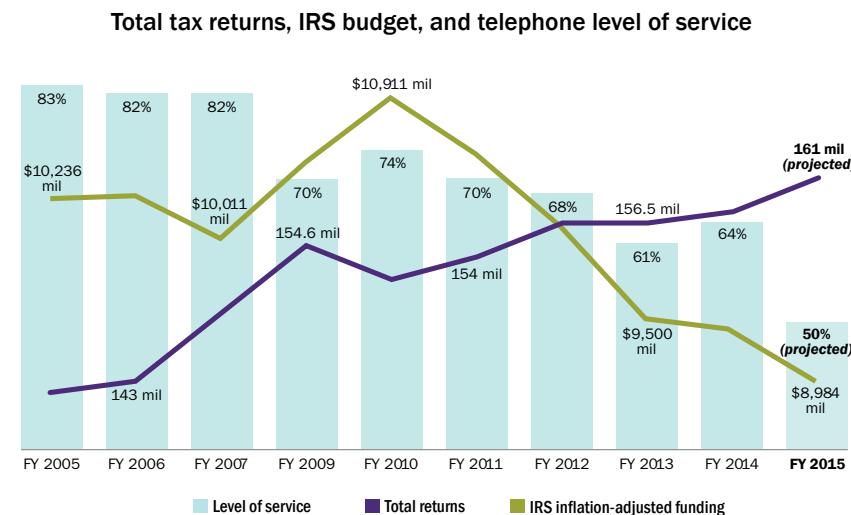
19 Government Accountability Office (GAO), GAO-15-173, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements* 111 (Nov. 2014), at <http://www.gao.gov/assets/670/666863.pdf>.

20 Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014).

21 IRS Wage & Investment Division, *Business Performance Review 4* (4th Quarter – FY 2014, Nov. 6, 2014). This projection was made prior to the enacted reduction in IRS funding for FY 2015. As a consequence of the funding reduction, the wait-time projections are likely to be increased.

telephone calls the IRS is able to answer from taxpayers seeking to speak with a telephone assist (known as the “Level of Service”) as a proxy for taxpayer service.<sup>22</sup>

**FIGURE 1.1.1**



In FY 2014, the IRS significantly reduced core taxpayer services it had long provided. As mentioned above, it substantially stopped answering tax-law questions from taxpayers, limiting the scope of questions it answered during the filing season ending on April 15 and answering no tax-law questions at all after that date. It also terminated its longstanding practice of preparing tax returns for certain populations of taxpayers.

With further reductions in the IRS’s budget and increasing challenges in 2015, the IRS leadership has been discussing further changes to its service delivery options. The National Taxpayer Advocate and her staff, who serve on committees discussing these contemplated changes, are deeply concerned about the long-term ability of the IRS to provide essential taxpayer services.

The causes of this unfortunate and worsening state of affairs are several:

- First, the complexity of the tax code makes tax administration far more complicated than it needs to be.
- Second, Congress has given the IRS the task of administering many social and economic benefit programs, including tax credits for low income and business taxpayers, and most recently, the Patient Protection and Affordable Care Act (ACA).<sup>23</sup> Both the ACA and the Foreign Account

22 The number of returns combines individual and business-entity returns. In this and several other workload-trend charts in this section, we omit data for FY 2008 because the data for that year was extreme and aberrational. As discussed in more detail below, the Economic Stimulus Act of 2008 caused the number of telephone calls the IRS received on its Account Management (AM) phone lines to more than double from 67 million in FY 2007 to 151 million in FY 2008, and the number of individual income tax returns to increase from 139 million in FY 2007 to 154 million in FY 2008.

23 Pub. L. No. 111-148, 124 Stat. 119 (2010).

Tax Compliance Act (FATCA),<sup>24</sup> a far-reaching compliance program, will substantially take effect during 2015.

- Third, and as described later in this section, the IRS's workload has been increasing significantly in recent years.
- Fourth, Congress has reduced the IRS's funding significantly since FY 2010. The IRS's budget has been cut by 10 percent, and we estimate the effects of inflation have reduced the agency's purchasing power by an additional 7.5 percent, effectively reducing its resources by about 17 percent overall. Among other things, these cuts have left the IRS without sufficient funds to hire enough customer service representatives to staff the phone lines, answer taxpayer correspondence, conduct taxpayer and practitioner outreach and education, and meet taxpayers' needs in its walk-in sites.

The National Taxpayer Advocate has repeatedly urged Congress to simplify the tax code,<sup>25</sup> and as a related matter, has suggested standards policymakers may use in evaluating which social and economic benefit programs the IRS is best equipped to administer and which programs are better left to other agencies.<sup>26</sup> In the long run, we continue to believe that tax simplification is of overriding importance.

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**It is in the government's self-interest to facilitate voluntary compliance because voluntary compliance is far more cost effective than enforced compliance. For context, more than 98 percent of all tax revenue collected by the government is paid voluntarily and timely. Less than two percent is collected through enforcement action. If the IRS were to collect 10 percent less in enforcement revenue, tax revenue would decline by less than \$6 billion. If voluntary tax payments were to drop by 10 percent, tax revenue would decline by more than \$300 billion.**

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24 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010).

25 See National Taxpayer Advocate 2012 Annual Report to Congress 3-23 (Most Serious Problem: *The Complexity of the Tax Code*); Testimony of Nina E. Olson, National Taxpayer Advocate, at *Hearing on Fundamental Tax Reform Before H. Comm. On Ways and Means*, 112th Cong. (2011), at <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=219701>; National Taxpayer Advocate 2010 Annual Report to Congress 3-14 (Most Serious Problem: *The Time for Tax Reform Is Now*); National Taxpayer Advocate 2010 Annual Report to Congress 365-72 (Legislative Recommendation: *Enact Tax Reform Now*); National Taxpayer Advocate 2005 Annual Report to Congress 375-80 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*); Presentation of Nina E. Olson, National Taxpayer Advocate, at Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) at <http://www.taxreformpanel.gov/meetings/meeting-03032005.shtml>. Over the past decade, the National Taxpayer Advocate's annual reports have contained dozens of additional proposals to simplify particular sections or areas of the tax code.

26 In our 2010 Annual Report to Congress, we recommended adoption of a process to evaluate whether a tax expenditure presents an administrative challenge to the IRS or taxpayers and the extent to which it achieves its intended purpose. See National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-19 (*Evaluate the Administration of Tax Expenditures*). In our 2009 report, we proposed an analytic framework for evaluating whether specific social benefit programs—whether for individuals or for businesses—should be run through the tax system. See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (*Running Social Programs Through the Tax System*). Among other factors, we suggested that Congress consider the IRS's existing relationship with and access to the targeted population as well as the additional burden imposed on that population, the IRS's ability to deliver the benefit in a timely manner and at the appropriate time, the IRS's access to the information required to make eligibility determinations, and the IRS's suitability to be the administrator of the provision in light of its enforcement culture.

In the short run, however, the IRS lacks sufficient resources to handle its growing workload. The National Taxpayer Advocate believes our government is not meeting the basic service needs of the taxpaying public, and if adequate funding is not provided, taxpayer service will continue to deteriorate.

### Why Taxpayer Service Matters

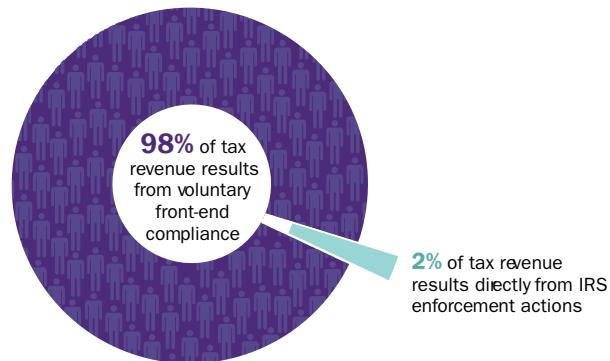
The proposition that the government should provide taxpayers with high quality service may seem obvious, but it is worth considering why taxpayer service is so important. In our view, there are two related but independent reasons.

First, it is, very simply, the right thing for the government to do for its taxpayers. The requirement to file a return and pay taxes is generally the most significant burden a government imposes on its citizens. The government therefore has a duty to make compliance as simple and painless as possible.

Second, it is in the government's self-interest to facilitate voluntary compliance because voluntary compliance is far more cost effective than enforced compliance. For context, more than 98 percent of all tax revenue collected by the government is paid voluntarily and timely. Less than two percent is collected through enforcement action.<sup>27</sup> If the IRS were to collect 10 percent less in enforcement revenue, tax revenue would decline by less than \$6 billion. If voluntary tax payments were to drop by 10 percent, tax revenue would decline by more than \$300 billion.

**FIGURE 1.1.2**

Tax revenue from voluntary compliance vs. enforcement actions



Some level of enforcement is necessary both to ensure that all taxpayers pay their fair share of taxes and to provide an incentive for all taxpayers to continue to comply. But we must not lose sight of the overriding importance of maintaining high levels of voluntary compliance, nor take it for granted. If the government treats its taxpayers poorly, voluntary compliance almost certainly will erode over time. Therefore, there is a strong business case for the government to provide sufficient funds for taxpayer service to ensure that taxpayer needs are adequately met.

<sup>27</sup> In FY 2014, the IRS collected total tax revenue of about \$3.1 trillion. Of that amount, it collected \$57.1 billion through enforcement actions. Government Accountability Office (GAO), GAO-15-173, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements* 29 (Nov. 2014), at <http://www.gao.gov/assets/670/666863.pdf>.

Yet as the discussion below shows, the workload of the IRS has been increasing over the past decade while the resources available to do its work have been shrinking, and the predictable result has been deteriorating levels of taxpayer service. We note that poor taxpayer service is not just limited to the IRS's pre-filing or filing activities. The quality of service the IRS provides to taxpayers in its enforcement functions has similarly eroded.<sup>28</sup>

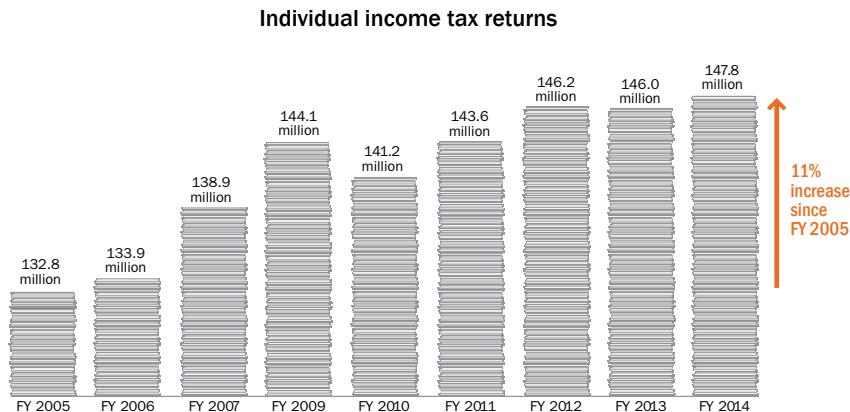
### The IRS's Workload Has Been Increasing

Because of the extensive nature of the IRS's responsibilities, no single metric provides an accurate reflection of changes in the agency's workload. However, two useful indicators are the number of tax returns processed and the number of telephone calls received.

Tax returns are a useful measure because the IRS's overall workload is largely derivative of the number of returns it receives. When that number increases, the IRS receives proportionately more telephone calls,<sup>29</sup> incurs proportionately greater costs to process the returns, performs proportionately more data matching, and would have to conduct proportionately more audits and take proportionately more collection actions to maintain consistent levels of enforcement.

From FY 2005 to FY 2014, the number of individual income tax returns rose from about 132.8 million to about 147.8 million, an increase of 11 percent. About 44 percent of that increase has occurred since FY 2010, when about 141.2 million returns were filed.<sup>30</sup>

**FIGURE 1.1.3**

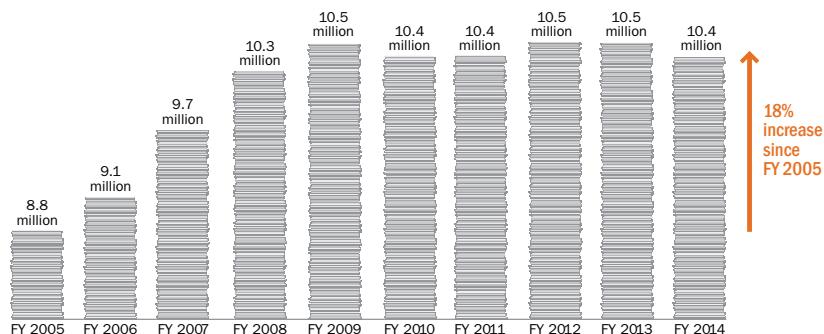


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- 28 For a discussion of the relationship between IRS service functions, such as the IRS's toll-free telephone lines and its correspondence units, and IRS enforcement functions, see Preface, *supra*.
- 29 In FY 2014, the number of returns increased slightly while the number of telephone calls declined. The IRS's explanation for the reduction in calls in FY 2014 is discussed in the text below.
- 30 See IRS Data Books, Table 2 (showing return totals for FY 2005 through FY 2013). Data for FY 2014 are projections made by the IRS Office of Research, Analysis, and Statistics; see IRS Publication 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014). In this and several other workload-trend charts in this section, we omit data for FY 2008 because the data for that year was extreme and aberrational. As discussed in more detail below, the Economic Stimulus Act of 2008 caused the number of telephone calls the IRS received on its Account Management phone lines to more than double from 67 million in FY 2007 to 151 million in FY 2008 and the number of individual income tax returns to increase from 139 million in FY 2007 to 154 million in FY 2008.

The percentage increase in returns was larger for business entities, which include C corporations, S corporations, and partnerships. From FY 2005 to FY 2014, the number of business entity returns rose from about 8.8 million to about 10.4 million, an increase of 18 percent.<sup>31</sup>

**FIGURE 1.1.4**

**Business entity income tax returns**



The number of telephone calls the IRS receives is also a useful measure of workload because answering phone calls is labor-intensive. As noted above, the IRS has received more than 100 million telephone calls in each year since 2008. Of those calls, the significant majority is directed to the “Accounts Management” phone lines, and the IRS focuses on this category of calls for purposes of measuring its “Level of Service” (discussed below).<sup>32</sup>

Since FY 2005, the IRS has seen a significant and continual increase in the number of calls it receives on its Accounts Management (AM) telephone lines, as shown in the graph below.<sup>33</sup> We note that two years on the graph are inconsistent with the general trend:

- In FY 2008, the IRS received an extraordinary one-time spike in telephone calls and returns due to enactment of the Economic Stimulus Act of 2008.<sup>34</sup> For that reason, we have omitted data from FY 2008 in several of the workload-trend charts included in this section.

31 See IRS Data Books, Table 2 (showing return totals for FY 2005 through FY 2013). Data for FY 2014 are projections made by the IRS Office of Research, Analysis, and Statistics; see IRS Publication 6292, Fiscal Year Return Projections for the United States 2014-2021, at 4 (Fall 2014).

32 The overall number of telephone calls the IRS receives is referred to as the “enterprise” total. The significant majority of those calls are directed to the AM telephone lines, which, among other things, provide answers to tax-law questions and account inquiries. A relatively small percentage of calls—typically about 16 million to 17 million calls—are directed to IRS compliance telephone lines and a few other less frequently used lines. Because of the purpose of the IRS’s “Level of Service” measure, those calls are excluded from the “Level of Service” computations.

33 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2005 through FY 2014).

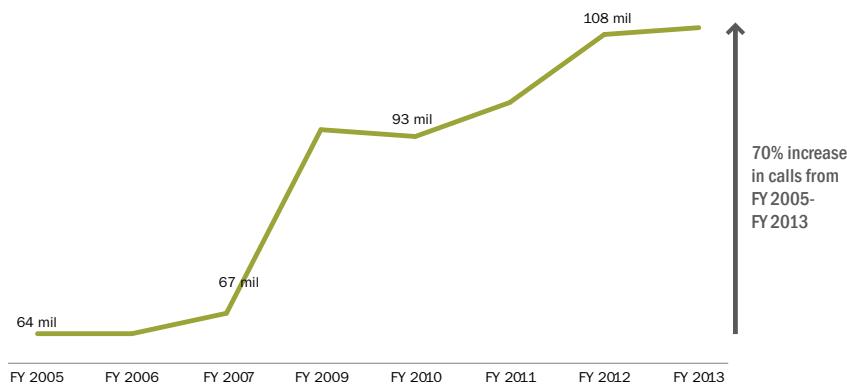
34 The Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 613 (2008), required the IRS to make one-time payments to nearly 119 million taxpayers. See IRS News Release, IR-2009-10, *IRS Offers Tips to Avoid Recovery Rebate Credit Confusion* (Jan. 30, 2009), at <http://www.irs.gov/uac/IRS-Offers-Tips-to-Avoid-Recovery-Rebate-Credit-Confusion>. The procedures for claiming these “stimulus payments” required millions of individuals otherwise without a filing obligation to file a tax return. The stimulus payments were paid out over several months, and taxpayers who did not receive their payments early in the process inundated the IRS with telephone calls. As a result, many IRS measures reflect the effects of this one-time event. The number of calls the IRS received on its AM telephone lines more than doubled from FY 2007 to FY 2008 (increasing from 67 million to 151 million), and the number of individual income tax returns jumped from 139 million to 154 million – the highest annual totals in the past ten years and probably ever.

- In FY 2014, the IRS received significantly fewer telephone calls.<sup>35</sup> The IRS has attributed the reduction in calls to two factors. First, tax-law changes often generate taxpayer confusion, and Congress made changes to the Internal Revenue Code on only two occasions during 2013.<sup>36</sup> Second, the IRS significantly limited the scope of tax-law questions it answered.<sup>37</sup> To manage its workload, it adopted a policy of answering only “basic” tax-law questions until April 15 and then no tax-law questions after that date.<sup>38</sup> The virtual absence of tax legislation in 2013 was an aberration that is unlikely to recur; for context, Congress made nearly 4,200 changes to the Code over the preceding decade—an average of about 420 changes per year.<sup>39</sup> The restriction on tax-law-questions may continue, but we believe that taxpayer frustration will eventually lead the IRS, in collaboration with Members of Congress, to find ways to reinstate discontinued services. Therefore, we believe that any apparent “improvements” in FY 2014 are illusory.

Omitting FY 2008 and FY 2014, the number of calls the IRS received on its AM lines over the past decade soared from about 64 million in FY 2005 to about 109 million in FY 2013, or about 70 percent. That is a substantial increase that requires significantly more resources to handle.<sup>40</sup>

**FIGURE 1.1.5**

**Taxpayer calls to IRS Accounts Management telephone lines**



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- 35 In FY 2014, the IRS received 86 million calls on its Accounts Management telephone lines. IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2014).
- 36 According to a GAO report, the IRS attributes the decline in taxpayer telephone calls in FY 2014 partly to “smooth tax return and refund processing” and partly to its “efforts to limit or eliminate assistor-based services and direct taxpayers to self-service options.” GAO, GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks* 11 (Dec. 2014). The report says the IRS attributed its smooth return processing, in turn, to “fewer tax-law changes that resulted in fewer system and form updates compared to previous years.” *Id.* at 9.
- 37 *Id.*
- 38 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.
- 39 Unpublished data provided to TAS by Wolters Kluwer, CCH (Dec. 12, 2012, supplemented on Sept. 29, 2014).
- 40 The majority of the additional calls was handled by automation. The increase in calls seeking to speak with a customer service representative was 23 percent. See IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of fiscal years 2005 and 2013) (indicating that the number of calls seeking to reach a representative on the Account Management telephone lines increased from about 40.4 million to about 49.8 million). The percentage increase in calls seeking to reach an assistor likely would have been considerably higher absent IRS policies designed to drive more taxpayers to use automated processes.

**While the National Taxpayer Advocate believes the IRS can operate more effectively and efficiently in certain areas, the only way the IRS can assist the tens of millions of taxpayers seeking to speak with an IRS employee is to have enough employees to answer their calls. The only way the IRS can timely process millions of letters from taxpayers is to have enough employees to read their letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.**

There are several other obvious sources of workload increase. First, the IRS has had to address a huge spike in tax-related identity theft and refund fraud. In FY 2014, the IRS assigned more than 3,000 employees to work on identity theft cases, which reduced the number of employees available to handle the IRS's traditional workload.<sup>41</sup> Second, and as mentioned above, Congress has continued to make significant changes to the tax code over the past decade—an average of about 420 changes per year from 2003 to 2012, according to one count.<sup>42</sup> Tax-law changes add to the IRS's workload, variously requiring the agency to reprogram its return processing systems, issue interpretive regulations or other guidance, and train its telephone assistants and auditors. Third, the Patient Protection and Affordable Care Act has been a heavy lift for the agency and will become even heavier in 2015—the Act's first year of substantial implementation.<sup>43</sup> Finally, the implementation of the Foreign Account Tax Compliance Act is also requiring changes to IRS technology and the commitment of personnel.

The combination of more tax returns, substantially more telephone calls, substantially more cases of tax-related refund fraud, and continual tax law changes, including implementation of the ACA and FATCA, have sharply increased the IRS's workload.

### The IRS's Resources Have Been Declining Overall

At the same time that the IRS's workload has been increasing, the resources available to handle that workload have been declining, particularly in inflation-adjusted dollars.

In FY 2005, the IRS operated on an appropriated budget of \$10.24 billion.<sup>44</sup> From FY 2005 to FY 2015 (projected), the non-defense sector of the U.S. economy has experienced price inflation of about 21.8 percent.<sup>45</sup> If the IRS's FY 2005 budget had kept pace with inflation, its budget in FY 2015 would be \$12.47 billion. In fact, the IRS's funding level for FY 2015 has been set at \$10.95 billion.<sup>46</sup> Thus, the IRS's budget has been reduced by approximately 12.2 percent since FY 2005 in inflation-adjusted terms.<sup>47</sup>

41 IRS Wage & Investment Division, Business Performance Review 25 (3rd Quarter – FY 2014, Nov. 6, 2014).

42 Unpublished data provided to TAS by Wolters Kluwer, CCH (Dec. 12, 2012, supplemented on Sept. 29, 2014). Congress made very few changes to the tax code in 2013. The number rose considerably in 2014, but a final count was not available as of our publication deadline.

43 See Most Serious Problem: *HEALTH CARE IMPLEMENTATION: Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers, infra*.

44 See Internal Revenue Service FY 2007 Budget-in-Brief, at <http://www.irs.gov/pub/irs-news/fy07budgetinbrief.pdf> (showing enacted FY 2005 IRS appropriation of \$10,236,087,000).

45 See Office of Management and Budget, *Fiscal Year 2015 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 217-218, at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/hist.pdf> (showing Gross Domestic Product and year-to-year increases in the GDP). For budgeting purposes, our understanding is that federal agencies use the Gross Domestic Product deflator, as reflected in the OMB charts.

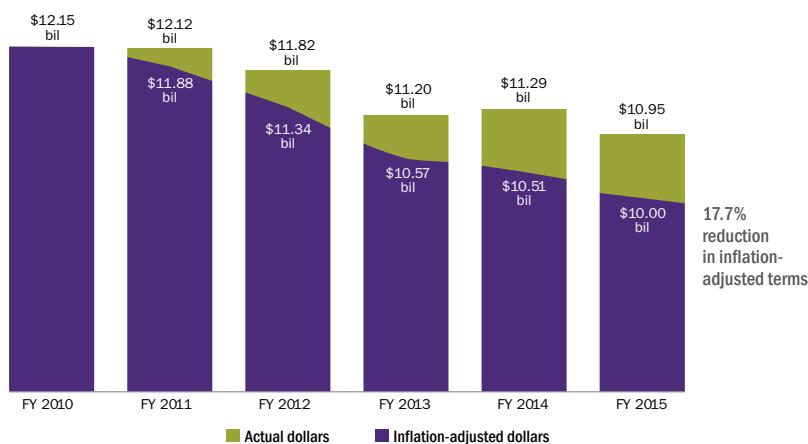
46 Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, Title I, 128 Stat. 2130, 2332 (2014). The total IRS appropriated budget represents the sum of the Taxpayer Services, Enforcement, Operations Support, and Business Systems Modernization accounts.

47 Budget numbers have been rounded, but percentage changes were computed using exact values.

From FY 2005 through FY 2010, the IRS's budget increased, but it has been cut sharply since.<sup>48</sup> In FY 2010, the agency's appropriated budget stood at \$12.1 billion. In FY 2015, its budget was set at \$10.9 billion, a reduction of about 9.9 percent. Inflation over the same period is estimated at about 9.4 percent.<sup>49</sup> In combination, the budget reduction and the effects of inflation suggest an effective reduction of nearly 18 percent.

**FIGURE 1.1.6**

**IRS budget reduction: FYs 2010-2015**



Because of the three-year federal pay freeze, we believe the impact of inflation may be slightly less than broad economic measures would suggest. Taking the effects of the pay freeze into account, we estimate the effective reduction in the IRS budget since FY 2010 has been about 17 percent.<sup>50</sup>

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- 48 See Department of the Treasury, Budget-in-Brief, at <http://www.treasury.gov/about/budget-performance/budget-in-brief/pages/default.aspx> (available for each fiscal year).
- 49 See Office of Management and Budget, *Fiscal Year 2015 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 217-218 (showing Gross Domestic Product (GDP) and year-to-year increases in the GDP) at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/hist.pdf>.
- 50 To determine whether IRS costs rose roughly in proportion to the Gross Domestic Product measure of inflation, we estimated the reduction in the IRS's resources using a different methodology and compared the results. Because the majority of the IRS budget is spent on employee salaries, we used the size of the IRS workforce as a proxy for the inflation-adjusted impact of budget changes over time. From FY 2010 to FY 2014, the number of full-time-equivalent employees (including seasonal employees) fell from 94,618 to 82,982, a drop of 12.3 percent. While the number of employees in FY 2015 has not yet been determined, the agency's budget has been reduced by 3.1 percent overall, and the IRS Commissioner has said the IRS faces cost increases of \$250 million, or 2.2 percent compared with FY 2014 funding levels. Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014) (i.e., a \$250 million increase in costs from the FY 2014 appropriated budget of \$11,290,612,000 translates to a 2.2 percent increase). Viewing in combination the FY 2010 to FY 2014 reduction in staffing of 12.3 percent, the FY 2014 to FY 2015 reduction in the IRS appropriated budget of 3.1 percent, and the Commissioner's statement that the IRS's costs will rise by 2.2 percent in FY 2015, this methodology suggests the inflation-adjusted reduction in the IRS budget from FY 2010 to FY 2015 was approximately 17.6 percent. That result is almost identical to the result produced using the GDP measure of inflation. For purposes of this report, we estimate the inflation-adjusted reduction in the IRS budget from FY 2010 to FY 2015 at about 17 percent (about 10 percent due to the dollar-denominated reduction and about 7 percent due to cost increases).

## The IRS's Resources for Taxpayer Services Have Declined Along with Its Overall Budget

Because the IRS budget consists of several accounts, of which Taxpayer Services is just one, we have also analyzed the trends in funding for taxpayer services. Under the current budget structure, the IRS receives funding through four accounts:

- Taxpayer Services;
- Enforcement;
- Operations Support; and
- Business Systems Modernization.

Over the ten-year period from FY 2006–FY 2015, the Taxpayer Services account received a significantly smaller pre-inflation funding increase than the overall IRS budget.<sup>51</sup> The overall IRS budget rose by 3.5 percent, while Taxpayer Services funding increased by only 0.7 percent. However, the changes did not occur evenly over the decade. From FY 2006–FY 2010, the Taxpayer Services account received considerably smaller increases than the overall IRS budget. From FY 2010–FY 2015, Taxpayer Services fared relatively better because it sustained smaller cuts, with the overall IRS budget reduced by 9.9 percent and the Taxpayer Services budget reduced by 5.4 percent.

In enacting the IRS's budget for FY 2015, Congress cut all accounts except Taxpayer Services, for which it provided the same funding as in FY 2014.<sup>52</sup> While that is comparatively welcome news, the resources available for the IRS to provide taxpayer services will still be lower in FY 2015 for two reasons. First, the Office of the IRS Chief Financial Officer has advised us that approximately 40 percent of the dollars in the Operations Support account, or \$1.5 billion, are apportioned to support Taxpayer Services operations, and the Operations Support account has been reduced by 4.2 percent.<sup>53</sup> A cut of 4.2 percent to \$1.5 billion translates to a reduction of about \$64 million for taxpayer service support.

Second, the Administration's budget proposal provided an estimate of additional funding that would be required in FY 2015 to maintain the same services provided in FY 2014 (known as "Maintaining Current Levels" or "MCLs").<sup>54</sup> The combined MCLs for the Taxpayer Services account and 40 percent of the Operations Support account are about \$138 million. Thus, the effective reduction in funds available to support taxpayer services will be about 3.8 percent.

51 In discussing 10-year trends in other portions of this discussion, we focus on the FY 2005–FY 2014 period. In discussing the Taxpayer Services account, however, relevant data for FY 2005 is not available. Congress realigned the IRS account structure beginning in FY 2007. The IRS Budget-in-Brief for FY 2008 showed how funding for years going back to FY 2006 would have been allocated under the new structure, but no such information was made available for earlier years. See Internal Revenue Service, FY 2008 Budget-in-Brief, at <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf>.

52 Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, Title I, 128 Stat. 2130, 2332 (2014). The total for FY 2014 includes base funding of \$2,122,554,000 and a \$34 million supplement reflecting the portion of a \$92 million non-recurring additional appropriation allocated to the Taxpayer Services account.

53 Funding for the Operations Support account was reduced from about \$3.8 billion in FY 2014 to about \$3.6 billion in FY 2015 (the reduction comes to 4.2 percent when exact numbers are used). The Operations Support account covers, among other things, infrastructure, including rent for IRS office space; shared services and support, including agency management functions, procurement, human resources, and certain employee benefits programs; and information services, including return processing and other tax administration technology systems, and employee technology.

54 See Internal Revenue Service, FY 2015 Budget-in-Brief 5, at <http://www.irs.gov/PUP/newsroom/IRS%20FY%202015%20Budget%20in%20Brief.pdf>

**FIGURE 1.1.7, Reduction in funding for taxpayer service activities from FY 2014–FY 2015**

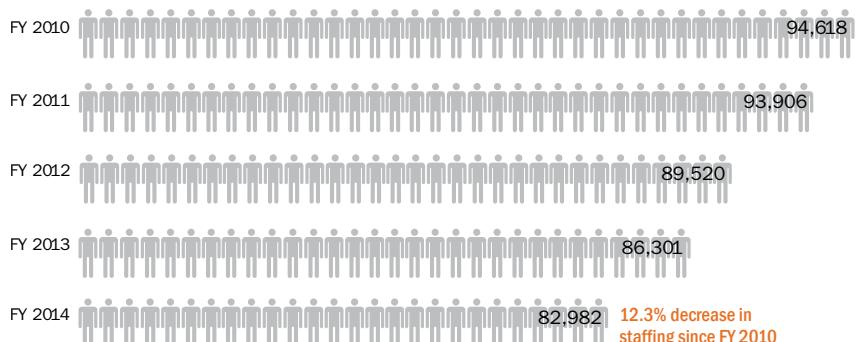
	FY 2014	FY 2015	Maintain current levels	FY 2015 Adjusted
Taxpayer services	\$2,156,554,000	\$2,156,554,000	\$(46,483,000)	\$2,110,071,000
Operations support dollars allocated to taxpayer services	\$1,519,577,000	\$1,455,378,000	\$(27,753,000)	\$1,427,625,000
<b>Total</b>	<b>\$3,676,131,000</b>	<b>\$3,611,932,000</b>	<b>\$(74,236,000)</b>	<b>\$3,537,696,000</b>
<b>Percent change</b>		<b>-1.7%</b>		<b>-3.8%</b>

### Declining Resources Have Led to a Reduced Workforce and Insufficient Employee Training

In light of the significant cuts to its budget, the IRS has substantially reduced the number of employees since FY 2010. The following chart shows that the number of full-time-equivalent employees has fallen by 12.3 percent from FY 2010 to FY 2014.<sup>55</sup>

**FIGURE 1.1.8**

Full-time equivalent IRS employees including seasonals



In light of the inflation-adjusted reduction to the IRS budget in FY 2015, the Commissioner has stated that the IRS workforce will shrink by several thousand additional employees.<sup>56</sup>

There is a close and obvious connection between the number of IRS employees and the IRS's ability to meet taxpayer needs. While the National Taxpayer Advocate believes the IRS can operate more effectively and efficiently in certain areas, the only way the IRS can assist the tens of millions of taxpayers seeking to speak with an IRS employee is to have enough employees to answer their calls. The only way the IRS can timely process millions of letters from taxpayers is to have enough employees to read their letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.

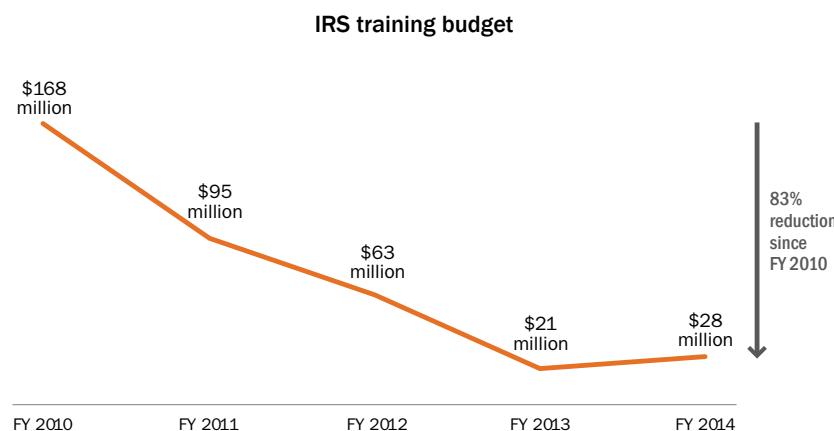
<sup>55</sup> IRS Chief Financial Officer, Corporate Budget. These figures represent actual full-time equivalent employees realized through appropriated dollars.

<sup>56</sup> Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014).

A closely related issue is employee training. In light of the complexity of the tax code and the wide range of issues that arise in tax administration, employees who interact with taxpayers require extensive training. It is of little value—and it is frustrating to taxpayers—if employees on the front lines cannot provide proper assistance.

The following charts show that the IRS's training budget, while up slightly in FY 2014 as compared with FY 2013, is still 83 percent below its FY 2010 level and that dollars spent on training per full-time-equivalent employee have declined substantially.<sup>57</sup>

**FIGURE 1.1.9**



**FIGURE 1.1.10, Training dollars per full-time equivalent (FTE) employee**

Fiscal year	Number of FTEs	Training dollars per FTE
2010	94,618	\$1,774
2011	93,906	\$1,014
2012	89,520	\$705
2013	86,301	\$240
2014	82,982	\$339

As discussed in more detail below, the combination of fewer employees and less training has impaired the IRS's ability to meet taxpayers' service needs.

**The Gap Between an Increasing Workload and Declining Resources Has Left the IRS Unable to Meet Taxpayer Needs, and Due to Concerns the Gap Will Widen, the IRS is Considering Long-Term Strategies That Will Cause Significant Harm to Groups of Taxpayers**

Many taxpayers use the Internet as their initial method of obtaining forms or other information from the IRS. For well over a decade, the IRS has devoted considerable resources to building and improving its website, and it is continuing to improve the availability of its resources online. Yet despite the IRS's efforts to transition taxpayers to its website, demand for personal contact has increased.

57 IRS Chief Financial Officer, Corporate Budget.

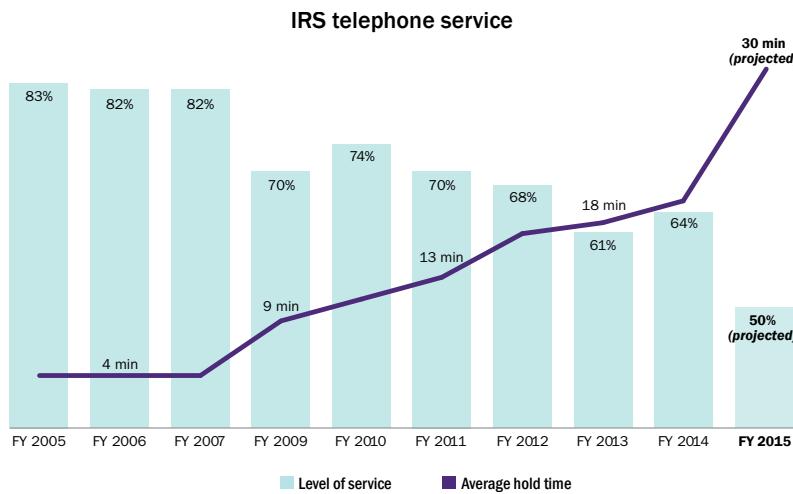
### a. Taxpayer Telephone Calls

During the past decade, the IRS's ability to answer taxpayer telephone calls—and do so promptly—has been declining. Among callers trying to reach a customer service representative on the IRS's Accounts Management telephone lines, the “Level of Service” (*i.e.*, the percentage of calls the IRS is able to answer among all callers seeking to reach a representative) decreased from 83 percent in FY 2005 to 64 percent in FY 2014.<sup>58</sup>

As noted above, FY 2014 was anomalous because the IRS overall received about 24 million fewer calls than the year before, including about 14 million fewer calls seeking to speak with a customer service representative. As a result, the IRS was able to answer about seven million fewer telephone calls than in FY 2013 and still raise its Level of Service from 61 percent to 64 percent.<sup>59</sup> Had the IRS received the same number of calls seeking to reach a representative in FY 2014 as it had received the previous year without additional staffing, the number of calls it answered would have produced a Level of Service below 50 percent.<sup>60</sup>

Moreover, even with the reduction in calls, the hold time for taxpayers who got through to an assist or reached nearly 20 minutes—the continuation of a worsening trend and far longer than the four-minute hold time at the beginning of the 10-year period.<sup>61</sup>

**FIGURE 1.1.11**



In FY 2014, the IRS reduced taxpayer services in several areas to conserve resources. One of the most significant and concerning reductions was to the scope of tax-law questions it answered. During the filing season (January through April), it announced it would answer only “basic” tax-law questions. It declined to answer “more complex” questions. It announced that after the April 15 filing deadline, it would not answer *any* tax-law questions (even basic ones), including tax-law questions from about 15 million

58 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2005 through FY 2014).

59 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of fiscal years 2013 and 2014).

60 *Id.*

61 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2005 through FY 2014).

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We are deeply concerned that the government is largely turning its back on the significant number of taxpayers who require face-to-face assistance to comply with their tax obligations.

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taxpayers who obtained filing extensions or otherwise filed their returns later in the year.<sup>62</sup> We think it is a sad state of affairs when the government writes tax laws as complex as ours—and then is unable to answer any questions beyond “basic” ones from baffled citizens who are doing their best to comply.<sup>63</sup>

As we discussed earlier, the IRS believes its decision to answer only “basic” tax-law questions, combined with fewer-than-usual tax-law changes, was responsible for at least a portion of the decline in telephone calls last year. What this makes clear is that the increase in the Level of Service on the toll-free telephone lines last year was not due to improved taxpayer service. Rather, it came about partly because Congress happened to make virtually no changes to the tax code and partly because the IRS simply shrank the categories of services it provides. Thus, the small “improvement” in the percentage of calls getting through to the IRS occurred, at least in part, because the IRS made a conscious decision to diminish the services it provides to taxpayers.

### b. Taxpayer Correspondence

Just as the IRS’s ability to handle its telephone call volumes has declined over the past decade, its ability to timely process taxpayer correspondence has also fallen off. When the IRS sends a taxpayer a notice proposing to increase his or her tax liability based on math error authority<sup>64</sup> or asserts a penalty against a taxpayer during processing, it typically gives the taxpayer an opportunity to present an explanation or documentation supporting the position taken on the return. Also, before the IRS sends the account of a delinquent taxpayer to its Collection function, the IRS sends the taxpayer a series of notices explaining the balance due and giving the taxpayer the opportunity to pay the debt. Each year, the IRS typically receives around ten million taxpayer responses to these notices, which are known collectively as the “adjustments inventory.”<sup>65</sup>

The IRS has established timeframes for processing taxpayer correspondence, generally 45 days. During the final week of FY 2005, the IRS failed to process two percent of its adjustments correspondence within its timeframes. During the final week of FY 2014, the IRS was unable to process 51 percent of

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62 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>. In both 2013 and 2014, the number of tax returns received after the filing season was about 15 million. See IRS 2014 Filing Season Statistics, at <http://www.irs.gov/uac/2014-and-Prior-Year-Filing-Season-Statistics> (showing 134.3 million returns received by April 25, 2014 and 149.2 million returns received by Nov. 21, 2014, an increase of 14.9 million; the increase over the same time period in FY 2013 was virtually identical.).

63 In fact, one could argue that the IRS should focus primarily on answering complex questions and direct taxpayers seeking answers to simple questions to IRS.gov or IRS publications. However, a question that seems simple to one taxpayer may appear complex to another. For this reason, we believe “*The Right to Quality Service*” means the IRS should answer both simple and complex questions.

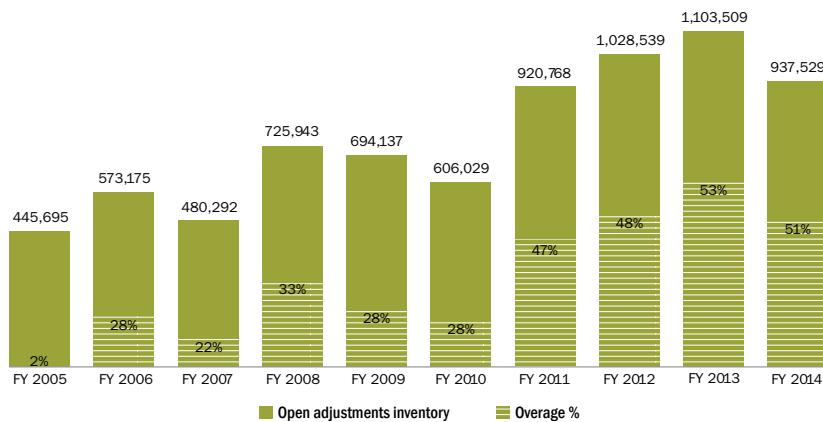
64 See IRC § 6213(b)(1), (g).

65 IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2005 through FY 2014)*.

its adjustments correspondence within the timeframes. That represents a *2,450 percent increase* in the percentage of taxpayer correspondence that the IRS could not answer within its established timeframes.<sup>66</sup>

**FIGURE 1.1.12**

**Open adjustments inventory at fiscal year end**



When the IRS becomes backlogged in processing correspondence, it often leads to adverse taxpayer impact. For a taxpayer who owes additional tax, interest charges and penalties generally will continue to accrue. For a taxpayer who has overpaid, a delay in processing correspondence may translate into a delay in receiving a refund.

As with telephone performance, correspondence performance has dropped off since FY 2010. Comparing the final week of FY 2010 with the final week of FY 2014, the percentage of overage correspondence rose from 28 percent to 51 percent, and open inventory grew from about 606,000 to about 938,000—both significant increases.<sup>67</sup>

### c. Taxpayer Walk-in Assistance

Many taxpayers prefer to communicate with the IRS in person. As an alternative to telephone or correspondence interaction, the IRS maintains walk-in sites known as Taxpayer Assistance Centers, or “TACs.” These sites are particularly important for taxpayers who do not have Internet access and for the low income, elderly, disabled, and Limited English Proficiency (LEP) populations. Over the past decade, the

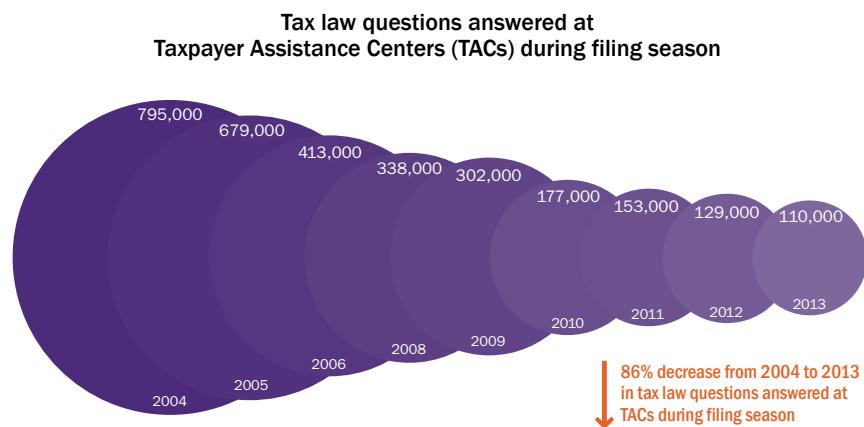
66 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 27, 2014). In auditing IRS correspondence operations, the GAO uses a broader definition of “taxpayer correspondence” than ours. According to the GAO: “We define taxpayer correspondence as written communication from taxpayers as well as work internally generated by IRS employees. This includes amended returns, carry back claims, employer identification numbers, identity theft, and refund check problems.” The GAO “[does] not include correspondence between taxpayers and IRS’s compliance and Automated Underreporter offices as this relates to ongoing work.” GAO, GAO-11-111, 2010 Tax Filing Season: IRS’s Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others 15 n.29 (Dec. 2010). Under the GAO’s broader definition of “taxpayer correspondence,” the IRS received about 20 million pieces of mail overall in FY 2014, and about 50 percent of the inventory was not handled within established timeframes (e.g., it was “overage”). See GAO, GAO-15-163, Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks 18 (Dec. 2014).

67 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Oct. 2, 2010 and Sept. 27, 2014).

services the IRS provides at the TACs have also been limited in several ways. First, the IRS has reduced the number of operational TACs.<sup>68</sup>

Second, we described above that the IRS implemented a new policy last year of declining to answer many tax-law questions—notably, those considered beyond “basic” questions—on its toll-free telephone lines during the filing season and declining to answer *any* tax-law questions after the filing season. The same policy applies at the TACs.<sup>69</sup> According to data compiled by the GAO, the number of tax-law questions answered in the TACs between 2004 and 2013 during the filing season declined by 86 percent—from about 795,000 questions to 110,000.<sup>70</sup>

**FIGURE 1.1.13**



In the past, the annual GAO filing season reports generally did not list the number of tax-law questions outside the filing season, but the numbers are significant. In FY 2004, for example, IRS data indicate that in addition to handling some 795,000 tax-law questions during the filing season, the IRS handled about 638,000 tax-law questions after the filing season. Thus, 45 percent of the 1.433 million questions

68 Between 2011 and 2014, the number of TACs declined from 401 to 382, and the number of TACs with zero or one full-time employee increased from 37 to 80. IRS Wage & Investment Division Response to TAS Information Request (Dec. 23, 2014). TACs with fewer than two employees are subject to unexpected closure due to employee absence and subject to extended wait times when there are more-than-projected taxpayer visits. For more detail, see National Taxpayer Advocate FY 2014 Objectives Report to Congress at 59.

69 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

70 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-08-38, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated* 27-28 (Nov. 2007); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006). To our knowledge, the GAO did not publish comparable data for 2007 or 2014. In a December 2014 report, the GAO published data for FY 2009–FY 2014 that shows a decline of 42 percent in tax-law questions from FY 2013 to FY 2014. However, the data in the report appears to cover more than just the filing season and therefore is not directly comparable to the data for earlier years. See GAO, GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks* 40 (Dec. 2014).

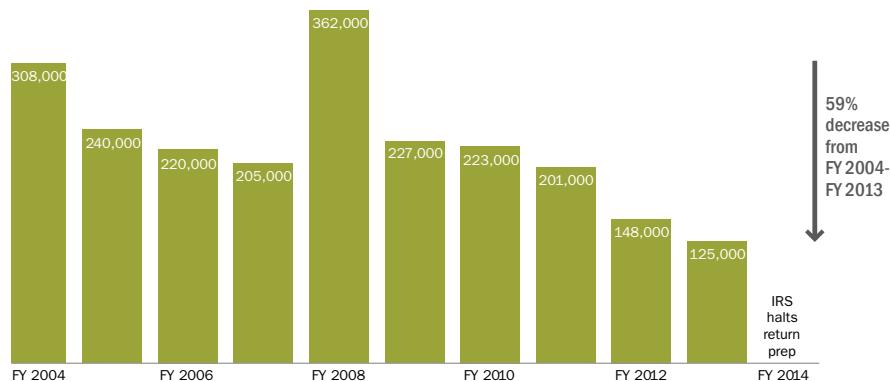
received came outside the filing season.<sup>71</sup> *None* of those 638,000 questions would be answered under the IRS's new policy.

It should be emphasized that the reduction in tax-law questions is not necessarily a function of reduced demand. Rather, the IRS has reduced TAC staffing and reduced the scope of the questions it is willing to answer, and wait times have often been unreasonably long. As a consequence, many taxpayers have simply given up.

Third, the TACs historically prepared tax returns for taxpayers seeking assistance, particularly low income, elderly, and disabled taxpayers. Over the past decade, the IRS has taken steps to reduce return preparation assistance in order to conserve resources. According to the GAO filing season reports, the number of returns prepared during the filing season from 2004 to 2013 declined by 59 percent.<sup>72</sup>

**FIGURE 1.1.14**

Returns prepared at Taxpayer Assistance Centers during filing season



As with tax-law questions, data covering solely the filing season understates the assistance the IRS has provided to taxpayers. In FY 2004, IRS data indicates that in addition to preparing some 308,000 returns during the filing season, the IRS prepared an additional 168,000 returns after the filing season. Thus, roughly 35 percent of the returns prepared by the TACs were prepared after April 15.<sup>73</sup> But with

71 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: Service at Taxpayer Assistance Centers). TAS does not have data on tax-law questions asked outside the filing season for more recent years.

72 GAO, GAO-14-133, 2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources 26 (Dec. 2013); GAO, GAO-11-111, 2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others 45 (Dec. 2010); GAO, GAO-08-38, Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated 27-28 (Nov. 2007); GAO, GAO-07-27, Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006); GAO, GAO-05-67, Tax Administration: IRS Improved Performance in the 2004 Filing Season, But Better Data on the Quality of Some Services Are Needed 18 (Nov. 2004). The GAO filing season reports do not provide a total for 2007. However, the report on the 2007 filing season said the number of TAC-prepared returns was almost 74 percent less than the number of TAC-prepared returns in 2001, and the report on the 2004 filing season said the number of TAC-prepared returns in 2001 was about 790,000. We therefore have provided an approximate total for 2007 in the chart above.

73 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: Service at Taxpayer Assistance Centers).

**It is unacceptable that the IRS may only be able to answer about half the calls it receives, that it will not be able to answer any tax-law questions beyond “basic” ones (and none at all beyond April), and that wait times to speak with customer service representatives will average about a half hour. All too often, the message the government is sending to U.S. taxpayers doing their best to comply with the law is, “We’re sorry. You’re on your own.” U.S. taxpayers deserve better.**

dwindling resources, the IRS had been placing increasing limits on return preparation assistance, and last year it made the decision to discontinue *all* return preparation assistance at the TACs.<sup>74</sup>

These service cutbacks represent a withdrawal from the IRS’s longstanding commitment to provide face-to-face assistance to taxpayers, particularly those who do not have Internet access or who encounter special challenges communicating with the IRS by mail or by phone, often because of language barriers. There is no doubt that organizations can achieve efficiencies by centralizing and automating operations, and centralized service delivery may be adequate for the majority of taxpayers. However, automated services do not meet the needs of many taxpayers. We are deeply concerned that the government is largely turning its back on the significant number of taxpayers who require face-to-face assistance to comply with their tax obligations. The net effect of withdrawing this assistance is that many taxpayers will not receive the help they need and many others will have to pay for a previously free service, often consulting “tax preparers” who generally are unregulated and do not have to meet even minimum competency requirements.<sup>75</sup>

### IRS Oversight Bodies Have Begun to Take Note of the Significance of Service Reductions

The significant IRS budget reductions that have taken place since FY 2010 result from two factors. First, Congress has reduced domestic discretionary spending, including IRS appropriations, as part of an agreement to reduce the federal budget deficit.<sup>76</sup> Second, reports by the Treasury Inspector General for Tax Administration (TIGTA) that the IRS used inappropriate criteria to screen certain applicants for tax-exempt status<sup>77</sup> and that an IRS business unit had

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74 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

75 Since 2002, the National Taxpayer Advocate has been recommending that Congress establish minimum standards for return preparers. On two occasions, the Senate Finance Committee on a bipartisan basis approved legislation to implement our recommendation. H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.). On one occasion, the full Senate approved the legislation as well. H.R. 1528 (incorporating S. 882) (108th Cong.). The House has not taken up companion legislation, but the Ways and Means Oversight Subcommittee held a hearing in 2005 at which five leading tax practitioner and preparer organizations testified in support of minimum preparer standards. See *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 109th Cong. (2005). Beginning in 2011, the IRS attempted to implement minimum preparer standards administratively, but the U.S. Court of Appeals for the District of Columbia upheld a district court decision invalidating the regulations, concluding that the IRS lacked the authority to regulate return preparers. *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014), aff’g 917 F.Supp.2d 67 (D.D.C. 2013). The National Taxpayer Advocate continues to recommend that Congress pass legislation to establish minimum preparer standards or authorize the IRS to do so. For a detailed discussion of this issue, see National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing its Efforts to Effectively Regulate Return Preparers*).

76 The most significant budget reduction was imposed in FY 2013 as a result of sequestration. See Pub. L. No. 112-25, 125 Stat. 240 (2011).

77 TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 2013).

misspent appropriated funds have raised concerns about the management of the agency.<sup>78</sup> The IRS has undergone leadership changes since that time, but concerns persist.

As discussed above, the agency's budget has been reduced by about 10 percent before taking account of inflation and by about 17 percent when cost increases are considered. Those reductions have had a significant impact on all IRS operations.

From a taxpayer advocacy perspective, we are pleased that that IRS oversight bodies are beginning to recognize the impact these reductions are having on taxpayer service.

### a. Congress

The most important IRS overseer is, of course, Congress. Several Members of Congress have made clear publicly and privately that, despite concerns about the IRS overall, they consider it important that the service needs of their constituents be met.

In enacting the IRS's budget for FY 2015, Congress spared the Taxpayer Services account from the reductions it made to other IRS accounts. In addition, the Appropriations Committees' Explanatory Statement accompanying the final bill directed the IRS to "alleviate difficulties faced by rural taxpayers seeking guidance and assistance to properly file their returns" and, more broadly, to examine "the impacts on minority, rural, elderly, disabled, and low-income populations" of certain service reductions the IRS has implemented.<sup>79</sup>

The National Taxpayer Advocate appreciates the Appropriations Committees' attention to the IRS's declining service capabilities and their awareness of the impact declining services are having on taxpayers, particularly rural taxpayers and other taxpayers who face particular challenges navigating the tax system. She will continue to monitor the IRS's performance in meeting taxpayer needs and will keep the committees up to date regarding her findings and concerns.

### b. The Government Accountability Office

The GAO maintains extensive audit coverage over IRS operations, and in particular, issues an annual review of the filing season. By 2012, the GAO was seeing a significant impact to taxpayers. In 2013, it titled its filing season report, "IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources."<sup>80</sup> Among other things, it noted that "[d]espite efficiency gains ..., the [IRS] was unable to keep up with the demand for telephone and correspondence services."<sup>81</sup> It reiterated its prior-year recommendation that the IRS undertake a "dramatic revision in [its] taxpayer service strategy ... to better balance demand for services with available resources."<sup>82</sup>

The "dramatic revision" is needed because the GAO recognized that the imbalance between funding and taxpayer demand for services has reached a point where taxpayer needs are not being adequately met. The

<sup>78</sup> See, e.g., TIGTA, Ref. No. 2013-10-037, *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California* (May 2013).

<sup>79</sup> Explanatory Statement accompanying H.R. 83, Consolidated and Further Continuing Appropriations Act, 2015 – Division E, at 10, at <http://rules.house.gov/sites/republicans.rules.house.gov/files/113-1/PDF/113-HR83sa-ES-E.pdf> (became Pub. L. No. 113-235).

<sup>80</sup> GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources*, "Highlights" page (Dec. 2013).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

GAO recommended that the IRS strategy could be used “to facilitate a discussion with Congress and other stakeholders about the appropriate mix of service, level of performance, and resources.”<sup>83</sup>

In its report on the 2014 filing season, the GAO again noted its concern about service levels:

Since fiscal year 2010, IRS has absorbed approximately \$900 million in budget cuts, resulting in significant staffing declines. Performance has declined in both enforcement and taxpayer services including telephone and correspondence services.<sup>84</sup>

### c. Treasury Inspector General for Tax Administration

TIGTA has also called attention to the IRS’s funding challenges in its audit reports and congressional testimony. For example, in testimony before the Senate Appropriations Subcommittee on Financial Services and General Government in April 2014, the Inspector General stated:

These budget constraints continue to result in the IRS cutting service to taxpayers which make it difficult for the IRS to effectively assist taxpayers. As demand for taxpayer services continues to increase, resources devoted to customer service have decreased, thereby affecting the quality of customer service that the IRS is able to provide.<sup>85</sup>

### d. IRS Oversight Board

The IRS Oversight Board consistently has been recommending that the IRS budget be increased and has been expressing concern about the impact of budget cuts on taxpayer service.<sup>86</sup> In addition, the Oversight Board has conducted a Taxpayer Attitude Survey in each year since 2004. In the 2014 survey, 74 percent of taxpayers reported they were satisfied with their personal interaction with the IRS. While that is a respectable number, the Board indicated it was a notable decline from prior years. In releasing the survey, IRS Oversight Board Chairman Paul Cherecwich, Jr., stated:

Taxpayer satisfaction with IRS customer service has fallen to its lowest level in more than a decade. The Board believes this can be directly tied to deep cuts in IRS funding which have served only to punish honest America’s taxpayers who must endure long wait times over the IRS toll-free telephone lines and at walk-in centers. Taxpayers understand what’s going on—a solid majority [61 percent] supports extra funding for IRS customer service .... It is time to reinvest in the IRS to help honest taxpayers comply with a complex tax code and to protect the integrity of our tax system.<sup>87</sup>

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<sup>83</sup> GAO, GAO-14-133, 2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources, “Highlights” page (Dec. 2013).

<sup>84</sup> See GAO, GAO-15-163, Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks 1 (Dec. 2014). In light of the additional cuts made in the IRS’s budget for FY 2015, the overall budget reduction since FY 2010 now comes to about \$1.2 billion.

<sup>85</sup> Review of the President’s Fiscal Year 2015 Funding Request for the Department of the Treasury and the Internal Revenue Service: Hearing Before the Subcomm. On Financial Services and General Government of the Senate Committee on Appropriations, 113th Cong. (2014) (statement of J. Russell George, Treasury Inspector General for Tax Administration).

<sup>86</sup> See IRS Oversight Board, FY 2015 IRS Budget Recommendation Special Report (May 2014), at <http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20FY2015%20Budget%20Report-FINAL.pdf>.

<sup>87</sup> IRS Oversight Board News Release, Vast Majority of Taxpayers Still Have No Tolerance for Income Tax Cheating; Solid Majority Trust IRS and Support Additional Funding (Dec. 8, 2014), at <http://www.treasury.gov/IRSOB/news/Pages/12082014.aspx>.

## CONCLUSION

Since FY 2010, the IRS's budget has been reduced by about 17 percent in inflation-adjusted terms while taxpayer needs have remained high overall and have increased in certain areas. The key reasons for the funding reduction have been sequestration and a mistrust of the IRS after certain significant management mistakes. Notwithstanding these concerns, the National Taxpayer Advocate believes Congress and the IRS have a shared responsibility to ensure that the taxpayers who pay our nation's bills receive the assistance they need when they seek to comply with their tax filing and payment obligations. It is unacceptable that the IRS may only be able to answer about half the calls it receives, that it will not be able to answer any tax-law questions beyond "basic" ones (and none at all beyond April), and that wait times to speak with customer service representatives will average about a half hour. All too often, the message the government is sending to U.S. taxpayers doing their best to comply with the law is, "We're sorry. You're on your own." U.S. taxpayers deserve better.

Whatever concerns may continue to exist about the IRS, we urge Members of Congress to provide sufficient funding for the IRS to meet taxpayer needs effectively and timely and to make taxpayers' *right to quality service* more than a mere distant aspiration.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress take the following actions:

1. In the short term, carefully monitor taxpayer service trends and ensure that the IRS receives the oversight and funding it requires to meet the needs of U.S. taxpayers.
2. Over the longer term, undertake comprehensive tax reform to reduce the complexity of the Internal Revenue Code and the associated compliance burdens it imposes on taxpayers.

**MSP****#2**

## TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions

### RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage & Investment Division

### DEFINITION OF PROBLEM

The National Taxpayer Advocate believes that when taxpayers are attempting to comply with laws that require them to turn over a significant portion of their incomes to pay our nation's bills, they have a right to expect that their government will take their telephone calls and answer their letters. The IRS agrees and included the *right to quality service* as a fundamental taxpayer right in its recent adoption of a taxpayer bill of rights.<sup>1</sup> The National Taxpayer Advocate is concerned, however, that the ongoing cuts to the IRS's budget in fiscal years (FY) 2010–FY 2014<sup>2</sup> have resulted in an unacceptably poor level of taxpayer service, a problem that will only be exacerbated in FY 2015.<sup>3</sup>

For FY 2015, the IRS is projecting it will be able to answer only about 50 percent of the telephone calls it receives from taxpayers seeking to speak with a telephone assistor, and it projects that those taxpayers lucky enough to get through "could easily wait 30 minutes or more for limited service."<sup>4</sup> This falls woefully short of the service that taxpayers deserve.

In response to these concerns, the Wage & Investment (W&I) Division and the Taxpayer Advocate Service (TAS) are collaborating on the development of a ranking methodology for the major taxpayer service activities offered by W&I. The new methodology will take taxpayer needs and preferences into account while balancing them against the IRS's need to conserve limited resources, thus enabling the IRS to make resource allocation decisions that will optimize the delivery of taxpayer service activities given resource constraints.<sup>5</sup> Congress will also be able to use the results of this methodology to determine whether it is adequately funding core taxpayer service activities. But limitations imposed by the lack of available data have delayed implementation, and it is unclear whether the IRS will devote the resources necessary to complete development of the methodology. In the absence of this or a similar methodology, the IRS lacks a principled basis for making the difficult resource allocation decisions necessitated by today's tight budget environment.

1 See IRS News Release, IR-2014-72, IRS Adopts "Taxpayer Bill of Rights"; 10 Provisions to Be Highlighted on IRS.gov, in Publication 1 (June 10, 2014), available at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights:-10-Provisions-to-be-Highlighted-on-IRSGov-in-Publication-1>.

2 The FY 2014 funding level of 11.3 billion is slightly above the 11.2 billion FY 2013 funding level, but is still significantly below the FY 2010 12.1 billion funding level. See Department of the Treasury, Budget-in-Brief, at <http://www.treasury.gov/about/budget-performance/budget-in-brief/pages/default.aspx> (available for each fiscal year).

3 For an in-depth discussion of the impact of IRS budget cuts on taxpayer service, see Most Serious Problem: *Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*.

4 Email from Commissioner Koskinen to All Employees, *Fiscal Year 2015 Funding* (Dec. 17, 2015).

5 We use the word "optimize" to mean that the ranking methodology will provide the IRS with a rigorous way to select the combination of competing taxpayer service initiatives that maximizes the "value" of service delivery given available resources.

## ANALYSIS OF PROBLEM

### The IRS Rationale for Recent Deep Cuts to Taxpayer Service is Unclear.

Since FY 2010, the IRS budget has been cut by ten percent, resulting in an ongoing erosion in IRS taxpayer service delivery, and culminating in a number of major cuts the IRS made to taxpayer services in FY 2014:<sup>6</sup>

- The IRS had fewer Customer Service Representatives on the phones to answer questions;
- IRS assistors, both on the phones and at the taxpayer assistance centers (TACs), only answered tax law questions during the filing season even though millions of taxpayers get extensions and do not file until later in the year;
- The IRS limited the scope of questions answered to the most “basic” taxpayer questions;
- The IRS ended tax return preparation services at its TACs; and
- The IRS had fewer TACs in operation.

In response to these budget cuts, the IRS has come under scrutiny by external oversight organizations who have questioned the IRS’s rationale for its budget decisions. They have not been satisfied with the IRS’s response to their inquiries.

In a recent review of the IRS’s provision of face-to-face services, the Treasury Inspector General for Tax Administration (TIGTA) found that the IRS did not have a rigorous methodology for identifying how best to make service cuts affecting face-to-face services, stating:

The IRS eliminated or reduced services at Taxpayer Assistance Centers as part of its Fiscal Year 2014 Service Approach … The reduction in service was implemented without completing the required taxpayer burden risk evaluation for the taxpayers most likely to visit a Taxpayer Assistance Center, such as low-income, elderly, and limited-English-proficient taxpayers … For example, taxpayers’ additional travel costs, wait times, and access to volunteer tax return preparation sites were not analyzed …<sup>7</sup>

TIGTA recommended that the IRS:

Continue working with the National Taxpayer Advocate to complete the Service Priority Project Initiative as well as coordinate the inclusion of Taxpayer Assistance Center services in future surveys that can be used with the Taxpayer Choice Model to obtain data on the services that are most important to taxpayers.

Similarly, when the Government Accountability Office (GAO) conducted its annual review of the IRS filing season, it found the IRS did not have an effective plan for analyzing service changes:

While IRS collected some data that it could use to evaluate effectiveness, it did not develop plans to analyze the data or track it in a way that would allow officials to draw causal connections and develop valid conclusions about the effectiveness of its 2014 service changes.<sup>8</sup>

<sup>6</sup> See Most Serious Problem: *Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*.

<sup>7</sup> See TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established*, 5-6 (June 27, 2014).

<sup>8</sup> See GAO, GAO-15-163, *TAX FILING SEASON: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks*, 22 (Dec. 2014).

As discussed below, W&I is collaborating with TAS on the Service Priorities Project. The project team is developing a tool that will provide the IRS with better information to make budget allocation decisions. Development of the ranking took has been delayed, however, due to the lack of available data needed to fully populate the ranking tool. Recently, the IRS Oversight Board questioned TAS at length on the goals and status of the Service Priorities Project, emphasizing the need for the IRS to have a methodology to inform its taxpayer service budget allocation decisions.<sup>9</sup>

### Automation Is Not a Complete Solution.

To address ongoing budget pressures, the IRS is increasingly turning away from personal service toward automation, and it is clear that cost-effective innovations could yield improvements in taxpayer service. For example, the IRS allows taxpayers to conduct simple actions through IRS.gov, but taxpayers cannot use the site for tasks such as:

- Correcting computational errors;
- Checking account status; or
- Obtaining prior year return information immediately.

By requiring a taxpayer to write, call, or visit a TAC to complete these tasks, the IRS creates a higher volume of calls, correspondence, and TAC visits, leading to lower levels of service for each of these service channels.

Moving tasks to the Internet would enable computer-savvy taxpayers to use this channel for these actions and could reduce stress on IRS walk-in, telephone and correspondence resources, allowing IRS assistors to focus on taxpayers who need and prefer the TACs, the phone or correspondence.

While automated options are an important component of a comprehensive taxpayer service strategy, the IRS cannot rely solely on these options to close gaps. As the tax code grows more complex, taxpayer issues become increasingly difficult and less suitable for automation. Additionally, IRS research shows that taxpayers prefer personal service for some activities, and that certain segments of the taxpaying public are unable or unwilling to use automation.

... taxpayers report they use IRS.gov most often to complete transactional tasks (*i.e.*, tasks that require minimal in-person assistance, such as obtaining a form or publication). However, when responding to a notice or obtaining payment information, taxpayers said that they are more likely to call the IRS toll-free telephone lines....Research also suggested that age, income, and education are correlated to taxpayer behavior, and recent findings show that taxpayers with lower household incomes reported higher use of non-web-based IRS service channels than taxpayers in higher income households ... Low income, limited English proficient (LEP), and elderly taxpayers tend to report a somewhat higher preference for the TAC channel and a lower preference for the electronic channel than the majority of taxpayers as a whole ... Low income and LEP taxpayers report using the telephone channel more than the overall taxpaying population.<sup>10</sup>

<sup>9</sup> IRS Oversight Board Operations Committee Meeting (Dec. 2, 2014). See also follow-up email from the IRS Oversight Board received on Dec. 11, 2014, requesting additional information on the Service Priorities Project ranking model (on file with author).

<sup>10</sup> See IRS, *The Taxpayer Assistance Blueprint: Taxpayer Service Improvements: October 2012 to September 2013* 3 (March 24, 2014).

As discussed below, implementation of the Service Priorities ranking methodology will enable the IRS to identify a proper balance between automated and personal service delivery.

### **The Service Priorities Project Can Help Optimize Service Delivery.**

In response to the National Taxpayer Advocate's concerns about the erosion of taxpayer service delivery, the W&I Division and TAS are collaborating on an initiative, the Service Priorities Project, which will enable the IRS to make resource allocation decisions that will optimize the delivery of taxpayer service activities given resource constraints. Congress will also be able to use the results of this methodology to determine whether it is adequately funding core taxpayer service activities. The implementation of this approach is particularly urgent in light of today's funding environment for taxpayer service.

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**The IRS included the right to quality service as a fundamental taxpayer right in its recent adoption of a taxpayer bill of rights. The National Taxpayer Advocate is concerned, however, that the ongoing cuts to the IRS's budget in fiscal years 2010-2014 have resulted in an unacceptably poor level of taxpayer service, a problem that will only be exacerbated in fiscal year 2015.**

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The project team is developing a ranking methodology for IRS taxpayer services that takes taxpayer needs and preferences into account. The methodology will value each of the major taxpayer services offered by the IRS from both the government's and the taxpayers' perspective. The IRS will be able to use this ranking methodology to make resource allocation decisions based on highest valued services in the face of budget or staffing constraints.

The methodology measures "value" using separate sets of criteria for taxpayers and the IRS. This is necessary because taxpayers and the IRS have different priorities. The IRS is concerned with conserving resources, especially in a tight budget environment.<sup>11</sup> Taxpayers need services that will enable them to understand their tax obligations and resolve tax issues without imposing undue burden. Frequently, these needs are best met by personal services that are more costly to the IRS than automated services, such as internet based services.

The methodology assigns a score to each initiative that reflects its overall value based on an appropriate balance between criteria that weigh the value of the initiative to the IRS and to the taxpayer.<sup>12</sup> The IRS can use these scores to choose between competing initiatives and identify a proper balance between automated and personal service delivery.

### **Service Priorities Project Status and Challenges**

TAS has recently held a number of conference calls with W&I Research to discuss the proposed ranking methodology and the steps needed to complete development of the ranking tool. TAS and W&I appear to have informal agreement on the proposed methodology, but some data availability issues still need to be resolved.

The project team identified a number of "data gaps" while attempting to do a trial ranking using a prototype ranking tool and available data. Some of these "data gaps" can be filled by tax year 2013 data that has recently become available, but some known gaps remain. TAS Research and W&I Research have informally agreed to conduct another trial ranking using the new 2013 data. We anticipate completing

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11 For a discussion of the current IRS funding environment see Most Serious Problem: *Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*.

12 For a more complete discussion of the ranking methodology, see National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 57-66 (Research Study: *The Service Priorities Project: Developing a Methodology for Optimizing the Delivery of Taxpayer Services*).

this ranking in early 2015. At that time the project team will identify all remaining data needs and TAS will need to negotiate an agreement with W&I to meet those needs.

## CONCLUSION

The National Taxpayer Advocate urges W&I to work with TAS to complete the research and data collection necessary to make the ranking tool effective as expeditiously as possible. While populating the tool will require the IRS to make additional investments in a time of severe resource constraints, the tool will provide the kind of information the IRS needs to inform the difficult resource allocation decisions that severe resource constraints impose. The tool will also position the IRS to make better investment decisions in the future to reach its goal of providing the world-class taxpayer service that taxpayers deserve.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Complete the ranking process with the newly available tax year 2013 data and identify all steps needed to fully populate the ranking tool.
2. Develop and execute a memorandum of understanding with the National Taxpayer Advocate to document the steps needed to complete development of the Service Priorities Project ranking tool.
3. Incorporate the ranking tool and methodology into plans currently under development for the Services on Demand initiative.<sup>13</sup>

<sup>13</sup> The Services on Demand Initiative has the goal of developing a multi-year plan to build “A tax administration ecosystem that delivers tailored efficient services where, when, and how customers should be served.” Services on Demand Executive Brief not currently available for distribution (June 2014).

**MSP  
#3****IRS LOCAL PRESENCE: The Lack of a Cross-Functional  
Geographic Footprint Impedes the IRS's Ability to Improve  
Voluntary Compliance and Effectively Address Noncompliance****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

The Internal Revenue Restructuring and Reform Act of 1998 (RRA 98) required the IRS to replace its geographic-based structure with organizational units serving groups of taxpayers with similar needs.<sup>1</sup> Congress mandated that the IRS change its organizational structure but did not require the IRS to eliminate its physical local presence or centralize its employees in certain locations. While the new taxpayer-based structure has produced some benefits, the elimination of a functional geographic presence, with IRS employees understanding the needs and circumstances of a specific geographic economy, may harm taxpayers and erode compliance. Maintaining a local presence in both service and enforcement operations is important because such presence enables the IRS to:

- Better understand local economic, social, and cultural conditions and tailor initiatives accordingly to maximize voluntary compliance;
- Identify local variations of nationwide compliance problems;
- Identify and address significant local compliance problems that do not show up nationwide and are unique to a particular local environment; and
- Put a local, human face on the IRS organization through the presence of employees who live in the communities and interact with taxpayers on a day-to-day basis.

By virtually eliminating geographic presence after RRA 98, the IRS has created the following concerns:

- **Increased Taxpayer Burden May Decrease Compliance.** Reduced geographic presence increases taxpayer burden and can lead to reduced compliance.
- **One Size Does Not Fit All Taxpayers.** The IRS does not tailor service or enforcement initiatives to the needs of taxpayers in different regions, which violates the taxpayer's rights to *quality service* and *a fair and just tax system*.
- **Missed Compliance Opportunities.** Centralized compliance initiatives miss chances to identify and address noncompliance specific to a geographic region.
- **Erosion of Taxpayer-Based Structure Since Restructuring.** The taxpayer-based structure has eroded since RRA 98 implementation.

<sup>1</sup> Internal Revenue Service Reform and Restructuring Act of 1998 (RRA 98), Pub. L. No. 105-206, §§ 1001(a)(1) - (3) (1998).

- **The IRS Can Learn From the Experience of Other Taxing Jurisdictions.** For example, Her Majesty's Revenue and Customs (HMRC) in the United Kingdom has taken an approach to taxpayer service and enforcement that combines the expertise of centralization with the ability to reach out to taxpayers on a local level.<sup>2</sup>
- **Congress Did Not Mandate the Elimination of Local Presence.** The IRS can retain its taxpayer-based structure and still maintain local presence.

## ANALYSIS OF PROBLEM

### Background

#### *Geographic Presence Promotes Voluntary Compliance.*

The U.S. tax system is built on voluntary compliance. The IRS structure should enable the IRS, through its service and enforcement activities, to influence taxpayers to voluntarily comply. Encouraging voluntary compliance is the most cost-effective approach for the government in the long term and is less harmful and intrusive to taxpayers.

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Research has shown that to improve tax compliance, one-size-fits-all enforcement is less effective than a “tax morale” model of tax administration. The tax morale model uses traditional enforcement techniques such as penalties and audits, but emphasizes taxpayers’ internal motivations and develops more individualized methods to match differing attitudes and behaviors of different types of taxpayers.<sup>3</sup>

For the 2012 and 2013 Annual Reports, the Taxpayer Advocate Service (TAS) developed and administered a survey to a national sample of sole proprietors to determine the factors that influence compliance behavior in this population. TAS also identified geographic communities where a disproportionate number of taxpayers were deemed to be either high or low compliant. Among many other findings, the studies found that respondents from low-compliance communities were suspicious of the tax system and its fairness. Those in the low-compliance group were clustered in geographic communities while those in the high-compliance group were more widely dispersed. The low-compliance group also reported more participation in local institutions. The research found that norms of belief and behavior, particularly local norms, were the most influential factors of tax compliance.

Accordingly, the research suggests the IRS should retain a local presence and conduct outreach and education events, particularly in low compliance communities.<sup>4</sup> Therefore, to maximize voluntary compliance, a one-size-fits-all approach may not be ideal. In fact, it seems to run counter to the IRS’s goals of fostering voluntary compliance and combatting noncompliance.

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2 HM Revenue and Customs News, *HMRC Comes Out of the Office to Support Customers Who Need Extra Help* (Feb. 12, 2014); HM Revenue & Customs, *Issue Briefing: Tackling Tax Evasion* (Jan. 2014).

3 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 138-50 (Research Study: *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

4 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 60-61 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*). Geographers have classified regions of the U.S. based on local history, values, behavior, and culture. See Colin Woodard, *American Nations: A Hist. of The Eleven Rival Regional Cultures of No. Amer.* (N.Y.: Viking, 2011).

### ***The IRS Moved from Geographic Presence Model to Centralization After the 1998 Restructuring.***

Prior to reorganization, the IRS was comprised of 33 districts and ten campuses (then called service centers). Each of these 43 organizations reported to a director who was charged with administering the entire tax code for every kind of taxpayer—from low income individuals to high income businesses, with simple and complex problems, from taxpayer outreach and education to criminal investigation—within his or her district or campus. All of these units were geographically based and functionally separate, with multiple management layers. Four regional offices and a national office conducted oversight of these districts.<sup>5</sup>

Congressional hearings in late 1997 uncovered a wide array of inconsistencies among districts, inefficiencies, and deficiencies in taxpayer service and enforcement practices, which Congress attributed in part to the geographically based structure.<sup>6</sup> The hearings prompted the enactment of RRA 98, which required the IRS to “eliminate or substantially modify the existing organization based on a national, regional, and district structure” and to “establish organizational units serving particular groups of taxpayers with similar needs.”<sup>7</sup> Congress also directed the IRS to “place a greater emphasis on serving the public and meeting taxpayers’ needs.”<sup>8</sup> Taxpayers are now classified as belonging to one of four operating divisions, each nominally charged with end-to-end responsibility for serving that particular group of taxpayers. Theoretically, this structure benefits taxpayers because it enables the IRS to gain a better understanding of the particular needs of each group and develop procedures accordingly.<sup>9</sup> However, it can also mean that taxpayers with the same issue receive different treatment depending on the operating division, or even campus, handling their cases.<sup>10</sup> Moreover, taxpayers with the same problem, but with specific needs because of localized community conditions, now work with IRS employees on the other side of the country who have no knowledge or understanding of those conditions. Finally, as we discuss below, the stated goals of the 1998 reorganization have been considerably undermined by later IRS staffing and policy decisions.

### ***Reduced Geographic Presence Increases Taxpayer Burden and May Decrease Voluntary Compliance.***

While the IRS is obligated to enforce complex tax laws, it does have the ability to simplify administrative procedures and make assistance accessible to all taxpayers. Taxpayers’ inability to obtain information and

5 See IRS Document 11052, IRS Organization Blueprint 2000 1-11, Figure 1-2 (Rev. 4-2000).

6 See *Report of the National Commission on Restructuring the Internal Revenue Service: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means* 105th Cong. (July 24, 1997). See also *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. (Jan. 28-29, 1998; Feb. 5, 11, and 25, 1998); *National Commission on Restructuring the Internal Revenue Service, A Vision for a New IRS* (1997).

7 RRA 98, Pub. L. No. 105-206, § 1001(a) (1998).

8 Pub. L. No. 105-206 § 1002 (1998).

9 For more information about the rationale and benefits of the IRS structure after RRA 98, see *Treasury Tax Court Nominations: Hearing Before the S. Comm. on Finance*, 105th Cong. (Jan. 28, 1998) (statement of Charles O. Rossotti, IRS Commissioner).

10 See, e.g., *National Taxpayer Advocate 2004 Annual Report to Congress* 132-142 (Most Serious Problem: *Inconsistent Campus Procedures*); *Annual RRA '98 Joint Hearing on IRS Progress: Hearing Before J. Comm. on Tax'n* (May 3, 2000) (statement of Charles O. Rossotti, IRS Commissioner) (“Each operating division will be responsible for creating and executing business practices and strategies to meet those needs, and managers at all levels will be expected to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their respective divisions.”) (Emphasis added); *Treasury Tax Court Nominations: Hearing Before the S. Comm. on Finance*, 105th Cong. (Jan. 28, 1998) (statement of Charles O. Rossotti, IRS Commissioner). In response to RRA 98, the IRS established the following four taxpayer-based operating divisions: (1) Wage and Investment Division (W&I); (2) Small Business/Self-Employed Division (SB/SE); (3) Tax Exempt and Government Entities (TEGE) Division; and (4) Large and Mid-Size Businesses (LMSB), which became the Large Business and International Division (LB&I) in 2010. *IRS, IRS Realigns and Renames Large Business Division, Enhances Focus on International Tax Administration*, IR-2010-88 (Aug. 4, 2010).

resolve tax issues by talking to a live IRS employee will certainly impact their ability and willingness to comply. By reducing services at Taxpayer Assistance Centers (TACs), centralizing examination and collection functions, and reducing the level of service on the phones, the IRS is essentially setting the taxpayer up to fail.<sup>11</sup> Even in the age of technological advances, there are still limited options for substituting face-to-face or local interaction with some taxpayer populations. The reduced geographic footprint is also a significant issue for taxpayers living abroad, as the IRS has decreased the number of tax attaché posts in foreign cities from 15 to three—even though the number of individual international taxpayers has increased 50 percent in the past five years alone.<sup>12</sup>

The reduced geographic footprint in enforcement activities is equally burdensome to taxpayers. Some states have neither an IRS Appeals Officer nor a Settlement Officer, and the number of states without these employees has grown from nine in 2011 to 12 in 2014. The IRS consolidated 33 geographically dispersed lien units into a single centralized unit in 2005, virtually eliminating taxpayers' ability to walk into an IRS office and obtain an immediate release of a lien.<sup>13</sup>

### **One Size Does Not Fit All Taxpayers—The IRS Does Not Tailor Service or Enforcement Initiatives to Meet the Particular Needs of Taxpayers in Different Geographic Regions.**

While the post-RRA 98 IRS is built around categories of taxpayers, the IRS has made no real effort to tailor service or enforcement initiatives to meet the particular needs of taxpayers based on their geographic locations. Failure to maintain a local presence infringes upon the taxpayer's *right to quality service*, whereby the taxpayer has the right to receive clear, easily understandable communications from the IRS. It also infringes upon the taxpayer's right to a *fair and just tax system*, because the taxpayer has the right to expect the system to consider facts and circumstances that might affect his or her underlying liabilities, ability to pay, or ability to provide information timely.<sup>14</sup> National "one-size-fits-all" service and enforcement policies for each category of taxpayer and the centralization of much IRS activity into remote "campuses" means the IRS is not addressing the particular attributes of local taxpayer populations. Therefore, not only will the IRS potentially violate the taxpayers' rights but the service and enforcement initiatives designed at the national level may vary in effectiveness across geographic lines.

Localized outreach and education have all but disappeared. For example, the Small Business/Self-Employed division (SB/SE), which serves approximately 65 million taxpayers, has no outreach and education employees in 13 states, plus the District of Columbia. In addition, the Wage and Investment division (W&I), which is responsible for helping approximately 126 million individuals understand and comply with their tax obligations, devotes about six percent of its outreach and education budget to

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11 See National Taxpayer Advocate 2013 Annual Report to Congress 20-39 (Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

12 National Taxpayer Advocate 2009 Annual Report to Congress 137; National Taxpayer Advocate 2013 Annual Report to Congress 205; Memorandum from Douglas W. O'Donnell, Acting Deputy Commissioner Large Business and International Division, to LB&I Commissioner, *Beijing Post Closure* (Oct 16, 2014).

13 See Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State, infra*; see also National Taxpayer Advocate 2006 Annual Report to Congress 130.

14 For more information about these and other taxpayer rights, see IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights/Taxpayer-Bill-of-Rights-Channel-Page#service>.

**Localized outreach and education have all but disappeared. For example, the Small Business/Self Employed division, which serves approximately 65 million taxpayers, has no outreach and education employees in 13 states, plus the District of Columbia.**

activities that involve face-to-face contact with taxpayers.<sup>15</sup> Despite the trend to reduce local outreach and education resources, the National Taxpayer Advocate urges the IRS, when designing an outreach and education campaign, to give significant attention to local culture and how different messages will be received across geographic lines

Without local expertise, it is nearly impossible for the IRS to understand and address the distinct attributes of local taxpayer populations. Some taxpayers may not require face-to-face assistance but instead need local personnel who understand their particular environment or occupation. IRS employees should have knowledge of local issues and know the demographics and normative culture of local populations.<sup>16</sup>

As illustrated in the Appendix to this Most Serious Problem, the IRS significantly reduced staffing in the local offices between 2001 and 2014. At the same time, the IRS increased staffing at the campuses, due to centralization.

### **Centralized Compliance Initiatives Miss Opportunities to Identify and Address Noncompliance Specific to a Geographic Region.**

Centralized compliance initiatives may miss chances to target strategies to locally noncompliant groups of taxpayers.<sup>17</sup> Significant local noncompliance may not even show up on the radar at a national level. In contrast, Local Compliance Initiative Projects (CIPs)<sup>18</sup> are likely to have a greater effect on voluntary compliance by cash economy businesses than seemingly random examinations.<sup>19</sup>

An example of a successful local initiative is one that took place in the early 1990s in Alaska, where the IRS used a “Compliance 2000” project to address noncompliance by commercial fishermen, which resulted from confusion as well as community norms and attitudes. With the assistance of local authorities, the IRS compared a list of fishing permit and license holders with existing data to identify nonfilers.

15 IRS, Individual Returns Transaction File, IRS Compliance Data Warehouse (Tax Year (TY) 2013 returns filed through Oct. 2014); IRS HRRC, Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees as of November 1, 2014 (Nov. 19, 2014) (13 states include Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, Wyoming); National Taxpayer Advocate 2012 Annual Report to Congress 319 (Most Serious Problem: *The IRS is Substantially Reducing Both the Amount and Scope of Its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of Its Remaining Outreach Activities, Thereby Risking Increased Noncompliance*).

16 See National Taxpayer Advocate 2011 Annual Report to Congress 273-335 (Most Serious Problem Category: *Diversity Issues*).

17 See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 168 (Most Serious Problem: *The IRS Exam Function is Missing Opportunities to Maximize Voluntary Compliance at the Local Level*); National Taxpayer Advocate 2009 Annual Report to Congress 185 (Most Serious Problem: *The IRS Does Not Have a Significant Audit Program Focused on Detecting the Omission of Gross Receipts*); National Taxpayer Advocate 2004 Annual Report to Congress 220 (Most Serious Problem: *IRS Examination Strategy*).

18 CIP procedures are followed when groups of returns with the same areas of potential noncompliance are selected and forwarded for examination in a project, either in the campus or area office. CIPs are characterized by the use of internal and external data to identify and quantify areas of noncompliance. They usually involve a study, survey, or other analysis of a group of individuals such as those involved in a specific economic activity, undertaken to identify, measure, or analyze compliance with the tax laws. CIPs are often multi-functional in their approach. IRM 4.19.10.2.5, SB/SE Compliance Initiative Project (CIP) Procedures, (Jan. 1, 2011).

19 Underreported income from the “cash economy”—taxable income from legal activities that is not subject to information reporting or withholding—is probably the single largest component of the tax gap, likely accounting for an estimated \$120 billion per year. IRS, Tax Gap for Tax Year 2006, Overview, Chart 1. See National Taxpayer Advocate 2007 Annual Report to Congress 35 (Most Serious Problem: *The Cash Economy*); National Taxpayer Advocate 2005 Annual Report to Congress 55 (Most Serious Problem: *The Cash Economy*). National Taxpayer Advocate 2004 Annual Report to Congress 220 (Most Serious Problem: *IRS Examination Strategy*).

Local IRS officials also proposed changes to federal and state laws to reduce confusion, promote compliance, and facilitate collection. The IRS simultaneously launched extensive outreach and education efforts in remote fishing villages and on fishing vessels, which included the preparation of returns and training local volunteers to assist taxpayers. The IRS also enlisted the help of local community organizations, which hired a Yupik speaker full-time to help local residents with tax problems, provided loans to help fishermen pay delinquencies, and helped to publicize the IRS's compliance initiatives.

The Alaska-based compliance initiative brought in over 1,000 unfiled returns and significantly improved voluntary compliance among the target population, reducing nonfiling from 13.1 percent in tax year 1990 to 9.2 percent in tax year 1992.<sup>20</sup> This shows how a local compliance effort can identify and address geographically-based noncompliance where a national or centralized compliance initiative would not. It also illustrates the need for a cross-functional approach with exam, collection, outreach and education, and TAS employees collaborating to develop and implement a comprehensive strategy.

Despite evidence that CIPs can generate valuable information and results, SB/SE Field Exam only had five open local CIPs (Part 2) as of November 10, 2014.<sup>21</sup>

### **The Taxpayer-Based Structure Has Eroded Since the IRS Implemented RRA 98.**

The taxpayer-based structure required by RRA 98 is beneficial to taxpayers but has eroded over time. After enactment of the law, both service and enforcement activities were initially organized around taxpayer populations. For example, each operating division (OD) had stakeholder relations groups. In addition, the enforcement procedures were initially specific to the type of taxpayer. However, the IRS has deviated from the goal of providing end-to-end service by taxpayer type in an attempt to achieve efficiencies. Notably, the IRS has charged the W&I division with performing key servicewide operations such as:

- Processing returns;
- Staffing telephone lines;
- Managing taxpayer accounts;
- Publishing all forms, instructions, and publications; and
- Maintaining the IRS's e-services.<sup>22</sup>

In addition, traditional local exam and collection work has been increasingly directed to remote centralized SB/SE sites for efficiency purposes.<sup>23</sup> As a result, the IRS now has large, remote organizations and little local presence. It retains virtually no local compliance initiatives, despite evidence that compliance

20 National Taxpayer Advocate 2008 Annual Report to Congress 177-78.

21 SB/SE Field has seven areas working CIPs (as opposed to one for each district pre-RRA 98). In addition, SB/SE Exam had 62 Part 1 CIPs open as of November 4, 2014. IRS, CIP National Office Database, SB/SE Field Open CIPs (Nov. 4, 2014). A Part 1 CIP is limited to fewer than 50 taxpayer contacts. IRM 4.17.4.1.1(2), *Types of CIP Requests*, (Feb. 25, 2010). A Part 2 CIP is an expanded initiative when there is a documented demonstrated level of non-compliance found on an initial Part 1 CIP. IRM 4.17.4.1.1(3), *Types of CIP Requests*, (Feb. 25, 2010). In addition, LB&I had 12 open CIPs as of December 18, 2014. IRS response to TAS fact check (Dec. 18, 2014).

22 National Taxpayer Advocate 2010 Annual Report to Congress 49-70 (*Most Serious Problem: The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding its Ability to Serve its Core Base of Individual Taxpayers Effectively*).

23 National Taxpayer Advocate Blog, *IRS Correspondence Examinations: Are they really as effective as the IRS thinks?*, available at <http://www.taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks>; National Taxpayer Advocate 2012 Annual Report to Congress 381-402 (*Most Serious Problem: The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively*).

is driven by community norms.<sup>24</sup> In addition, remote centralization has been made worse by the batch processing approach in which, generally, no one employee is assigned to work a particular case end to end. In other words, no employee is accountable for what happens with that case. This lack of individual accountability undermines both the efficiency and effectiveness benefits of centralization.

An example of how to retain centralization and expertise while still addressing the particular local needs of taxpayers is the way the IRS processes innocent spouse relief claims. Generally, the IRS has centralized innocent spouse case processing at the Cincinnati Centralized Innocent Spouse Operation (CCISO). This structure is essential for the expeditious handling of these cases. However CCISO will refer the case to an Area office if the case satisfies certain criteria set forth in IRM 25.15.6.1(3).<sup>25</sup>

#### **The IRS Can Learn From the Experience of Other Countries.**

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**The Alaska-based compliance initiative brought in over 1,000 unfiled returns and significantly improved voluntary compliance among the target population, reducing nonfiling from 13.1 percent in tax year 1990 to 9.2 percent in tax year 1992. This shows how a local compliance effort can identify and address geographically-based noncompliance where a national or centralized compliance initiative would not.**

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In the United Kingdom, Her Majesty's Revenue and Customs has acted to meet the needs of taxpayers through a combination of centralization and local presence. HMRC closed its tax offices, called "enquiry centres," in early 2014 and launched a new approach to customer service. Based on the findings from a seven-month pilot, HMRC implemented a national service to bring expert advisers together to resolve multiple issues on a single phone call without transferring the taxpayer to different parts of the organization. The new approach also provides mobile advisors for taxpayers who need face-to-face help. The mobile advisors meet with taxpayers by appointment at a variety of venues, from government and community buildings to a taxpayer's home or business.<sup>26</sup>

HMRC also has a geographic presence in its enforcement activities. For example, since 2011, it has set up more than 60 regional task forces aimed at high-risk sectors, such as markets in London, taxi firms in Yorkshire and the East Midlands, property rentals in several regions, and restaurants in the Midlands.<sup>27</sup>

#### **The IRS Can Retain its Taxpayer-Based Structure and Still Maintain Local Presence.**

The IRS can retain its national policymaking structure without losing the ability to respond to local conditions and challenges. In RRA 98, Congress did not mandate that the IRS completely eliminate its local presence. It only directed the IRS to reorganize in a taxpayer-based model.

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24 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 60-61 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

25 IRM 25.15.6.1 (3), *Overview: Purpose of Manual* (Mar. 21, 2008). See also IRM 25.15.8.5.3.2, *CCISO Processing* (Nov. 13, 2014) (transferring collection cases with "unusual situations" to field examination). In addition, the LB&I Division restructured in 2012 to retain its six industry organizational structure but to realign the industries using a geographic model. That is, the six industries were realigned so they follow more contiguous geographic boundaries. However, the individual Industry Directors retain responsibility for strategic issues in their industries no matter where the issue is located. IRS Fact Sheet, *Large Business & International (LB&I) Realignment* (May 2012).

26 HM Revenue and Customs News, *HMRC Comes Out of the Office to Support Customers Who Need Extra Help* (Feb. 12, 2014).

27 HM Revenue & Customs, *Issue Briefing: Our Approach to Tax Compliance* (Sept. 2012); HM Revenue & Customs, *Issue Briefing: Tackling Tax Evasion* (Jan. 2014).

The IRS is currently realigning its compliance operations in the W&I and SB/SE Divisions, with the stated goals of increasing organizational efficiencies and improving the agency's ability to quickly identify emerging compliance risks.<sup>28</sup> The IRS even solicited suggestions from all employees. The National Taxpayer Advocate believes the current realignment is an ideal time to reassess the IRS structure to better achieve the goals of RRA 98. The IRS's structure should balance the need for centralization of certain activities and the need for local presence in others. To achieve the goals of RRA 98, the IRS should attempt to maximize the benefits of both the "taxpayer type" model and the geographic presence model and mitigate any associated risks. Accordingly, the IRS should take the following six administrative actions to enhance its local presence while retaining its taxpayer-based structure:

- 1. Reinigrate the Local Compliance Initiative Program.** To accomplish this objective, the IRS must increase local staffing and research in outreach and education, Exam, Collection, and Appeals.<sup>29</sup> The creation of additional local positions should not necessarily cause a net gain in employees, because the IRS can shift campus positions to the field (the IRS can decrease campus staffing through attrition and not filling vacancies). The reinvigorated local presence groups would still report to the operating divisions and have cross-divisional local compliance counsels.<sup>30</sup> Finally, the local groups could propose compliance pilots that include outreach, service, and problem resolution components that would further the National Office goals but with a local flavor.
- 2. Introduce videoconferencing for a virtual remote office audit or office collection visit.** Providing taxpayers with the ability to discuss their tax controversies virtually will combine the benefits of centralization and geographic presence. It will also enable remote taxpayers to explain their particular circumstances to a live person working their cases.
- 3. Assign one employee to work each case end to end.** The IRS should modify batch-processing procedures so that once the taxpayer has responded, the case is assigned to one employee for its duration. This one employee can hear and consider the taxpayer's unique circumstances, and the IRS can better understand whether to refer that case to the local office.<sup>31</sup>
- 4. Re-staff Appeals Officers and Settlement Officers locally.** The IRS should re-staff Appeals Officer and Settlement Officer positions so at least one of each is located and regularly available in every state, the District of Columbia, and Puerto Rico.<sup>32</sup>
- 5. Re-staff Local Outreach and Education Positions.** The IRS should increase outreach and education staff for each operating division to ensure that at least one W&I and one SB/SE outreach employee is located in every state, the District of Columbia, and Puerto Rico.

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28 See IRS, *IRS to Realign Compliance Operation*, 2014 TNT 196-18, Tax Analysts Tax Notes Today (Oct. 9, 2014); *IRS Looks at Realigning Compliance Operations*, available at <http://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (last visited Dec. 22, 2014), noting that "Generally, this plan would move pre-filing compliance work to W&I and post-filing compliance work for individuals and small businesses to SB/SE."

29 Criminal Investigation is already geographically-based. It is divided into geographic areas throughout the United States—Southern, Northern, and Western. The Director of Field Operations in each area has functional coordination and program oversight responsibilities over criminal investigation activities for that area. In addition, the three geographic areas are further divided into field offices. Each field office has a Special Agent in Charge to direct, monitor, and coordinate the criminal investigation activities within that office's area of responsibility. Several smaller posts-of-duty are located within each field office. See also IRS Criminal Investigation Division (CI), Business Architecture Version 2.0 slides 41-47 (July 30, 2003).

30 While further evaluation is necessary, perhaps the IRS could have 33 cross-BOD local compliance counsels, similar to the old district structure. Alternatively, the structure could entail 32 officials overseeing the compliance counsel and those officials reporting to the national office.

31 See Most Serious Problem: *CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *infra*.

32 See Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *infra*; National Taxpayer Advocate 2009 Annual Report to Congress 346-50.

6. **Provide face-to face service through mobile vans in each state.** Similar to HMRC, the IRS should use mobile vans to tour each state on a set schedule, so taxpayers, including those in remote areas, can receive education or face-to-face assistance with tax controversies. The employees in these mobile units would be well-versed in the local culture as well as any issues specific to the local economy.

## CONCLUSION

When implementing the congressional directive to reorganize, the IRS should not have eliminated its local structure. The National Taxpayer Advocate believes the IRS can maintain its current taxpayer-based structure without abandoning a geographic footprint. While the IRS is already realigning its compliance operations in the Wage and Investment and Small Business/Self-Employed Divisions to increase organizational efficiencies, it should reconsider its structure and balance the need for centralization of certain activities and the need for local presence in others.<sup>33</sup> The IRS can modify the current structure to meet taxpayer needs and compliance challenges specific to a certain locale.

## RECOMMENDATIONS

To improve the IRS's geographic presence, the National Taxpayer Advocate recommends that the IRS take the following actions:

1. Reinvigorate the Local Compliance Initiative Program by increasing local staffing and research in outreach and education, Exam, Collection, and Appeals.
2. Introduce videoconferencing for a virtual remote office audit or office collection visit.
3. Modify batch processing procedures so that once the taxpayer has responded, the case is assigned to one employee for the duration of the case.
4. Re-staff Appeals Officers and Settlement Officers locally so that one of each employee is located and regularly available in every state, the District of Columbia, and Puerto Rico.
5. Re-staff local outreach and education positions to bring an actual presence to every state.
6. Provide face-to face service through the use of mobile vans in each state.

<sup>33</sup> See IRS Looks at Realigning Compliance Operations, available at <http://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (last visited Nov. 20, 2014), noting that "Generally, this plan would move pre-filing compliance work to W&l and post-filing compliance work for individuals and small businesses to SB/SE."

## APPENDIX: A Case Study in Local Presence in Various Regions: Substantial Reduction of Geographic Presence in Local Offices as Compared to the Campuses.

The impact of the reduced geographic footprint is best told through examples of offices located around the country. We have chosen IRS offices in the state of Wyoming and the New York City borough of Manhattan to illustrate two locations at opposite ends of the spectrum in terms of the volume of taxpayers and type of assistance required. To contrast the staffing trends in these local offices, we have also provided staffing data for the IRS Campus in Kansas City.<sup>34</sup> The data for each of the jurisdictions illustrate the significant changes in staffing from 2001 to 2014 for IRS functions with significant roles in IRS compliance functions and customer service.<sup>35</sup> We have excluded Taxpayer Advocate Service employees and those from Submission Processing, where relevant.

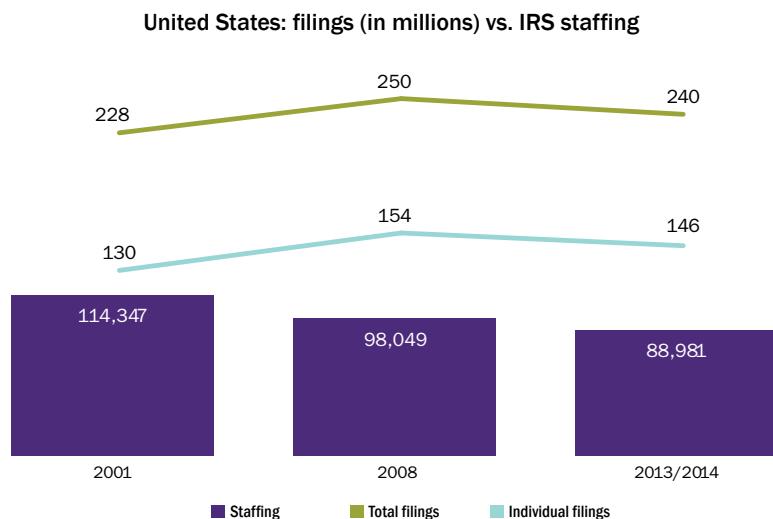
### Background: Total IRS Staffing and Tax Returns.

Over the last 13 years, the IRS experienced a significant drop in staffing. Excluding TAS, IRS employee levels dropped approximately 22 percent since 2001. While staffing dropped, total and individual filings increased between 2001 and 2013 by five percent and 12 percent, respectively.

Specifically, there were over 114,000 employees in 2001 and this staffing level dropped by more than 22 percent to fewer than 89,000 in 2014. At the same time, according to the annual IRS data books, taxpayer filings showed growth over the first decade of the 21<sup>st</sup> century, followed by a slightly downward trend in recent years, as displayed in the following chart. Overall, individual filings grew by five percent and total filings grew by 12 percent between 2001 and 2013.

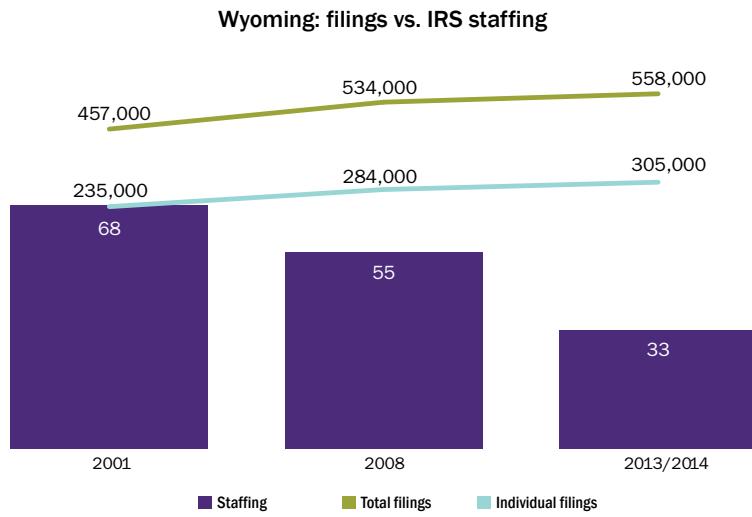
34 The data only includes specific functions that are mutual to both local offices and the campuses. Thus, we have excluded some functions, such as submission processing, because there is no corollary in the field. We have excluded TAS because, by statute, TAS is required to maintain at least one Local Taxpayer Advocate office in each state. IRC § 7803(c)(2)(D)(i)(I).

35 The staffing data in this discussion was obtained from the IRS Human Resources Reporting Center.

**FIGURE 1.3.1<sup>36</sup>**

### **Out West: Significant Drop in Wyoming Staffing.**

The downward trend in staffing is even more pronounced in some states, such as Wyoming, where staffing dropped by 50 percent while total and individual filings increased over the same period by 22 percent and 30 percent, respectively, as displayed in the following chart.

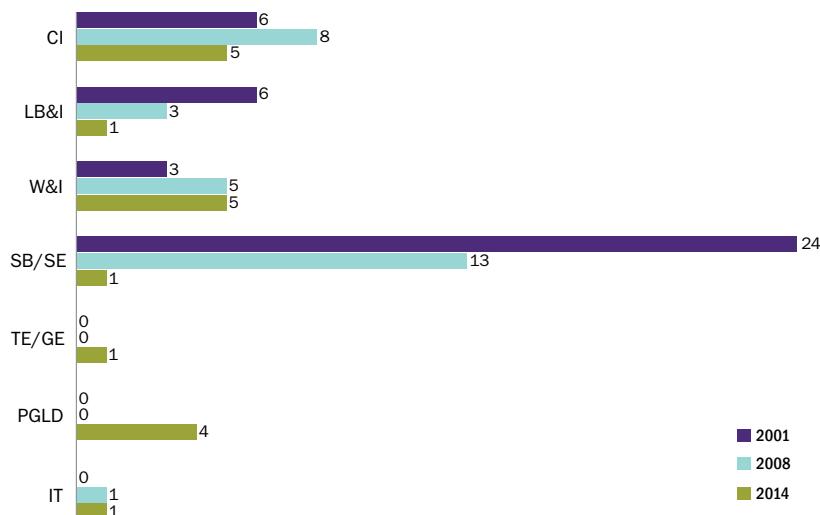
**FIGURE 1.3.2<sup>37</sup>**

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- 36 Data summarizes total staffing (full time, part time, seasonal and intermittent), excluding TAS, for 2001, 2008 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were January 27, 2001, January 5, 2008 and October 18, 2014. Filing data from IRS Databooks for 2001, 2008, 2013. Filing data for 2014 will not be available until March, 2015.
- 37 Data summarizes total staffing (full time, part time, seasonal and intermittent), excluding TAS, for 2001, 2008 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001, Jan. 5, 2008 and Oct. 18, 2014. Filing data from IRS Databooks for 2001, 2008, 2013, rounded to the nearest thousand. Filing data for 2014 will not be available until March, 2015.

Focusing on Cheyenne, the state capitol, there was a decrease for most of the operating divisions, as shown in the below graph.

**FIGURE 1.3.3<sup>38</sup>**

Cheyenne, Wyoming: IRS staffing, 2001-2014



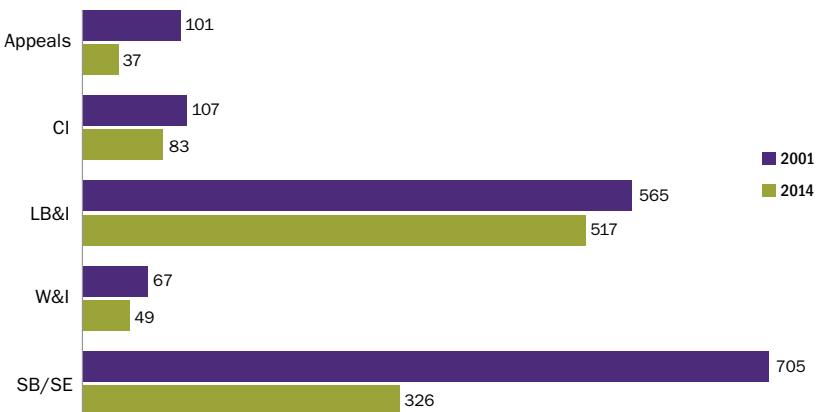
Notably, SB/SE employees dropped from 24 to one between 2001 and 2014, a decline of 96 percent, despite an increase in small businesses in the Cheyenne area of 10 percent for businesses with less than 100 employees between 2001 and 2011.<sup>39</sup>

#### The Big City: Manhattan Also Experienced a Significant Drop in Staffing.

Another example from a much larger metropolitan area, Manhattan, shows that staffing in major operating divisions dropped 34 percent from 2001 to 2014.

<sup>38</sup> CI is Criminal Investigation Division; LB&I is Large Business and International Division; W&I is Wage and Investment Division; SB/SE is Small Business/Self-Employed Division; TE/GE is Tax Exempt/Government Entities Division; PGLD is Privacy, Government Liaison and Disclosure; and IT is Information Technology. Staffing data for 2001, 2008 and 2014 from IRS, Human Resources Reporting Center, Post of Duty Building Reports, Workforce Information by Building – Now with Employee Listing Option (using the dates Jan. 27, 2001, Jan. 5, 2008 and Oct. 18, 2014).

<sup>39</sup> U.S. Census Bureau, Statistics of U.S. Businesses, Historical Data Tabulations by Enterprise Size, available at [http://www.census.gov/econ/susb/historical\\_data.html](http://www.census.gov/econ/susb/historical_data.html) (last visited Dec. 22, 2014). The number of businesses rose from 13,465 in 2000-2001 to 14,839 in 2010-11.

**FIGURE 1.3.4<sup>40</sup>****Manhattan, New York: IRS staffing, 2001 & 2014**

Specifically, although individual filings increased by 12 percent, staffing of Wage & Investment employees decreased by 27 percent. Small business corporations and partnerships increased by 19 and 94 percent, respectively, but SB/SE staffing (which handles both service and enforcement activities with respect to the small business population) decreased by more than 50 percent.

Thus, while staffing significantly decreased in all of the above-displayed operating divisions, total filings of the above-mentioned forms (Forms 1040, 1120, 1120S, and 1065) grew by almost 14 percent in Manhattan between TY 2000 and TY 2013.<sup>41</sup>

**FIGURE 1.3.5, Manhattan filings, tax years 2000-2013**

Form	TY 2000	TY 2007	TY 2013	% Change from 2000 to 2013
Form 1040	1,993,379	2,385,057	2,227,685	12%
Form 1120	79,758	75,396	74,906	-6%
Form 1120S	93,828	107,397	111,700	19%
Form 1065	64,836	104,036	125,734	94%

**To The Middle: Kansas City Campus Experiences a Significant Growth in Staffing.**

The Kansas City campus experienced overall growth, due to centralization. This campus houses, among others, the following operations: Submission Processing, Accounts Management, Correspondence Exam, and Automated Collection System (ACS). The following table shows a drop in campus staffing for most operating divisions, but a significant (23 percent) increase for non-submissions processing staff in Wage &

40 Staffing data for all Manhattan locations, excluding Support and Headquarters positions, 2001 (Jan. 27, 2001) and 2014 (Oct. 18, 2014) from IRS, Human Resources Reporting Center, Post of Duty Building Reports, Workforce Information by Building available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014).

41 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File and Business Returns Transaction File, Tax Years 2000, 2007 and 2013.

Investment.<sup>42</sup> We excluded Submission Processing staff from the campus data for comparison purposes, because there is no counterpart to this function in the local offices in the field.<sup>43</sup> We have included staffing numbers for Overland Park, Kansas (OVP) in the totals because staff from the OVP office moved to the campus during the period under review.

**FIGURE 1.3.6, IRS staffing for Kansas City, 2001 and 2014, Submission Processing excluded**

Operating Division	As of January 27, 2001			As of October 18, 2014			Percent change
	OPK	KC	Total	OPK	KC	Total	
Appeals	0	21	21	0	14	14	-33%
Criminal Investigation	0	58	58	7	20	27	-53%
Large Business and International LB&I (formerly LMSB)	0	35	35	5	1	6	-83%
Small Business/Self-Employed	5	53	58	48	13	61	5%
Wage & Investment	1,350	187	1,537	5	1,888	1,893	23%
<b>Total</b>	<b>1,355</b>	<b>354</b>	<b>1,709</b>	<b>65</b>	<b>1,936</b>	<b>2,001</b>	<b>17%</b>

In contrast, the outlying towns and cities, with few exceptions, experienced steep declines in staffing, between 2001 and 2014.<sup>44</sup>

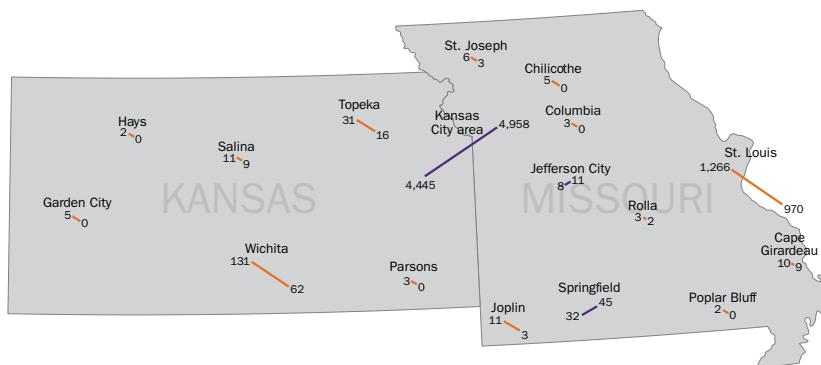
42 Total W&I staff in OVP and KC campus increased from 1,537 on Jan. 27, 2001 to 1,893 on Oct. 18, 2014. IRS, Human Resources Reporting Center (using the dates Jan. 27, 2001 and Oct. 18, 2014).

43 Submission Processing's mission is to receive, process and archive tax and information returns; issue taxpayer notices; process refunds; and account for all tax revenues. See also IRM 21.3.4.8, Receipt of Tax Returns, (Jan. 2, 2014).

44 Data summarizes total staffing (Full time, part time, seasonal and intermittent), excluding TAS, for 2001 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001 and Oct. 18, 2014.

**FIGURE 1.3.7<sup>45</sup>**

Decrease in staffing in local offices surrounding Kansas City, 2001-2014



Notably, Wichita dropped 53 percent and the St Louis area (St. Louis, Town and Country, Sunset Hills, and Florissant) by 23 percent. Ten locations in Kansas and Missouri had some staffing in 2001, but no staffing at all in 2014.

The increase in W&I staffing can also be seen in the IRS campuses across the country. The following chart compares W&I staffing in Accounts Management and Compliance for all the existing campuses between January 27, 2001 and October 18, 2014.<sup>46</sup>

**FIGURE 1.3.8, W&I Accounts Management and Compliance staff for all IRS campuses<sup>47</sup>**

W&I Function	2001 Staff	2014 Staff	% Change
W&I Accounts Management	8,025	16,655	108%
W&I Compliance	5,456	5,237	-4%
<b>Total W&amp;I AM and Compliance</b>	<b>13,481</b>	<b>21,892</b>	<b>62%</b>

45 Data summarizes total staffing (Full time, part time, seasonal and intermittent), excluding TAS, for 2001 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001 and Oct. 18, 2014.

46 In 2001, the IRS had W&I AM and compliance staff in the following campuses: Andover, Atlanta, Austin, Fresno, and Kansas City. In 2014, the IRS had the W&I staff in the following campuses: Andover, Atlanta, Austin, Brookhaven, Cincinnati, Fresno, Kansas City, Memphis, Ogden, and Philadelphia.

47 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001 and Oct. 18, 2014.

**MSP****#4**

## APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State

### RESPONSIBLE OFFICIAL

Kirsten B. Wielobob, Chief, Appeals

### DEFINITION OF PROBLEM

Congress has long recognized that “all taxpayers should enjoy convenient access to Appeals, regardless of their locality.”<sup>1</sup> As a result, Congress required the IRS, among other things, to “ensure that an appeals officer is regularly available within each State.”<sup>2</sup> Recently, in adopting the Taxpayer Bill of Rights (TBOR), the IRS reaffirmed its commitment to a number of related principles including *the right to appeal an IRS decision in an independent forum, the right to quality service, the right to challenge the IRS’s position and be heard, and the right to a fair and just tax system.*<sup>3</sup> All of these fundamental rights are adversely affected when a face-to-face Appeals conference is not readily and conveniently available.

The IRS maintains that this mandate is met by Appeals Officers “riding circuit” (*i.e.*, traveling into the jurisdiction so as to meet with taxpayers in person) at least quarterly in states lacking a permanent Appeals presence.<sup>4</sup> Nevertheless, circuit riding Appeals cases often take an additional six months or more to resolve and have significantly lower levels of agreement than face-to-face Appeals cases conducted in field offices.<sup>5</sup> Appeals’ physical presence in certain states has continued to be restricted or has been eliminated entirely. Almost one quarter of the states (12 out of 50) have no permanent Appeals presence, and this number of states lacking a permanent field office has increased by 33 percent, from nine to 12, since 2011.<sup>6</sup>

The National Taxpayer Advocate has long warned of the dangers to taxpayer rights inherent in such a course of action.<sup>7</sup> Taxpayers in states without an Appeals presence may be forced to travel long distances,

1 S. REP. No. 105-174, at 92 (1998).

2 The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465 (b) (July 22, 1998).

3 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. In particular, *the right to appeal an IRS decision in an independent forum* is explained by TBOR as follows: “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.”

4 *The U.S.-China Economic Relationship: A New Approach For a New China*, Hearing Before the S. Comm. on Finance, 111th Cong., 69-70 (2010) (testimony of Timothy F. Geithner, Sec. of Treasury). See also National Taxpayer Advocate 2009 Annual Report to Congress 81.

5 See Figures 3 and 4, *infra*.

6 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014). The territory of Puerto Rico has also lacked a permanent Appeals office during this time period.

7 See National Taxpayer Advocate 2009 Annual Report to Congress 346-350. See also *Hearing on Filing Season 2012, Hearing Before the S. Comm. on Finance*, 112th Cong. 3-12 (2012) (testimony of Teresa Thompson, Local Taxpayer Advocate, MT).

incur additional expenses, or face delays in obtaining an in-person hearing.<sup>8</sup> Even if they persevere and obtain a face-to-face hearing, their cases may be handled by an Appeals Officer or a Settlement Officer unfamiliar with the local economy or other relevant community issues.<sup>9</sup> Additionally, curtailed face-to-face conferences can make it more difficult for Appeals Officers to gauge the credibility of oral testimony and can cause taxpayers to question the independence and impartiality of Appeals.<sup>10</sup> Videoconferencing could be part of the solution to the lack of Appeals presence; however, it is not a panacea and is no replacement for local knowledge, experience, or presence.

## ANALYSIS OF PROBLEM

### **When Passing RRA 98, Congress Expressed its Intent that Taxpayers Should Have Convenient Access To Appeals Regardless of Their Locality.**

Congress believed that making Appeals Officers available in each state would provide a place for taxpayers to turn when they disagreed with the IRS.<sup>11</sup> Congress was further convinced that this convenient access was not only an important element of taxpayer rights, but would also contribute to the goal of more timely and efficient resolution of disputes between taxpayers and the IRS.<sup>12</sup> Moreover, Appeals Officers who are well versed in the local industries and economic circumstances prevailing within a particular region are indispensable as a means of preserving both the appearance and the reality of fair and equitable treatment.<sup>13</sup>

As explained by Senator Roth, when adding § 3465 to RRA 98:

With this legislation, we require the agency to establish an independent Office of Appeals—one that may not be influenced by tax collection employees or auditors. Appeals officers will be made available in every state, and they will be better able to work with taxpayers who proceed through the appeals process.<sup>14</sup>

### **The IRS's Contention that Circuit Riding Complies With the Mandate of RRA 98 Regarding Ready Access to Appeals Does Not Comport With Reality.**

The IRS does not dispute that it is subject to § 3465(b) of RRA 98. Instead, the IRS argues that it meets its obligations by allowing for “circuit riding” on at least a quarterly basis to states lacking a permanent

8 See National Taxpayer Advocate 2009 Annual Report to Congress 346-350. See also *Hearing on Filing Season 2012, Hearing Before the S. Comm. on Finance*, 112th Cong. 3-12 (2012) (testimony of Teresa Thompson, Local Taxpayer Advocate, MT). The terms “in-person” Appeals conferences and “face-to-face” Appeals conferences are used interchangeably and should be distinguished from “virtual face-to-face” Appeals conferences, which the IRS hopes to make available through the use of technology. VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services, *infra*. See also Legislative Recommendation: Virtual Service Delivery (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet, *infra*.

9 National Taxpayer Advocate 2009 Annual Report to Congress 76.

10 For a suggestion from the National Taxpayer Advocate regarding congressional intervention as a means of solving this problem, see Legislative Recommendation: Access to Appeals: Require That Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, *infra*.

11 See, e.g., 144 CONG. REC. S7639 (1998) (statement of Sen. Jeffords).

12 S. Rep. No. 105-174, at 88 (1998).

13 National Taxpayer Advocate 2009 Annual Report to Congress 76. See also Filing Season Update: Current IRS Issues, *Hearing before the S. Comm. on Finance*, 111th Cong. 18-19 (2010) (remarks of Sen. Enzi).

14 144 CONG. REC. S7622 (1998) (statement of Sen. Roth).

**Not only are states without an Appeals post of duty increasing, but the number of Appeals Officers and Settlement Officers located in existing field offices has diminished. Between the summer of 2010 and the summer of 2014, this category of Appeals personnel has dropped by approximately 27 percent, from 817 to 593.**

Appeals field office.<sup>15</sup> Additionally, the IRS states that, “Taxpayers are never required to travel out of state for face-to-face meetings unless they prefer meeting in an alternate location as a matter of convenience.”<sup>16</sup>

Doubts persist, however, regarding whether circuit riding satisfies the congressional intent underlying § 3465(b).<sup>17</sup> Circuit riding existed prior to the passage of RRA 98.<sup>18</sup> Nevertheless, Congress felt compelled to require that Appeals Officers be made regularly available in *all* states. Unlike some other aspects of RRA § 3465, which the legislative history explained as a codification of existing IRS procedures, the “regularly available within each State” mandate was presented as a new requirement.<sup>19</sup> Despite this legislative indication that Congress desired more convenient access and local presence than was being supplied by circuit riding, the IRS has expanded the number of states without an Appeals Officer or Settlement Officer, and has contended that circuit riding alone fulfills its post-RRA 98 obligations.

Unsatisfied with this position, Senator Enzi, as part of the fiscal year 2011 Senate Budget Resolution, introduced legislation requiring redeployment of existing IRS resources “to provide at least one full-time Internal Revenue Service appeals officer and one full-time settlement agent in every State.”<sup>20</sup> In connection with this legislation, Senator Enzi explained:

Section 3465(b) of the IRS Restructuring and Reform Act of 1998 states, ‘The Commissioner of the Internal Revenue Service shall ensure that an appeals officer is regularly available within each state,’ yet Wyoming and eight other states have no such personnel physically located within their borders. The Appeals process is the last step for taxpayers to argue the merits of their return before a Notice of Deficiency is recorded and collection processes begin. Therefore, it is critical that all taxpayers—even rural taxpayers—have unfettered access to IRS appeals officers. … I think it is perfectly reasonable to suggest that the IRS redeploy existing resources to provide at least one full-time appeals officer and one full-time settlement agent in every state.<sup>21</sup>

In response, Treasury Secretary Geithner stated:

The appeals process uses circuit riding to mitigate the need for specialization and where the nearest office is more than 150 miles from the taxpayer, while at the same time ensuring that the needs of each and every taxpayer are timely met. This structure is consistent with the statutory requirement in the IRS Restructuring and Reform Act of 1998, which provides the IRS Commissioner must ‘ensure that an Appeals Officer is regularly available in each state.’

<sup>15</sup> National Taxpayer Advocate 2009 Annual Report to Congress 81; IRM 8.6.1.4.1.1 (June 8, 2010).

<sup>16</sup> National Taxpayer Advocate 2009 Annual Report to Congress 81.

<sup>17</sup> See *id.*

<sup>18</sup> IRM 8622 (April 20, 1990).

<sup>19</sup> S. REP. NO. 105-174, at 88 (1998).

<sup>20</sup> See 156 Cong. Rec. S2654 (2010).

<sup>21</sup> Filing Season Update: Current IRS Issues, Hearing before the S. Comm. on Finance, 111th Cong., 18-19 (2010) (remarks of Sen. Enzi). See also Press Release, Senator Enzi, Budget Is Sweet and Sour: Enzi Improves Bill But Can’t Support Final (Apr. 22, 2010), available at [http://www.enzi.senate.gov/public/index.cfm/news-releases?ContentRecord\\_id=278e14e5-802a-23ad-4646-e63f9f3b85d6](http://www.enzi.senate.gov/public/index.cfm/news-releases?ContentRecord_id=278e14e5-802a-23ad-4646-e63f9f3b85d6) (last visited on Oct. 20, 2014).

IRS, as part of its regular planning, will continue to look at resource allocation, and is committed to ensuring adequate access to the appeals process for every taxpayer.<sup>22</sup>

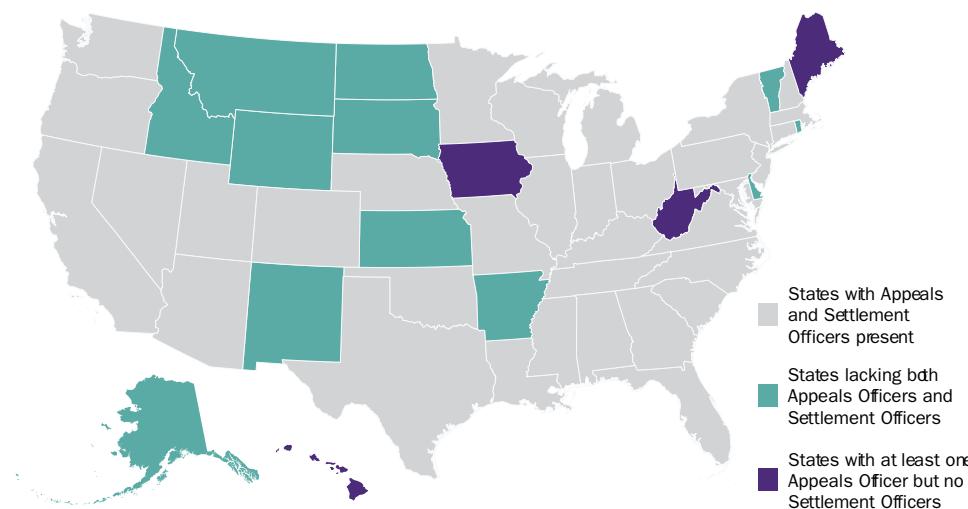
Ultimately, the Budget Resolution that included Senator Enzi's amendment was never acted upon by Congress. Nevertheless, the concerns giving rise to this legislation remain.

### In Practice, Many Taxpayers are Experiencing Limitations on Their Ability to Have an In-Person Appeals Conference With the IRS.

The number of states and territories in which Appeals lacks both an Appeals Officer and a Settlement Officer has grown by 33 percent since 2011. Twelve states and Puerto Rico, roughly a quarter of U.S. states and territories, have no Appeals or Settlement Officers with a post of duty within their borders.<sup>23</sup> The current distribution of states lacking a permanent Appeals presence is illustrated by the following map:

**FIGURE 1.4.1<sup>24</sup>**

**States without a permanent Appeals presence**



Not only are states without an Appeals post of duty increasing, but the number of Appeals Officers and Settlement Officers located in existing field offices has diminished. Between the summer of 2010 and the summer of 2014, this category of Appeals personnel has dropped by approximately 27 percent, from 817 to 593.<sup>25</sup> Appeals Officers and Settlement Officers located in field offices are, among other things,

22 *The U.S.-China Economic Relationship: A New Approach For a New China*, Hearing Before the S. Comm. on Finance, 111th Cong., 69-70 (2010) (testimony of Timothy F. Geithner, Sec. of Treasury).

23 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014). This map does not include Puerto Rico, which also has no Appeals presence.

24 The following states lack both Appeals Officers and Settlement Officers: Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont and Wyoming. The following states have at least one Appeals Officer but no Settlement Officers: Hawaii, Iowa, Maine, and West Virginia. See Appeals' Response to TAS information request (Aug. 5, 2014).

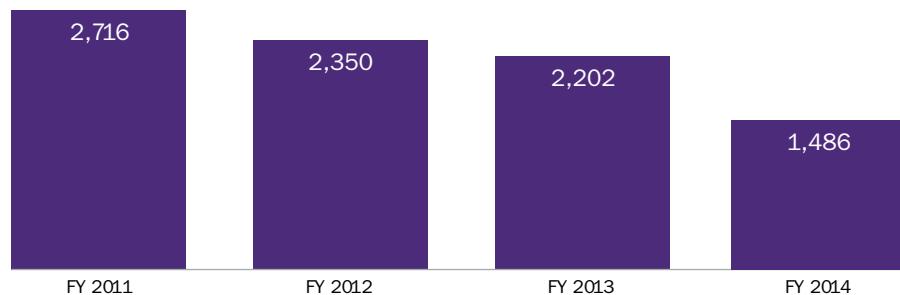
25 See user data from on rolls listing, comparing personnel data from Aug. 23, 2010 with personnel data from Aug. 23, 2014, available at <https://persinfo.web.irs.gov/track/workorg.asp> (last visited on Oct. 2, 2014).

the group responsible for circuit riding. Accordingly, this reduction in field-based Appeals Officers and Settlement Officers has the impact of limiting the number of Appeals personnel available to ride circuit in states without an Appeals presence, and in rural areas where taxpayers lack access to an Appeals field office.

The overall number of Appeals cases closed via circuit riding likewise has progressively fallen in each of the last four years.<sup>26</sup> This trend is illustrated in the accompanying graph.

**FIGURE 1.4.2<sup>27</sup>**

Circuit riding closed cases



Although the IRS does not report this data on a state-by-state basis, it is not unreasonable to infer that there has been an equal or greater drop in the number of in-person Appeals conferences held in states with no Appeals presence. If the IRS wishes to make the case that circuit riding is sufficient to satisfy RRA 98 in states lacking a regular Appeals presence, the IRS should support this contention with data regarding the availability and effectiveness of face-to-face appeals in such states. Otherwise, the IRS's position regarding RRA 98 compliance is based on unsubstantiated assertions.

The National Taxpayer Advocate is concerned that this decreasing trend in the number of circuit riding cases, and the isolation it portends for states without an Appeals presence, is not the result of taxpayer choice. Rather, it is effectively imposed on taxpayers by the expansion of states without a permanent Appeals office and by the diminishing availability of Appeals personnel who can ride circuit.

### The Lack of Face-to-Face Access to Appeals in all States is Harmful to Impacted Taxpayers.

The ability to interact on a face-to-face basis with the IRS has a significant effect on taxpayer perceptions and satisfaction. For example, an IRS survey has indicated that overall satisfaction with face-to-face examinations is much higher (71 percent) than for correspondence examinations (43 percent).<sup>28</sup> Similarly,

26 Appeals does not report circuit riding data on a state-by-state basis. Appeals response to TAS information request (Aug. 5, 2014). Note that circuit riding can occur in rural areas of states that have permanent Appeals offices. Moreover, taxpayers in some states lacking a permanent Appeals presence occasionally have convenient access to a field office in a nearby state. Additionally, circuit riding can occur for reasons unrelated to geography, such as substantial books and records, high inventories, or lack of technical expertise. See IRM 8.6.1.4.1.1 (June 8, 2010). Nevertheless, this is currently the best available data regarding the effectiveness of circuit riding.

27 Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014.

28 IRS, National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012).

overall dissatisfaction is more than twice as great for correspondence examinations (41 percent) than for face-to-face examinations (18 percent).<sup>29</sup> Consistent with this data, TAS has also found that taxpayers receiving the Earned Income Tax Credit (EITC) are substantially more likely to respond to face-to-face examinations.<sup>30</sup> Likewise, a recent TAS study of taxpayers eligible to use low income taxpayer clinics (LITC) indicated that 77 percent of the surveyed taxpayers preferred face-to-face interactions with their local LITC.<sup>31</sup>

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**The National Taxpayer Advocate is concerned that this decreasing trend in the number of circuit riding cases, and the isolation it portends for states without an Appeals presence, is not the result of taxpayer choice. Rather, it is effectively imposed on taxpayers by the expansion of states without a permanent Appeals office and by the diminishing availability of Appeals personnel who can ride circuit.**

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The Appeals Customer Satisfaction Survey provides further evidence of the importance taxpayers place on the availability of face-to-face meetings. For example, in its 2008 survey, Appeals highlighted seven particular categories of specific suggestions from customer comments, one of which was, “Taxpayers would like in-person meetings with Appeals.”<sup>32</sup> Among other things, one survey taxpayer stated, “It would be nice to meet with somebody in person, it might get done faster face-to-face.”<sup>33</sup> Another taxpayer responded, “I feel they need to have face-to face appeals.”<sup>34</sup>

In addition to taxpayer perceptions and satisfaction, the National Taxpayer Advocate is particularly concerned that the lack of an Appeals presence in certain states has a demonstrably negative effect on the cycle times and outcomes of tax disputes in those states. Taxpayers forced to rely on circuit riding in order to obtain a face-to-face Appeals conference must wait substantially longer for a resolution of their appeals case than do taxpayers fortunate enough to live near an Appeals office. A comparison of the time needed for resolving Appeals cases (cycle time) is depicted in the table below.

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29 IRS, National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012).

30 National Taxpayer Advocate, Briefing for the Enforcement Committee, *Examination Strategy: The Impact of Increasing Automation*, slide 15 (Apr. 23, 2012).

31 TAS, Survey of Taxpayers who are Eligible to Use IRS’s Low Income Taxpayer Clinics, slide 11, July 2014. Taxpayers are generally eligible to use LTCs if their income is at or below 250 percent of the federal poverty level (e.g., \$29,175 for a single taxpayer; \$59,625 for a family of 4 in calendar year (CY) 2014). See IRC § 7526(b)(1) for the definition of a qualified low income taxpayer clinic. For the 2014 Federal Poverty Guidelines, see U.S. Department of Health & Human Services, 2014 Poverty Guidelines, available at <http://aspe.hhs.gov/poverty/14poverty.cfm> (last visited on Oct. 20, 2014).

32 IRS, Appeals Customer Satisfaction Survey, National Report, Fiscal Year 2008 Results, slide 11, Feb. 2009, available at <http://appeals.web.irs.gov/stratplan/custsat.htm>.

33 *Id.*

34 *Id.*

**FIGURE 1.4.3, Cycle times (in days)<sup>35</sup>**

Fiscal year	Field cases with face-to-face conferences	Circuit riding
2011	388	628
2012	373	677
2013	344	816
2014	406	628

Moreover, circuit riding Appeals conferences have significantly higher indicia of disagreement between taxpayers and the IRS, and lower indicia of agreement, than face-to-face Appeals conferences conducted in field offices. This outcome is illustrated in the following table:

**FIGURE 1.4.4, Agreement/disagreement percentages comparison<sup>36</sup>**

Appeals percentages	Case types	FY 2011	FY 2012	FY 2013	FY 2014
Agreed	Field cases with face-to-face conferences	65%	64%	63%	63%
	Cases with circuit riding	51%	47%	52%	40%
Unagreed	Field cases with face-to-face conferences	14%	14%	15%	14%
	Cases with circuit riding	27%	30%	27%	33%

To the extent that taxpayer satisfaction, cycle time, and outcome are adversely affected, one factor may be that decisions are being made by Appeals Officers with no first-hand connection with, or knowledge of, the local area involved.<sup>37</sup> Appeals Officers who reside within the community, or at least in the same states as the taxpayers with whom they are interacting, have a greater likelihood of being well-versed in the local industries and economic circumstances prevailing in a particular region, and preserving both the appearance and the reality of fair and equitable consideration.<sup>38</sup> Conversely, taxpayers residing in a state without a permanent Appeals office may be disadvantaged in the presentation of their case, or disenchanted with the Appeals process itself, because of the cost and inconvenience of traveling extended distances for a hearing, or the wait for a circuit riding Appeals Officer to appear in an accessible location.

Reduced taxpayer satisfaction and negative outcomes, whether a result of perception or reality, can have a powerfully adverse downstream impact on the IRS as well. The potential consequences of limiting access to face-to-face Appeals conferences include an impaired IRS ability to determine litigation hazards,

35 Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014. Note that the column entitled “Field cases with face-to-face conferences” excludes cases held via circuit riding, which are separately stated for comparison. References to “field” information in subsequent tables likewise excludes circuit riding data.

36 Data for this figure is drawn from Attachments 3 and 4 of Appeals’ response to TAS information request (Aug. 5, 2014) as supplemented by FY 2014 data provided by Appeals on November 6, 2014. Agreed cases combine codes 03 (Agreed Non-Docketed), 08 (Docketed – Appeals Secured Agreement), and 15 (Fully Allowed) set forth in those attachments. Unagreed cases combine codes 05 (Defaulted Notice of Deficiency), 13 (Unagreed Non-Docketed), and 14 (Fully Disallowed), also provided in those attachments. Other codes are excluded from this agreed/unagreed analysis as, for example, they reflect cases resolved after leaving Appeals’ jurisdiction or cases that are only partially agreed and partially unagreed. Even if such codes were considered as part of the analysis, however, the trends illustrated in the accompanying table would remain present.

37 National Taxpayer Advocate 2009 Annual Report to Congress 76; National Taxpayer Advocate 2009 Annual Report to Congress 347-48.

38 *Id.* See also Filing Season Update: *Current IRS Issues, Hearing before the S. Comm. on Finance*, 111th Cong., 18-19 (2010) (remarks of Sen. Enzi).

evaluate collection alternatives, and timely settle cases. As a result, cases that Appeals could have resolved may be left for IRS counsel attorneys to settle or litigate, resulting in downstream costs for the government. Likewise, some taxpayers may feel they are compelled to bring suit in court in order to gain the opportunity to present their case in person. Thus, the lack of a permanent Appeals office in each state may well have the unintended consequence of draining IRS administrative resources and increasing litigation with taxpayers.

### **Videoconferencing Could Be Part of the Solution with Respect to the Lack of Appeals Presence, but Is Not a Cure-All.**

Recognizing that videoconferencing might be one means of alleviating the scarcity of Appeals Officers in a given state or area, Congress, as part of RRA 98, also directed the IRS to consider using videoconferencing as a means of holding Appeals conferences “between appeals officers and taxpayers seeking appeals in rural or remote areas.”<sup>39</sup> Although the IRS has moved slowly in responding to this directive, recently some IRS divisions, including Appeals, have held pilot studies of virtual service delivery (VSD).<sup>40</sup> These pilots, as well as the experiences of other agencies such as the Social Security Administration and the Department of Veterans Affairs, indicate that VSD holds great promise for expanding the accessibility, timeliness, and quality of IRS service delivery through virtual face-to-face technology.<sup>41</sup>

The IRS should continue to expand the scope and availability of VSD. Nevertheless, VSD, or any other means of conducting an Appeals conference, should never supersede, or in any way compromise, a taxpayer’s right to an in-person Appeals conference with an Appeals Officer stationed in the taxpayer’s state of residence.

## **CONCLUSION**

When passing RRA 98, Congress expressed the desire that “all taxpayers should enjoy convenient access to Appeals, regardless of their locality.” Nevertheless, the number of states without a permanent Appeals office has been steadily rising. The IRS’s contention that this absence can be remedied by riding circuit, however, is not supported by the available evidence. Rather, the number of face-to-face Appeals conferences held through circuit riding is steadily falling. Taxpayer satisfaction, the appearance of fairness, and the outcome of proceedings are all adversely affected by the lack of an Appeals Officer and a Settlement Officer in each state. Congress desired better for taxpayers, and more from the IRS, when it passed § 3465(b) of RRA 98.

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39 RRA 98, Pub. L. No. 105-206, Title III, Subtitle E, § 3465(c) (July 22, 1998).

40 Additionally, Appeals recently has established procedures for making VSD available for Campus Appeals in situations where Appeals personnel are co-located with VSD equipment and the taxpayer or representative is located within 100 miles of a VSD customer-facing location. See Memorandum from John Cardone, Director, Policy Quality and Case Support to Appeals Employees, Re: Implementation of Virtual Service Delivery (VSD), (July 24, 2014). To this point, however, the lack of customer-facing locations places a significant practical limitation on the ability of taxpayers to utilize this option.

41 VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services, *infra*.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS should:

1. Expand Appeals duty locations in a way that ensures at least one Appeals Officer and one Settlement Officer are stationed within every state, the District of Columbia, and Puerto Rico.
2. Begin systematically collecting information allowing for a more precise analysis of the timeliness and fairness of Appeals conferences conducted through circuit riding both in states without a permanent Appeals presence and in states where Appeals field offices are augmented by circuit riding.

**MSP  
#5****VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

**DEFINITION OF PROBLEM**

On January 2, 2014, the IRS ceased providing free return preparation services at its local Taxpayer Assistance Centers (TACs).<sup>1</sup> Instead, taxpayers were directed to use Free File, tax preparation software that is free for taxpayers whose 2013 incomes were less than \$58,000, or obtain the services at Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA or TCE) sites.<sup>2</sup>

In fiscal year (FY) 2014, VITA and TCE programs prepared 3,472,696 returns, an increase of about 27 percent over the FY 2009 level.<sup>3</sup> VITA and TCE sites that received funding from the IRS, also referred to as award grantees, alone prepared more than 1.4 million and 1.3 million returns, respectively, during FY 2014.<sup>4</sup> Inexplicably, the IRS awarded VITA grantees \$100,000 less than in FY 2013 and committed more resources to the TCE grant program, despite the fact that the number of returns prepared by VITA programs increased at a substantially higher rate than the number of returns prepared by TCE programs in FYs 2009-2013.<sup>5</sup> Because every VITA grant dollar must be matched by the VITA grantee, a requirement not imposed on TCE grantees, the IRS funding decision had the effect of reducing resources available to the VITA grant program by two hundred thousand dollars in FY 2014.

These data do not capture the number of taxpayers who are turned away from VITA or TCE sites because the issues they need help with are “out of scope.”<sup>6</sup> VITA and TCE sites have reported an increase in these

1 TACs are local IRS sites where taxpayers can go for face-to-face assistance. IRS, *Contact Your Local IRS Office*, available at <http://www.irs.gov/uac/Contact-Your-Local-IRS-Office-1> (last visited Oct. 27, 2014).

2 VITA and TCE sites provide free tax preparation services for qualified individuals in conjunction with IRS assistance and direction. See IRS, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources*, available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources> (last visited Oct. 17, 2014); IRS, *Free File: Do Your Federal Taxes for Free*, available at <http://www.irs.gov/uac/Free-File:-Do-Your-Federal-Taxes-for-Free> (last visited Oct. 27, 2014). The income amount changes each taxable year.

3 IRS response to TAS information request (Aug. 15, 2014). In FY 2009, VITA prepared 417,741 returns; TCE sites prepared 1,538,181 returns; and VITA Grantees—a total of 779,734 returns (included in the total VITA number).

4 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014). The number of returns prepared by VITA grantees increased by 66,182 in FY 2014 compared to FY 2013. The number of returns prepared by TCE grantees decreased in FY 2014 for the first time, by 251,929 returns compared to FY 2013.

5 TAS teleconference with Wage and Investment (W&I) (Nov. 24, 2014). W&I was unable to explain why or how funding over the congressionally appropriated amounts (discretionary funding) were determined. IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014). TCE grantees prepared 1,538,181 returns in FY 2009 and 1,595,860 returns in FY 2013, resulting in an increase of 57,679 returns. VITA grantees prepared 779,734 returns in FY 2009 and 1,353,433 in FY 2013, an increase of 573,699 returns. See Figure 1.5.2, *Tax Returns Prepared at VITA/TCE Sites in FYs 2009-2014* *infra*.

6 “Out of scope” returns include forms, schedules, and tax law topics the IRS identifies each year, which may change every year. Examples of out of scope items are cancellation of debt other than nonbusiness credit card debt, some expenses on Form 3903, *Moving Expenses*, some Forms 1040X, *Amended Returns*, and transactions in virtual currencies. See IRS Pub. 4012, *VITA/TCE Volunteer Resource Guide*, Scope of Service 8-10 (Oct. 2014).

types of returns.<sup>7</sup> IRS Free File software cannot address these issues either.<sup>8</sup> Consequently, these taxpayers have nowhere to turn for free assistance in preparing their returns.<sup>9</sup>

The National Taxpayer Advocate is concerned that the IRS's approach to free tax preparation assistance falls short of Congress' expectations that the IRS would "extend services to underserved populations and hardest-to-reach areas, ... heighten quality control, enhance training of volunteers, and significantly improve the accuracy rate of returns prepared by VITA sites."<sup>10</sup>

By eliminating tax preparation services at TACs and inadequately supporting VITA or TCE sites, the IRS makes it more difficult for taxpayers to obtain tax preparation assistance that helps them meet their reporting obligations and comply with the tax laws. These shortcomings burden taxpayers because those who cannot obtain free filing assistance may pay more in taxes than they are legally required to pay, or seek preparation services from unqualified or unscrupulous preparers, undermining voluntary compliance and eroding the *taxpayer's rights to be informed, to quality service, and to pay no more than the correct amount of tax.*<sup>11</sup>

## ANALYSIS OF PROBLEM

### Background

Volunteer taxpayer assistance programs administered by the IRS originated with the Tax Reform Act of 1969 and were later consolidated as VITA.<sup>12</sup> VITA partners offer free tax assistance and help in preparing income tax returns for low to moderate income individuals, the disabled, the elderly, and those with limited English proficiency (LEP).<sup>13</sup> The IRS provides VITA partners with tax preparation software, limited amounts of hardware, online training for volunteer certification, and advertising on IRS.gov. VITA partners are responsible for all other aspects of their program, including:

- Publicity;
- Volunteer recruitment;
- Training;
- Providing the site; and

7 2014 Common Cents Conference, IRS VITA Communications Panel, *Impact of Taxpayer Assisted Center Closures: VITA Field Survey Results*, available at <http://commonecentsconference.mdcash.org/wp-content/uploads/2013/01/VITA-Field-Survey-Summary-FINAL.pdf> (last visited Dec. 16, 2014).

8 IRS, *Available Forms and Limitations*, available at <http://www.irs.gov/uac>List-of-Available-Free-File-Fillable-Forms> (last visited Dec. 16, 2014).

9 TACs were able to prepare tax returns that are more technical and did not have as many out of scope limitations compared to the VITA or TCE sites and the Free File software.

10 S. Comm. on Appropriations, *Financial Services and General Government Appropriations Bill, 2014*, report to accompany S. 1371, 113th Cong., S. REP. No. 113-80, at 27 (2014).

11 On June 10, 2014, the IRS formally adopted the Taxpayer Bill of Rights (TBOR). See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). The right to be informed includes the right to know what the taxpayer need to do to comply with the tax laws and clear explanations of the laws and IRS procedures. The right to quality service includes the right to receive prompt, courteous, and professional assistance in their dealings with the IRS. Taxpayers also have the right to pay only the amount of tax legally due, including interest and penalties.

12 See *Income Tax Overpayments by the Elderly, IRS Commissioner Hearing Before the S. Comm. On Aging*, 95th Cong. 44 (1970) (statement of Randolph W. Thrower, IRS Commissioner). Commissioner Thrower submitted a written answer to Congress describing the Taxpayer Assistance Training Program, which was the pilot of the IRS volunteer tax programs. See also IRS Pub. 4671, *VITA Grant Program Overview and Application Instructions* 6 (Apr. 2014).

13 IRS, *Free Tax Return Preparation for Qualifying Taxpayers*, available at <http://www.irs.gov/Individuals/Free-Tax-Return-Preparation-for-You-by-Volunteers> (last visited on Nov. 14, 2014).

- All aspects of management.<sup>14</sup>

The IRS administers the VITA program through the Stakeholder Partnership, Education and Communications program (SPEC) in the W&I division.<sup>15</sup>

Prior to 2007, the VITA partners funded their programs without any financial assistance from the IRS. However, in December 2007 Congress created and appropriated funding for the VITA grant program to provide matching funds (*i.e.*, the IRS may match the funds the organization has secured).<sup>16</sup> In 2008, the House Appropriations Committee directed the IRS, through VITA and TCE, to “strengthen, improve, and expand taxpayer service overall.”<sup>17</sup> The Committee explained the purpose of the VITA grant funds was “[t]o enable VITA programs to extend services to underserved populations and hardest-to-reach areas, both urban and non-urban, as well as to increase the capacity to file returns electronically, heighten quality control, enhance training of volunteers, and significantly improve the accuracy rate of returns prepared by VITA sites.”<sup>18</sup>

Once awarded, grant funds are restricted and can only be used for reasonable costs that would not have existed but for the program, such as:

- Hardware used to prepare returns;
- Salaries, wages, and benefits of clerical personnel, interpreters, program and site coordinators, and tax law instructors;
- Office supplies;
- Rent;
- Utilities; and
- Equipment and technical personnel that relate to electronic filing services.

The IRS does not allow VITA or TCE to use grant funds as compensation for tax assistors or preparers, screeners, or quality reviewers.<sup>19</sup> Not all VITA participants seek or receive grants; some operate without monetary support from the IRS.

In 1978, Congress created the TCE program, which allows the IRS to provide funding (without the matching requirement) to various private and public nonprofit agencies and organizations that offer free

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<sup>14</sup> Internal Revenue Manual (IRM) 22.30.1.5.1.2(6), *Volunteer Income Tax Assistance (VITA) Grant* (Oct. 01, 2011).

<sup>15</sup> SPEC handles the outreach and education functions of the IRS, and manages the VITA and TCE programs. SPEC’s mission is to “assist taxpayers in satisfying their tax responsibilities” and is accomplished by partnering with various organizations providing access to low income and underserved populations in the local communities. IRM 22.30.1.1(2), *What is Stakeholder Partnerships, Education and Communications* (Oct. 1, 2013).

<sup>16</sup> Consolidated Appropriations Act of 2008, Pub. L. No. 110-161, 121 Stat. 1844, 1975-76 (2007). See also IRM 22.30.1.5.1.2(2), *Volunteer Income Tax Assistance (VITA) Grant* (Oct. 01, 2011). The IRS may match funds that an organization provides in the form of cash, software, hardware, supplies, salaries, and volunteer services. IRS, *VITA Grant FAQs Category: Matching Funds* (Mar. 28, 2014), available at <http://www.irs.gov/Individuals/VITA-Grant-FAQs-Category-Matching-Funds>. The goal of the grant program is to provide free tax return preparation and electronic filing to taxpayers that are low to moderate-income, elderly, disabled, and individuals with limited English proficiency. IRM 22.30.1.5.1.2(3), *Volunteer Income Tax Assistance (VITA) Grant* (Oct. 01, 2011).

<sup>17</sup> H. Comm. on Appropriations, *Financial Services and General Government Appropriations Bill, 2008*, report to accompany H.R. 2829, 110th Cong., H.R. REP. No. 110-207, at 26 (2008).

<sup>18</sup> 153 Cong. Rec. H16049 (daily ed. Dec. 17, 2007).

<sup>19</sup> IRM 22.30.1.3.3.1.2(1), *Compensation for the Grant Program* (Oct. 01, 2011).

tax counseling and assistance to individuals over the age of 60.<sup>20</sup> TCE volunteers are IRS-certified and serve all taxpayers but specialize in issues unique to older taxpayers, such as pensions and retirement.<sup>21</sup>

### Congress Intended the IRS to Sufficiently Fund, Expand, and Improve the Reach of the VITA and TCE Programs.

At the same time Congress authorized funding for the VITA grant program, legislators were concerned about the IRS reducing taxpayer services and the associated adverse impact on voluntary compliance:

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**The IRS discontinued tax preparation services at Taxpayer Assistance Centers without properly evaluating the limitations of the most vulnerable taxpayer populations—the elderly, low income, rural, and those not proficient in English.**

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If the IRS proposes further reductions in specific taxpayer services ... the IRS must demonstrate that such reductions will not result in a decline in voluntary compliance. Where such reductions involve a reduction in face-to-face service, the IRS must demonstrate that the proposed reductions do not adversely impact compliance by taxpayers ...<sup>22</sup>

In 2014, Congress directed the IRS to “expand the quantity and funding level of VITA grants focused on serving persons with disabilities proportional to the growing disability population requiring tax assistance” and “allow national coalitions responsible for the coordination of local community partnerships focused specifically on the expanded provision of tax services for individuals with disabilities to compete in the VITA community matching grant processes.”<sup>23</sup> Congress directed the IRS to fund the TCE and VITA programs at no less than \$5,600,000 and \$12,000,000 respectively.<sup>24</sup>

### Eliminating Tax Return Preparation Services at TACs Harms the Most Vulnerable Taxpayers and Voluntary Compliance.

Prior to 2014, taxpayers turned to TACs for assistance in preparing and filing tax forms such as IRS Form 1040 Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, complicated and advanced forms such as Schedule D, *Capital Gains and Losses*, and Schedule F, *Profit or Loss From Farming*, because VITA and TCE sites generally cannot prepare these out-of-scope forms.<sup>25</sup> In addition to Schedules C, D, and F, low and moderate income taxpayers also may need tax preparation assistance with Form 3903, *Moving Expenses* and Form 1099-C, *Cancellation of Debt*.<sup>26</sup> At the start of 2014, the IRS stopped preparing returns at TACs and directed taxpayers to use other free options such as the IRS Free File program,

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20 Federal Grant and Cooperative Agreement Act of 1977, Pub. L. No. 95-224, § 6, 92 Stat 3, 5 (1978). See also Statement of Procedural Rules, Treas. Reg. § 601.802. Unlike VITA grant funding, TCE grant funding does not require matching funds.

21 IRS, *Free Tax Return Preparation for Qualifying Taxpayers*, available at <http://www.irs.gov/Individuals/Free-Tax-Return-Preparation-for-You-by-Volunteers> (last visited on Nov. 14, 2014).

22 153 CONG. REC. H16049 (daily ed. Dec. 17, 2007).

23 U.S. Congress, S. Comm. on Appropriations, *Financial Services and General Government Appropriations Bill*, 2014, report to accompany S. 1371, 113th Cong., S. REP. No. 113-80, at 28 (2014).

24 Consolidated Appropriations Act of 2014, Pub. L. No. 113-76, 128 Stat. 5, 188 (2014).

25 IRS Pub. 3676 (EN/SP), *IRS Certified Volunteers Providing Free Tax Preparation* 1 (Jan. 2014). In June 2013, the National Taxpayer Advocate met with executives from the IRS Wage & Investment division to discuss the National Community Tax Coalition (NCTC), a SPEC national partner, request for the IRS to reconsider a decision to discontinue the Expanded Form 1040 Schedule C, *Profit or Loss From Business (Sole Proprietorship)* pilot tax return preparation program after the 2013 filing season. The discussions resulted in SPEC continuing the program.

26 Pub. 4012, *VITA/TCE Volunteer Resource Guide*, Scope of Service 8-10 (Oct. 2014).

Facilitated Self-Service Assistance (FSA) sites, or VITA and TCE.<sup>27</sup> The IRS stated that commercial tax software and paid preparers are additional options.<sup>28</sup> However, these alternatives are not replacements for the service formerly offered by TACs. Unlike TACs, VITA and TCE sites and Free File software cannot prepare forms or handle issues that are “out of scope.” Low income taxpayers may not be able to afford software or a paid preparer, while taxpayers with disabilities, limited technology skills, or no access to a computer may be unable to use Free File or commercial software.

As discussed in the National Taxpayer Advocate’s 2013 Annual Report to Congress, TACs are preferred by some taxpayers “who do not have Internet access or prefer in-person assistance.”<sup>29</sup> A 2011 SPEC Rural Strategy Initiative acknowledged, “[e]ven though the percentage of low-income residents per capita is higher in rural areas than in larger cities, the coverage rates for free tax preparation services are lower. While many partners want to service rural areas, there are often barriers and challenges that are difficult to overcome.”<sup>30</sup> As the Senate Appropriations Committee FY 2015 Financial Services and General Government Subcommittee draft report noted, “Given the significant wait times and deteriorating rate of response for assistance provided through the national toll-free line, it is imperative the IRS Taxpayer Assistance Centers [TACs] in rural areas are fully staffed and capable of resolving taxpayer issues.”<sup>31</sup>

The IRS discontinued tax preparation services at TACs without properly evaluating the limitations of the most vulnerable taxpayer populations—the elderly, low income, rural, and those not proficient in English. In April 2012, members of the Taxpayer Advocacy Panel (TAP) performed a survey of taxpayers that indicates that even though taxpayers tried to resolve their issues through other means, they still needed face-to-face assistance from a TAC.<sup>32</sup> The IRS’s own taxpayer service plan acknowledges that some taxpayers, including those with income restrictions, the elderly, or individuals with limited English abilities, are more likely to visit a location that offers face-to-face services to complete their tasks.<sup>33</sup> Individuals prefer face-to-face help for a few reasons:

- Some may want the opportunity to receive an immediate response, or to clarify that they fully understand any information, direction, or guidance;
- Some may lack computer or Internet access;<sup>34</sup> and

27 IRS, *Growth Through Alternative Filing Strategies in the Next ERA* FY 2014 Program Guide 7 (2014). See also IRS, *Contact Your Local IRS Office*, available at <http://www.irs.gov/uac/Contact-Your-Local-IRS-Office-1> (last visited on Oct. 17, 2014). FSA is interactive tax preparation software that is available at some VITA and TCE sites that the taxpayer uses with very little assistance and does not require face-to-face interaction. For further information on Face-to-Face taxpayer services, see National Taxpayer Advocate 2012 Annual Report to Congress 20-39 (Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*).

28 IRS, *FY 2014 Service Approach Return Preparation Clarification* 3 (Jun. 9, 2014).

29 See National Taxpayer Advocate 2013 Annual Report to Congress 20-39, at 30 (Most Serious Problem: *IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

30 IRS, *Fact Sheet for SPEC Partners, SPEC Rural Strategy Initiative* 1 (July 2011). Since FY 2012, W&I rural areas as part of the overall low income population and no longer captures or has knowledge of the actual coverage rates for rural areas. IRS response to fact check (Dec. 27, 2014).

31 *FY15 Financial Services and General Government Subcommittee Reported Bill and Draft Report* (July 24, 2014), available at <http://www.appropriations.senate.gov/news/fy15-fsgg-subcommittee-reported-bill-and-draft-report> (last visited Oct. 30, 2014).

32 The TAP is a federal advisory committee comprised of citizen volunteers who work to improve IRS services by providing the taxpayers’ perspective to various IRS operations. The National Taxpayer Advocate and her Research and Systemic Advocacy staffs provided support to this survey effort. TAP volunteers returned 664 completed surveys from 37 different TAC offices. While these results are not statistically representative of all TAC visitors, they represent the needs and activities of a sizable number of TAC customers during one week in the tax filing season. Percentages shown are out of all 664 respondents. Some respondents did not answer every question. Taxpayer Advocacy Panel, 2012 Annual Report 33 (Apr. 2012).

33 IRS, *2007 Taxpayer Assistance Blueprint Phase II*, 111.

34 Kathryn Zickuhr, Pew Research Center, *Who’s not online and why* 2 (Sep. 25, 2013), available at <http://www.pewinternet.org/2013/09/25/main-report-2/>.

- Some may have education, income, disability, language, or age barriers.<sup>35</sup>

According to a Pew study, “[a]s of May 2013, 15 percent of American adults age 18 and older do not use the internet or email.”<sup>36</sup> The study found, “[a]s in previous surveys, internet use remains strongly correlated with age, education, and household income.”<sup>37</sup> Pew also noted, “Many seniors have physical conditions or health issues that make it difficult to use new technologies.”<sup>38</sup> The following percentages of adults are not online:

- 44 percent of those over the age of 65;
- 41 percent of those who have not graduated from high school;
- 24 percent of Hispanics;
- 15 percent of black non-Hispanics;
- 24 percent of those residing in households with income of less than \$30,000 per year; and
- 20 percent of those living in rural areas.<sup>39</sup>

All of these taxpayers are more likely to need face-to-face services.<sup>40</sup> However, in the absence of return preparation services at TACs, their tax assistance options are limited to paid preparers, commercial software, or VITA or TCE sites. Some taxpayers turn to Low Income Taxpayer Clinics (LITCs), but the clinics’ mission is to provide low income taxpayers representation in tax controversies, and they generally cannot prepare current-year tax returns.<sup>41</sup> As a result, some taxpayers may become frustrated and stop filing returns altogether.

### **Increased Activity and Inadequate Resources at VITA/TCE Sites Burden Taxpayers Who Depend on Them.**

In FY 2014, the IRS funded both VITA and TCE at the congressionally appropriated levels, but decreased discretionary funding for the VITA program and increased discretionary funding for the TCE program for FY 2014 as compared to FY 2013 levels.<sup>42</sup> As depicted below, VITA discretionary funding decreased by one percent, from \$12.1 to \$12 million and TCE discretionary funding rose by nine percent, from \$5.6 million to \$6.1 million.

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35 Kathryn Zickuhr, Pew Research Center, *Who's not online and why* 2, 4 (Sep. 25, 2013), available at <http://www.pewinternet.org/2013/09/25/main-report-2/>. Pew found that groups of individuals with similar characteristics to older and less affluent persons over the age of 65 had “significant challenges with health or disability” that prevented their use of “digital tools and services, both physically and psychologically.” Aaron Smith, Pew Research Center, *Older Adults and Technology Use* 1 (Apr. 3, 2014), available at <http://www.pewinternet.org/2014/04/03/older-adults-and-technology-use/>.

36 *Id.* at 4.

37 *Id.*

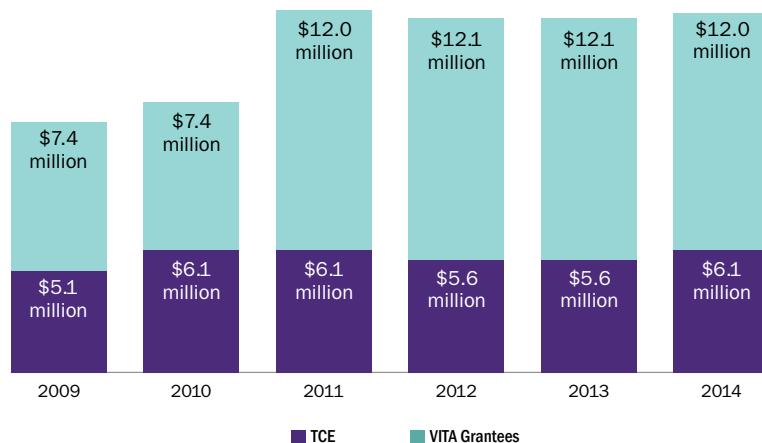
38 Aaron Smith, Pew Research Center, *Older Adults and Technology Use* 2 (Apr. 3, 2014), available at <http://www.pewinternet.org/2014/04/03/older-adults-and-technology-use/>.

39 Kathryn Zickuhr, Pew Research Center, *Who's not online and why* 2 (Sep. 25, 2013), available at <http://www.pewinternet.org/2013/09/25/main-report-2/>.

40 IRS, 2007 Taxpayer Assistance Blueprint Phase II, 111.

41 Internal Revenue Service Restructuring Act of 1998, Pub.L. No. 105-206, Title III, § 3601(a), 112 Stat. 685. 774 (1998). See also IRC § 7526. The LITC program was created and funded to provide taxpayers much needed tax assistance when there is a tax controversy with the IRS. Any other purpose is an inappropriate use of LITC grant funds.

42 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014). For FY 2014 the IRS award amount for the VITA and TCE sites was \$12 million and \$6.1 million respectively.

**FIGURE 1.5.1<sup>43</sup>****IRS funding of volunteer programs, FYs 2009-2014**

During the same period, the number of tax returns prepared by VITA sites increased five percent while the number prepared by TCE decreased 16 percent as shown on Figure 1.5.2.<sup>44</sup>

**FIGURE 1.5.2<sup>45</sup>****Tax returns prepared at VITA/TCE sites, FYs 2009-2014**

<sup>43</sup> IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014).

<sup>44</sup> *Id.* The IRS awarded seven fewer grants to VITA sites from FY 2013 to FY 2014 while the number remained the same for the TCE sites for the same period. The IRS increased funding for the TCE sites while the number of returns prepared by these sites decreased for the first time since the program was created.

<sup>45</sup> IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014).

The IRS awarded seven fewer grants to VITA sites from FY 2013 to FY 2014 while the number remained the same for the TCE sites for the same period.<sup>46</sup> The IRS increased discretionary funding for the TCE sites despite the fact that the number of returns prepared by TCE sites increased at a significantly slower pace than the number of returns prepared by VITA sites in FYs 2009-2013.<sup>47</sup> In fact, the number of returns prepared at TCE sites decreased in FY 2014 for the first time since the program was created.<sup>48</sup> The decision by the IRS to decrease discretionary funding for VITA also decreased the dollar amount of matching funds dedicated to volunteer tax preparation by two hundred thousand dollars.<sup>49</sup> Moreover, since VITA programs actually increased the number of returns prepared in FY 2014 despite funding cuts, the IRS could have served more taxpayers by increasing funding for VITA programs.<sup>50</sup> It is unclear on what basis the IRS decided to supplement the congressionally directed appropriations level for the TCE program by about \$500,000 while allowing funding for the VITA program to decline.

As the Treasury Inspector General for Tax Administration has noted, the combination of increased activity and decreased funding can strain the VITA and TCE program partners' ability to meet taxpayer needs and improve voluntary compliance.<sup>51</sup> The increased burden on the programs may force some sites to turn people away, while others may be unable to provide quality services.<sup>52</sup> This may leave taxpayers with no way to obtain prompt, courteous, and professional assistance from the IRS as well as organizations funded by the IRS, undermining the taxpayer right to quality service.<sup>53</sup>

A small sample of VITA site responses to a survey conducted by the non-profit Maryland CASH Campaign includes specific concerns about the IRS's decision to eliminate tax preparation services at TACs.<sup>54</sup> Those include:

- Increased referrals from TACs for returns involving issues that are out of scope for VITA sites;
- Increased referrals outside of tax season (most VITA sites are open only during the tax season);
- Increased referrals for amended and prior year returns;
- A simultaneous decrease in IRS SPEC staff traveling to the VITA sites;
- A simultaneous decrease in IRS SPEC staff conducting training or presentations; and

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<sup>46</sup> IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014).

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> IRS response to TAS information request (Nov. 19, 2014).

<sup>50</sup> IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014). VITA grantees prepared 66,182 more returns in FY 2014 than in FY 2013 (1,419,615 vs. 1,353,433), while TCE grantees prepared 251,929 fewer returns over the same period (1,343,931 vs. 1,595,860).

<sup>51</sup> Treasury Inspector General for Tax Administration (TIGTA), Audit No. 201240049, *Additional Steps Are Needed to Ensure the Volunteer Income Tax Assistance Grant Program Reaches More Underserved Taxpayers* (Apr. 30, 2012).

<sup>52</sup> The guiding principle of the IRS VITA Grant Program is that the grantees should show "incremental increases" in their return preparation each year. The IRS also expects grantees to achieve 100 percent of their grant agreement goals as well as increasing the amount of returns compared to the prior year with similar amounts of funding. IRS, Pub. 4883, *Grant Programs Resource Guide for VITA Volunteer Income Tax Assistance & TCE Tax Counseling for the Elderly* 5 (Aug. 2014).

<sup>53</sup> IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014).

<sup>54</sup> Maryland CASH Campaign released the survey at the 2014 Common Cents Conference. 2014 Common Cents Conference, IRS VITA Communications Panel, *Impact of Taxpayer Assisted Center Closures: VITA Field Survey Summary Results*, available at [https://www.surveymonkey.com/sr.aspx?sm=mDtJcp\\_2f5M9bobk33J0o8\\_2ffhVCxrf2eyFcarkizSSx4\\_3d](https://www.surveymonkey.com/sr.aspx?sm=mDtJcp_2f5M9bobk33J0o8_2ffhVCxrf2eyFcarkizSSx4_3d) (last visited Nov. 15, 2014).

- A simultaneous decrease in the availability of IRS resources, such as training materials and site tools.<sup>55</sup>

VITA and TCE sites must perform intake and interview each taxpayer who visits a site;<sup>56</sup> however, the sites do not report the time spent on intake and processing for a taxpayer whose issue is out of scope or needs an amended or prior year tax returns prepared. The initial interviews provide valuable information and guidance to taxpayers, even if they ultimately cannot be assisted by the VITA or TCE site. However, by the IRS not counting and funding the time spent on this valuable service, taxpayers experience longer wait times or risk being turned away. These limitations, in the absence of tax return preparation services at TACs, erode the taxpayer's *right to be informed* of compliance requirements and receive a clear explanation of the laws and procedures.<sup>57</sup>

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**The IRS's restrictions on which volunteers can prepare prior year or amended returns, combined with the limitations of software, discourage sites from preparing these returns. And because the IRS no longer prepares them in the Taxpayer Assistance Centers, taxpayers no longer have access to free assistance in this area.**

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### VITA/TCE Programs Are Subject to Limitations and Restrictions that Impede Their Effectiveness.

In addition to the out of scope restrictions, the IRS suggests that volunteer preparers have two years of previous experience and be trained and certified at the advanced level before preparing prior year or amended returns. This policy means some taxpayers will not receive service, because the sites lack preparers qualified to handle their returns.<sup>58</sup> Volunteer preparers who work in the tax and accounting field, such as attorneys and certified public accountants, are also burdened by the IRS training and certification policy requirement that volunteers who answer tax law questions, instruct tax law classes, prepare or correct tax returns, or conduct quality reviews of completed tax returns must be certified in tax law annually.<sup>59</sup> The IRS should require these volunteers to recertify only on new provisions and changes in tax law much like the IRS proposed in its pre-*Loving* regulation of return preparers, which could possibly increase volunteer participation.<sup>60</sup>

Moreover, although the IRS encourages electronic filing, the TaxWise software it provides to VITA and TCE volunteers allows return preparation only for the current year and the three previous taxable years.<sup>61</sup> Because VITA and TCE sites are only authorized to use this software, they cannot fully assist a taxpayer

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55 2014 Common Cents Conference, IRS VITA Communications Panel, *Impact of Taxpayer Assisted Center Closures: VITA Field Survey Summary Results*, available at [https://www.surveymonkey.com/sr.aspx?sm=mDtFjCp\\_2f5M9bobk33J0o8\\_2ffhVCxrf2eyFcarkizSSx4\\_3d](https://www.surveymonkey.com/sr.aspx?sm=mDtFjCp_2f5M9bobk33J0o8_2ffhVCxrf2eyFcarkizSSx4_3d) (last visited Nov. 15, 2014).

56 IRM 22.30.1.3.13.1.2, *Intake and Interview Process* (Oct. 1, 2014).

57 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014).

58 IRS, *Fact Sheet for SPEC Partners, Preparing Prior Year and Amended Returns at VITA/TCE sites* (Oct. 2014), available at [http://www.irs.gov/pub/irs-utl/Fact\\_Sheet\\_Prior\\_Year\\_and\\_Amended\\_Returns%20with%20Addendum\\_Updated%2010-3-14.pdf](http://www.irs.gov/pub/irs-utl/Fact_Sheet_Prior_Year_and_Amended_Returns%20with%20Addendum_Updated%2010-3-14.pdf) (last visited Oct. 30, 2014).

59 IRM 22.30.1.3.13.1.2, *Intake and Interview Process* (Oct. 1, 2014). The IRS provides training to volunteers through the Link and Learn application. IRM 22.30.1.3.7.1.3, *Link and Learn Taxes (LLT)* (Oct. 1, 2014).

60 *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (upholding the District Court's decision to enjoin the IRS's enforcement of the testing and CE requirements).

61 The IRS is required by law to facilitate electronic filing (e-file) of returns. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, § 2001, 112 Stat. 723 (1998). IRS, *Fact Sheet for SPEC Partners, Preparing Prior Year and Amended Returns at VITA/TCE sites* (Oct. 2014), available at [http://www.irs.gov/pub/irs-utl/Fact\\_Sheet\\_Prior\\_Year\\_and\\_Amended\\_Returns%20with%20Addendum\\_Updated%2010-3-14.pdf](http://www.irs.gov/pub/irs-utl/Fact_Sheet_Prior_Year_and_Amended_Returns%20with%20Addendum_Updated%2010-3-14.pdf) (last visited Oct. 30, 2014).

who has several years of returns to be filed.<sup>62</sup> The IRS's restrictions on which volunteers can prepare prior year or amended returns, combined with the limitations of software, discourage sites from preparing these returns. And because the IRS no longer prepares them in the TACs, taxpayers no longer have access to free assistance in this area.

Taxpayers *have a right to pay no more than the current amount of tax due*. However, restrictions on VITA sites with respect to the types of permitted return preparation may lead to taxpayers failing to file a timely return, which could result in the taxpayer owing more than the original amount, due to penalties and interest.<sup>63</sup>

In light of the restrictions and limitations discussed above, the IRS grant funding process must change to reduce the additional burdens on taxpayers and the VITA and TCE sites. As stated earlier, the IRS does not fund quality reviewers, yet the volunteer sites need them (even in a part-time funded capacity) to ensure the accuracy of returns; TIGTA has consistently noted quality issues in its reports about VITA and TCE sites.<sup>64</sup> Because the programs have to depend on volunteers to verify the quality of the prepared returns, some taxpayers are burdened with improperly prepared returns, possibly causing reduced or delayed refunds, or payment of unnecessary taxes.<sup>65</sup>

In addition to the lack of funding for quality reviewers, the IRS restricts funding of Certified Acceptance Agents (CAAs) at VITA and TCE sites, creating an additional burden to taxpayers who need an Individual Taxpayer Identification Number (ITIN).<sup>66</sup> The National Taxpayer Advocate has drawn attention to issues with the ITIN application process multiple times.<sup>67</sup> Taxpayers who are ineligible for a Social Security

<sup>62</sup> This has always been an issue for taxpayers in need of filing returns for immigration reasons. These taxpayers are sometimes required to provide several years of tax returns to meet certain immigration related requirements.

<sup>63</sup> IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). IRC § 6651(a)(1), (b)(1). Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before its due date (including extensions) will be subject to a penalty of five percent of the tax due (minus any credit the taxpayer is entitled to receive and payments made by the due date) for each month or partial month the return is late, up to a maximum of 25 percent, unless the failure is due to reasonable cause and not willful neglect. See also Most Litigated Issue: *Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654*, *supra*.

<sup>64</sup> IRM 22.30.1.3.3.1.2, *Compensation for Grant Program* (Oct. 1, 2011). For further information on the accuracy of returns prepared by TACs, see National Taxpayer Advocate 2012 Annual Report to Congress 20-39 (Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*). See TIGTA, Audit No. 201240049, *Additional Steps Are Needed to Ensure the Volunteer Income Tax Assistance Grant Program Reaches More Underserved Taxpayers* (Apr. 30, 2012); TIGTA, Audit No. 201340110, *Inconsistent Adherence to Quality Requirements Continues to Affect the Accuracy of Some Tax Returns Prepared at Volunteer Sites* (Sep. 15, 2013).

<sup>65</sup> The IRS monitors the quality of the VITA and TCE sites as part of their participation in the grant programs. Quality is measured and is used to evaluate whether the site receives funding in the future. See IRM 22.30.1.3.13, *Quality Review Process* (Oct. 10, 2013). However, every tax return must be quality reviewed by a person other than the preparer. See IRM 22.30.1.3.13.1(4), *VITA and TCE Quality Site Requirements (QSR)* (Oct. 1, 2013).

<sup>66</sup> A certified acceptance agent is a person (i.e., an individual or an entity) who, is authorized to assist alien individuals and foreign persons in obtaining ITINs from the IRS. Rev. Proc. 2006-10, 2006-2 IRB 293 (released Jan. 9, 2006).

<sup>67</sup> See 2013 Annual Report to Congress 214-227 (Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*); National Taxpayer Advocate 2012 Annual Report to Congress 154-79 (Most Serious Problem: *The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Deter Fraud*); National Taxpayer Advocate 2010 Annual Report to Congress 319-338 (Most Serious Problem: *Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers*); National Taxpayer Advocate 2008 Annual Report to Congress 126-140 (Most Serious Problem: *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*); National Taxpayer Advocate 2004 Annual Report to Congress 143-162 (Most Serious Problem: *Processing Individual Taxpayer Identification Number Applications and Amended Income Tax Returns*); National Taxpayer Advocate National Taxpayer Advocate 2003 Annual Report to Congress 60-86 (Most Serious Problem: *Individual Taxpayer Identification Number (ITIN) Program and Application Process*).

number (SSN) need an ITIN to meet their tax return filing obligations or claim the personal exemptions for spouses and children, and the tax credits and refunds to which they are legally entitled. These taxpayers also need ITINs to have the proper amount of taxes withheld, claim tax treaty benefits, and comply with reporting laws such as the Foreign Account Tax Compliance Act (FATCA).<sup>68</sup>

The problems facing ITIN taxpayers include forgoing filing a joint return and claiming exemptions, possibly resulting in the payment of more taxes than are legally due; and the hardship associated with mailing original documents to the IRS for an extended period (often many months), risking fines and incarceration in some locations, or lost documents by the IRS resulting in high replacement costs.<sup>69</sup> Having a paid CAA on staff at the VITA or TCE site would allow certification of documents that taxpayers bring in with their Form W7, *Application for IRS Individual Taxpayer Identification Number*, thus reducing the burden to taxpayers. It would also promote accountability and protect against fraud. The IRS's policy of not funding quality reviewers and CAAs undermines the meaning and value of the rights *to quality service*, and *to pay no more than the correct amount of tax*.

As discussed above, IRS restrictions on how the VITA and TCE sites use their funds limit the effectiveness and reach of both programs. Absent these restrictions, the IRS could develop an infrastructure that:

- Allows the VITA and TCE sites to assist more taxpayers in need (especially the hard-to-serve taxpayer communities that Congress intended the VITA program to help);
- Encourages the VITA and TCE sites to provide year-round services, as taxpayers need return preparation assistance year-round and not just during the January-April filing season; and
- Minimizes enforcement costs resulting from noncompliant taxpayers having no place to go to get free tax return preparation services that are easily accessible, or turning to unregulated and incompetent (or unscrupulous) return preparers for assistance.<sup>70</sup>

## CONCLUSION

The IRS's approach to VITA and TCE programs, in a time of significant reductions in face-to-face service, increases taxpayer burden and may adversely and significantly impact voluntary compliance, a result Congress wanted to avoid. Between elimination of tax preparation services at TACs, increased VITA and TCE activity, inadequate funding of the VITA grant program, restrictive grant guidelines, and software and volunteer training limitations, the IRS may overburden volunteer program partners and effectively eliminate any expectations that low income, disabled, rural, and elderly taxpayers can obtain free tax return preparation services. The IRS should refocus on the congressional intent behind VITA and TCE programs and tailor its administration of these programs to the specific needs of underserved taxpayer populations.

<sup>68</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 238-48 (Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*).

<sup>69</sup> National Taxpayer Advocate 2013 Annual Report to Congress 214-27 (Most Serious Problem: *INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS: ITIN Application Procedures Burden Taxpayers and Create a Barrier to Return Filing*).

<sup>70</sup> For a more detailed description of return preparer misconduct and IRS efforts to regulate them, see National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78 (IRS Steps to Create a Voluntary Program for Tax Return Preparer Standards in Light of the Loving Decision Are Well Intentioned, But the Absence of a Meaningful Competency Examination Limits the Program's Value and Could Mislead Taxpayers).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Increase VITA funding to maximize the overall resources (federal and matching funds) available for free tax preparation assistance.
2. Remove VITA and TCE program grant restrictions for specific tax forms, schedules, and issues, including Schedules C, D, and F, and ITINs.
3. Allow grant funding for quality review, CAAs, and year-round services at select sites.
4. Require volunteers who are authorized under Circular 230 to practice before the IRS (*i.e.*, attorneys, CPAs, and Enrolled Agents) to annually recertify only on new provisions and changes in tax law.
5. Provide free tax preparation assistance at TACs in areas with limited access to VITA or TCE volunteers, along with proper staffing and hours to handle taxpayer traffic.

**MSP  
#6****HEALTH CARE IMPLEMENTATION: Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

The Patient Protection and Affordable Care Act of 2009 (ACA) was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, the ACA provides targeted tax credits for low income individuals and for small businesses, while imposing a personal responsibility on individuals to have health coverage.<sup>1</sup>

Since enactment, the IRS has been implementing complicated ACA provisions that require developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies. The true test for the IRS and individual taxpayers begins in 2015, when taxpayers filing tax year (TY) 2014 federal income tax returns have to report that they have “minimum essential coverage” or are exempt from the responsibility to have the required coverage. If the taxpayer does not have coverage and is not exempt, he or she must make a shared responsibility payment (SRP) when filing a return.<sup>2</sup> Additionally, many taxpayers will have to reconcile the Premium Tax Credit (PTC) amounts they received in advance with the amounts to which they are entitled.<sup>3</sup> At the same time, the IRS will receive and process a significant amount of new information returns from employers, insurers and exchanges.<sup>4</sup>

Through representation on the IRS ACA Executive Steering Committee and several joint implementation teams, the National Taxpayer Advocate and Taxpayer Advocate Service (TAS) have identified the following concerns with ACA procedures and implementation:

- Delays in implementing health care procedures have impacted the training of IRS employees;

1 Internal Revenue Code (IRC) § 4980H(a)(1) also imposes a responsibility for applicable large employers to offer health care to employees in certain circumstances. Patient Protection & Affordable Care Act of 2009, Pub. L. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Education Reconciliation Act of 2010 (HERCA), Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).

2 IRC § 5000A.

3 The Premium Tax Credit is a refundable tax credit paid both in advance and at return filing to help taxpayers with low to moderate income purchase health insurance through the marketplace. IRC § 36B. As explained below, the amount of the credit paid in advance is based on projected income, while the amount for which a taxpayer is actually eligible is based on actual income.

4 The Health Insurance Marketplace, also called the “Exchange,” is a state or federally operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or buy insurance on their own. See <http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace>. IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. Section 6056 requires annual information reporting by applicable large employers relating to the health insurance that the employer offers (or does not offer) to its full-time employees. IRS Notice 2013-45, 2013-31 IRB 116, provides transition relief but the IRS has encouraged entities to voluntarily provide information returns for coverage provided in 2014, which are due to be filed and furnished in early 2015.

- IRS outreach and education should continue to focus on increasing taxpayer awareness of the need to update information with the exchanges throughout the year;
- Problems with state calculations of the advanced PTC and delays in processing PTC Change in Circumstances information can result in inaccurate advanced PTC payments and thereby harm taxpayers;
- The inability of the IRS to adequately test the accuracy of information-reporting data before the filing season can inhibit IRS verification efforts and cause significant taxpayer burden;
- The IRS may take inappropriate collection actions on shared responsibility payment liabilities;
- The use of “combination letters” for a disallowed PTC may confuse taxpayers;
- The inability of health insurers and self-insured employers to match tax identification numbers (TINs) before filing their information returns may lead to mismatches and unnecessary notices; and
- The IRS should provide additional guidance to employers on how to calculate the number of full-time equivalents for purposes of meeting the minimum essential coverage requirements.

Notwithstanding these concerns, we acknowledge the tremendous efforts made by the IRS to implement the healthcare provisions given their interdependency on decisions made by other federal agencies. Because the IRS's role is downstream of many external reporting processes, taxpayers and the IRS may experience problems over which the IRS has no control. Yet, the IRS will certainly bear much of the public blame because many of the problems will arise in the context of return filing. Conversely, taxpayers and the IRS will experience problems created specifically by IRS policies or processes, some of which are exacerbated by the general reduction in funding for taxpayer service.<sup>5</sup>

## ANALYSIS OF PROBLEM

### Background

#### *Shared Responsibility Payment*

Beginning in January 2014, non-exempt U.S. citizens and legal residents are required to maintain minimum essential coverage<sup>6</sup> or be subject to a shared responsibility payment (SRP).<sup>7</sup> The individual shared responsibility provision (ISRP) of the ACA phases in the amount of the payment until tax year (TY) 2016, when the payment amount will be the greater of:

1. 2.5 percent of household income for the taxable year over the threshold amount of income required for tax return filing for that taxpayer under § 6012(a)(1); or
2. \$695 per uninsured adult in the household and indexed for inflation thereafter.

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5 For a discussion of the reduction in taxpayer services, see Most Serious Problem: *TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*. For a discussion of how the IRS should prioritize taxpayer services, see Most Serious Problem: *TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions*, *supra*.

6 Minimum essential coverage includes government-sponsored programs, eligible employer-sponsored plans, plans in the individual market, grandfathered group health plans and other coverage as recognized by the Secretary of Health and Human Services (HHS) in coordination with the Secretary of the Treasury. IRC § 5000A(f).

7 Individuals are exempt from the requirement for months they are incarcerated, not legally present in the United States, or maintain religious exemptions. IRC § 5000A(d).

If an uninsured individual in the household has not attained the age of 18 as of the beginning of a month, the penalty amount for that individual for the month is equal to one-half of the applicable dollar amount for the calendar year in which the month occurs.<sup>8</sup> For TY 2014, the phased-in amount is the greater of (1) one percent of excess household income or (2) \$95 per uninsured adult in the household.<sup>9</sup>

The SRP is considered an excise tax that is assessed in the same manner as an assessable penalty under the enforcement provisions of the Code. While the IRS has the authority to offset refunds or credits to collect the SRP, it does not have the authority to collect through the use of liens and seizures. Moreover, noncompliance with the SRP requirement to have health coverage is not subject to criminal or civil penalties under the Code.<sup>10</sup>

### Premium Tax Credit

Individuals and families who purchase health insurance through an exchange may be eligible for the PTC (also called the “premium assistance credit”), which subsidizes the purchase of certain health insurance plans through an exchange.<sup>11</sup> The credit is refundable and payable in advance directly to the insurer. It is available for individuals (single or joint filers) who have household incomes between 100 and 400 percent of the federal poverty line (FPL) for the family size involved and who do not receive health insurance through an employer or a government-sponsored program.<sup>12</sup>

When applying for the credit, the individual must submit income and family size information to the exchange.<sup>13</sup> During the open enrollment period, participants must provide an estimate of their projected household income based on their most recently filed income tax return and any anticipated changes to income in the upcoming year. The exchange can verify data with the Department of Health and Human Services (HHS), which has authority under the ACA to obtain limited IRS data, and then disclose any inconsistency to the exchange.<sup>14</sup> The IRS provides limited tax return information to the marketplace, using the latest tax return information relevant to the healthcare coverage year.

The IRS data used is typically two years prior to the coverage year at issue.<sup>15</sup> For example, during the open enrollment season for 2015, which runs from November 15, 2014, through February 15, 2015, an applicant estimates projected 2015 household income to the exchanges, which typically involves looking at the most recently filed tax return (in this case usually TY 2013) with modifications to reflect any projected changes for 2015.<sup>16</sup> The exchange then verifies, via the Department of Health and Human Services (HHS), the taxpayer’s projected 2015 household income against IRS records based on the taxpayer’s most

<sup>8</sup> IRC § 5000A(c)(3)(C).

<sup>9</sup> IRC § 5000A(c)(2)(B)(i) & (c)(3)(B).

<sup>10</sup> IRC § 5000A(g); J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act,”* JCX-18-10 31 2 (Mar. 21, 2010).

<sup>11</sup> The Health Insurance Marketplace, also called the “Exchange,” is a state or federally operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or buy insurance on their own. See <http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace>.

<sup>12</sup> IRC § 36B; J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act,”* JCX-18-10 17 (Mar. 21, 2010).

<sup>13</sup> See ACA § 1411(b), 124 Stat. 119, 224 (2010).

<sup>14</sup> See IRC § 6103(l)(21).

<sup>15</sup> IRC § 6103(l)(21). The Treasury Inspector General for Tax Administration (TIGTA) conducted a review of the IRS’s response to 101,018 income and family size verification (IFSV) information requests received by the IRS between October 1 and October 4, 2013, and found that the IRS provided accurate responses for 100,985 (99.97 percent) of the 101,018 requests. TIGTA, Ref. No. 2014-43-044, *Affordable Care Act: Accuracy of Responses to Exchange Requests for Income and Family Size Verification Information and Maximum Advance Premium Tax Credit Calculation* (July 3, 2014).

<sup>16</sup> See <https://www.healthcare.gov/income-and-household-information/>.

recently processed tax return, typically TY 2013 in this case.<sup>17</sup> If IRS information is outdated due to the time difference, the individual may need to provide updated documentation or other evidence to the exchange to establish eligibility for the PTC.

The eligibility for and amount of the PTC are determined in advance of the coverage year, on the basis of:

1. Projected household income and family size; and
2. The monthly premiums for qualified health plans in the individual market in which the taxpayer, spouse and any dependent enroll in an exchange.

Any advanced PTC amount is paid during the year by the federal government to the insurer to offset the cost of the individual's insurance premiums.<sup>18</sup>

In the filing season for the tax year in question (for example, the 2015 filing season for TY 2014 returns), the individual taxpayer must reconcile the amount of any advanced PTC on the tax return with the allowable total credit for the year of coverage, based on that coverage year's *actual* household income, family size, and premiums. Any adjustment to tax resulting from the difference between the advance payment amount and the total allowable credit would be assessed as additional tax, subject to a repayment limitation, or a reduction in tax on the return.<sup>19</sup>

### **Delays in Implementing New Health Care Procedures Have Impacted the Training of IRS Employees.**

The new work caused by the ACA will likely exacerbate the IRS's already low level of service on its phone lines, as well as increasing the backlog of correspondence from taxpayers.<sup>20</sup> The IRS has estimated that it needs more than 2,300 employees to handle ACA implementation requirements, additional calls, and correspondence. However, the IRS has not received funding for these necessary additional hires.<sup>21</sup>

The IRS also must ensure that employees who work ACA-related issues, especially those in taxpayer-facing roles, are properly trained. In general, the IRS has worked diligently to develop and deliver a substantial amount of training on schedule.<sup>22</sup>

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<sup>17</sup> IRC § 36B; J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act,"* JCX-18-10 17 (Mar. 21, 2010).

<sup>18</sup> If a taxpayer's household status at year's end is other than anticipated—due to a change in income or family size—the Premium Tax Credit may be more or less than the amount advanced. Consequently, the IRS may recover the excess as a tax, subject to a repayment limitation, or owe the taxpayer a refund. IRC § 36B(f)(2)(B); Treas. Reg. §1.36B-4(a)(3).

<sup>19</sup> Taxpayers are not required to claim the PTC in advance. They can claim the PTC on the tax return instead. The PTC is a refundable credit and either reduces their tax liability or increases their refund. IRC § 36B. The repayment of any additional tax computed during the reconciliation may be limited if the taxpayer's household income is less than 400 percent of the Federal poverty line. Treas. Reg. §1.36B-4(a)(3). J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in combination with the "Patient Protection and Affordable Care Act,"* JCX-18-10 17 (Mar. 21, 2010). TAS was initially concerned that the existence of separate verification systems to process ACA items on the return would lead to either delays in processing or the issuance of multiple notices. However, we have been assured that ACA computer systems will not impose greater burdens on taxpayers. IRS response to TAS fact check (Dec. 23, 2014).

<sup>20</sup> National Taxpayer Advocate 2013 Annual Report to Congress 20; National Taxpayer Advocate 2012 Annual Report to Congress 34.

<sup>21</sup> Affordable Care Act (ACA) Program Management Office, ACA Enterprise Integrated Program Plan & Risk Register Executive Reports 7 (Oct. 31, 2014). For FY 2014, W&I had 180 full time equivalent employees (FTEs) working on ACA implementation and planned to have 2,358 FTEs for FY 2015. W&I response to TAS information request (Oct. 28, 2014).

<sup>22</sup> Summary of Affordable Care Act Training Plans for W&I, W&I response to TAS information request (Oct. 28, 2014).

However, delays in implementation have impacted training for certain ACA topics. For example, it is our understanding that delays in the development of the 1094 and 1095 series forms and instructions have also delayed the associated training of employees.<sup>23</sup> These forms provide information-reporting data from the exchanges and employers regarding taxpayer's minimum essential coverage. Forms 8962 and 8965—on which taxpayers claim and reconcile the PTC and claim an exemption from the SRP, respectively, were only finalized on November 13, 2014 and their instructions were not finalized as of December 29, 2014. These documents are the basis of the majority of IRS training for W&I employees, and the IRS was forced to roll out its training without final forms and instructions. If IRS employees are not properly trained on these forms, they may not be able to accurately determine a taxpayer's liability for the SRP or verify eligibility for the PTC.

### **IRS Outreach and Education Should Focus on Increasing Taxpayer Awareness of the Need to Update Information with the Exchange Throughout the Year.**

During the 2015 filing season, many taxpayers will need to reconcile the advanced PTC amounts they received in 2014 (based on *projected* 2014 income) with the credit amounts to which they are entitled (based on *actual* TY 2014 income).<sup>24</sup> We commend the IRS for focusing on educating taxpayers about the importance of updating their information throughout the year with the exchange if they are receiving

the advance credit. To avoid complications associated with receiving an excess credit, taxpayers must update their information with the exchange if their income or other relevant circumstances change. In the future, during each tax year, we urge the IRS to educate taxpayers early and repeatedly about this requirement to prevent them from owing money to the IRS (or reducing their refunds) or claiming too little advanced credit.<sup>25</sup> Although almost 80 percent of individual returns are refund returns, in which the IRS may offset some or all of a reconciliation PTC amount (resulting in a reduced credit), the IRS still should do all it can to ensure that as few taxpayers as possible have excessive advanced PTC payments and instead receive the correct amount throughout the year.<sup>26</sup>

The Taxpayer Advocate Service has developed an estimator to help taxpayers and practitioners understand how changes in circumstances will impact their PTC amounts.<sup>27</sup>

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**Because the IRS's role is downstream of many external reporting processes, taxpayers and the IRS may experience problems over which the IRS has no control. Yet, the IRS will certainly bear much of the public blame because many of the problems will arise in the context of return filing.**

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- 23 There were late revisions made to Forms 1094-B, *Transmittal of Health Insurance Coverage Information Returns*; 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*; 1095-B, *Health Coverage*; and 1095-C, *Employer-Provided Health Insurance Offer and Coverage*. Affordable Care Act (ACA) Program Management Office, ACA Enterprise Integrated Program Plan & Risk Register Executive Reports 4 (Oct. 31, 2014). The Forms 1094 and 1095 B and C are voluntary for TY 2014 and are not used during the filing of the tax returns. IRS response to fact check (Dec. 23, 2014).
- 24 The Premium Tax Credit is a refundable tax credit (which may be payable in advance) available to help certain low and moderate income taxpayers purchase health insurance through a marketplace. IRC § 36B. Taxpayers will reconcile the advanced PTC with the actual PTC claimed on IRS Form 8962, *Premium Tax Credit (PTC)*.
- 25 The IRS has developed Publication 5152, *Report Changes to the Marketplace as They Happen*. Other IRS publications explaining the Premium Tax Credit include Publication 5120, *Facts About the Premium Tax Credit* (flyer), and Publication 5121, *Facts About the Premium Tax Credit* (brochure).
- 26 IRS Compliance Data Warehouse, Individual Returns Transaction File Tax Year 2012 (June 2014).
- 27 Available at <http://www.taxpayeradvocate.irs.gov/Individuals/Affordable-Care-Act>.

While the IRS raises awareness about the taxpayer's need to report Premium Tax Credit changes in circumstances to the exchanges, at least one state exchange experienced delays in processing this information, and was even forced to manually process such requests. When an exchange delays its processing for a significant time, the longer the delay, the more inaccurate the advanced Premium Tax Credit amount might become.

In addition, taxpayers may have their refunds delayed if, due to an unreported change in circumstances, they claim a larger PTC on their returns than what was advanced to the insurance company during the year. If the IRS flags these returns as potentially fraudulent, it may hold up the PTC portion of legitimate refunds, which TAS has seen happen with other refundable credits, especially when large dollar amounts are at stake.<sup>28</sup> While there is always a risk of individuals trying to game the system, the risk of fraud may be lower with the PTC than with other credits because the advance credit amount is paid directly by the federal government to established insurance companies once the policy is actually in place. The IRS will also be able to verify coverage and premiums amounts through third-party information reporting, assuming the reports are accurate and timely.

After taxpayers file their TY 2014 returns, TAS will explore whether the IRS could have alleviated burden by identifying earlier any discrepancies between income reported on taxpayers' health care applications and income actually reported on their TY 2013 returns. When taxpayers applied for coverage through the exchanges in 2014, the exchanges verified taxpayers' reported projected household income by using IRS data for TY 2012. However, a substantial portion of the more recent TY 2013 data may be available months before the 2015 filing season. We plan to use 2015 filing season data to evaluate whether the use of soft notices sent in 2014 based on TY 2013 return data would have been an effective way to inform taxpayers that they potentially need to report their change in circumstances to the exchange, based on information reported on their most recently filed tax return. The sooner the taxpayers are aware of any income discrepancies, the sooner they can address the issue.

### Problems with State Calculations of Advanced PTC Amounts and Delays in Processing PTC Change in Circumstances Information Can Result in Inaccurate Advanced PTC Payments and Thereby Harm Taxpayers.

While the IRS raises awareness about the taxpayer's need to report PTC changes in circumstances to the exchanges, at least one state exchange experienced delays in processing this information, and was even forced to manually process such requests.<sup>29</sup> When an exchange delays its processing for a significant time, the longer the delay, the more inaccurate the advanced PTC amount might become. If the advanced PTC amount is too high, the taxpayer could have an unwelcome surprise and owe money when reconciling the advanced amount with the actual allowable PTC on the TY 2014 return. Again, this is a circumstance completely out of the IRS's control. However, the IRS will share the public blame when this pattern occurs during the 2015 filing season.

28 See National Taxpayer Advocate 2012 Annual Report to Congress 111-13; National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 28-32; National Taxpayer Advocate 2011 Annual Report to Congress 687-89.

29 See, e.g., Taylor Boggs, *Vermont Public Radio*, *Vermont Health Connect Development Slowed By Contractor Switch, Open Enrollment* (Aug. 29, 2014); Peter Hirschfeld, *Vermont Public Radio*, *Thousands of Vermont Health Connect Customers Stuck on Service Backlog* (Apr. 21, 2014).

In addition, at least one state exchange calculated the amount of the advanced PTC inaccurately.<sup>30</sup> As a result, some taxpayers will learn about the discrepancy upon reconciling the total advanced payment amount, which was based on projected income, with the total PTC allowed on the tax return, which is based on actual income. In this case, the taxpayer owes additional money through no fault of the taxpayer or the IRS. Although the taxpayer was not in control of the advanced PTC payments paid over to the insurer, the taxpayer may be assessed a negligence penalty or underpayment penalty and have to request abatement for reasonable cause.<sup>31</sup>

### **The Inability of the IRS to Adequately Test the Accuracy of Information-Reporting Data Before the Filing Season Can Inhibit IRS Verification Efforts and Cause Significant Taxpayer Burden.**

The IRS relies on information reports to verify data relevant to the SRP liability and PTC eligibility. However, as of December 26, 2014, the IRS had not completed testing of the data from several state exchanges. As of that same date, the IRS received and tested actual data from the Centers for Medicare and Medicaid Services (CMS), the federal exchange which provides coverage information for the states that did not develop their own exchanges.<sup>32</sup> If the IRS cannot receive data from exchanges accurately and timely, the IRS has little opportunity to identify problems and even less opportunity to fix them. In addition, if the IRS receives incomplete or inaccurate data, it cannot accurately verify coverage, which will inhibit the IRS's ability to verify eligibility for the PTC. In response, the IRS has developed a contingency plan to enable the IRS to continue processing returns.<sup>33</sup> While these contingency procedures will identify questionable returns with possible ACA compliance issues, they may also inadvertently flag some compliant tax returns as well. The extent of this issue will become clear during the 2015 filing season when the IRS actually receives data from the exchanges.

### **The IRS May Take Inappropriate Collection Actions on Shared Responsibility Payment Liabilities.**

The ACA prohibits the IRS from filing a notice of lien or levying to collect any SRP liabilities.<sup>34</sup> The SRP was not enacted to be a revenue raiser. In fact, the Congressional Budget Office (CBO) scored the provision to raise only \$55 billion from 2015 through 2022 as compared to the total estimated cost of the ACA of over \$1.1 trillion through 2022.<sup>35</sup> Rather, the main purpose of the provision was, working in unison with the other core provision of the ACA, to achieve “near-universal” health insurance coverage.<sup>36</sup>

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30 ACA Program Office response to TAS information request (Dec. 11, 2014); Cover Oregon, *Advanced Premium Tax Credit (APTC) Update* (Sept. 15, 2014).

31 IRC §§ 6662, 6664(c).

32 As of December 26, 2014, the IRS had not completed testing on the data from the exchanges in the following jurisdictions: Colorado, District of Columbia, Hawaii, Minnesota, and Oregon. ACA Program Office response to TAS information request (Dec. 30, 2014); IRS response to fact check (Dec. 23, 2014). Affordable Care Act (ACA) Program Management Office, *ACA Enterprise Integrated Program Plan & Risk Register Executive Reports* 7 (Nov. 28, 2014). As of January 2014, there were 19 state-based marketplaces. <http://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/state-marketplaces.html>.

33 Affordable Care Act (ACA) Program Management Office, *ACA Enterprise Integrated Program Plan & Risk Register Executive Reports* 5-6 (Oct. 31, 2014).

34 IRC § 5000A(g)(2)(B).

35 Congressional Budget Office, *Estimates for the Insurance Coverage Provisions of the Affordable Care Act Updated for the Recent Supreme Court Decision*, Table 4 (July 2012).

36 See Patient Protection & Affordable Care Act of 2009, Pub. L. 111-148, 124 Stat. 119, §1501(a)(2)(D) (Mar. 2010), as amended by the Health Care & Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010); Brief for State Petitioners on Severability at 11, *National Federation of Independent Business v. Sebelius*, 132 U.S. 2566 (2012) (Nos. 11-393, -400).

In accordance with this public policy, the Act limits the IRS's collection authority with respect to the SRP and currently restricts collection actions to refund offsets.<sup>37</sup>

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**If the IRS cannot receive data from exchanges accurately and timely, the IRS has little opportunity to identify problems and even less opportunity to fix them.**

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IRS collection efforts for SRP liabilities may indirectly burden taxpayers. For example, if an installment agreement (IA) defaults due to insufficient payment or any reason other than an outstanding SRP liability, the IRS is currently considering only reinstating the agreement if all tax liabilities, including SRP liabilities, are included.<sup>38</sup> The National Taxpayer Advocate questioned whether the IRS has the legal authority to include SRP liabilities in installment agreements.

In response to a query from the National Taxpayer Advocate, the Office of Chief Counsel has concluded that the IRS has authority to include SRP in IAs and offers in compromise (OICs). However, the response was issued as a draft "white paper" that is not publicly available.<sup>39</sup> The "white paper" also stated that the IRS is neither precluded from conditioning, nor required to condition, agreements on the inclusion of SRP liabilities. Further, the IRS has the discretion to require terms or conditions that protect the government's interests.<sup>40</sup> Because Chief Counsel's reasoning in this matter potentially affects millions of taxpayers, the National Taxpayer Advocate believes it should be rewritten in the form of Program Manager Technical Advice (PMTA) and released to the public.<sup>41</sup>

The IRS applies IA payments in a manner that will protect the government's best interests.<sup>42</sup> This generally means that the IRS will apply payments to the oldest liability first.<sup>43</sup> However, it is unclear the order in which the IRS will apply payments. It is the position of the National Taxpayer Advocate that any policy to apply payments first to SRP liabilities is inconsistent with the best interest of the government in many cases, and a deviation from established practices. If the IRS applies the payments to the SRP liability first, then it risks the oldest debt becoming unenforceable by virtue of the expiration of the statutory period to collect the tax.<sup>44</sup>

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37 IRC § 5000A(g); J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act,"* JCX-18-10 31 (Mar. 21, 2010). TAS was initially concerned that the IRS may attempt to apply excess levy proceeds toward SRP liabilities. However, it is our understanding that IRS collection systems have been programmed to prevent such application. In addition, IRM 5.11.2.6, *Disposing of Surplus Proceeds* (Jan. 1, 2015) prohibits such application of surplus levy proceeds to SRP balance due accounts. IRS response to TAS information request (Dec. 15, 2014).

38 Draft IRM 5.19.1.5.4.26, page 23, bullet 4 (Aug. 19, 2014); IRM 5.14.11.5, *Defaulted Installment Agreements: Considerations after Default or Termination, Including Reinstatement* (Jan. 1, 2015).

39 The Office of Chief Counsel sometimes provides legal analysis in the form of a "white paper" when the analysis and conclusions are the result of a collaborative effort among multiple functions. Because this draft "white paper" was meant to guide a discussion of issues and was not a formal legal opinion, it was not released to the public.

40 See Treas. Reg. § 301.6159-1(c)(iii)(B).

41 PMTA is legal advice, signed by attorneys in the National Office of the Office of Chief Counsel and issued to IRS personnel who are national program executives and managers. Although PMTAs are not precedential, they nonetheless are instructive and provide guidance to assist IRS personnel in administering their programs. PMTAs are publicly available in the electronic reading room at <http://www.irs.gov/uac/Electronic-Reading-Room>.

42 See, e.g., IRM 5.14.7.5, *Payments on Trust Fund Accounts During Approved In-Business Trust Fund Installment Agreements* (Aug. 5, 2010); *Concert Staging v. Comm'r*, T.C. Memo. 2011-231 (Sept. 26, 2011).

43 Rev. Proc. 2002-26 applies to OICs and collateral agreements and does not apply to installment agreements. However, as a practical matter, it is generally in the best interest of the IRS to follow the payment application ordering rules of the Rev. Proc. in the majority of cases. Non-designated payments will generally be applied to the oldest liability first. Designated payments will generally be applied as requested by the taxpayer. Rev. Proc. 2002-26, 2002-1 C.B. 746; IRM 5.1.2.8, *Designated Payments* (June 20, 2013).

44 IRC § 6502.

### The Use of “Combination Letters” for Disallowed PTC May Confuse Taxpayers.

The National Taxpayer Advocate is concerned that the IRS will use combination or “combo” letters to notify taxpayers of disallowed PTCs or advanced PTCs that have not been reconciled. These letters, which the IRS sometimes sends in an effort to “streamline” examination processes, merge two distinct audit letters:

1. The initial contact letter; and
2. The 30-day letter that includes the preliminary audit report and describes the taxpayer’s appeal rights.

The National Taxpayer Advocate has consistently opposed the IRS’s use of combo letters.<sup>45</sup> They are confusing because taxpayers do not know whether to respond to the exam and risk forfeiting their appeal rights, file an appeal and risk annoying the examiner, or both.<sup>46</sup> Further, in addition to information about appeal rights, we believe the 30-day letters should include information about TAS and Low Income Taxpayer Clinics (LITCs).<sup>47</sup>

### The Inability of Health Insurers and Self-Insured Employers to Match TINs Before Filing May Lead to Mismatches and Unnecessary Notices.

The IRS has not expanded the tax identification number (TIN) matching program to health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.<sup>48</sup> The current e-Services TIN Matching Program (TMP) allows participating payers of reportable payments subject to backup withholding under IRC § 3406(b), to match the TIN and name of payees subject to potential backup withholding with IRS records prior to filing the information report.<sup>49</sup> Using the TMP helps payers avoid penalties for submitting incorrect TINs on information returns.<sup>50</sup>

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45 Statement of Procedural Rules, § 601.105(d)(1)(iv) authorizes the 30-day letter, which explains the proposed changes and advises the taxpayer of the liability and of the right to file a protest within 30 days to be considered by IRS Appeals. Concerns about the use of the combination letter in Examination were initially raised in the National Taxpayer Advocate’s 2001 Annual Report to Congress 20-22 (Most Serious Problem: *Documenting Earned Income Tax Credit Eligibility*). See also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 85; National Taxpayer Advocate 2008 Annual Report to Congress 227-59 (Most Serious Problem: *Suitability of the Examination Process*, and Most Serious Problem: *The IRS Correspondence Examination Process Promotes Premature Notices, Case Closures, and Assessments*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2006 Annual Report to Congress 289-310 (Most Serious Problem: *Correspondence Examination*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *EITC Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress 163-180 (Most Serious Problem: *Lack of Notice Clarity*); National Taxpayer Advocate 2003 Annual Report to Congress 87-98 (Most Serious Problem: *Combination Letter*); National Taxpayer Advocate 2002 Annual Report to Congress 55-63 (Most Serious Problem: *Procedures of Examining EITC Claims Cause Hardship and Infringe on Appeal Rights*).

46 Combo letters are even more burdensome under Appeals’ new Appeals Judicial Approach and Culture (AJAC) project by which Appeals will not conduct fact-finding and will send the case back to exam for further development, thereby treating the taxpayer like a ping-pong ball. Memorandum for Appeals employees from Director, Policy, Quality and Case Support, IRS Office of Appeals, Implementation of the Appeals Judicial Approach and Culture (AJAC) Project Examination and General Matters—Phase 2, Control No. AP-08-0714-0004 (July 2, 2014).

47 An example of a combo letter used for ACA purposes is Letter 566-B. The notices should provide contact information in addition to brief summaries of the services offered by each organization. Per IRC § 7526, LITCs represent low income individuals in disputes with the Internal Revenue Service, including audits, appeals, collection matters, and federal tax litigation. LITCs can also help taxpayers respond to IRS notices and correct account problems. Some LITCs provide education for low income taxpayers and taxpayers who speak English as a second language (ESL) about their taxpayer rights and responsibilities.

48 IRC § 6055.

49 IRM 5.19.3.4.1.6, e-Services Taxpayer Identification Number (TIN) Matching Program (Apr. 23, 2014).

50 The penalty for failure to file a correct information return is generally \$100, and the penalty for failure to furnish a correct payee statement is also generally \$100. IRC §§ 6721, 6722. The IRS will not impose the penalty if the filer shows the failure was due to reasonable cause and not willful neglect. IRC § 6724.

Likewise, TMP would also benefit the filers of Forms 1095-B, which provide the names and TINs of all covered individuals and the months for which they had minimum essential coverage. The IRS will use the forms to verify an individual's compliance with the ISRP. The reporting entities are not required to file the forms until the 2016 filing season.<sup>51</sup>

However, many Form 1095-B filers have never had to verify the accuracy of the name/TIN information, and the inability to verify the information before issuing the forms could cause inaccurate TIN reporting. If information returns with incorrect or incomplete names or TINs are submitted (because the issuers are not able to run the numbers through the IRS TIN matching program before filing), the IRS will not be able to verify that the individuals have minimal essential coverage. Therefore, even covered individuals could receive notices imposing the SRP or insurers would receive avoidable penalty assessments arising from such mismatches.<sup>52</sup>

#### **The IRS Should Expand Its Employer Shared Responsibility Q&A Page to Provide Additional Guidance to Employers on How to Calculate the Number of Full-Time Equivalents for Purposes of Meeting the Minimum Essential Coverage Requirements.**

Employers not in compliance with the provisions under IRC § 4980H may be subject to an assessable payment, referred to as the “employer shared responsibility payment” (ESRP). Section 4980H(a)(1) provides that an applicable large employer (ALE) must offer minimum essential coverage to its full-time employees. In general, an employer is considered an ALE if it employs 50 or more full-time workers (or full-time equivalents (FTE)).<sup>53</sup> The ESRP provisions generally are not effective until January 1, 2015, meaning that no ESRP will be assessed for the 2014 tax year.<sup>54</sup> Under the statute, an employee is deemed full-time for a calendar month, if he or she averages at least 30 hours of work per week.<sup>55</sup>

On February 12, 2014, the IRS and Treasury issued final regulations on the ESRP provisions.<sup>56</sup> The guidance acknowledges that there are certain categories of employees whose hours of service will be particularly challenging to identify and track, and advises their employers to use “a reasonable method of crediting hours of service that is consistent with section 4980H.” While far from comprehensive, the preamble does provide good examples of what may be considered a reasonable method in certain industries.

In addition to the final regulations, the IRS provides additional guidance in the form of an ESRP Q&A page on IRS.gov.<sup>57</sup> While it contains helpful information, the limited Q&A page does not adequately address many questions about the calculation of FTEs for purposes of meeting the minimum essential

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51 Notice 2013-45, 2013-31 IRB 116; T.D. 9660, 2014-13 IRB 842 (Mar. 24, 2014). Reporting entities will not be subject to penalties for failure to comply with the IRC § 6055 reporting requirements for coverage in 2014 (including the provisions requiring the furnishing of statements to covered individuals in 2015 with respect to 2014). Accordingly, a reporting entity will not be subject to penalties if it first reports beginning in 2016 for 2015 (including the furnishing of statements to covered individuals).

52 Michael M. Lloyd and S. Michael Chittenden, *Expand TIN Matching Program to Avert Another ACA Debacle*, TAX NOTES TODAY (Jan. 15, 2014).

53 IRC § 4980H(c)(2).

54 Notice 2013-45, 2013-31 I.R.B. 116.

55 IRC § 4980H(c)(4).

56 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at <https://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage>.

57 See <http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act#Identification> (last visited Dec. 2, 2014).

coverage requirements. The IRS cannot realistically be expected to post answers to every possible scenario, but it should expand this page. For example:

- What would be a reasonable method of determining FTE for clergy who have not taken a vow of poverty?<sup>58</sup> Members of religious orders often have responsibilities that do not fit a typical “9 to 5” schedule. Arriving at hours to include in the calculation of FTE seems problematic for such a profession.
- What would be a reasonable method of determining FTE for commission-based salespersons? If a significant portion of a salesperson’s compensation comes from commissions, and the employer does not require (or track) a certain number of hours to be worked, determining FTE could be problematic.
- What would be a reasonable method of determining FTE for pilots? Even full-time pilots generally have a good deal of downtime, so hours in the air may not be an ideal way of determining FTE. How would an employer count a pilot who is available for three flights a month for purposes of the FTE calculation for the small business health care tax credit (SBHCTC)?

To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC.<sup>59</sup>

This tool allows small businesses to estimate their credits (if any) and find out how any changes in circumstances will impact their eligibility. Since November 2012, we have placed the SBHCTC estimator on the TAS Tax Toolkit,<sup>60</sup> where small businesses and tax professionals can access it easily, and have continually promoted the estimator through social media, including Twitter and Facebook.<sup>61</sup>

## CONCLUSION

The IRS has made tremendous progress, considering the monumental task of implementing and administering the many complicated tax provisions of the ACA. The new systems and procedures developed for ACA administration will be tested beginning in the 2015 filing season when individual taxpayers file their TY 2014 returns, report SRP liabilities, and claim or reconcile PTC. At the same time, the IRS will receive and process a significant amount of new information returns from insurers and exchanges to identify errors and noncompliance. While the IRS has little control over some of the anticipated risks, such as delayed or inaccurate data reporting from the exchanges, it will be held publicly responsible when the associated problems surface during the tax return filing process. In addition, the IRS bears

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58 Until further guidance is issued, a religious order is not required, for purposes of determining if an employee is a full-time employee for the ESRP, to include as an hour of service any work performed by clergy who have taken a vow of poverty when the work is in the performance of tasks usually required of an active member of the order. See Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at <https://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage>.

59 The estimator is available at <http://www.taxpayeradvocate.irs.gov/Businesses/Small-Business-Health-Care-Tax-Credit-Estimator>.

60 The TAS Tax Toolkit is a website that contains useful tax information for individuals, businesses, tax professionals and media, including news and updates, ways TAS helps taxpayers, and important information about tax topics and rights and is available at <http://www.taxpayeradvocate.irs.gov/>.

61 The IRS linked to the estimator on IRS.gov and the Kaiser Permanente health care company placed a link to the estimator on its website. On March 10, during the 2014 filing season, the IRS placed a link to the estimator in a news release on helpful resources and tax tips. See <http://www.irs.gov/uac/Newsroom/IRS-Encourages-Small-Employers-to-Check-Out-Small-Business-Health-Care-Tax-Credit;Helpful-Resources,-Tax-Tips-Available-on-IRS.gov>. After the new release, the number of views increased from a quarterly average of 110 per day to 1,502 and 483 for March 10 and March 11, respectively. The estimator introduction page has received high traffic overall so far in fiscal year 2014, with 30,990 views through May 2014, an average of over 3,800 per month. Weber Shandwick, *TAS Electronic Toolkit Usage Report* (Oct. 2013–May 2014).

sole responsibility for other anticipated risks, such as possible inappropriate collection actions taken with respect to the SRP.

The 2015 filing season will potentially be the most challenging in several decades and it occurs in a context of historically low levels of taxpayer service. Because of the great risk of taxpayer harm this filing season, TAS will continue to address issues as they arise and identify systemic problems. In fact, TAS will create an ACA Rapid Response team to immediately address any potential ACA systemic issues that arise during the 2015 filing season. In addition, we encourage both internal and external stakeholders to report any suspected ACA systemic issues on TAS's Systemic Advocacy Management System (SAMS).<sup>62</sup>

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS take the following actions:

1. Educate taxpayers early and repeatedly about the requirement to update their information throughout the year with the exchange, if they are receiving the advanced PTC, to prevent them from owing money to the IRS (or reducing their refunds) or qualifying for too little advance credit during the year.
2. For those installment agreements, partial pay installment agreements, and offers in compromise including SRP liabilities, apply payments to the oldest liability first to protect the government's best interests.
3. Reissue the current white paper addressing the IRS's authority to include SRP liabilities in installment agreements and offers in compromise in the form of Program Manager Technical Advice to be released to the public.
4. Include information about TAS and Low Income Taxpayer Clinics in 30-day letters that include both the preliminary audit report and describe the taxpayer's appeal rights.
5. Expand the tax identification number matching program to include health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.
6. Provide additional guidance to employers on how to calculate the number of full-time equivalents for purposes of meeting the minimum essential coverage requirements.

<sup>62</sup> Stakeholders can report suspected systemic issues at: <http://www.irs.gov/Advocate/Systemic-Advocacy-Management-System-SAMS>.

**MSP****#7**

## **OFFSHORE VOLUNTARY DISCLOSURE (OVD): The OVD Programs Initially Undermined the Law and Still Violates Taxpayer Rights**

### **RESPONSIBLE OFFICIALS**

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### **DEFINITION OF PROBLEM**

Between 2009 and 2014, the IRS generally required “benign actors”—people who inadvertently failed to report offshore income and file one or more related information returns (*e.g.*, the *Report of Foreign Bank and Financial Accounts* (FBAR))—to enter into a punitive offshore voluntary disclosure (OVD) program and either pay an “offshore penalty” designed for “bad actors” or “opt out” and be examined.<sup>1</sup> Inside the 2011 OVD programs, taxpayers with small accounts paid over eight times the unreported tax—over ten times the 75 percent penalty for civil tax fraud—and those who were unrepresented generally paid even more.<sup>2</sup>

Because violations by taxpayers who have small accounts or who do not obtain representation are more likely to have been inadvertent, the OVD programs undermined the statutory scheme, which applies a higher penalty to “willful” violations than to those that are not willful or are due to “reasonable cause.”<sup>3</sup> Some benign actors did not opt out because the cost of representation in a post-opt-out examination could exceed the “offshore penalty.” Others did not opt out because the IRS’s broad discretion in applying penalties outside the OVD programs was too frightening.

In addition, the IRS’s seemingly arbitrary and one-sided interpretations of the OVD frequently asked questions (FAQs)—interpretations that the IRS would not explain and that were not published or subject to appeal—eroded confidence that the IRS would be reasonable in a post-opt-out examination. Thus, the IRS’s OVD programs turned the statutory scheme on its head while eroding trust for the IRS and eroding

1 IRS, *Voluntary Disclosure: Questions and Answers*, <http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers> (posted May 6, 2009) [hereinafter “2009 OVDP FAQ”]; IRS, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, <http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers> (posted Feb. 8, 2011) [hereinafter “2011 OVDI FAQ”]; IRS, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers> (posted June 26, 2012) [hereinafter “2012 OVDP FAQ,” or collectively the “OVD programs”]. For several years, the National Taxpayer Advocate and other stakeholders have expressed concerns about the OVD programs. See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 228-238; National Taxpayer Advocate 2012 Annual Report to Congress 134-153; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29 [collectively, OVD Reports].

2 AIMS Closed Case Database and the Individual Master File Transaction History (Aug. 29, 2014) (TAS analysis of closed case data where an offshore penalty was assessed inside the 2011 OVD program); IRC § 6663 (civil fraud penalty). This is more than the nearly 600 percent they paid under the 2009 OVD program. National Taxpayer Advocate 2013 Annual Report to Congress 228-238. Thus, the 2011 program appears to have exacerbated the disproportionality of the offshore penalty.

3 See 31 U.S.C. § 5321(a)(5).

taxpayer rights, such as the rights *to pay no more than the correct amount of tax, challenge the IRS's position and be heard, appeal an IRS decision in an independent forum, and to a fair and just tax system.*<sup>4</sup>

Recent changes to the OVD programs address some of these concerns. However, unlike the last time the IRS made taxpayer-favorable changes to an OVD program, the IRS will not allow those who already agreed to pay disproportionate offshore penalties to benefit from them. Moreover, the IRS has not formally asked for comments or explained why it adopted some suggestions and not others. Nor does it disclose internal guidance (*e.g.*, its counter-intuitive interpretations of FAQs) to the public, eroding the taxpayer *right to be informed.*<sup>5</sup>

The National Taxpayer Advocate is analyzing the OVD programs closely in the context of taxpayer rights because the IRS is likely to use settlement initiatives in the future. Any program that applies an opaque one-size-fits-all approach, as the IRS chose to do with the OVD programs, is likely to produce unfairness and injustice, particularly when taxpayers have diverse facts and circumstances. Thus, this analysis is meant to help improve tax administration efforts going forward.

## ANALYSIS OF PROBLEM

### The penalty for failure to file an FBAR was aimed at criminals and other bad actors.

Under the Bank Secrecy Act (BSA) a U.S. person who owns (or has signature authority over) one or more foreign accounts exceeding \$10,000, during the prior calendar year, can be subject to civil and criminal penalties unless he or she reports the account(s) on an FBAR by June 30.<sup>6</sup> Congress enacted this requirement in 1970 after hearing testimony that criminals were using secret foreign bank accounts for illegal purposes (*e.g.*, tax evasion, securities manipulation, insider trading, evasion of Federal Reserve margin limitations, storing and laundering funds from illegal activities, and acquiring control of U.S. industries without detection by the U.S. Securities and Exchange Commission), and that U.S. law enforcement agencies faced difficulty in obtaining information about these accounts from foreign authorities.<sup>7</sup>

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4 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014). For a detailed discussion of taxpayer rights, see National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

5 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014). The IRS has issued some clarifications informally. See, *e.g.*, Kristen A. Parillo, *ABA Meeting: More Guidance Coming on Modified OVDP and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014) (explaining, for example, that even people who do not need to file an amended return could come into the 2014 streamlined program; that although the streamlined program references the instructions to Form 8938, which exclude assets reported on Form 5471, assets reported on delinquent Forms 5471 would nonetheless be included in the penalty base; and that IRS employees had received training regarding willfulness determinations and were using a 'job aid' neither of which would be disclosed to the public). These clarifications were later published as updates to FAQs. See IRS, *Streamlined Filing Compliance Procedures for U.S. Taxpayers Residing in the United States Frequently Asked Questions and Answers* (Oct. 8, 2014) [hereinafter, the 2014 streamlined program], <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures-for-U-S-Taxpayers-Residing-in-the-United-States-Frequently-Asked-Questions-and-Answers>.

6 See, *e.g.*, 31 U.S.C. §§ 5314, 5321; 31 C.F.R. §§ 1010.350, 1010.306(c); FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), [http://www.fincen.gov/forms/bsa\\_forms/](http://www.fincen.gov/forms/bsa_forms/).

7 See, *e.g.*, Pub. L. No. 91-507, § 241, 242 (1970); S. REP. No. 91-1139 at 2-4, 8-9 (1970); H. REP. No. 91-975 at 12 (1970). Accord H.R. REP. No. 241-3, at 27, 50 (1970) (statement of Robert M. Morgenthau, U.S. Att'y S.D.N.Y.) ("in addition to the usual difficulties attending to the detection of criminal conduct in financial transactions, we have here the added obstacle of the use of secret foreign accounts to avoid discovery... where criminals have made such extraordinary efforts to cover their tracks, we must respond with equal vigor to uncover them."); *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency*, 91st Cong. 2nd Sess. at 170 (1970) (statement of Eugene T. Rossides, Assistant Secretary of the Treas. for Enforcement and Operations) ("Our overall aim is to build a system to combat organized crime and white collar crime and to deter and prevent the use of secret foreign bank accounts for tax fraud and their use to screen from view a wide variety of criminally related financial activities, and to conceal and cleanse criminal wealth.").

**Under the 2011 OVD program, the median offshore penalty for those with the smallest accounts rose to eight times the unreported tax, up from about six times the unreported tax under the 2009 program.**

Although a criminal penalty already applied to those who willfully failed to report the existence of a foreign account on Schedule B of a Form 1040, *U.S. Individual Income Tax Return*, Treasury Department officials testified that a less-severe civil penalty would be easier to assert and less likely to violate the U.S. Constitution.<sup>8</sup>

Later, in 2002, the IRS reported to Congress that the FBAR compliance rate was less than 20 percent because about one million U.S. taxpayers may have been required to file FBARs, but the IRS had received fewer than 200,000 filings.<sup>9</sup> Its estimate of required FBAR filings was based in part on the number of credit and debit cards held by U.S. citizens and residents to access funds in offshore accounts. The IRS also cited the difficulty of proving willfulness as one of the reasons why it imposed so few FBAR civil penalties, even against those who intentionally failed to file an FBAR to conceal tax evasion or other crimes.<sup>10</sup>

#### **Following reports of people intentionally “attempting to conceal income from the IRS,” Congress enacted a non-willful FBAR penalty.**

In 2004, Congress dramatically increased the maximum penalty for willful violations and imposed—for the first time—a penalty for non-willful violations.<sup>11</sup> The maximum civil penalty for willful FBAR violations is now 50 percent of the maximum balance in each overseas account for each year of non-reporting (or, if greater, \$100,000 per violation).<sup>12</sup> By contrast, the maximum penalty for non-willful violations is \$10,000.<sup>13</sup> It may be waived if the taxpayer has “reasonable cause” and pays the tax on the income from the account.<sup>14</sup> Legislative history suggests the IRS’s estimate that hundreds of thousands of taxpayers were “attempting to conceal income from the IRS” was a reason for this change.<sup>15</sup> It did not reference a

8 See, e.g., *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency*, 91st Cong. 2nd Sess. at 152 (1970) (statement of Robert Cole, Special Assistant for Int’l Affairs, Treas. Dept.) (“Civil penalties can be imposed administratively and there are cases where it might be appropriate to impose a civil penalty where imposition of a criminal penalty [under IRC § 7203 or IRC § 7206(1)] would seem unduly harsh or could raise evidentiary or constitutional problems.”).

9 U.S. Department of the Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, 6 (Apr. 26, 2002); IRS Sets New Audit Priorities, FS-2002-12 (Sept. 2002).

10 U.S. Department of the Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, 10 (Apr. 26, 2002) (“taxpayers generally assert to the IRS that they were not aware that they were required to file an FBAR. Often, the administrative record lacks evidence to the contrary, such as an advice letter from an accountant or financial planner or any witness to testify that the taxpayer knew of the filing requirement. In such cases the litigation risk in assessing a penalty is substantial, particularly where, after notice from the IRS or FinCEN, the person has voluntarily backfiled the missing forms. Rather than go forward with penalty assessments based on a less than substantial record, FinCEN’s limited resources have been allocated to other compliance and enforcement efforts...”). In January 2003, the IRS offered to settle with persons using offshore payment cards to avoid paying taxes. 2003 IR-2003-5 (Jan 14, 2003); Rev. Proc. 2003-11, 2003-1 C.B. 311.

11 The American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 821(a), 118 Stat. 1586 (Oct. 22, 2004) (amending 31 U.S.C. § 5321(a)(5)).

12 31 U.S.C. § 5321(a)(5). Criminal penalties may also apply to willful violations. 31 U.S.C. § 5322.

13 31 U.S.C. § 5321(a)(5).

14 *Id.*

15 Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 108th Cong., JCS-5-05, 377-378 (2005) (“For one scheme alone, the IRS estimates that there may be hundreds of thousands of taxpayers with offshore bank accounts attempting to conceal income from the IRS.”). See also S. Rep. No. 108-11, at 101 (2003) (“attempting to conceal”); S. Rep. No. 108-257, at 32 (2003) (same).

concern about taxpayers inadvertently failing to file the form. Thus, even the non-willful FBAR penalty appears to have been aimed at willful violations.

Another penalty of \$10,000 or more may apply if the person does not report the same account on Form 8938, *Statement of Specified Foreign Financial Assets*.<sup>16</sup> Similar information reporting requirements apply to those who own interests in foreign entities.<sup>17</sup> Yet many benign actors who are not criminals (*e.g.*, immigrants, U.S. citizens living abroad, and those who relied on uninformed preparers) have *inadvertently* failed to file these forms.

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**The IRS's seemingly arbitrary and one-sided approach to interpreting the OVD FAQs—interpretations that the IRS did not publish, explain, or subject to an appeal—eroded confidence that the IRS would be reasonable in post-opt-out examinations, prompting some benign actors to agree to pay disproportionate offshore penalties.**

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#### **The IRS's effort to apply willful penalties to bad actors has eroded the distinction between willful and non-willful violations.**

The IRS may only apply the penalty for willful violations when it can prove willfulness.<sup>18</sup> According to the Supreme Court (and the Internal Revenue Manual or IRM) the IRS may meet its burden to prove willfulness if it shows a violation is a “voluntary, intentional violation of a known legal duty.”<sup>19</sup>

However, the government has eroded the distinction between willful and non-willful violations. Because Schedule B of Form 1040 (*U.S. Individual Income Tax Return*) asks if the taxpayer has a foreign account and references the FBAR filing requirement, the government has been somewhat successful in arguing—in court cases involving bad actors—that in some cases the filing of a Schedule B can turn a subsequent failure to file an FBAR into a willful violation (called “willful blindness”).<sup>20</sup>

The IRS acknowledges that the existence of the checkbox on Schedule B does not turn every FBAR violation into a willful one.<sup>21</sup> However, it suggests that it may do so when the taxpayer has also tried to conceal the account and/or has

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16 See IRC § 6038D.

17 See, e.g., Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, Form 5472, *Information Return of a Foreign Owned Corporation*, Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*, Form 8921, *Return by a Shareholder of a Passive Foreign Investment Co. or Qualified Electing Fund*, Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, Form 3520-A, *Annual Return of Foreign Trust With a U.S. Owner*, Form 8938, *Statement of Foreign Financial Assets*. The penalty for failure to file these information returns is generally \$10,000 per violation or a percentage of the funds transferred. See generally IRC §§ 6038, 6038B, 6038D, 6039F, 6048. Accord 2012 OVDP FAQ #5. The failure to file these information returns generally means that the statute of limitations for the related income tax return does not begin to run. See IRC § 6501(c)(8). In addition, a 40 percent penalty may apply to the portion of any understatement attributable to a transaction involving an undisclosed foreign financial asset. IRC § 6662(j). Thus, taxpayers who failed to file could be liable for tax underpayments, delinquency penalties, and elevated accuracy-related penalties for many years—liabilities generally avoided under OVD settlement programs. Thus, these rules can increase the risk of severe penalties for those who opt out.

18 31 U.S.C. § 5321(a)(5).

19 *Ratzlaf v. U.S.*, 510 U.S. 135, 142 (1994) (*citing Cheek v. U.S.*, 498 U.S. 192, 201 (1991)); IRM 4.26.16.4.5.3 (July 1, 2008).

20 See, e.g., *Williams v. Comm'r*, 489 Fed. Appx. 655 (4th Cir. 2012) (unpublished) (holding that the filing of Schedule B put the taxpayer on inquiry notice concerning the FBAR filing requirement, turning his continuing ignorance into “willful blindness,” and triggering the willful FBAR penalty); *U.S. v. Sturman*, 951 F.2d 1466, 1477 (6th Cir. 1991) (same); *U.S. v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012) (same).

21 IRM 4.26.16.4.5.3(6) (July 1, 2008) (“The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness.”).

a large account.<sup>22</sup> The IRS does not identify other relevant factors or provide assurance that it will only pursue a willful penalty against those also engaged in tax shelters, tax evasion, or criminal conduct. As a result, most taxpayers do not know how the IRS will apply this guidance to them. Even a taxpayer who inadvertently overlooked the FBAR filing requirement cannot be sure the violation will be treated as non-willful or due to reasonable cause. Thus, the government's position has likely discouraged benign actors from opting out of the OVD programs and seeking judicial review.

**It is inconsistent with the statutory scheme for benign actors to pay the same penalty as bad actors.**

The IRM acknowledges that the maximum statutory penalties for "willful" failures to file an FBAR may "greatly exceed an amount that would be appropriate in view of the violation."<sup>23</sup> Because the statute only specifies the "maximum" FBAR penalty that the IRS "may" impose, it would be inconsistent with the statute for the IRS to assert the maximum penalty in every case.<sup>24</sup>

Moreover, legislative history (cited above) may suggest the IRS should only impose a penalty against those "attempting to conceal income from the IRS," rather than inadvertent violators.<sup>25</sup> Some commentators have gone so far as to suggest that FBAR penalties can be so disproportionate as to violate the Excessive Fines Clause of the Eighth Amendment to the U.S. Constitution.<sup>26</sup> Thus, it is inconsistent with the statutory scheme for benign actors to pay the same penalty as bad actors.

**Until recently, the IRS generally required benign actors to enter its OVD settlement programs and pay the same offshore penalty as bad actors or risk "opting out."**

Between May 6, 2009 and July 1, 2014, the IRS generally required anyone who failed to report offshore income and file an FBAR or other information return to enter into an offshore voluntary disclosure (or OVD) settlement program.<sup>27</sup> Under the 2009 program, these taxpayers were required to pay:

- All unpaid taxes;
- A 20 percent accuracy-related penalty; and
- An "offshore penalty" of 20 percent of their highest offshore account balance (plus foreign assets) during a six-year period (2003-2008).<sup>28</sup>

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22 IRM 4.26.16.4.5.3(6) (July 1, 2008) ([after filing a Schedule B,] "the failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness.").

23 IRM 4.26.16.4(5) (July 1, 2008).

24 31 U.S.C. § 5321(a)(5).

25 Indeed, the IRM (quoted above) suggests that the failure to report an account on Schedule B combined with, "efforts taken to conceal the existence of the accounts" may constitute willful blindness. IRM 4.26.16.4.5.3(6) (July 1, 2008). However, it is unclear if the efforts to conceal the accounts must be made with the intent to evade taxes or conceal crimes, rather than reasonable concerns about privacy or unwarranted persecution by a government or others. At a recent American Bar Association (ABA) conference, one IRS employee reportedly expressed the view that a person would not be deemed willful if he was concealing the account to evade foreign taxes. See Kristen A. Parillo, *ABA Meeting: More Guidance Coming on Modified OVDP and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014) (quoting John McDougal as saying "the willfulness we're trying to determine is with respect to U.S. obligations, not foreign obligations... [if] I'm convinced he had no clue he had to file in the United States, then that seems to me to be the answer to the question").

26 See Steven Toscher and Barbara Lubin, *When Penalties Are Excessive — The Excessive Fines Clause as a Limitation on the Imposition of the Willful FBAR Penalty*, J. TAX PRACTICE & PROCEDURE 69-74 (Jan. 2010).

27 See, e.g., 2012 OVDP FAQs 15 and 16 (threatening those who make quiet disclosures with examinations and criminal prosecution, and pointedly providing no assurance that these threats do not apply to benign actors); 2009 OVDP FAQs 10 and 49 (same).

28 2009 OVDP FAQs #'s 12, 13, 32, and 33.

The offshore penalty rose to 25 percent of the highest account balance during an eight-year period under the 2011 program, to 27.5 percent under the 2012 program, and up to 50 percent (still over an eight-year period) under the 2014 program.<sup>29</sup> With few exceptions, the OVD programs applied the same offshore penalty to benign and bad actors. The exceptions included:

- A five percent penalty for those holding inactive offshore accounts funded with previously-taxed proceeds and for certain foreign residents;<sup>30</sup>
- A 12.5 percent penalty for those with accounts never exceeding \$75,000;<sup>31</sup> and
- A streamlined program that allowed certain “low risk” foreign residents with a *de minimis* amount of unreported income to avoid the OVD program. However, they could still be deemed “high risk” by the IRS and audited.<sup>32</sup>

Statistics suggest that all or nearly all of the taxpayers who applied to the streamlined programs were benign actors. Between Sept. 1, 2012 and April 24, 2014, the streamlined program attracted 8,851 taxpayers, and only eight percent (or 697 taxpayers) were classified as high risk and examined, as shown by the figure below.

**FIGURE 1.7.1. OVD streamlined program submissions by risk level<sup>33</sup>**

Submissions	Taxpayers	Percent of Total
Classified Low Risk	1,334	15%
Classified High Risk and Examined	697	8%
Subtotal Classified High or Low Risk	2,031	23%
Not Classified by Exam	6,820	77%
<b>Total Submissions</b>	<b>8,851</b>	<b>100%</b>

Even among the “high risk” group, most returns (51 percent) were not changed by the IRS, as shown on the figure below.

29 2014 OVDP FAQ #9; 2012 OVDP FAQ #8; 2011 OVDI FAQ #8.

30 2011 OVDI FAQ #52; 2012 OVDP FAQ #52 (eliminated under the 2014 program).

31 2011 OVDI FAQ #53; 2012 OVDP FAQ #53 (eliminated under the 2014 program).

32 See Form 14438, *Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer* (Aug. 2013); IRS, *Streamlined Filing Compliance Procedures* (Oct. 9, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures> (describing changes to the streamlined program first announced in 2012).

33 IRS response to TAS information request (July 30, 2014) (reflecting submissions received between Sept. 1, 2012 and April 24, 2014). The IRS stopped classifying returns as either high or low risk on June 18, 2014 when it announced the updated streamlined and OVDP programs. IRS response to TAS information request (Dec. 2, 2014). All the tables, charts, and figures in this discussion use numbers that may not add to 100 percent due to rounding.

**FIGURE 1.7.2, Examination results for “high risk” taxpayers on cases closed as of July 15, 2014<sup>34</sup>**

Examination Results	Returns	Percent of Total
No Change	182	51%
Adjustment Agreed	159	45%
Adjustment Unagreed/Other	15	4%
<b>Total Closed</b>	<b>356</b>	<b>100%</b>

Even among those whose returns were adjusted, the average adjustment was only \$810 per return.<sup>35</sup> However, the IRS discouraged many taxpayers (including benign actors) from applying to the streamlined program, for example, if they had an understatement of more than \$1,500 or other “risk factors.”<sup>36</sup>

In addition, the IRS narrowly construed the exceptions under which taxpayers could receive lower rates within the OVD programs. Fewer than two percent of the offshore penalties assessed against OVD applicants were assessed at these reduced offshore penalty rates, as shown on the figure below.

**FIGURE 1.7.3, Total OVD offshore penalty assessments by rate<sup>37</sup>**

Offshore Penalty Rate	Total (millions)	Percent
Regular Rate (20%, 25%, or 27.5%)	\$4,143	98.4%
Reduced Rate (5% or 12.5%)	\$58	1.4%
Other	\$7	0.2%
<b>Total</b>	<b>\$4,208</b>	<b>100.0%</b>

The only other option for benign actors was to opt out of the OVD programs and be examined. However, because those opting out faced prolonged uncertainty, the expense and stress of an examination, potential appeals, and the risk of even more severe penalties, some agreed to pay the (offshore) penalty designed for bad actors, as described in prior reports.<sup>38</sup>

#### **IRS data indicate that benign actors paid a proportionately greater offshore penalty than bad actors.**

People who are unrepresented or who have small accounts are perhaps more likely to make inadvertent reporting violations than those who are represented or have large accounts. Those with small accounts generally had less to gain from failing to disclose them and fewer resources to investigate the reporting requirements. Similarly, those without representation were probably less likely to know about the requirement.

34 IRS response to TAS information request (July 30, 2014).

35 IRS response to TAS information request (Dec. 2, 2014).

36 See Form 14438, *Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer* (Aug. 2013).

37 IRS response to TAS information request (July 30, 2014) (analysis of data from OVD closed case reports for the 2009, 2011, and 2012 programs).

38 See, e.g., OVD Reports.

Under the 2009 OVD program, however, the median offshore penalty paid by those with the smallest accounts was nearly six times the median unreported tax, as compared to about three times the unreported tax for those with the largest accounts, as shown on the figure below. Moreover, unrepresented taxpayers paid proportionately more regardless of the size of their accounts, as shown below.

**FIGURE 1.7.4, Comparison of median offshore penalties to unpaid tax by median account size and representation for the 2009 OVD program<sup>39</sup>**

	Bottom 10%	Middle 80%	Top 10%
Offshore account(s) balance	\$44,855	\$607,875	\$7,259,580
2009 OVD penalty	\$8,540	\$117,803	\$1,410,517
Additional tax, tax years 2002–2011	\$1,472	\$30,894	\$452,966
Offshore penalty as a percent of tax assessed	580%	381%	311%
Unrepresented percent	31%	11%	4%
Offshore penalty as a percent of tax assessed (unrepresented taxpayers only)	772%	474%	398%

Under the 2011 OVD program, the median offshore penalty for those with the smallest accounts rose to eight times the unreported tax, up from about six times the unreported tax under the 2009 program, as shown above and below. Unrepresented taxpayers continued to pay proportionately more except for those with the smallest accounts, as shown on the figure below. Moreover, for the middle 80 percent of taxpayers, the offshore penalty percentage increased by about 85 percent between the 2009 and 2011 programs (from 381 to 706 percent) while the median account balance declined by about 70 percent (from \$607,875 to \$183,993). Thus, the offshore penalty became increasingly more disproportionate for those with small accounts who were most likely to have been benign actors.

<sup>39</sup> National Taxpayer Advocate 2013 Annual Report to Congress 228-238. All figures are medians rather than averages because the data contains extreme outliers. The 2009 OVD program data was not updated because it has not changed significantly since last year's report. For the purposes of this analysis (and the analysis in the table below), we consider unrepresented taxpayers to be those without a Transaction Code 960 present on the Compliance Data Warehouse Individual Master File Transaction History table as of October 3, 2013. If the IRS Master File database indicated that a taxpayer had a representative on any tax module for any of tax years 2003-2012, then the taxpayer was considered represented, even though he or she may have been unrepresented in connection with the OVD program.

**FIGURE 1.7.5, Comparison of median offshore penalties to unpaid tax by median account size and representation for the 2011 OVD program<sup>40</sup>**

	Bottom 10%	Middle 80%	Top 10%
Offshore account(s) balance	\$17,368	\$183,993	\$3,833,152
2011 OVD penalty	\$2,202	\$41,238	\$888,943
Additional tax, tax years 2003–2012	\$268	\$5,845	\$190,579
Offshore penalty as a percent of tax assessed	821%	706%	466%
Unrepresented percent	53%	30%	10%
Offshore penalty as a percent of tax assessed (unrepresented taxpayers only)	788%	736%	705%

Disproportionality may have increased between the 2009 and 2011 programs because those settling under the 2011 program generally had proportionately less unreported tax, but were still mostly subject to the “one-size-fits-all” offshore penalty, which rose from 20 percent in the 2009 program to 25 percent for 2011.

#### Taxpayers who opted out or were removed paid much less.

Taxpayers who had the courage to opt out or who were removed from the IRS’s OVD programs generally paid far smaller penalties. As shown on the following table, they were assessed less in penalties (including the FBAR penalty) than in additional taxes.

**FIGURE 1.7.6, Opt-out and removal examination results<sup>41</sup>**

Program	Returns Closed	Avg. Tax Assessed	Avg. FBAR Penalty <sup>42</sup>	Avg. Tax Penalty	Penalty to Tax Assessment Ratio
2009 OVD	1,865	\$13,667	\$2,288	\$10,633	95%
2011 OVD	1,381	\$3,974	\$794	\$930	43%
2012 OVD	34	\$178	\$0	\$31	17%
Canadian opt-out and streamlined	6,085	\$110	\$0	\$6	6%

40 Audit Information Management System Closed Case Database and the Individual Master File Transaction History (Aug. 29, 2014) (TAS analysis of closed case data where an offshore penalty was assessed inside the 2011 OVD program). Like those in the table above, all figures are medians. Although TAS pulled the 2009 OVD program data (above) based on directions from technical experts at the IRS, the IRS formally objected that the 2009 data “fails to capture taxpayers closed under old FAQ 35 where there was no additional tax assessment or taxpayers with offsetting adjustments.” IRS response to TAS information request (Dec. 6, 2013); IRS response to TAS information request (Dec. 2, 2014) (same). Accordingly, when TAS pulled the 2011 OVD program data it included taxpayers with no additional tax assessments or offsetting adjustments (as requested by the IRS), but the penalties were even more disproportionate, as shown above. All similar comparisons between the 2009 and 2011 program data in this report assume this difference in methodology does not materially affect the results.

41 IRS response to TAS information request (July 30, 2014). TAS received aggregate figures from the IRS and then divided them by the number of closed returns to compute averages. The penalty-to-tax assessment percentage is the sum of the average tax and FBAR penalties divided by the average tax assessment. The IRS recorded data on Canadians who opted out separately from other taxpayers. IRS response to TAS information request (July 30, 2014). It also combined streamlined examination results with the results of examinations of Canadians who opted out. *Id.*

42 By comparison, the average FBAR penalty assessed in the 4,584 examinations closed in 2011-2013 outside of the OVD programs was about \$40,685, with the IRS issuing warning letters in 791 (or about 17 percent) of them. IRS response to TAS information request (July 30, 2014). It also initiated about 95 criminal investigations and obtained 35 convictions during the 2011-2013 periods. *Id.*

For example, this figure shows that when taxpayers opted out of the 2011 OVD and were examined they only paid about \$5,698 on average (\$3,974 in tax, plus \$930 in tax penalties and \$794 in FBAR penalties), with penalties comprising only about \$1,724 of that amount. These results are not surprising. The IRS designed the opt-out process for those who felt the offshore penalty was too high—higher than the penalty that they would pay under the statute as enacted by Congress. The problem is that many benign actors did not opt out. Moreover, while the analysis above suggests that the penalties for benign actors have grown proportionately more severe inside the programs, they appear to have declined for those who opted out. As shown above, the penalty to tax percentage for those who opted out or were removed declined from 95 percent under the 2009 OVD program to 17 percent under the 2012 program.

**IRS delays may have prompted some benign actors to accept disproportionate offshore penalties.**

The potential cost of representation in a lengthy examination and potential appeal, may have prompted some benign actors to pay a disproportionate offshore penalty. As shown on the following figure, OVD cases generally remained unresolved for long periods.

**FIGURE 1.7.7, OVD program applications, dispositions, and processing times as of September 30, 2014<sup>43</sup>**

	2009 OVDP		2011 OVDI		2012 OVDP	
	Number	Average Processing Days	Number	Average Processing Days	Number	Average Processing Days
Closed certifications	10,774	311.2	9,616	246.0	1,790	219.9
Closed opt-outs	264	566.7	500	195.5	34	308.6
Closed removals	88	620.4	576	482.4	0	0.0
<b>Total closed cases</b>	<b>11,126</b>	<b>318.9</b>	<b>10,692</b>	<b>240.0</b>	<b>1,824</b>	<b>221.2</b>
Open certifications	20	1,011.2	2,263	384.5	5,072	212.2
Open opt outs	0	0.0	135	437.7	26	377.6
Open removals	0	0.0	80	542.6	3	271.1
Open suspense	0	0.0	19	580.8	5	356.5
<b>Total open cases</b>	<b>20</b>	<b>1,011.2</b>	<b>2,497</b>	<b>396.0</b>	<b>5,106</b>	<b>214.7</b>
<b>TOTAL CASES</b>	<b>11,146</b>	<b>n/a</b>	<b>13,189</b>	<b>n/a</b>	<b>6,930</b>	<b>n/a</b>

Not everyone who feels comfortable making an OVD submission without representation also feels confident to represent themselves in a post-opt-out examination. Thus, the expected cost of such representation—costs that increase the longer the process—likely discouraged some benign actors from opting out.

**The IRS's one-sided interpretations of OVD FAQs likely prompted other benign actors to accept disproportionate offshore penalties.**

Taxpayers who inadvertently violated the rules would be more likely to risk opting out and being examined by the IRS if they believed the IRS would treat them fairly and take only reasonable positions in any post-opt-out examination. Significant uncertainty about what constitutes a “willful” FBAR violation,

<sup>43</sup> IRS response to TAS information request (Oct. 8, 2014). These figures do not include the time that taxpayers waited for the IRS's Criminal Investigation Division to clear them to participate or for the IRS to load their cases onto its tracking system.

what is required to establish “reasonable cause,” and the IRS’s wide latitude to determine the FBAR penalty amount increased the importance of how the IRS used its broad discretion in applying the rules.<sup>44</sup>

However, the IRS’s unreviewable, unpublished, and one-sided interpretations of certain OVD FAQs eroded confidence that the IRS would be reasonable in post-opt-out examinations. Stakeholders complained about the IRS’s strained interpretations of FAQs and recommended that the IRS adopt more formal guidance such as a revenue procedure.<sup>45</sup> One well-documented example, discussed in prior reports, is the IRS’s interpretation of 2009 OVDP FAQ 35.<sup>46</sup> In the context of the 2011 OVDI, the Taxpayer Advocate Service (TAS) continues to encounter other similarly strained interpretations on a regular basis. Although we were unable to obtain taxpayer consent to discuss even more egregious cases, the following example illustrates this ongoing problem.<sup>47</sup>

*Example:* An IRS employee took the position that a taxpayer’s foreign apartment must be included in the “offshore penalty” base solely because the taxpayer filed returns reporting income from the apartment between two and fifteen months late—after receipt of foreign information reporting documents relating to inherited property. The employee concluded the delay in filing returns meant that the apartment was related to tax noncompliance. Under the 2011 OVDI FAQ 35, “[t]he offshore penalty is intended to apply to all of the taxpayer’s offshore holdings that are related in any way to tax noncompliance.” FAQ 35 defines tax noncompliance as follows:

“Tax noncompliance includes failure to report income from the assets, as well as failure to pay U.S. tax that was due with respect to the funds used to acquire the asset.”

The taxpayer timely overpaid her taxes and reported the income from the apartment (albeit on late-filed returns), and the apartment was not acquired with untaxed funds. Thus, the IRS employee’s unreviewable determination to include the apartment in the offshore penalty base appears to contradict FAQ 35.

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44 For further discussion of these issues, see, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 228-238.

45 See, e.g., Letter from New York State Bar Association Tax Section to Commissioner, IRS, Chief Counsel, IRS, and Acting Assistant Secretary (Tax Policy) Department of the Treasury, 2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers, reprinted as, NYSBA Tax Section Comments on FAQ for 2011 Offshore Voluntary Disclosure Initiative, 2011 TNT 153-13 (Aug. 9, 2011) (hereinafter “NYSBA Letter”) (identifying inconsistencies and recommending “FAQs be incorporated into some type of more permanent guidance such as a Revenue Procedure and that such guidance be subject to public comments.”); National Taxpayer Advocate 2013 Annual Report to Congress 228-238. Formal guidance could be interpreted by one branch of National Office of Chief Counsel attorneys whose advice could be published as Chief Counsel Advice (CCA), rather than by IRS technical advisors and SB/SE field attorneys. See, e.g., IRC § 6110.

46 See, e.g., OVD Reports; NYSBA Letter.

47 TAS has obtained taxpayer consent to discuss the case example described above. TAS developed its procedure for obtaining consents to publish case examples in consultation with the IRS Office of Chief Counsel. In response to a formal TAS request for the IRS to confirm whether the FAQ interpretations described in the example were correct—a request that also gave the IRS an opportunity to rectify the situation—the IRS stated:

“The IRS cannot confirm the allegations of employee interpretations as stated by TAS. Moreover it is not appropriate to discuss individual taxpayer cases as part of the Most Serious Problem process. There are separate processes for addressing individual taxpayer cases and the IRS works with TAS as appropriate through those processes. Finally, information being requested is information protected under IRC § 6103 and is not appropriate for a publicly released report.” IRS response to TAS information request (July 30, 2014).

The IRS Office of Chief Counsel has advised the National Taxpayer Advocate that the IRS was legally authorized to provide TAS with the requested information. Moreover, the IRS routinely provides TAS with information about individual taxpayer cases (e.g., as part of a case review or study) for the purpose of compiling this report.

Although the apartment would not be included in the penalty base outside of the OVD program, the taxpayer was unwilling to opt out. She feared that opting out could somehow affect her status as a green card holder or her application for U.S. citizenship.

When a taxpayer disagrees with a revenue agent's (*i.e.*, an auditor's) interpretation of an FAQ, the agent is not required to explain the interpretation or allow the taxpayer to speak with the technical advisor or counsel attorney whose advice he or she sought. Nor can the taxpayer have the interpretation reviewed by the IRS Office of Appeals. Moreover, these interpretations are unpublished. Thus, neither taxpayers nor the IRS can be sure revenue agents, technical advisors, or IRS attorneys are applying the FAQs consistently.

The IRS may, in fact, achieve consistency through frequent informal electronic and telephonic communications among IRS revenue agents, technical advisors, and attorneys. For example, IRS officials revealed at an ABA conference that some agents had attended web-based training and were using checksheets concerning willfulness determinations. While these efforts should promote consistency, the materials were withheld from the public.<sup>48</sup> Without transparency as to these checklists and FAQ interpretations, neither taxpayers nor other IRS employees (including TAS employees and IRS executives) can be sure the IRS is treating taxpayers consistently.<sup>49</sup> Nor can they be confident IRS employees are consistently interpreting willfulness and reasonable cause *correctly*.

The IRS's seemingly arbitrary and one-sided approach to interpreting the OVD FAQs—interpretations that the IRS did not publish, explain, or subject to an appeal—eroded confidence that the IRS would be reasonable in post-opt-out examinations, prompting some benign actors to agree to pay disproportionate offshore penalties.

### Recent OVD program changes treat certain benign actors more reasonably.

On June 18, 2014 the IRS adopted some of the National Taxpayer Advocate's OVD-related recommendations. It modified the terms of the 2012 OVD program (called the 2014 OVDP) and created a new 2014 “streamlined” program that allows those who failed to file an FBAR and report offshore income to pay a reduced offshore penalty—five percent for U.S. residents and zero percent for nonresidents—if they certify that their violations were not willful.<sup>50</sup> At five percent of the offshore account balance, the penalty

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- 48 Kristen A. Parillo, *ABA Meeting: More Guidance Coming On Modified OVDP and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014). For a broader discussion of the IRS's difficulty with the Freedom of Information Act (FOIA), see for example, National Taxpayer Advocate 2011 Annual Report to Congress 380-403 (Most Serious Problem: *The IRS's Failure to Consistently Vet and Disclose its Procedures Harms Taxpayers, Deprives It of Valuable Comments, and Violates the Law*); National Taxpayer Advocate 2006 Annual Report to Congress 10-30 (Most Serious Problem: *Transparency of the IRS*); National Taxpayer Advocate 2008 Objectives Report to Congress xxi-xxvii (*Update on Transparency of the IRS*); and National Taxpayer Advocate 2010 Annual Report to Congress 71-84 (Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review*).
- 49 TAS gave IRS management an opportunity to comment on whether it believes the FAQs were applied consistently and correctly in a handful of cases TAS had worked where revenue agents either disregarded the FAQs completely or gave them strained anti-taxpayer interpretations, including the example above. As noted above, IRS management said it “cannot confirm the allegations of employee interpretations.” IRS response to TAS information request (July 30, 2014). While also asserting that providing such information would not be “appropriate,” the response suggests at least tacit management support for the anti-taxpayer interpretations about which we have raised concerns.
- 50 To qualify for the nonresident streamlined program, a person must have been a nonresident in one of the last three years for which a return was required. IRS, *U.S. Taxpayers Residing Outside the United States* (Oct. 9, 2014). However, the program defines “nonresident” very narrowly—generally excluding people if they or their spouses have visited the U.S. for vacation, to work, to visit a sick relative, or to shop on more than 35 days. IRS, *U.S. Taxpayers Residing Outside the United States* (Oct. 9, 2014); IRS, *U.S. Taxpayers Residing in the United States* (Oct. 9, 2014). TAS commented that the IRS should use a more expansive definition of nonresident.

is less harsh than the 27.5 percent (or 50 percent) penalty under the 2012 or 2014 OVDP.<sup>51</sup> Because taxpayers are not offered a closing agreement under the 2014 program, however, the IRS could examine them and assess higher penalties. Thus, benign actors in the streamlined program do not have the same right to finality as bad actors in the other OVD programs.<sup>52</sup>

During a transition period, taxpayers with open OVD program cases, who had not signed closing agreements, could also participate in the streamlined program and receive a closing agreement if the IRS agreed their violations were not willful.<sup>53</sup> The last time the IRS created more favorable rates for certain types of benign actors—the 5 and 12.5 percent rates (described above)—it allowed qualifying taxpayers who already had signed closing agreements to amend them so they were not disadvantaged by having come forward earlier.<sup>54</sup> For the 2014 program changes, however, the IRS did not offer the same terms to benign actors who already had signed (and countersigned) closing agreements. Thus, the 2014 OVD-related changes represent a major step forward in distinguishing between benign actors and bad actors, as contemplated by Congress, but they leave many benign actors with previously signed closing agreements feeling punished for having come forward early.

### The OVD program guidance-making and disclosure process remains flawed.

The IRS still has not adopted the National Taxpayer Advocate's recommendations to improve transparency or accountability in its program guidance or FAQ interpretations. Although it may receive OVD-related comments from TAS and the public, it has not formally asked for comments from internal or external stakeholders, and does not necessarily address the comments it receives to explain why it has adopted some and not others.<sup>55</sup> Nor does it disclose all of the guidance that employees are applying (*e.g.*, the FAQ interpretations described above). Thus, the OVD-related guidance-making process remains flawed. As a result, the IRS will continue to be viewed as ignoring reasonable concerns and some OVD

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51 As of the end of FY 2014, there were approximately 3,085 applicants to the new 2014 streamlined program and 1,409 applicants to the 2014 OVDP. IRS response to TAS information request (Dec. 2, 2014). As of October 8, 2014, no results had been captured for either program. *Id.*

52 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014) (announcing the IRS's intention to give taxpayers the right to finality). Only taxpayers with open OVD program cases were permitted to obtain closing agreements under the 2014 streamlined program terms. IRS, *Transition Rules: Frequently Asked Questions (FAQs)* (June 18, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Transition-Rules-Frequently-Asked-Questions-FAQs>.

53 Streamlined Filing Compliance Procedures (June 18, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures>. (“A taxpayer eligible for treatment under the streamlined procedures who submits, or has submitted, a voluntary disclosure letter under the OVDP (or any predecessor offshore voluntary disclosure program) prior to July 1, 2014, but who does not yet have a fully executed OVDP closing agreement, may request treatment under the applicable penalty terms available under the streamlined procedures.”)

54 See 2011 OVDI FAQ #52 (“Taxpayers who participated in the 2009 OVDP whose cases have been resolved and closed with a Form 906 closing agreement who believe the facts of their case qualify them for the 5% reduced penalty criteria of the 2011 OVDI, but paid a higher penalty amount under the 2009 OVDP should provide a statement to this effect ... Upon receipt of this information, the case will be assigned to an examiner to review and make a determination.”); 2011 OVDI FAQ #53 (same).

55 Although the Large Business and International (LB&I) division does not ask for public comments before issuing OVD-related guidance, it has begun asking a member of the National Taxpayer Advocate's staff to comment on such guidance on short notice. TAS appreciates this opportunity to comment. However, LB&I has not asked for TAS or other affected IRS functions for comments using the normal Internal Management Document (IMD) process for clearing and disclosing interim guidance to staff or IRM changes. IRM 1.11.1 (Sept. 4, 2009); IRM 1.11.9 (Apr. 7, 2014). The IMD process contains procedures for dispute resolution. *Id.* Thus, LB&I has not explained why it has not adopted some of TAS's comments. Nor has LB&I asked for comments from the IRS Office of Servicewide Penalties (OSP)—the IRS office supposedly charged with “coordinating policy and procedures concerning the administration of penalty programs.” IRM 20.1.6.1.1 (Sept. 17, 2010); IRM 4.24.9.1 (Oct. 26, 2012) (same); OSP response to TAS information request (July 10, 2014) (indicating that LB&I had merely asked OSP for new penalty reference numbers in connection OVD-related program changes). For a more detailed discussion of this problem see, *Most Serious Problem: PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others, infra*.

participants will continue to believe the IRS is not applying the FAQs consistently or fairly. This state of affairs does not engender trust in IRS policies, procedures, or actions.

## CONCLUSION

OVD program data suggest that the IRS turned the statutory scheme on its head by charging benign actors the same offshore penalty as bad actors. Further, the pressure benign actors felt to accept the OVD program terms rather than opting out, eroded taxpayer rights, such as the *rights to pay no more than the correct amount of tax, challenge the IRS's position and be heard, appeal an IRS decision in an independent forum, and to a fair and just tax system.*<sup>56</sup>

Recent changes to the OVD programs address some of TAS's concerns. However, unlike the last time the IRS made taxpayer-favorable changes to an OVD program, the IRS will not allow those who already agreed to pay disproportionate offshore penalties to benefit from the most recent changes.

Moreover, the IRS still does not formally ask for internal or external comments before issuing OVD guidance, or publicly explain why it has adopted some comments and not others. Nor does it disclose its interpretations of FAQs or other internal guidance to the public. Correcting these flaws would further the taxpayer *right to be informed.*<sup>57</sup>

The flaws in the OVD programs, outlined in this report, do not bode well for fairness and justice in the IRS's implementation of future settlement programs where taxpayers have diverse facts and circumstances. Moreover, the IRS's unwillingness to address these flaws and fundamentally restructure its offshore initiatives undermines voluntary compliance and places taxpayers at risk of disproportionate penalties.

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

57 *Id.*

## RECOMMENDATIONS

In the interests of effective tax administration, the National Taxpayer Advocate recommends the IRS:

1. Improve the transparency of the OVD and streamlined programs by:
  - a. Publishing OVD-related program guidance as a revenue procedure (or similar guidance published in the Internal Revenue Bulletin) that incorporates comments from internal and external stakeholders, and assigning interpretation of the guidance to national office attorneys whose advice would be disclosed to the public just like other Chief Counsel Advice (CCA).
  - b. Providing instructions to OVD program staff by incorporating them into the IRM, which incorporates comments from internal stakeholders and is disclosed to the public.
  - c. Publishing interpretations of the program terms by any IRS employees authorized to interpret them (*e.g.*, by IRS attorneys and technical advisors) just like CCA.
  - d. More frequently updating the guidance on the IRS website with any clarifying interpretations rendered by technical advisors or other IRS employees to the extent those interpretations are not incorporated into other public guidance.<sup>58</sup>
2. Allow taxpayers to elevate or appeal a revenue agent's OVD and streamlined program determinations. At a minimum, the agent and anyone who advised him or her (*e.g.*, a technical advisor or IRS attorney) with respect to a disputed assumption should be required to explain his or her reasoning to the taxpayer in writing and reconsider the advice in light of any new facts or analysis provided by the taxpayer.
3. Allow taxpayers to amend their closing agreements to benefit from recent OVD-related program changes.<sup>59</sup>

<sup>58</sup> Rather than changing the FAQs each time, a list of all clarifying guidance applicable to a specific FAQ could be made visible if a user clicked on that particular FAQ.

<sup>59</sup> The IRS previously offered to amend 2009 OVDP agreements for taxpayers who would qualify for the reduced 5 percent or 12.5 percent offshore penalty rates under the 2011 OVDI. See 2011 OVDI FAQ #52; 2011 OVDI FAQ #53.

**MSP  
# 8****PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

Over 20 years ago, Congress recommended the IRS “develop better information concerning the administration and effects of penalties” to ensure they promote voluntary tax compliance.<sup>1</sup> It is the IRS’s official policy to do so,<sup>2</sup> and many of the IRS’s stakeholders, including the National Taxpayer Advocate, have recommended that the IRS do more in this area.

The IRS has assigned responsibility for IRS-wide penalty policy to the Office of Servicewide Penalties (OSP). As the number of civil penalties has increased—from 14 in 1955 to more than 170 today—this responsibility has become more difficult.<sup>3</sup> However, OSP has not been given the resources to conduct (or review) penalty research on a regular basis and has ignored TAS’s penalty research. OSP, an office buried at least three levels below the Small Business/Self-Employed (SB/SE) division Commissioner, cites insufficient resources, insufficient staffing, employees with the wrong skillsets, and a lack of access to penalty-related data as barriers to conducting such research.<sup>4</sup> It also appears to lack the authority to implement any significant IRS-wide changes to penalty administration. Other IRS business units do not ask OSP for substantive comments before they implement major penalty initiatives or policy changes. Moreover, the IRS has not developed a plan to address the challenges faced by OSP, as it committed to do in 2009.<sup>5</sup> As a result, some of the IRS’s penalty procedures are more likely to discourage than encourage voluntary compliance.<sup>6</sup>

1 See, e.g., H.R. REP. NO. 101-386, at 661 (1989) (Conf. Rep.).

2 Policy Statement 20-1 (Formerly P-1-18), reprinted at IRM 1.2.20.1.1(1)-(2) (June 29, 2004).

3 IRM 20.1.1.1.1 (Nov. 25, 2011) (14 civil penalties in 1955); IRS response to TAS information request (July 10, 2014) (stating OSP is charged with “administering more than 170 different civil penalties”). The IRS only assessed 151 different penalties in fiscal year (FY) 2013). TAS research data from the Enforcement Revenue Information System (ERIS) on the Compliance Data Warehouse (CDW) (Oct. 8, 2014) (reflecting assessments of 151 different penalties—67 for individuals and 84 for businesses—for FY 2013).

4 IRS response to TAS information request (July 10, 2014); IRS Human Resources Reporting Center (HRRC), Servicewide Penalties Organizational Chart (Sept. 20, 2014).

5 Government Accountability Office (GAO), GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009) (IRS response).

6 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). For a discussion of various problems with penalty procedures see, e.g., National Taxpayer Advocate 2007 Annual Report to Congress 275 (Most Serious Problem: *The Accuracy-Related Penalty in the Automated Underreporter Units*); National Taxpayer Advocate 2013 Annual Report to Congress 103 (Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*); National Taxpayer Advocate 2013 Annual Report to Congress 228 (Most Serious Problem: *The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Made Honest Mistakes*).

## ANALYSIS OF PROBLEM

### The IRS is Supposed to Ensure that its Penalty Policy Promotes Voluntary Compliance.

The last comprehensive reform of the Internal Revenue Code's (IRC's) penalty provisions was enacted in 1989, after careful study by Congress, the IRS, and other stakeholders.<sup>7</sup> As part of these reforms, Congress recommended that the IRS "develop better information concerning the administration and effects of penalties" to ensure penalty provisions and the IRS's administration of them promote voluntary compliance.<sup>8</sup> In a hearing leading up to the 1989 legislation, Senator Pryor explained that:

[t]he IRS places a low priority on collecting data necessary in the administration of those [sic] penalties. To use an analogy, I would find it very difficult to believe that a major U.S. company would manage a comparable program so vital to its business mission without essential data collection to analyze the success and failure of the program.<sup>9</sup>

The IRS adopted a policy statement consistent with Congress's recommendation. It states that:

- "The Office of Penalty and Interest Administration [a predecessor of OSP] must review and approve changes to the Penalty Handbook for consistency with Service Policy before making recommended changes."
- "The Service collects statistical and demographic information to evaluate penalties and penalty administration, and to determine the effectiveness of penalties in promoting voluntary compliance."
- "The Service continually evaluates the impact of the penalty program on compliance and recommends changes when the Internal Revenue Code or penalty administration does not effectively promote voluntary compliance."<sup>10</sup>

More recently, the National Taxpayer Advocate, the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), the American Bar Association (ABA) Tax Section, and the American Institute of Certified Public Accountants (AICPA) have all recommended that the IRS collect more data on penalties and do more to analyze their effect on voluntary compliance.<sup>11</sup> Penalty analysis is increasingly difficult because the number of civil penalties the IRS administers has increased from 14 in 1955 to more than 170 today.<sup>12</sup> The IRS assessed about 37.9 million (or \$25.9 billion in aggregate) civil penalties in FY 2013, up from about 15 million (or \$1.3 billion in aggregate) in FY 1978 (the earliest year available).<sup>13</sup> It also abated about 4.9 million civil penalties (or \$11.5 billion in aggregate) in FY 2013, up from 1.4 million (or \$338 million in aggregate) in FY 1978.<sup>14</sup>

<sup>7</sup> See, e.g., Executive Task Force for Internal Revenue Commissioner's Penalty Study, *A Philosophy of Civil Tax Penalties* (Discussion Draft), reprinted in 111 DTR L-1 1988, 9-10 (June 9, 1988); H.R. REP. No. 101-386 at 661 (1989) (Conf. Rep.).

<sup>8</sup> H.R. REP. No. 101-386 at 661 (1989) (Conf. Rep.) (also stating that, in connection with civil tax penalty reform, "the IRS should develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance").

<sup>9</sup> Hearing Before the Comm. on Finance, Subcomm. on Private Retirement Plans and Oversight of the Internal Revenue Service, 100th Cong. 2d Sess. 2 (Sept. 28, 1988) (Opening Statement of Sen. David Pryor).

<sup>10</sup> Policy Statement 20-1 (Formerly P-1-18), reprinted at IRM 1.2.20.1.1(11)-(12) (June 29, 2004).

<sup>11</sup> See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*); GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009); TIGTA, Ref. No. 2001-40-069, *Ineffective Administration of the Individual Taxpayer Penalty Program Creates Inequity* 9 (Apr. 2001); ABA Section of Taxation, *Statement of Policy Favoring Reform of Federal Civil Tax Penalties* 13 (Apr. 21, 2009); Am. Inst. of Certified Pub. Accountants, *Report on Civil Tax Penalties: The Need for Reform* 16 (Aug. 28, 2009).

<sup>12</sup> IRM 20.1.1.1.1 (Nov. 25, 2011); IRS response to TAS information request (July 10, 2014).

<sup>13</sup> IRS Data Book (FY 2013) (Table 17); IRS Data Book (FY 1978) (Table 13).

<sup>14</sup> *Id.*

### The IRS Does Not Regularly Study the Effect of Penalties on Voluntary Compliance.

The IRS has assigned responsibility for “reviewing and analyzing penalty information, researching penalty effectiveness on compliance trends, and determining appropriate action necessary to promote voluntary compliance” to OSP.<sup>15</sup> Over 20 years after Congress’s recommendation and at least five years after the IRS’s stakeholders (identified above) recommended the IRS do more to study the effect of penalties on voluntary compliance—or at least develop a plan to do so—the OSP has neither produced nor reviewed much research regarding the extent to which penalties promote voluntary compliance (or noncompliance).

Since 2004, the OSP has reviewed only one inconclusive study concerning the effect of three penalties on voluntary compliance.<sup>16</sup> The study did not prompt any policy changes. According to the IRS, it does not do more penalty research because:

[OSP does not have] sufficient resources with the specialized knowledge and skill sets nor access to all the various databases which could assist in civil penalty research and analysis … the IRS functions OSP relies on to compile such data do not have specialized knowledge to apply all of the intricacies and nuances associated with civil penalty assessments and abatements … [and] The separation of different specialized knowledge between two different IRS offices often results in misinterpretations of the type and extent of analyses needed for civil penalties. In addition, the massive amount of data needed to analyze behavior over multiple years as well as the numerous variables to be analyzed each year in order to fully determine a penalty’s impact on voluntary compliance is a barrier to effective data analysis.<sup>17</sup>

Despite this acknowledged lack of expertise and resources, since 2008 OSP has not obtained any new authority, resources, staffing, data/information, systems, or training, and its staff has diminished to six analysts.<sup>18</sup> Further, OSP is buried in the IRS bureaucracy, reporting to the SB/SE Director of Examination Policy, a position three levels below the SB/SE Commissioner.<sup>19</sup> The net effect of this situation is that the IRS has abdicated its responsibility to conduct effective penalty administration, as it continues to apply penalties without regard to whether its penalty-related policies further voluntary compliance.

<sup>15</sup> IRM 20.1.1.1.3 (Dec. 11, 2009). See also IRM 20.1.6.1.1 (Sept. 17, 2010) (“Overall responsibility for the penalty programs is assigned to OSP … OSP is charged with coordinating policy and procedures concerning the administration of penalty programs and ensuring consistency with the penalty policy statement”); IRM 4.24.9.1 (Oct. 26, 2012) (same).

<sup>16</sup> In response to a TAS request to “provide any research OSP has conducted, requested, or reviewed and considered in evaluating penalty policy changes since … 2004,” the IRS identified inconclusive research completed in 2011 by SB/SE research concerning the effect of the first time abatement (FTA) program on future compliance by business taxpayers. IRS response to TAS information request (July 10, 2014). It also identified a request for SB/SE Research to participate as facilitator for the Civil Penalties Administration Improvement Team (CPAIT), to assist “OSP with the Force Field Analysis results obtained during the Civil Penalties Forums in 2011,” and to study the subsequent compliance of the taxpayers that received FTF, FTP or FTD penalties. *Id.* However, this last study “did not meet the stated objectives because Exam Policy sought a dedicated database” and is currently being conducted by the IRS Research Analysis and Statistics (RAS) function. *Id.* The IRS’s response also suggests that OSP does not contract with external researchers or review penalty research conducted by them.

<sup>17</sup> IRS response to TAS information request (July 10, 2014).

<sup>18</sup> *Id.* IRS HRRC, *Servicewide Penalties on Rolls List* (Sept. 20, 2014).

<sup>19</sup> IRS HRRC, *Servicewide Penalties, Organization Chart* (Sept. 20, 2014).

## OSP Does Not Regularly Make or Recommend Changes to Enhance Voluntary Compliance, as Contemplated by the Policy Statement.

In response to a TAS request, OSP did not identify any significant changes to IRS-wide penalty policy that it had implemented to enhance voluntary compliance in the last ten years.<sup>20</sup> In 2009, OSP recommended that the penalty under IRC § 6657 for bad checks be extended to various types of electronic payments.<sup>21</sup> However, it has not offered any other legislative recommendations.

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**Since 2004, the Office of Servicewide Penalties has reviewed only one inconclusive study concerning the effect of three penalties on voluntary compliance.**

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## The IRS Has Not Implemented TAS's Research-Based Penalty Policy Recommendations to Improve Voluntary Compliance.

TAS recently completed a number of penalty-related studies and analyses about the appropriate use of penalties. A 2008 TAS study identified areas where penalty administration deviated from core principles articulated in 1989, potentially discouraging voluntary compliance.<sup>22</sup> Between 2011 and 2013, TAS repeatedly analyzed the effect of the IRS's disproportionate "offshore penalty" on voluntary compliance and suggested reforms that could help it better promote voluntary compliance.<sup>23</sup> A 2013 TAS study analyzed the effect of accuracy-related penalties on voluntary compliance.<sup>24</sup> Although these studies identified administrative changes that could improve voluntary compliance, with the exception of some recent recommendations relating to the "offshore penalty," the IRS has not adopted them.<sup>25</sup>

## *The IRS Still Imposes Penalties Automatically—Before Determining if They Actually Apply.*

A 2008 TAS study discussed the IRS's policy of automatically proposing the negligence penalty when the IRS finds a mismatch between the taxpayer's return and an information return in two or more years, and the taxpayer does not respond to the IRS's form letter by satisfactorily explaining the apparent discrepancy.<sup>26</sup> In such cases the IRS is not required to make an outgoing call (unless the taxpayer responds to the letter) to determine if the taxpayer was actually negligent or had reasonable cause.<sup>27</sup> The study observed

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20 IRS response to TAS information request (July 10, 2014) (describing, instead, challenges from implementing newly enacted legislation, updating and maintaining IRMs, various forms, publications, letters, and notices, and from responding to executive requests, congressional inquiries, TIGTA investigations, and GAO reports).

21 *Id.*

22 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*); National Taxpayer Advocate 2008 Annual Report to Congress 414 (Legislative Recommendation: *Reforming the Penalty Regime*).

23 See, e.g., National Taxpayer Advocate 2015 Objectives Report to Congress; National Taxpayer Advocate 2013 Annual Report to Congress 223; National Taxpayer Advocate 2012 Annual Report to Congress 134-53; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29 [collectively the OVD Reports].

24 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). The 2013 study built on a 2012 TAS study which suggests trust for the IRS may promote voluntary compliance more strongly than deterrence—the possibility that the IRS will detect and penalize tax cheating—findings with significant implications for penalty administration. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 13 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

25 For a discussion of the OVD programs, see, e.g., the OVD Reports.

26 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*). See also National Taxpayer Advocate 2007 Annual Report to Congress 275 (Most Serious Problem: *The Accuracy-Related Penalty in the Automated Underreporter Units*).

27 Exam generally sends Letter 566 to ask for documentation before sending Letter 525 to propose a deficiency and penalty. IRM 4.19.10.4.10.1, *Initial Contact Letter (ICL) Procedures* (Jan. 1, 2013). However, even Exam will only try to call the taxpayer if it receives a response. See IRM 4.19.13.11, *No Response and Unagreed Cases* (Jan. 1, 2013).

that many stakeholders object to such automated penalty procedures,<sup>28</sup> which seem to violate direction from Congress to “make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later.”<sup>29</sup> The policy also ignored concerns expressed in a House Budget Committee report:

[t]hat the present-law accuracy-related penalties (particularly the penalty for substantial understatements of tax liability) have been determined too routinely and automatically by the IRS. The committee expects that enactment of standardized [reasonable cause] exception criterion will lead the IRS to consider fully whether imposition of these penalties is appropriate **before** determining these penalties (emphasis added).<sup>30</sup>

TAS recommended the IRS discontinue its practice of assessing accuracy-related penalties for negligence before actually determining whether the taxpayer was negligent.<sup>31</sup> Rather than *reconsidering* its automated approach to penalties, the IRS *extended* it to the penalty for improperly claiming credits.<sup>32</sup>

A 2013 TAS study suggested that accuracy-related penalties do not improve reporting compliance among taxpayers subject to default assessments, such as those resulting from automated programs, and five years later these taxpayers appeared *less* compliant than those not subject to penalties.<sup>33</sup> The IRS has neither disputed the findings of this study—that such automated penalty assessments policies undermine long-term voluntary compliance—nor agreed to change its policies.

### *The IRS’s Offshore Voluntary Disclosure (OVD) Programs Extracted Disproportionate Penalties From Unrepresented Taxpayers Trying to Correct Inadvertent Errors.*

Another core principle identified in 1989 as consistent with voluntary compliance—as well as the research discussed above—is that penalties should be perceived as proportionate. However, the IRS’s policies create the perception that it is using its broad discretion in applying penalties for failure to file information returns—such as the penalties for failure to file Forms 3520, 3520-A, 5471, 5472, 926, 8865, 8938, or a Foreign Bank Account Report (FBAR)—to extract seemingly arbitrary and disproportionate “offshore penalties” in connection with its Offshore Voluntary Disclosure (OVD) settlement programs.<sup>34</sup> Moreover, these programs penalized unrepresented taxpayers with small unreported accounts—those most likely to

28 Am. Inst. of Certified Pub. Accountants, *Report on Civil Tax Penalties: The Need for Reform* (Aug. 28, 2009); ABA Tax Section, *Comments Concerning Possible Changes to Penalty Provisions of the Internal Revenue Code* (1999).

29 H.R. Rep. No. 101-386, at 661 (1989) (Conf. Rep.). See also IRC § 6751(b)(1) (generally requiring penalties to be personally approved by a supervisor before assessment unless automatically calculated through electronic means).

30 H.R. Rep. No. 101-247 at 2863 (1989) (Budget Comm. Rep.).

31 See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*).

32 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 182 (Most Serious Problem: *The IRS Assessed Penalties Improperly, Refused to Abate them, and Still Assesses Penalties Automatically*) (discussing IRS’s use of the accuracy-related penalties for credit claims); National Taxpayer Advocate 2013 Annual Report to Congress 108 (Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*) (discussing the “penalty” for improperly claiming the Earned Income Tax Credit (EITC) (i.e., the two-year ban)); National Taxpayer Advocate 2013 Annual Report to Congress 311 (Legislative Recommendation: *Allocate to the IRS the Burden of Proving It Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit*). The IRS views the EITC two-year ban as a procedural rule, rather than a penalty. IRS response to TAS information request (July 10, 2014). Regardless of its characterization, the rule penalizes taxpayers, and, if it creates the impression the IRS is unfair, it likely affects voluntary compliance.

33 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

34 See, e.g., OVD Reports.

have made inadvertent or unintentional mistakes that they were trying to correct—more severely than criminal tax evaders with large accounts.<sup>35</sup>

To make matters worse, the IRS's computation of the offshore penalty, which is often counterintuitive, is not subject to appeal or adequate explanation. The IRS does not publish its interpretations of the frequently asked questions (FAQs) describing how the offshore penalty is computed and taxpayers are not entitled to speak to the IRS employee (*e.g.*, a technical advisor or attorney) who decided how to compute it. This lack of transparency and due process in connection with the offshore penalty computation is perceived as unfair and violates the spirit, if not the letter, of the IRS's penalty policy statement, which states:

[T]he Service will demonstrate the fairness of the tax system to all taxpayers by: Providing every taxpayer against whom the Service proposes to assess penalties with a reasonable opportunity to provide evidence that the penalty should not apply; Giving full and fair consideration to evidence in favor of not imposing the penalty, even after the Service's initial consideration supports imposition of a penalty ...<sup>36</sup>

Moreover, the perceived unfairness, and lack of transparency and due process in the OVD programs violates the IRS's recently-adopted Taxpayer Bill of Rights. Those rights include *the right to be informed, the right to challenge the IRS's position and be heard, the right to appeal an IRS decision in an independent forum, and the right to a fair and just tax system.*<sup>37</sup>

### The IRS Has Resisted Research-Driven Recommendations to Improve the Effect of Penalties on Voluntary Compliance.

As noted above, OSP has not reviewed TAS's studies or other studies conducted by outside researchers or academics. Moreover, OSP appears to disagree with direction from Congress to "make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later,"<sup>38</sup> because it "does not consider it unfair to taxpayers for the IRS to assert penalties through a systemic process which applies distinct criteria to identify **potential** instances of noncompliance ..." (emphasis added).<sup>39</sup>

Further, OSP responded to TAS's suggestion that the IRS stop automating various penalty assessments by stating that it had no authority to change those procedures even though they were described in the Penalty Handbook, which it is responsible for updating.<sup>40</sup> According to OSP, any change in penalty policy requires a collaborative decision between OSP, IRS Counsel, and the business operating divisions impacted by such change.<sup>41</sup> However, other IRS business units do not ask OSP for substantive comments before they implement major penalty policy changes or initiatives. For example, other business units did not ask OSP for substantive comments before implementing the 2009, 2011, 2012 or 2014 OVD programs or before automating the assertion of penalties for failure to file Form 5471 in 2009 or Form 5472

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35 See *id.* These policies are also inconsistent with Congress' direction in 1989. See H.R. REP. No. 101-247 at 1405 (Budget Committee) ("The IRS should better use its limited enforcement resources to ensure that taxpayers who continually fail to comply with the reporting requirements are identified and penalized, rather than focusing only on taxpayers who are working with the IRS in an attempt to comply with the law.").

36 IRS Policy Statement 20-1 (Formerly P-1-18), reprinted as IRM 1.2.20.1.1 (June 29, 2004).

37 IRS, Pub. 1, *Your Rights as a Taxpayer* (Rev. 6-2014).

38 H.R. REP. No. 101-386, at 661 (1989) (Conf. Rep.). See also H.R. REP. No. 101-247 at 2863 (1989) (Budget Comm. Rep.).

39 IRS response to TAS information request (July 10, 2014).

40 *Id.* Meeting with OSP executives (Mar. 21, 2014).

41 *Id.*

in 2013.<sup>42</sup> The result of this lack of communication and splintered responsibility is an ineffective penalty regime that harms taxpayers and does not foster voluntary compliance.

### The IRS Still Has No Plan to Evaluate Penalty Administration or the Effect of Penalties on Voluntary Compliance.

In response to a 2009 GAO report, the IRS agreed that OSP would develop a plan to evaluate penalty administration and the impact of penalties on voluntary compliance.<sup>43</sup> Recognizing that this plan should incorporate comments from internal and external stakeholders, the IRS conducted two civil tax penalty forums in June 2011 and formed a Civil Penalties Administration Improvement Team (CPAIT).<sup>44</sup> However, the IRS put development of the plan on hold due to budgetary constraints.<sup>45</sup> The draft plan has not been finalized, approved, or provided to GAO or TAS.<sup>46</sup>

## CONCLUSION

The IRS and its stakeholders, including Congress, all agree that the IRS should use data and research to ensure that penalties promote voluntary compliance, and change IRS procedures or make recommendations for legislative change when they do not. However, the IRS has delegated this responsibility to OSP and declined to provide it with the resources necessary to do so. OSP's staff of six employees does not conduct penalty research. They assert they do not have the skills or access to data they would need to conduct such research. They also face barriers in obtaining assistance from IRS research functions. Moreover, OSP does not review private-sector research or act on TAS's penalty research. OSP apparently has not been given authority to do so. In addition, the IRS still does not have a plan to evaluate penalty administration and the impact of penalties on voluntary compliance.

It will be difficult for the IRS (or OSP) to evaluate the effect of penalties if it ignores prior research. It would be easier for the IRS to evaluate their effects in light of the research and conclusions already reached by the IRS and its stakeholders. For example, the findings of various studies by TAS and others are consistent with what the IRS and Congress found in 1989 – penalties promote voluntary compliance when they are perceived as fair and administered in a way that is consistent with fundamental

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In response to a TAS request, OSP did not identify any significant changes to IRS-wide penalty policy that it had implemented to enhance voluntary compliance in the last ten years.

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42 IRS response to TAS information request (July 10, 2014) (indicating that the business units merely asked OSP for new penalty reference numbers).

43 GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009).

44 IRS response to TAS information request (July 10, 2014).

45 *Id.*

46 *Id.*

taxpayer rights.<sup>47</sup> Otherwise, they are more likely to erode voluntary compliance, wasting IRS resources and decreasing government revenues. This conclusion is also consistent with the IRS's recently-adopted Taxpayer Bill of Rights.<sup>48</sup> If OSP were more effective in protecting those core principles and conducting research or reviewing research by TAS and other stakeholders, it could better ensure that penalty rules and administration actually promote voluntary compliance.

## RECOMMENDATION

The National Taxpayer Advocate recommends that the IRS:

1. Finalize a plan for OSP (or a successor organization) to ensure that all parts of the IRS are administering penalties to promote voluntary compliance in accordance with congressional directives and the IRS policy statement.
2. Provide OSP with sufficient authority, resources, staffing, training, and access to data and systems to ensure the IRS is achieving its penalty-related objectives.
3. Require that all penalty policies and initiatives owned by other IRS business units be incorporated into the IRM and substantively reviewed by OSP for consistency with IRS-wide penalty policy before they are implemented. OSP should also review all previously-adopted policies.
4. Direct OSP to partner with private-sector researchers to study the effect of penalties on voluntary compliance.
5. Direct OSP to compile, review, and consider current and historical internal and external penalty studies (including TAS studies) in connection with any reevaluation of (or change to) IRS penalty policy or administration.
6. Direct OSP to publish the studies it considers and the conclusions it reaches after any such review, so that internal and external IRS stakeholders can build on and contribute to its analysis.

<sup>47</sup> A number of studies other than those described above lend support to this conclusion. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 13 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, § 6 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*) (describing wide range scholarly studies); Swedish Tax Agency, *Right From The Start, Research and Strategies* 38-51 (Aug. 2005) (surveying papers from various disciplines, and concluding that trust for tax agencies is an important determinant of voluntary compliance); Kristina Murphy, *The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders*, 28 LAW & HUM. BEHAV. 187 (Apr. 2004) (finding that perceptions of procedural fairness and trust in the taxing authority had an impact on the motivation to comply); Tom R. Tyler, *Why People Obey the Law* 58-62 (Princeton Univ. Press 2006) (finding that respect and support for enforcement agencies has a significant positive impact on compliance after controlling for other variables); *Taxpayer Compliance, Volume 1: An Agenda for Research* 118 (Jeffrey A. Rother, John T. Scholtz, and Ann Dryden Witte eds., Univ. of Penn. Press 1989) (summarizing various studies that suggest attitudes toward the IRS, law, and government may have an impact on tax compliance). See also Joint Committee on Taxation, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (Nov. 24, 1998) (describing the 1998 IRS reorganization as needed to restore public confidence in the IRS, in large part, because "the Congress believed that most Americans are willing to pay their fair share of taxes, and that public confidence in the IRS is key to maintaining that willingness."). Of course, penalties may also deter noncompliance and demonstrate the fairness of the tax system to those who are compliant. Policy Statement 20-1 (Formerly P-1-18), *reprinted as IRM 1.2.20.1.1(1)-(2)* (June 29, 2004).

<sup>48</sup> The notion that only penalties that are perceived as being fair and administered fairly have a positive effect on voluntary compliance is so well established that GAO suggested: "In addition to analyses related to voluntary compliance that could be done internally, by developing a plan, OSP may be able to identify other means of developing information useful to gauging penalties' effect on voluntary compliance. Taxpayer surveys or focus groups, for instance, could provide information on taxpayers' perceptions about the fairness of penalties." GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* 10 (June 2009).

**MSP  
#9****COMPLEXITY: The IRS Does Not Report on Tax Complexity as Required by Law****RESPONSIBLE OFFICIALS**

John A. Koskinen, Commissioner of Internal Revenue  
Rosemary Marcuss, Director, Office of Research, Analysis, and Statistics

**DEFINITION OF PROBLEM**

The IRS is required by law to report to Congress each year on the sources of complexity in tax administration and on ways to reduce it.<sup>1</sup> However, the IRS has issued only two such reports and none since 2002.<sup>2</sup> Congress adopted many of the recommendations in those reports. As the tax administrator, only the IRS has certain data about complexity, and its short reports probably helped both the IRS and Congress to identify and address key problem areas. Thus, the IRS's decision to discontinue the reports has likely contributed to tax complexity, which burdens taxpayers and the IRS alike. Conversely, revisiting this decision could help improve tax law clarity, administrability, and fairness. If the IRS did this, it would further the taxpayer *rights to be informed* (e.g., to know and understand what they need to do to comply), *to quality service* (e.g., to receive clear and easily understandable communications from the IRS), and *to a fair and just tax system*.<sup>3</sup>

**ANALYSIS OF PROBLEM****Congress Requires the IRS to Analyze and Report on Complexity.**

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to analyze and report on the sources of complexity in tax administration each year.<sup>4</sup> Specifically, RRA 98 § 4022(a) states:

- (1) In general.--The Commissioner of Internal Revenue shall conduct each year after 1998 an analysis of the sources of complexity in administration of the Federal tax laws. Such analysis may include an analysis of—
  - (A) questions frequently asked by taxpayers with respect to return filing;
  - (B) common errors made by taxpayers in filling out their returns;
  - (C) areas of law which frequently result in disagreements between taxpayers and the Internal Revenue Service;
  - (D) major areas of law in which there is no (or incomplete) published guidance or in which the law is uncertain;

<sup>1</sup> See Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105–206, Title IV, § 4022(a), 112 Stat. 785 (1998) (codified at Internal Revenue Code (IRC) § 7801(note)).

<sup>2</sup> IRS, Office of Research Analysis and Statistics, *Annual Report from the Commissioner of Internal Revenue on Tax Law Complexity*, Pub. 4105 (June 5, 2000) [hereinafter 2000 Complexity Report]; IRS, Office of Research Analysis and Statistics, *Annual Report from the Commissioner of Internal Revenue on Tax Law Complexity*, Pub. 4105 (Sept. 20, 2002) [hereinafter 2002 Complexity Report].

<sup>3</sup> See IRS, Pub. 1, *Your Rights as a Taxpayer* (2014).

<sup>4</sup> RRA 98 § 4022(a) (codified at IRC § 7801(note)).

(E) areas in which revenue officers make frequent errors interpreting or applying the law;<sup>5</sup>  
 (F) the impact of recent legislation on complexity; and  
 (G) forms supplied by the Internal Revenue Service, including the time it takes for taxpayers to complete and review forms, the number of taxpayers who use each form, and how recent legislation has affected the time it takes to complete and review forms.

(2) Report.--The Commissioner shall not later than March 1 of each year report the results of the analysis conducted under paragraph (1) for the preceding year to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate. The report shall include any recommendations—

- (A) for reducing the complexity of the administration of Federal tax laws; and
- (B) for repeal or modification of any provision the Commissioner believes adds undue and unnecessary complexity to the administration of the Federal tax laws.

The Joint Committee on Taxation (JCT) explained the reason for the provision as follows:

The National Commission on Restructuring the IRS found a clear connection between the complexity of the Internal Revenue Code and the difficulty of tax law administration and taxpayer frustration. The Committee shares the concern that complexity is a serious problem with the Federal tax system. Complexity and frequent changes in the tax laws create burdens for both the IRS and taxpayers. Failure to address complexity may ultimately reduce voluntary compliance....

In some cases other policies, such as fairness, may outweigh concerns about complexity. Nevertheless, the Congress believed complexity of the tax system should be reduced whenever possible. Accordingly, the Congress believed ... that the tax-writing committees should receive periodic input from the IRS regarding areas of the law that cause problems for taxpayers. This input will be valuable in developing future legislation.<sup>6</sup>

In other words, Congress required the IRS to prepare an annual complexity report to highlight administrative and legislative changes that could reduce complexity and taxpayer frustration, while improving voluntary tax compliance. In addition, Congress suggested that the report include data that would aid Congress in crafting future legislation, and also enable Congress to determine that taxpayer protections were being followed (*e.g.*, by reporting where revenue officers make frequent errors).

The tax code is so complicated that it is probably difficult for most members of Congress to know how to simplify it without large-scale tax reform. However, large-scale tax reform does not happen very often. In the meantime, Congress might be able to make steady progress toward simplification if it had a data-driven road map to highlight the areas of complexity that are causing the most problems for taxpayers and the IRS. The IRS is uniquely positioned to provide Congress with that map, which is what it is required to do under RRA 98 § 4022(a).

5 The IRS's complexity reports identified the areas of the tax code where revenue agents (not revenue officers) made frequent errors, but the IRS no longer tracks tax law errors by code section. IRS response to TAS information request (June 5, 2014); IRS response to TAS fact check (Oct. 30, 2014) (clarifying the IRS could identify the code sections that were the source of frequent errors by reviewing a sample of cases where employees were deemed to have made tax law errors). In general, a revenue agent audits returns, whereas a revenue officer collects tax assessments.

6 Joint Committee on Taxation (JCT), JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 142–143 (Nov. 24, 1998).

## Tax Complexity Remains a Costly and Burdensome Problem for the IRS and Taxpayers Alike.

The complexity of the tax code, which has reached nearly four million words, continues to burden taxpayers and drain IRS resources.<sup>7</sup> According to a tally compiled by a leading publisher of tax information, there have been approximately 4,107 changes to the tax code since 2004, an average of more than one a day.<sup>8</sup> The number of IRC sections, subsections and cross-references increased by 46 percent (from 45,789 to 66,812) between 1991 and 2012.<sup>9</sup> Individual taxpayers find return preparation so overwhelming that about 94 percent of them used a preparer or tax software in processing year (PY) 2013.<sup>10</sup>



While preparers' fees vary widely, leading software packages often cost \$50 or more.<sup>11</sup> For 2007, IRS researchers estimated the monetary compliance burden of the median individual taxpayer (as measured by income) was \$258.<sup>12</sup>

It is difficult to quantify the additional costs to the government of increasing complexity. However, tax expenditures—rules that contribute to complexity by providing special tax benefits to certain taxpayers—are estimated at about \$1.4 trillion for fiscal year (FY) 2015.<sup>13</sup> Tax expenditures also increase IRS operating costs. As one example, for FY 2015 the Treasury Department requested about \$452 million for the IRS to administer the recently-enacted Affordable Care Act (ACA) program for one year.<sup>14</sup>

<sup>7</sup> See National Taxpayer Advocate 2012 Annual Report to Congress 3–23; National Taxpayer Advocate 2010 Annual Report to Congress 3–14; National Taxpayer Advocate 2008 Annual Report to Congress 3–14; see also *Hearing on Fundamental Tax Reform: Hearing Before the H. Comm. on Ways and Means*, 112th Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate).

<sup>8</sup> Email from Wolters Kluwer, Commerce Clearing House (CCH) to TAS (Sept. 29, 2014). This data does not include changes after September 29, 2014. 4,107 changes divided by 3,924 days (365 per year, plus four leap days, and 271 days in 2014) equals 1.05 changes per day.

<sup>9</sup> Rosemary Marcuss et. al., *Income Taxes and Compliance Costs: How are They Related?*, 66(4) N. Tax J. 833–54 (Dec. 2013).

<sup>10</sup> IRS Compliance Data Warehouse, Individual Returns Transaction File (Oct. 23, 2014).

<sup>11</sup> See, e.g., TurboTax, <https://turbotax.intuit.com/personal-taxes/compare.jsp> (last visited Oct. 1, 2014) (listing paid software prices ranging from \$39.99 to \$99.99, with all but “basic” priced at or above \$49.99).

<sup>12</sup> George Contos, John Guyton, Patrick Langetieg & Melissa Vigil, *Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity* 26 (presented at IRS Research Conference, June 2010).

<sup>13</sup> See Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2015*, Table 14–1, at [http://www.whitehouse.gov/omb/budget/Analytical\\_Perspectives/](http://www.whitehouse.gov/omb/budget/Analytical_Perspectives/). See also Staff of the JCT, 112th Cong., JCS-1–13, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017* (Feb. 1, 2013), at <https://www.jct.gov/publications.html?func=select&id=5> (listing about \$1.348 billion in tax expenditures).

<sup>14</sup> U.S. Department of Treasury, IRS, *The Budget in Brief* 20 (FY 2015), <http://www.irs.gov/uac/Strategic-Plan-and-Other-References>.

**While the IRS would need to spend some resources to produce the complexity report, these costs pale in comparison to the costs of complexity.**

IRS employees also require more training to administer complex provisions. Moreover, tax complexity can create ambiguities that lead to tax shelters and a loss of confidence by the public in the fairness of the tax code. As a result, complexity can lead to a reduction in voluntary tax compliance and revenue.

While the IRS would need to spend some resources to produce the complexity report, these costs pale in comparison to the costs of complexity.<sup>15</sup> Moreover, if they prompt a reduction in tax complexity, the reports might ultimately help the IRS do its job and reduce the cost of administering the tax code.

### According to the IRS, Reducing Complexity Furthers its Mission.

In its first complexity report, the IRS explained that complexity reduction furthers its mission, as follows:<sup>16</sup>

Aside from the requirements of RRA 98, the Service believes complexity must be addressed to effectively reduce taxpayer burden and improve taxpayer compliance, two key components of the Service's mission. Reducing complexity can reduce taxpayer burden by reducing the time and costs taxpayers face in meeting their tax obligations and increase compliance by making those same obligations easier to understand and meet. Reducing complexity also will make it easier for Service employees to do their jobs of providing services to taxpayers and enforcing the law....

Reducing complexity is important to the success of the Service. The mission of the Service is to '[P]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all' .... Reducing complexity will aid the Service in achieving all of its strategic goals. By reducing burden, the IRS better serves each taxpayer. By increasing compliance, IRS better serves all taxpayers. In making the Code less complex, the working environment for IRS employees becomes more productive.<sup>17</sup>

In other words, if the complexity report helps reduce complexity, it also helps the IRS achieve its mission.

### The IRS's Two Complexity Reports Helped Reduce Complexity, as Intended.

The process of drafting the complexity reports prompted the IRS to analyze all of the information suggested by Congress, and consult with stakeholders, such as tax preparation software vendors, practitioners,

<sup>15</sup> In response to a request for an estimate of the resources the IRS would need to produce the complexity report, the IRS's Research, Analysis and Statistics (RAS) function stated that "as an order of magnitude" a paper that examined the relationship between tax complexity and income tax compliance required about two full time employees working for about a year. IRS response to TAS information request (June 20, 2014). It later clarified that it had no information about the resources required by other functions to assist or coordinate this work. IRS response to TAS information request (Oct. 27, 2014). It noted that the previous complexity reports required considerable data extraction and verification from IRS units, and the issue identification, development and recommendations in the previous reports required significant coordination and collaboration with Treasury's Office of Tax Analysis. IRS response to TAS information request (Oct. 30, 2014).

<sup>16</sup> The IRS mission is to "[P]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." Internal Revenue Manual 1.1.1.1, *The IRS Mission* (Mar. 1, 2006).

<sup>17</sup> 2000 Complexity Report at 4.

academics, and IRS employees who interact with taxpayers. This activity prompted policymakers within the IRS to make forms and instructions easier to understand.<sup>18</sup>

In addition, Congress ultimately adopted many of the reports' recommendations. In the 2000 complexity report, which was only 40 pages (excluding Appendix), the IRS provided options for reducing complexity associated with three issues: filing definitions, the individual Alternative Minimum Tax (AMT), and estimated taxes.<sup>19</sup> Other stakeholders (such as the National Taxpayer Advocate) made similar and more detailed proposals, and Congress ultimately adopted at least one of the IRS's recommendations in each of those areas:<sup>20</sup>

- Creating a uniform definition of a “qualifying child;”<sup>21</sup>
- Indexing the individual AMT exemption for inflation;<sup>22</sup> and
- Keeping the estimated tax safe harbor threshold constant.<sup>23</sup>

Similarly, in the 2002 report, which was still only 52 pages (excluding Appendix) the IRS highlighted options for reducing complexity associated with three more issues: personal credits, deductions and exemptions, and capital gains.<sup>24</sup> As with the 2000 report, Congress ultimately enacted at least one of the IRS's suggestions in each of those areas:

- Creating a uniform definition of a “qualifying child” for purposes of personal credits (as noted above);
- Coordinating the personal exemption and itemized deduction phase-out ranges;<sup>25</sup> and
- Reducing the number of capital gains rates.<sup>26</sup>

Given the seeming success of these relatively short reports that tackled only three issues each, the tax system would likely be simpler if the IRS had not discontinued them. According to the IRS, taxpayers have the *right to be informed* (e.g., know and understand what they need to do to comply), *to quality service* (e.g., to receive clear and easily understandable communications from the IRS), and *to a fair and*

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<sup>18</sup> *Id.* at 11.

<sup>19</sup> 2000 Complexity Report at 1–2.

<sup>20</sup> Others may have been adopted or included in bills, but the IRS was unable to identify any legislative activity associated with these particular recommendations. IRS response to TAS information request (July 15, 2014).

<sup>21</sup> Working Families Tax Relief Act of 2004, Pub. L. No. 108–311, § 201, 118 Stat. 1166, 1169–1175 (2004) (enacting uniform definition of a qualifying child). The National Taxpayer Advocate and other stakeholders, including the American Bar Association (ABA) and the American Institute of Certified Public Accountants (AICPA) and the Tax Executives Institute (TEI), made similar and more comprehensive recommendations. See, e.g., National Taxpayer Advocate 2001 Annual Report to Congress 78–100; ABA/AICPA/TEI Tax Simplification Recommendations (Sept. 13, 2002) (Attachment A).

<sup>22</sup> The American Taxpayer Relief Act of 2012 (ATRA), Pub. L. No. 112–240, 126 Stat. 2317 (Jan. 2, 2013) (indexing the AMT exemption amount for inflation). The National Taxpayer Advocate and other stakeholders made similar recommendations. See, e.g., National Taxpayer Advocate 2001 Annual Report to Congress 82–100.

<sup>23</sup> The National Taxpayer Advocate had also observed that fluctuation of the estimated tax penalty threshold was a problem requiring a legislative solution. See, e.g., National Taxpayer Advocate 2001 Annual Report to Congress 256. The threshold has remained at 110 percent of the tax shown on the prior year return for about the last ten years. See IRC § 6654(d)(1)(C)(i).

<sup>24</sup> 2002 Complexity Report at 9.

<sup>25</sup> ATRA, Pub. L. No. 112–240, Title I, § 101(b)(2), 126 Stat. 2313, 2317 (Jan. 2, 2013) (codified at IRC §§ 68(b) and 151(d)(3)) (modifying the personal exemption phase-out (PEP) threshold amounts to be the same as those applicable to the limitation on itemized deductions (called “Pease”), as recommended).

<sup>26</sup> See The Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108–27, Title III, § 301, 117 Stat. 752, 758 (May 28, 2003) (amending IRC § 1(h) and 55(b) to eliminate two capital gains rates for property held for five years or more).

*just tax system.*<sup>27</sup> Thus, if these reports ultimately improved tax law clarity, administrability, and fairness, they would promote these fundamental taxpayer rights.

Moreover, by issuing complexity reports, the IRS could show taxpayers that it understands the burden the tax laws impose on them, and that it is not always the cause of the problem—sometimes the law itself is the problem. Thus, regular complexity reports could also help to restore and maintain taxpayers' faith in the fairness of the tax system.

## CONCLUSION

**...Congress might be able to make steady progress toward simplification if it had a data-driven road map to highlight the areas of complexity that are causing the most problems for taxpayers and the IRS.**

The complexity reports, which are typically relatively short, addressing only three issues each, provide a road map for stakeholders to address tax law complexity. This roadmap could help Congress improve tax law clarity, administrability, and fairness, thereby reducing burden and promoting fundamental taxpayer rights. Moreover, the reports could encourage the IRS to track how its employees are applying and observing taxpayer protections, specifically in the collection area.

Because complexity affects different taxpayers in different ways, the complexity reports could address the complexity facing different taxpayer segments. For example, over a rolling five-year period the IRS could issue one report addressing complexity faced by each of five different taxpayer groups, such as domestic individuals, tax exempt and government entities, international individuals and businesses, small business and self-employed taxpayers, and large businesses. In the sixth year, the IRS could revisit the complexity still facing the taxpayers discussed in the first report. If structured this way, the IRS's complexity reports are more likely to help Congress and other stakeholders address complexity faced by taxpayers throughout the tax system.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Analyze and report to Congress each year on the sources of complexity in tax administration and on ways to reduce it, as required by law.
2. Issue a report addressing the complexity faced by a different taxpayer segment each year over a rolling multi-year period so that these reports address the complexity faced by taxpayers throughout the tax system.
3. Include in the complexity report all of the data suggested by Congress, including areas where employees make frequent errors interpreting or applying the law (*e.g.*, the errors collection employees make in applying taxpayer protection provisions).

<sup>27</sup> See IRS, Pub. 1, *Your Rights as a Taxpayer* (2014).

**MSP  
#10****COMPLEXITY: The IRS Has No Process to Ensure Front-Line Technical Experts Discuss Legislation with the Tax Writing Committees, as Requested by Congress****RESPONSIBLE OFFICIALS**

John A. Koskinen, Commissioner of Internal Revenue  
Terry Lemons, Chief, Communications and Liaison

**DEFINITION OF PROBLEM**

Pursuant to the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), the tax-writing committees in Congress should hear from “front-line technical experts” at the IRS with respect to the “administrability” of pending amendments to the tax code.<sup>1</sup> However, the IRS has not established a process to encourage such discussions. Congress is more likely to enact tax laws that are simpler, more taxpayer-focused, and easier for taxpayers to comply with and for the IRS to administer if it receives current and relevant information from front-line technical experts who communicate with taxpayers on a regular basis. If such information empowered Congress to write tax laws that were more fair and easier to understand and administer, it would also promote the taxpayer rights to a *fair and just tax system* and to *quality service*.<sup>2</sup> The IRS should seize the opportunity to implement RRA 98’s recommendation to help Congress write better laws.

**ANALYSIS OF PROBLEM****Front-line Technical Experts at the IRS Are in a Good Position to Identify Ways to Improve Tax Administration.**

When developing recommendations to restructure and reform the IRS in 1997, the National Commission on Restructuring met privately with over 500 individuals, including senior-level and front-line IRS employees across the country.<sup>3</sup> The Commission apparently felt that front-line employees were uniquely qualified to offer good suggestions about how to improve tax administration because they could see how the law affected taxpayers one at a time.<sup>4</sup>

<sup>1</sup> RRA 98, Pub. L. No. 105-206, Title IV, § 4021, 112 Stat. 685, 785 (1998).

<sup>2</sup> See IRS, *Publication 1, Your Rights as a Taxpayer* (2014).

<sup>3</sup> The Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 5 (June 25, 1997). The National Commission included bipartisan representatives from Congress, the IRS, Treasury, and major external stakeholder groups. *Id.*

<sup>4</sup> Similarly, in his first four months on the job, the current IRS Commissioner visited 25 cities and met about 10,000 IRS employees because “leaders can learn a lot by talking with and listening to people on the front lines.” Email from IRS Commissioner to all IRS employees, *Listening to you in 25 cities and finding improvements* (Apr. 24, 2014); *IRS improvement recommendations* (Apr. 14, 2014). As a result of suggestions the Commissioner received from front-line employees, the IRS immediately initiated a wide range of reforms. *Id.*

## Congress Asked to Hear from Front-line Technical Experts About How Pending Tax Legislation Could Be Simpler and Easier to Administer.

The bipartisan report of the National Commission on Restructuring the IRS recommended that: “Congress hear an uncensored view of the administrability of all tax legislative proposals from the IRS,” just as it had done in formulating its own recommendations.<sup>5</sup> According to the House Report:

The Committee also believes that encouraging the participation of IRS personnel in drafting legislation will help to highlight administrative and complexity issues while legislation is being developed.<sup>6</sup>

Then-Representative Portman, a co-chairman of the Commission, further explained:

Despite claims of the Treasury Department to the contrary, *front-line* IRS employees consider the complexity of the Internal Revenue Code to be a major obstacle. The commission conducted a survey of almost 300 front-line IRS employees, and they overwhelmingly felt that the complexity of the Tax Code impedes their work.... The commission proposes to give the IRS a voice in the legislative process. In a very real sense, the IRS will serve as an advocate for Tax Code simplicity.<sup>7</sup>

Congress refined the proposal and asked to hear directly from “front-line technical experts” at the IRS. Section 4021 of RRA 98 provides:<sup>8</sup>

It is the sense of the Congress that the Internal Revenue Service should provide Congress with an independent view of tax administration, and that during the legislative process, the tax writing committees of Congress should hear from front-line technical experts at the Internal Revenue Service with respect to the administrability of pending amendments to the Internal Revenue Code of 1986.

By discussing proposals with “front-line” employees who, by definition, regularly interact with taxpayers, Congress could get a sense of how proposals might affect such interactions. If the employees were also “technical experts,” they would be more likely to understand how changes to the law might affect these contacts and other IRS procedures.

In addition, if the IRS could facilitate more uncensored, unfiltered group discussions between members of Congress and their staffs and front-line technical experts in various areas of tax administration on an ongoing basis, Congress would gain a better foundational understanding of tax administration.<sup>9</sup> Congress might also better understand the challenges facing employees charged with administering an almost impossibly complex tax code, and be less likely to vilify them. Thus, RRA 98 provided the IRS with an opportunity to open this important dialogue, which could help Congress draft better laws.

<sup>5</sup> The Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* § 6 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>.

<sup>6</sup> H.R. Rept. 105-364 at 86-67 (1997).

<sup>7</sup> 105 Cong. Rec. E1605 (Aug. 1, 1997) (statement of Cong. Portman) (emphasis added). See also 105 Cong. Rec. S4187 (May 4, 1998) (statement of Sen. Johnson) (“front-line IRS technical experts should be heard during congressional consideration of tax legislation in an effort to avoid additional complexity to the Tax Code.”).

<sup>8</sup> RRA 98, Pub. L. No. 105-206, Title IV, § 4021, 112 Stat. 685, 785 (1998).

<sup>9</sup> The IRS Commissioner could still select the specific front-line technical experts to represent the IRS in discussing issues with members of Congress and their staff, just like the National Taxpayer Advocate selects Local Taxpayer Advocates who sometimes meet with them. See, e.g., Internal Revenue Manual (IRM) 13.1.8, *Congressional Affairs Program* (Feb. 27, 2012).

Such laws would probably be more fair or at least easier to understand and administer. If so, then establishing a process to facilitate discussions between Congress and front-line technical experts would also promote the taxpayer rights to a *fair and just tax system* and to *quality service*.<sup>10</sup>

### The IRS Does Not Have a Process to Ensure Front-line Technical Experts Offer Comments on Pending Legislation or Communicate with Congress.

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**When legislation is crafted with smooth tax administration in mind, and is informed by discussions with the front-line employees who may have to explain it to taxpayers, it is likely to be simpler, less burdensome, more taxpayer-focused, and easier to administer.**

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Following enactment of RRA 98, the IRS did not implement section 4021.<sup>11</sup> When the IRS receives a request to comment on pending legislation, the Office of Legislative Affairs generally seeks the views of the business operating divisions (BODs).<sup>12</sup> It does not specifically seek the views of front-line technical experts.<sup>13</sup> Nor does it ask to bring them before Congress or even identify them for Congress.

According to the IRS, Legislative Affairs “shares these requests with the appropriate [Business Operating Divisions] BOD(s) on a case-by-case basis. The BOD(s) will solicit comments from ‘front line technical experts’ as needed, again on a case-by-case basis.” The IRS could not identify any front-line technical expert(s) who had ever been consulted.<sup>14</sup> Thus, the IRS has no process to ensure that front-line technical experts are consulted, given the opportunity to discuss the administrability of pending legislation with the tax-writing committees, or even identified for these committees or their staff either on a regular basis or in connection with specific pending legislation.

### The IRS Could Simply Expand Existing Procedures to Ensure Congress Can Hear From Front-line Technical Experts.

When Legislative Affairs identifies pending tax legislation that Congress would like to discuss, it could simply ask the BODs to identify front-line technical experts who could address administrability issues, rather than waiting for Congress to ask to hear from them.<sup>15</sup> Once Legislative Affairs identifies these experts, it could suggest that Congress convene a group discussion with them. Even if Congress declines such an offer, once the IRS identifies the front-line technical experts, Congress may be more likely to open a dialogue with them about tax administration. Such communications can be critically important. When legislation is crafted with smooth tax administration in mind, and is informed by discussions with

<sup>10</sup> See IRS, *Publication 1, Your Rights as a Taxpayer* (2014).

<sup>11</sup> According to an IRS database that tracks the steps it takes to implement various provisions, the IRS’s only activity in response to RRA 98 § 4021 was to “[A]dvide JCT and Treasury that Legislative Affairs is the contact point” on December 28, 1998. IRS, *Enacted Law Report – Actions*, AT-2009-13387 (May 28, 2014). When asked about what other actions it took to implement this provision, the IRS did not identify any. IRS response to TAS information request (July 15, 2014).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* The IRS later clarified that it does not maintain a list of these communications and did not create one in response to TAS’s information request. IRS response to TAS information request (Nov. 20, 2014). It asserted that technical experts may be consulted and described a recent situation in which a legislative liaison solicited comments on pending legislation from a Revenue Officer Technical Advisor (RATA) in response to a request from Congress. *Id.* However, the response did not indicate that the RATA was a front-line employee. *Id.*

<sup>15</sup> There would be no need to change the IRS’s existing policy of authorizing only certain employees to comment on legislation. See, e.g., IRM 11.5.2.5, *Legal and Policy Considerations* (Sept. 1, 2014) (“Comments on legislation may only be made with the approval of the Commissioner or designee, and must be limited to the administrative aspects of the legislation”); Policy Statement 11-87 (Formerly P-1-24) (Aug. 12, 1976). Currently, only the Director of Legislative Affairs has been delegated this authority. IRS response to TAS information request (July 15, 2014). This restriction is inapplicable to TAS, given its statutory mandate, and the Governmental Liaison function. IRM 11.5.2.5, *Legal and Policy Considerations* (Sept. 1, 2014).

the front-line employees who may have to explain it to taxpayers, it is likely to be simpler, less burdensome, more taxpayer-focused, and easier to administer.

## CONCLUSION

If the IRS establishes a process by which it automatically identifies specific front-line technical experts who can discuss the administrability of pending (or existing) legislation directly with the tax-writing committees, then members of Congress and their staff are more likely to consult with these experts before finalizing legislation, and that legislation is likely to be simpler, easier for taxpayers to understand and for IRS employees to administer. Such laws would better effectuate the taxpayer rights to *a fair and just tax system and quality service*.<sup>16</sup>

## RECOMMENDATION

The National Taxpayer Advocate recommends the IRS establish a process to automatically provide the tax writing committee staff with a list of specific front-line technical experts who can discuss the administrability of pending (or existing) legislation directly with the tax-writing committees, as provided by RRA 98, without waiting for a specific request from the tax-writing committees.

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16 See IRS, *Publication 1, Your Rights as a Taxpayer* (2014).

**MSP  
#11**

## WORKLOAD SELECTION: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy

### RESPONSIBLE OFFICIALS

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### DEFINITION OF PROBLEM

The IRS generally strives to audit only taxpayers it believes are not in compliance with the tax laws.<sup>1</sup> At the same time, it cannot audit every return it believes contains an error. Congressional bodies have recommended that the IRS select returns to audit on the basis of research, with the goal of not only correcting errors, but also enhancing *future* tax compliance.<sup>2</sup> For tax administration today, the research required to carry out this recommendation is broader than just numbers derived from tax returns, and a successful audit strategy is broader than just the audit.

IRS audit selection processes should support the Taxpayer Bill of Rights (TBOR) by comprising part of an overall compliance strategy—one that will drive future compliance, not only by the taxpayer under audit, but also by other taxpayers in similar situations.<sup>3</sup> Because a compliance strategy based on applied and behavioral research allows the IRS to adopt the least intrusive enforcement measure necessary in light of known taxpayer behaviors and motivators, it protects taxpayers' *right to privacy*. Because such a strategy reaches noncompliant taxpayers and addresses their outstanding tax liabilities, it promotes taxpayers' *right to finality*. Using research about taxpayers' characteristics and behaviors to design a compliance strategy that takes into account their facts and circumstances promotes the right to a *fair and just tax system*.

1 See, e.g., Internal Revenue Manual (IRM) 4.22.1.5, *Benefits of NRP* [National Research Program] (Oct. 1, 2008), noting "The IRS should audit those returns most likely to have errors. Various methods are used to identify errors with the most common method using Discriminant Function (DIF) formulas [discussed below] to select returns for examination."

2 See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 26-7 (1997). See also H.R. 2292, 105th Cong. (1998) and S. 1096, 105th Cong. (1997) that culminated in the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998), referencing the need for targeted compliance and enforcement initiatives, in addition to taxpayer service and education.

3 Taxpayer Bill of Rights (TBOR), available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.

In order to succeed, however, such a strategy must be based on various types of data—numeric, return-based,<sup>4</sup> geographic,<sup>5</sup> demographic,<sup>6</sup> socio-demographic,<sup>7</sup> and psychographic<sup>8</sup>—as well as the impact of tax morale and the impact of perceptions of fairness on tax compliance.<sup>9</sup> It should incorporate not only audits but also education and outreach that leverage partner relationships and it should include an effective communication strategy.<sup>10</sup>

The IRS has not integrated this type of research into an overarching compliance strategy, essentially because it perceives doing so as too difficult.<sup>11</sup> The IRS claims to recognize the value of a holistic approach to encouraging compliance, but it actually intends to continue to base its compliance initiatives primarily, if not exclusively, on tax data.<sup>12</sup> Without a more expansive definition of research to drive its initiatives, and without using pilots to test and evaluate initiatives before implementing them, IRS compliance initiatives will not drive future compliance. Audit selection will continue to be only a tactic rather than part of an overall compliance strategy.

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- 4 As discussed below, the IRS generally selects returns for audit on the basis of return characteristics or numeric targets.
  - 5 See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*) (discussing TAS's survey of taxpayers at random in certain communities which revealed, among other things, that taxpayers with low compliance levels clustered in geographic communities, while those with high compliance levels were more dispersed).
  - 6 See, e.g., Russell Research, *Findings From The TAS Benchmark Awareness & Usage Study* (2002), report prepared for the IRS and Cossette Post, showing that the underserved taxpayer audience divided into seven segments based upon demographics, behavior, and personal situations: Surviving Spouses; Struggling Young Families; Unmarried Low Income; Affluent Families; Empty Nesters; Stable Middle Class; and Income Secretive.
  - 7 See, e.g., Russell Research, *Report Of Findings From 2007 Market Research For The Taxpayer Advocate Service* (2007), report prepared for TAS, updating its 2002 report and also segmenting taxpayers on a socio-demographic basis: Affluent Families; Upper-Middle Unmarrieds; Middle-Income Families; Low-Income Singles; Low-Income Families; and Financially Distressed.
  - 8 See, e.g., Russell Research, *Report Of Findings From 2007 Market Research For The Taxpayer Advocate Service* (2007), report prepared for TAS, updating its 2002 report and identifying an additional segment of underserved taxpayers based on attitudes toward the IRS and TAS: Rejectors; Distrusters; Indifferents; Acceptors; Doubters; and Believers.
  - 9 See National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 138-80 (Research Study: Marjorie Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*) noting: “[t]raditional methods of enforcement through audit and penalties explain only a small fraction of voluntary tax compliance. Theorists and researchers attribute the vast majority of compliance to what they loosely describe as internal motivations or ‘tax morale.’”
  - 10 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 27 (1997), noting that “[t]axpayer education is core to voluntary compliance. There are many facets to taxpayer education, including outreach programs, post office and library programs, small business education programs, programs at post and secondary educational institutions, practitioner education, pro bono tax clinics, emergency assistance, media information programs, volunteer tax assistance, and the distribution of tax forms and publications. Professional educators and adult education techniques facilitate greater compliance by emphasizing education over enforcement. If properly designed, taxpayer education and outreach can be a proactive method of enhancing compliance.”
  - 11 See, e.g., GAO 13-151, *TAX GAP IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* 26 (Dec. 2012).
  - 12 Compare Internal Revenue Service FY 2015 Budget Request, Congressional Budget Submission 187, discussed below, available at [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY\\_2015\\_CJ\\_Submission.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY_2015_CJ_Submission.pdf) with W&I and SB/SE Compliance ConOps (Concept of Operations) v2.2, July 31, 2014, on file with the National Taxpayer Advocate. The ConOps, discussed below, indicates that W&I and SB/SE will attempt to use third-party data and will engage in limited pre-filing initiatives but the ConOps does not envision a comprehensive strategy based on research.

## ANALYSIS OF PROBLEM

### Background

#### *A Congressional Commission Directed the IRS to Adopt Audit Selection Processes that Would Prevent Noncompliance.*

The National Commission for Restructuring the IRS, noting that “[t]he IRS constantly struggles to ensure compliance with the tax law in a system that depends on citizens to voluntarily calculate and pay their taxes,” urged the IRS to select returns for audit on the basis of more than just discriminant index function formulas, or DIF scores.<sup>13</sup> Rather, the IRS was to use analytic tools to increase effectiveness of audit selection—and to “emphasiz[e] research to prevent noncompliance before it occurs.”<sup>14</sup>

Scholars have echoed the Commission’s recommendation, and pointed out the relevance of research in fields such as behavioral economics and psychology, cognitive psychology, and social psychology in understanding the dynamics of taxpayer compliance.<sup>15</sup> As one writer explained:

Research shows that tax compliance is affected by (social and personal) norms such as those regarding procedural justice, trust, belief in the legitimacy of the government, reciprocity, altruism, and identification with the group. Cognitive processes, such as prospect theory, also influence an individual’s reaction to tax issues. Studies also indicate that certain demographic factors such as age, gender and education correlate with tax morale.<sup>16</sup>

Similarly, the Senate Appropriations Committee has included the following language (or language that is almost identical) in its IRS appropriations bills for the past four fiscal years:

The Committee remains concerned that absent a better understanding of the current sources of noncompliance, efforts to improve compliance may be hampered, misdirected, and difficult to measure. To gain meaningful insights into taxpayer behavior, the Committee strongly supports the work of the National Taxpayer Advocate and the IRS Office of Research to examine factors that influence taxpayer compliance behavior, including how and the extent to which

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13 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 26-7 (1997). IRM 4.19.11.1.5.1, *How DIF Works*, (Nov. 9, 2007), provides: “(1) DIF is a mathematical technique used to score income tax returns as to examination potential. (2) Under this concept, mathematical formulas are developed based on available TCMP data and are programmed into the computer. (3) The computer identifies returns by assigning weights to certain basic return characteristics. (4) These weights are added together to obtain a systemic composite score for each return processed. (5) This score is used to systematically rank the returns in numerical sequence (highest to lowest). (6) Generally, the higher the score the greater is the probability of significant tax change. (7) The highest scored returns are made available to Examination upon request. (8) DIF mathematical formulas are confidential in nature and are distributed to IRS personnel only on a need-to-know basis. (9) DIF formulas are for official use only and will not be discussed with unauthorized personnel. (10) Furthermore, the DIF score assigned to a return should not be disclosed. (11) Many returns, both individual and corporate, that are examined each year are DIF returns.”

14 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 26 (1997).

15 See National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 138-80 (Research Study: Marjorie Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

16 National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 138 (Research Study: Marjorie Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

various factors influence such behavior, and how the establishment of a cognitive learning and applied research laboratory might facilitate continued evaluation.<sup>17</sup>

### *The IRS Selects Returns for Audit Without an Overall Compliance Strategy and Without Considering Audits' Effects on Future Compliance.*

The IRS selects examination work by taking into account one or more of the following:

- DIF scores indicating a high probability of noncompliance;<sup>18</sup>
- Scores assigned by or query results from other IRS systems that indicate a high probability of noncompliance or fraud;<sup>19</sup>
- A study or other analysis identifying “a group of individuals such as those within an occupation, industry, geographic area or specific economic activity or event” with compliance issues;<sup>20</sup>
- The anticipated amount of dollars to be assessed;<sup>21</sup>
- Anticipated no change-rates;<sup>22</sup>
- Emerging issues;<sup>23</sup>
- Referrals from the field;<sup>24</sup>
- Any requirement to examine a specific return;<sup>25</sup> and
- Special audit programs.<sup>26</sup>

17 S. REP. No. 113-80, at 25 (2013); S. REP. No. 112-177 (2012); S. REP. No. 112-79 (2011), S. REP. No. 111-238 (2010). The Senate Appropriations Committee has expressed its continued interest in this approach by including the same language in the draft of the FY 2015 appropriations bill it posted on its website. S. REP. No. 113-000, at 27 (2014), Financial Services and General Government Appropriations Bill, 2015, at 27, 113th Cong., (2014) (draft for use of the Committee and its staff only, in preparation for markup), available at <http://www.appropriations.senate.gov/sites/default/files/FSGG%20Report%20w%20Chart%2003REPT.PDF>.

18 See, e.g., IRM 4.19.11.1.4, *Sources of Returns for Classification*, (Nov. 9, 2007).

19 See, e.g., IRM 4.19.14.1, *Earned Income Tax Credit (EITC) Revenue Protection Strategy (RPS)*, (Nov. 25, 2011), noting “Exam receives the majority of its EITC work from the Dependent Data Base (DDb) and Electronic Fraud Detection System (EFDS).” The Tax Exempt and Government Entities (TE/GE) division uses software to analyze data from Forms 990, *Return of Organization Exempt From Income Tax*, to select some cases for examination. TE/GE response to TAS information request (Oct. 16, 2014).

20 See IRM 4.1.4.3.8, *Compliance Initiative Projects (CIP)*, (Oct. 24, 2006); TE/GE response to TAS information request (Oct. 16, 2014) (describing TE/GE’s past use of questionnaires, e.g., for group exemption parents to “perform triage” in selecting cases for audit).

21 See, e.g., IRM 4.1.5.1.2, *Discriminant Function (DIF) System*, (Aug. 24, 2012) noting that “[m]any returns...that are examined each year are above the DIF cutoff score. Therefore, a significant portion of the classifiers’ work will be to screen DIF returns,” and IRM 4.1.5.1.5.1.1, *Materiality – Significance of the Issue*, (Oct. 24, 2006), providing that “[c]lassifiers should compare the potential benefits to be derived from examining a return to the resources required to perform the examination. Although you may identify some potentially good issues on the return, if they would not yield a significant adjustment, the return should be accepted as filed.”

22 See, e.g., IRM 4.1.5.1.5.2, *Review of Performance*, (Aug. 24, 2012), noting that classifiers will be evaluated on whether their “[a]ccepted returns have little or no examination potential or if examined would probably result in no change cases.”

23 See, e.g., IRM 4.40.2.1.4.1, *Industry Knowledge and Expertise*, (Mar. 1, 2002), describing how Examination Technical Advisors “identify novel and/or controversial tax treatment of transactions” to assist in planning and developing audits of emerging issues.

24 See, e.g., IRM 4.23.3.1, *Overview*, (Jan. 25, 2011), noting that “The Employment Tax Examination Program is a lead-driven program.”

25 See, e.g., IRM 4.1.24.6.1.1, *Joint Committee Claims*, (Aug. 1, 2007) noting that “[a]ny tentative carryback allowance (form 1139) or claim (1120X), in excess of \$2,000,000 to the same taxpayer must be selected for examination. These claims meet Joint Committee criteria.”

26 See, e.g., 4.1.21.2.2.1, *Front End Loaded Planning Time*, (Aug. 1, 2007), noting that for some matters, such as cases with abusive tax avoidance transactions and coordinated industry cases, LB& examination resources “are allocated, after consideration of work in process, prior to committing resources available to other compliance initiatives.”

None of these approaches involves considering the extent to which an audit plan would prevent non-audited taxpayers, or even the audited ones, from becoming or remaining noncompliant in the future, *i.e.*, audits' indirect effects. The IRS also selects returns to maintain audit "coverage ratios"—examining a given percentage of various categories of returns.<sup>27</sup> These audits may affect future noncompliance by influencing taxpayers' perceived threat of being audited, but the IRS does not establish coverage ratios on the basis of research about taxpayer behavior, or with the objective of maximizing these indirect effects.<sup>28</sup> Moreover, because none of these methods are based on applied or behavioral research that would allow the IRS to take into account taxpayers' facts and circumstances or calibrate its actions to be as least intrusive as possible, taxpayers' *right to a fair and just tax system* and *right to privacy* are impaired.<sup>29</sup>

The IRS does not attempt to measure, *post hoc*, the effect of an audit initiative on noncompliance. Its measures relate only to whether an audited return was in fact noncompliant and employees' effectiveness in carrying out the audit.<sup>30</sup> Because the IRS does not know whether its audits help taxpayers to avoid future audits, perhaps for the very same misstep, it cannot tell whether audits enhance taxpayers' *right to finality*. The IRS has been forthright about the shortcomings of its approach to allocating examination resources.<sup>31</sup>

### *Despite Language in its FY 2015 Budget Submission to Congress, the IRS Does Not Integrate Data About Taxpayer Behavior Into a Compliance Strategy.*

The IRS reported to Congress, in its FY 2015 budget request, that its Market Segmentation Compliance Program (MSCP):

seeks to establish a data-driven decision matrix for implementing approaches that work for the individual taxpayer. By integrating market segmentation with internal IRS data and certain external data, the IRS can incorporate taxpayer perspectives, compliance behavior, and attitudes to design and tailor compliance treatments so that the right treatment is delivered to the right taxpayer at the right time. RAS [IRS Research, Analysis and Statistics] is currently

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27 See Policy Statement P-4-21, 1.2.13.1.10 (June 1, 1974), noting the need to "select[] sufficient returns of all classes of returns in order to assure all taxpayers of equitable consideration" and IRS Statistics of Income Data Book Tables 9a, 9b, 10-13, available at <http://www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book> for examples of various groups for which the IRS calculates audit coverage.

28 GAO 14-605, *IRS 2015 BUDGET Long-Term Strategy and Return on Investment Data Needed to Better Manage Budget Uncertainty and Set Priorities* 24 (June 2014), available at <http://gao.gov/products/GAO-14-605>. The IRS first attempted to quantify the indirect effects of audits on compliance levels in 1996. See Alan H. Plumley, *The Determinants of Individual Income Tax Compliance: Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness*, Publication 1916 (Rev. 8-96).

29 The TBOR *right to a fair and just tax system* includes the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. The *right to privacy* includes the right to expect that any IRS inquiry, examination, or enforcement action will be no more intrusive than necessary. TBOR, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.

30 These measures include: Cases started; Cases closed; Time per case; Number of fraud referrals; Dollars per hour; Dollars per return; Total dollars assessed; Percentage of agreed cases; Amount of revenue protected; No change rate; Cycle time; Accuracy; Timeliness; and Professionalism. SB/SE response to TAS information request (July 17, 2014) and SB/SE Operating Division Fact Check (Dec. 19, 2014).

31 Internal Revenue Service FY 2015 Budget Request, Congressional Budget Submission 193, available at [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY\\_2015\\_CJ\\_Submission.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY_2015_CJ_Submission.pdf)., noting "Net revenue is maximized only when resources are allocated according to marginal direct and indirect return on investment [ROI], but those ratios are much more challenging to estimate than the average ROI shown here." Similarly, the IRS responded to a 2012 GAO recommendation that "While we agree with your recommendation in principle, developing meaningful estimates of marginal and indirect effects remains a challenge as it will require improved data systems and new estimation techniques. These will take years to implement, not months." GAO 13-151, *TAX GAP IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* 26 (Dec. 2012).

working on an effort with enforcement programs, *i.e.*, Examinations, Collections, Offer in Compromise (OIC), and Underreporter, to influence and improve taxpayer compliance.<sup>32</sup>

The IRS went on to note:

Social science research reveals that the traditional deterrence theory, fear of detection and/or punishment, contributes a portion to actual compliance rates. Recent studies indicate that social norms, personal values, and attitudes may have a large impact on compliance decisions. Market segmentation approaches—behavioral, psychographic, and attitudinal, are widely used in commercial marketing to develop, design, and position products and services towards the right customer base. The knowledge gained from both social science and marketing research can assist the IRS with appropriate identification and alignment to the proper taxpayer.

The MSCP is helping the IRS improve its methods of communication with taxpayers. For example, response rates from taxpayers improved after several notices were tailored for specific taxpayer segments.<sup>33</sup>

Despite these representations to Congress, the IRS informed TAS that it is not actually pursuing the MSCP. Instead, “[t]he market segmentation approach is still in a conceptual phase. It is being considered as part of the Compliance ConOps. At this time no decision has been made regarding the implementation of a market segmentation approach to compliance.”<sup>34</sup> In other words, the IRS continues to approach compliance, including audit selection, as it always has, largely on the basis of return characteristics. Like other compliance initiatives the IRS has launched in the past that “seemed to represent a fundamental change in the way the IRS thought about its mission,” the MSCP risks “not materializ[ing] into any fundamental change in the way that IRS [does] business.”<sup>35</sup>

### *The IRS Lags Years Behind Other Jurisdictions in Providing Taxpayer Services Designed to Enhance Compliance.*

In 2014, the IRS formed the Compliance Capabilities Initiative, led by senior leaders across various IRS divisions, which “seeks to enhance taxpayer experience and deliver transformative improvements to tax administration by 2019.”<sup>36</sup>

When implemented, the Initiative is expected to allow the IRS to better interact with taxpayers throughout their compliance lifetimes by taking into consideration individual characteristics. For example, a taxpayer who historically files returns and pays taxes timely might receive pre-filing notification of tax law changes that might apply to that taxpayer (*e.g.*, provisions of the Affordable Care Act). The taxpayer might also receive information that reflects transitions through life stages (*e.g.*, as retirement approaches). If this compliant taxpayer is audited (resulting in no change to his or her tax liability), the IRS could adjust its audit selection processes so taxpayers like this one are not also selected for audit in later years or later in the filing season.

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32 Internal Revenue Service FY 2015 Budget Request, Congressional Budget Submission 187, available at [http://cio.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY\\_2015\\_CJ\\_Submission.pdf](http://cio.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY_2015_CJ_Submission.pdf).

33 *Id.*

34 SB/SE response to TAS information request (Sept. 15, 2014). The referenced Compliance ConOps, or Compliance Concept of Operations, is the IRS’s vision of how it will implement its compliance programs. According to the Compliance ConOps draft, the IRS’s insight into taxpayer compliance will be based on its analysis of tax returns. W&I and SB/SE Compliance ConOps v2.2, July 31, 2014, on file with the National Taxpayer Advocate.

35 Adrienne Poulton, *Addressing Noncompliance at the Internal Revenue Service* 8, submitted to the National Commission on Restructuring the Internal Revenue Service, describing the evolution and demise of Compliance 2000, on file with TAS.

36 Compliance Capabilities Initiative, Draft Blueprint for the Vision 1 (June 19, 2014), on file with the National Taxpayer Advocate.

A taxpayer who is newly employed, with no history of return filing, might be treated differently. To ensure that this first-time filer does not become a nonfiler, the IRS might work with employers or other external partners to ensure they provide this “new hire” with information about filing and payment obligations, including a link to a withholding calculator. When the IRS receives third-party information returns for this taxpayer, it might send the taxpayer information about the requirement to file a return. If this taxpayer does not file by April 15, the IRS would intervene quickly and resolve the taxpayer’s case within the current tax year. The IRS would then remind this taxpayer to file in the following year.<sup>37</sup>

These initiatives are appropriate uses of tax return data. Chile is one jurisdiction that has had this type of taxpayer service in place for over a decade as a means of encouraging compliance.<sup>38</sup> Since the early 2000’s, Chilean taxpayers have been able to access their online tax accounts, view any third party reporting of their income or income tax withholding, and pay their income, value-added (VAT), and real estate taxes online.<sup>39</sup> Since 2008, business taxpayers in Chile have been able to create personal pages through the government website and receive information and published guidance pertinent to their specific lines of businesses, in real time as it is published.<sup>40</sup> The Chilean tax authority also provides taxpayer education through its Tax Education Portal, which includes material aimed at children and classroom tools teachers can use to explain basic tax concepts.<sup>41</sup>

### *The IRS Does Not Incorporate Existing Relevant Research Into its Audit Selection Processes.*

In 2013, the IRS developed the Individual Reporting Compliance Model (IRCM).<sup>42</sup> In a simulation experiment, the model estimated the direct and indirect effects of taxpayer audits.<sup>43</sup> However, the IRS does not view these research results as directly translatable into the development of audit selection formulas or methods, in part because “the state of knowledge about taxpayer behavior is limited.”<sup>44</sup> Moreover, according to the IRS, “[m]any of the variables (‘characteristics’ or ‘behaviors’) that would be associated with indirect effects would be taxpayer personal characteristics considered inappropriate to use for selecting particular returns for audit—assuming that data about these characteristics were actually available.”<sup>45</sup>

The National Taxpayer Advocate would be the first to condemn “audit profiling” on the basis of taxpayers’ unrelated personal characteristics, as opposed to audit selection based on research about what drives taxpayer compliance. However, the IRS’s obligation to respect taxpayers’ rights does not excuse it from developing compliance initiatives based on unbiased, applied research about taxpayer behavior.

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37 The IRS would tailor its approach to other groups of taxpayers (e.g., victims of identity theft, or those who file returns but do not fully pay the tax) along these lines. Compliance Capabilities Initiative, Draft Blueprint for the Vision (June 19, 2014), on file with the National Taxpayer Advocate.

38 See Caroline Musalem, Commissioner’s Special Advisor For International Affairs And Cooperation, Chilean Internal Revenue Service, *Successful practices in the use of electronic means to improve compliance: the Chilean example*, available at <http://cstest.s4tp.org/wp-content/uploads/2010/10/15-musalem.pdf>.

39 See *id.* at 3.

40 See *id.* at 8, *Successful practices in the use of electronic means to improve compliance: the Chilean example*, available at <http://cstest.s4tp.org/wp-content/uploads/2010/10/15-musalem.pdf>.

41 See [www.siieduca.cl](http://www.siieduca.cl).

42 Kim Michael Bloomquist, IRS Office of Research, *Incorporating Indirect Effects in Audit Case Selection: An Agent-Based Approach* (June 2013), available at <http://research.web.irs.gov/compliance.htm>.

43 Of four audit strategies analyzed, the strategy with the highest combined direct and indirect effect on voluntary reporting compliance was one with a relatively high coverage rate of business audit classes and a minimum coverage of nonbusiness audit classes.

44 Additionally, the IRCM is a prototype representing a particular geographic area and is not a nationwide model. SB/SE response to TAS information request (Sept. 15, 2014).

45 SB/SE response to TAS information request (Sept. 15, 2014).

Other research on the earned income tax credit provides insight about the causes of compliance and taxpayers' compliance behavior, and the National Taxpayer Advocate has made specific recommendations based in part on that research.<sup>46</sup> As part of a multi-year study to identify the major factors that drive taxpayer compliance, TAS has also recently researched the effects of audits on certain small business taxpayers' subsequent compliance.<sup>47</sup> The findings suggest that audits may minimally deter future noncompliance, on returns filed immediately after the audit, but this effect disappears within five years. Field and office audits may be more effective deterrents than correspondence audits, and audits that result in large assessments may be more effective in promoting future compliance. However, there may be a group of taxpayers for whom audits do not have a deterrent effect.<sup>48</sup> TAS is willing to work with the IRS to incorporate these research findings into an overall strategy.

***For Compliance Initiatives to Promote Future Compliance, They Must be Driven by Social Science Research and Tested Before Implementation.***

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**IRS audit selection processes should support the Taxpayer Bill of Rights (TBOR) by comprising part of an overall compliance strategy—one that will drive future compliance, not only by the taxpayer under audit, but also by other taxpayers in similar situations.**

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As discussed above, the IRS articulates its commitment to integrating research into its overall compliance strategy, and has advanced technology to do so, but is not actively seeking the data it needs.<sup>49</sup> Without the data social science research would yield, the IRS cannot consider return information in the light of other variables—such as whether a given population of taxpayers, taking into account its demographics and other factors, is likely to comply in the future in response to an audit or whether education and outreach would drive future compliance. The IRS's general approach to compliance will consist only of tactics and will not constitute a compliance strategy.

Other IRS initiatives have different hallmarks. For example, before launching the Payment Card Compliance Program, designed to address income under-reporting by small businesses, the IRS adopted a “multi-year test, learn and build” approach.<sup>50</sup> The approach allows the IRS to test its matching program on a sample of taxpayers and adjust its practices in the light of initial experience with the program.<sup>51</sup>

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46 Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 KAN. L. REV. 1145 (2003); *Internal Revenue Service Oversight: Hearing Before the H.R. Comm. on Appropriations Subcomm. on Financial Services and General Government*, 113th Cong. 42-47 (2014) (written testimony of Nina E. Olson, National Taxpayer Advocate), describing the IRS Tax Year 2006–2008 National Research Program Compliance Study (Feb. 12, 2014).

47 *Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Reports*, vol. 2, *infra*.

48 *Id.*

49 See, e.g., IRS Information Technology News, *CADE 2 & You: the implementation of the CADE 2 database* (Nov. 7, 2012) available at <http://mits.web.irs.gov/News/20121107HTLCADE2&You-DatabaseImplementation.htm>, describing the IRS's relational database, Customer Account Data Engine (CADE) 2 as “the most complex database in the world.”

50 Consolidated W&I and SB/SE response to TAS information request (Sept. 15, 2014) (providing IRS Office of Compliance Analytics Payment Card Program Pilot, *Preliminary Year 1 Results Update* slide 2 (June 29, 2014)).

51 See Jaime Arora, *SB/SE Payment Card Reporting Program Still In Pilot Stage*, 2013 TNT 215-6 (Nov. 6, 2013), quoting the IRS Small Business/Self-Employed Division Commissioner inviting practitioners to send him any “horror stories” they had from the program; Letter from Sam Graves, Chairman, Committee on Small Business, to Faris Fink, Commissioner, IRS Small Business/Self-Employed Division (Aug. 9, 2013), describing concerns with the IRS “soft notice” (letter advising taxpayers they may have underreported their gross receipts) (on file with TAS); SB/SE Office of Compliance Analytics, *Payment Card Case Management Tech Demo Phase II* (Sept. 17, 2014), on file with the National Taxpayer Advocate.

### ***Other Jurisdictions Have Adopted a More Comprehensive Approach to Tax Compliance.***

Practices of other tax authorities also provide useful insights, particularly with respect to the use of a broad approach to taxpayer characteristics and norms to identify the most effective compliance touch. For example, the United Kingdom's (UK) tax authority has an external research program, the Behavioural Evidence and Insight Team. In 2012, the team researched why small and medium sized businesses enter and operate in the hidden economy, identified six hidden economy "typologies," and provided insights about how to reach each group and advice on what messages to avoid for each group.<sup>52</sup> The team then presented four options for gathering additional information about participants in the hidden economy, such as surveys or samples.<sup>53</sup>

The UK's compliance strategy also includes "campaigns" directed at taxpayers in certain occupations where underreporting is known or suspected, with the objective of improving tax compliance generally and not just from evaders.<sup>54</sup> An electricians' campaign, for example, consisted of first surveying electricians about their views and attitudes about tax evasion. The electricians were then advised, through letters, radio spots,<sup>55</sup> trade media,<sup>56</sup> flyers,<sup>57</sup> and outdoor posters,<sup>58</sup> that they would be treated leniently if they came forward and disclosed previously unreported income. The disclosure period lasted from February through August of 2012, after which the tax authority targeted for audit those whom it suspected should have disclosed but who did not.<sup>59</sup> The campaign concluded with another survey to measure electricians' changes in attitudes towards tax evasion as a result of the campaign.

The UK also seeks to prevent tax noncompliance in ways that involve the tax authority only indirectly. For example, the Security Industry Authority (SIA), the organization responsible for regulating the private security industry in the UK, carries out a risk assessment of businesses that apply for a license.<sup>60</sup> The evaluation, intended "[t]o assess the overall risk your business represents to our regulatory objectives," includes tax compliance as a component of a separate risk category, "financial probity."<sup>61</sup> Once approved,

52 HM Revenue & Customs, Business Customer & Strategy, Behavioural Evidence & Insight Team *Understanding key problems for SMEs: Hidden Economy Levers, Ghosts and Moonlighters, Identifying effective levers to reduce entrants into, and encourage SMEs out of the Hidden Economy* (May 2012), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/344827/report208.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344827/report208.pdf).

53 HM Revenue & Customs, Business Customer & Strategy, Behavioural Evidence & Insight Team, *Hidden Economy: Quantitative Feasibility Study, Establishing effective research methods for future quantitative analysis of the Hidden Economy* (May 18, 2012), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/344826/report209.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344826/report209.pdf).

54 See, e.g., HM Revenue and Customs Research Report 260, *HMRC Electricians Tax Safe Plan Research Report* (Apr. 2013), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/344773/report260.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344773/report260.pdf).

55 The radio script was: "SFX [sound effects]: The click of an electric switch. MVO [male voice over]: Us electricians can't afford to take chances with safety. There's a responsibility to do the job right, so our customers stay safe and so do we. This responsibility also applies to our tax. If we don't declare our earnings, we're running a risky business. Revenue and Customs want electricians to talk to them about undeclared income by May 15th. Or they'll come looking. So stay safe. Contact them before they contact you. Call HMRC [Her Majesty's Revenue and Customs] now on 0845 601 5041." *Id.*, at 55.

56 An ad placed in trade press, captioned "HMRC to pull the plug on electricians" explained how electricians could come forward and report previously undisclosed income, noting that "a low rate penalty charge will be made to any electricians who complete a notification form, but this is better than facing a possible criminal investigation." *Id.*

57 A flyer directed at electricians described a previous successful campaign directed at plumbers and announced, "We are now looking closely at electricians and we are using a number of different sources to help us target those who have not declared their full income. We are building on the same methods that we used for the plumbers' campaign—because they work." *Id.*, at 54.

58 An outdoor sandwich board featured a picture of a multimeter (a device electricians use to measure various characteristics of an electrical circuit) captioned "Electricians you have until 15 May to check your tax affairs are in order" with an explanation of how to come forward, by email, text, or phone, and report previously unreported income. *Id.*, at 53.

59 By November 2012, the campaign had raised more than 2.2 million pounds. *Id.*, at 12.

60 Security Industry Authority (SIA), available at <http://www.sia.homeoffice.gov.uk/Pages/home.aspx>

61 SIA, Risk Assessments, available at <http://www.sia.homeoffice.gov.uk/Pages/business-risk.aspx>.

“a business license holder must provide a yearly return as and when it is due” or risk suspension of or withdrawal of the license.<sup>62</sup>

## CONCLUSION

Sixteen years after the National Commission for Restructuring the IRS directed the IRS to base its audit selection process on research—which for tax administration today means applied social science research about taxpayer behavior—the IRS’s approach to compliance, including audit selection, continues to be driven primarily by tax return data. Tax authorities in other jurisdictions rely on social science research in determining how to promote taxpayer compliance, and the service they provide to taxpayers as part of an overall compliance strategy is more advanced than at the IRS. The IRS is aware that it should adopt a holistic approach to compliance, and articulates its commitment to doing so, but has not wholeheartedly embraced that commitment.

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62 SIA, Approval Conditions, available at <http://www.sia.homeoffice.gov.uk/Pages/business-conditions.aspx>.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt “increasing voluntary compliance” as the primary measure for evaluating both enforcement and taxpayer service initiatives.
2. Not only incorporate applied and behavioral research into all of its compliance initiatives, but also fund or activate compliance initiatives only after adopting an integrated strategy that articulates how the IRS will:
  - a. Use education, outreach, partners, assistance, non-invasive compliance touches, and enforcement touches to increase compliance;
  - b. Test the initiative before full deployment, and use tests or pilots to project the effect on future compliance;
  - c. Measure the initiative’s success, including conducting surveys and focus groups both before and after the initiative; and
  - d. Adjust its overall compliance plan in the light of continuing research findings and trends.

**MSP  
#12****ACCESS TO THE IRS: Taxpayers Are Unable to Navigate the IRS  
and Reach the Right Person to Resolve Their Tax Issues****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division  
 Heather C. Maloy, Commissioner, Large Business and International Division  
 Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division  
 Kirsten B. Wielobob, Chief, Office of Appeals  
 Richard Weber, Chief, Criminal Investigation

**DEFINITION OF PROBLEM**

Taxpayers very often face difficulty in reaching the right person at the IRS in order to resolve their problems. The IRS Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to make itself accessible to taxpayers, specifically by phone. Section 3709 of RRA 98 mandates that the IRS place the addresses and telephone numbers for local offices in local phone directories across the country.<sup>1</sup> However, even though the IRS largely meets this requirement, calling the local offices does little good. The IRS does not answer the phone at local offices and has even removed the option it once provided for taxpayers, including the elderly and disabled, to leave a message.<sup>2</sup>

Another provision of RRA 98 requires the IRS to provide taxpayers with an option to talk to an employee on IRS helplines in “appropriate circumstances” and direct a taxpayer’s questions to other IRS employees who can help.<sup>3</sup> Although the IRS does transfer callers on its main toll free phone line to live assistors in some circumstances, it does not offer taxpayers the option of choosing to speak to a live person. The IRS has failed to engage in forward thinking or embrace current technology that would allow it to comply with the intent (and not just the letter) of the RRA 98 provisions—ensuring taxpayers can reach the person at the IRS who can answer their questions or help with their problem.<sup>4</sup> Taxpayers have the *right to quality service*—to receive prompt, courteous, and professional assistance and to speak to a supervisor about inadequate service, and the right to be informed, meaning they have a right to know what they need to do to comply with the tax laws.<sup>5</sup> When taxpayers cannot speak to a person at their local

<sup>1</sup> Section 3709 of the IRS Restructuring and Reform Act of 1998 (RRA 98), 105 Pub. L. No. 206, 112 Stat. 779 provides: “The Secretary of the Treasury or the Secretary’s delegate shall, as soon as practicable, provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area.”

<sup>2</sup> The listings for local IRS offices in the phonebooks provide the number for the local Taxpayer Assistance Center (TAC). Using the numbers from local phonebooks, on July 31 and August 1, 2014, TAS called a sample of 80 TACs around the country during normal business hours and found that none allowed the taxpayer to leave a message or speak to a live person. According to the IRS, taxpayers have never had the ability to speak to a live person when calling these phone numbers. See IRS response to TAS information request (Sept. 19, 2014).

<sup>3</sup> RRA 98 § 3705(d), 105 Pub. L. No. 206, 112 Stat. 777. “The Secretary of the Treasury or the Secretary’s delegate shall provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours. The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer.”

<sup>4</sup> The National Taxpayer Advocate has repeatedly raised the issue of the difficulty taxpayers have in navigating the IRS. See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 114-25 (Most Serious Problem: *Navigating the IRS*).

<sup>5</sup> See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

IRS office, or find the right person to talk to, their *right to quality service* and *right to be informed* are compromised.

## ANALYSIS OF PROBLEM

### Legislative History of RRA 98

Section 3709 of RRA 98 requires the IRS to publish the phone numbers and addresses of local IRS offices in local phone books.<sup>6</sup> The RRA 98 Senate Committee Report reflects the intent that “every taxpayer should have convenient access to the IRS.”<sup>7</sup> A key part of convenient access is the ability for taxpayers to find and contact the right person to solve their tax matters. Speaking about RRA 98, Senator Domenici

explained, “Taxpayers are often left with no option but to contact my office asking for help in simply identifying who they should talk to at the IRS to settle their tax matter. The caseworkers are experts, but it would take them two days to track down the right IRS office so that the constituent could try and solve their problem.”<sup>8</sup>

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Only some of the phonebooks sampled by TAS provided a nationwide phone number for the IRS Office of Appeals, and this turned out to be the number for a private business.

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Section 3705(d) of RRA 98 requires the IRS to not only make a live person available on helplines in appropriate circumstances, but for that person to direct the taxpayer to another employee who can help the taxpayer resolve problems.<sup>9</sup> Senator Domenici explained this provision requires that “automated phone lines include the option to talk to a real, knowledgeable person who can answer the taxpayers’ questions. This would be an option in addition to merely listening to a recorded message.”<sup>10</sup>

### IRS Implementation of Sections 3709 and 3705(d)

When implementing Section 3709 in the years following RRA 98, the IRS created a template to update telephone directories with the numbers and addresses for local Taxpayer Assistance Center (TAC) offices and sent it to the phone companies.<sup>11</sup> In 2001, the IRS determined the standard services to be provided on the TAC phone numbers and developed message scripts and procedures for returning calls.<sup>12</sup> In 2003, the IRS established a quarterly certification process to ensure the accuracy of the published phone numbers.<sup>13</sup> When the IRS initially implemented RRA 98 § 3709, it only required each local office to

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6 Section 3709 of RRA 98, 105 Pub. L. No. 206, 112 Stat. 779, provides: “The Secretary of the Treasury or the Secretary’s delegate shall, as soon as practicable, provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area.”

7 S. REP. NO. 105-174, at 106 (1998).

8 144 CONG. REC. S 4473 (daily ed. May 7, 1998) (statement of Sen. Domenici).

9 RRA 98 § 3705(d), 105 Pub. L. No. 206, 112 Stat. 777. “The Secretary of the Treasury or the Secretary’s delegate shall provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours. The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer.”

10 144 CONG. REC. S 4473 (daily ed. May 7, 1998) (statement of Sen. Domenici).

11 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-12857, AT-2009-12858 (retrieved May 28, 2014).

12 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-12866, AT-2009-12867 (retrieved May 28, 2014).

13 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-12874 (retrieved May 28, 2014).

have “a local telephone line with a mailbox capable of playing a generic script, taking incoming messages, and remote message retrieval.”<sup>14</sup>

When taxpayers were allowed to leave messages, the IRS required all calls to be “returned within two business days regardless of the issue even if just to provide the taxpayer with the appropriate toll-free number to access in order to answer a technical or account related question.”<sup>15</sup> However, in early 2013 the IRS removed the option for any taxpayer to leave a message, including the elderly and disabled.<sup>16</sup> Currently, the message on 3709 lines instructs elderly or disabled taxpayers to email the IRS to make an appointment.<sup>17</sup> During the 2014 filing season, the IRS received 212 such emails from elderly or disabled taxpayers. The IRS has no way of knowing how many elderly or disabled taxpayers called to make an appointment in prior years because it did not keep records of the number of messages received from elderly or disabled taxpayers during the 2012 and 2013 filing seasons.<sup>18</sup>

To implement Section 3705(d), the IRS made only a few changes. According to the IRS’s Legislative Analysis, Tracking and Implementation Services (LATIS) the IRS only had three action items related to implementing RRA 98 § 3705(d): revising the IRM to “provide Spanish Telephone Helplines in addition to helpline options enabling the taxpayer to speak to a live assist” and providing an option for a taxpayer to speak to a live person on the Forms-Only Toll-Free line and Teletax line.<sup>19</sup> These efforts, while limited, did bring the IRS closer to compliance with section 3705(d).

### The Phone Numbers Provided in Local Phone Books Fall Short of the Level of IRS Access Intended by Congress.

TAS found the IRS has been largely successful in listing phone numbers for local offices in local phone books nationwide.<sup>20</sup> However, these numbers are not helpful to taxpayers. The phone books only list the main line for each local office and do not provide numbers for specific functions such as the local Appeals, Examination, or Collection office.<sup>21</sup> While the phone books do list a few nationwide toll-free numbers, they do not give the taxpayer the number to call if he or she needs to reach a specific person or department. If a taxpayer is experiencing a problem with part of the IRS, for example, having trouble with an Appeals Officer assigned to his or her case, contacting the local TAC—assuming someone would answer

<sup>14</sup> Memorandum from Jeff Cooper, Director Telecommunications to Dave Gaugler, Director, Information Systems Field Operations, IRS (Sept. 19, 2001) (on file with TAS).

<sup>15</sup> IRM 21.3.4.3.3.1.1, *Procedures for Taxpayer Assistance Centers* (Apr. 26, 2012).

<sup>16</sup> The ability to leave a voice message was ended for all taxpayers and all TACs on April 12, 2013. See IRS response to TAS research request (Sept. 19, 2014).

<sup>17</sup> See IRS response to TAS research request (Sept. 19, 2014). The message advises: “If you are disabled or elderly and require special accommodations for service, please email us at....” See IRM Exhibit 1.4.11-1 (Aug. 15, 2014). According to the IRM, all email messages sent to the email address stated on the 3709 line will be returned within three business days, regardless of the issue. See IRM 21.3.4.3.2.1.1, *Procedures for Taxpayer Assistance Centers*, (Feb. 12, 2014). Under the prior policy, callers who left a message on the 3709 lines would be called back within two business days to arrange an appointment. See IRM 21.3.4.3.3, *3709 Line and Assisting Taxpayers with Disabilities* (Oct. 1, 2009).

<sup>18</sup> See IRS response to TAS research request (Sept. 19, 2014).

<sup>19</sup> IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-13275, AT-2009-13314 (retrieved May 28, 2014). The IRS uses LATIS to track all provisions, actions, and status of enacted legislation that impacts the Service. 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.

<sup>20</sup> TAS conducted a convenience survey of 20 phone books and found that all included numbers for local TAC offices.

<sup>21</sup> In addition to the main numbers for the local IRS offices, the phone books surveyed also included the following nationwide, toll-free numbers for the IRS: Need a Tax Form; Checking on a Refund; 24-Hour Recorded Tax Help; Federal Tax Questions; TDD-TTY Telephone Service; Report Tax Fraud Violations; National Taxpayer Advocate; Taxpayer Advocacy Panel; Tax Exempt-Government Entities; Appeals; and Citizens Advocacy Panel. The Citizen Advocacy Panel is no longer in existence; it was replaced in 2002 by the Taxpayer Advocacy Panel.

...not even elderly or disabled taxpayers, who are less likely to have access to the Internet and email, can leave a message on these lines.

(which is currently not the case)—would do no good. The taxpayer would need the number for the local Appeals office. Only some of the phonebooks sampled by TAS provided a nationwide phone number for Appeals, and this turned out to be the number for a private business.<sup>22</sup> The Office of Appeals has an Appeals Account Resolution Specialist phone line, which callers can use to find out if their cases have been assigned to an Appeals employee and how to contact that employee.<sup>23</sup> However, this number is not a toll-free number, it was not listed in local phone books surveyed by TAS, and was difficult to locate.<sup>24</sup>

Another reason the phone book listings are not helpful is that the phone lines for local offices, known as “3709 lines,” do not help taxpayers reach the IRS because they are not answered by a live person. As explained above, not even elderly or disabled taxpayers, who are less likely to have access to the Internet and email, can leave a message on these lines.

Demographic research data show only 57 percent of adults over age 65 use the Internet compared to 87 percent of all adults.<sup>25</sup> According to 2010 Census data, only 41 percent of those with a non-severe disability use the Internet and only 22 percent of those with a severe disability age 65 and older use the Internet.<sup>26</sup> For those without Internet access, the only viable ways to reach the IRS are by phone, or in person.<sup>27</sup>

TAS surveyed a statistically valid sample of 80 TACs in July 2014 and found that all 80 had the same recording of a generic script.<sup>28</sup> The recordings do not state all services the TACs provide, and instead instruct taxpayers to access IRS.gov for a full list of available services.<sup>29</sup> In a 2011 employee training, the IRS identified the purpose of 3709 lines: to “[a]dvice Taxpayer [of] the options available to obtain assistance other than making an appointment.”<sup>30</sup> However, the only option the message provides is for the taxpayer to find information on IRS.gov, or email the IRS if the taxpayer is elderly or disabled.<sup>31</sup> The message does not even offer another number for the taxpayer to call, let alone the ability for the taxpayer to be transferred to another number or speak with a live assistor.

TAS twice inquired of the IRS in a formal information request whether it considers the 3709 lines to be “helplines” for the purpose of § 3705(d) of RRA 98, which would require them to have an option to speak with a live person. TAS also asked what lines the IRS does consider to be helplines. Twice, the IRS

22 At the time of this report, multiple phone books listed a number for Appeals Nationwide that belonged to a company offering non-IRS related services.

23 See IRS, *What Can You Expect from Appeals?*, available at <http://www.irs.gov/Individuals/What-Can-You-Expect-from-Appeals%3F> (last updated Nov. 5, 2014). See IRM 8.1.9.4, *Appeals Customer Service Telephone Line* (Dec. 17, 2013).

24 As of December 18, 2014, TAS found only one webpage on the IRS.gov website that listed this number. See IRS, *What Can You Expect from Appeals?*, available at <http://www.irs.gov/Individuals/What-Can-You-Expect-from-Appeals%3F> (last updated Nov. 5, 2014).

25 Pew Research Center, *Internet User Demographics* (2014), available at <http://www.pewinternet.org/data-trend/internet-use/latest-stats/>.

26 U.S. Census, *Reported Computer and Internet Access, by Selected Individual Characteristics: 2010*, Table 4, available at <http://www.census.gov/hhes/computer/publications/2010.html> (last visited on Nov. 24, 2014).

27 Reaching the IRS in person is becoming increasingly difficult due to the degradation of taxpayer service at TACs. See National Taxpayer Advocate FY 2015 Objectives Report to Congress 135 (Review of the 2014 Filing Season).

28 TAS randomly sampled the population of 377 TACs at a 90 percent confidence with a precision of five percent assuming an estimated population percentage with the characteristic at 10 percent. The 10 percent estimated population percentage with the characteristic was determined by conducting a five percent random sample of the population that showed that no TAC varied from the generic script.

29 IRM Exhibit 1.4.11-1 (Aug. 15, 2014).

30 IRS, *FY 2011 Field Assistance Continuing Practical Education*, 3709 Telephone Line.

31 IRM Exhibit 1.4.11-1 (Aug. 15, 2014).

declined to answer these questions.<sup>32</sup> Without defining what phone lines are helplines, the IRS is avoiding its responsibility to implement § 3705(d) of RRA 98. Even if the IRS does not consider the 3709 lines to be helplines, and thus technically meeting the requirements of §§ 3709 and 3705(d) of RRA 98, it has failed to meet the purpose of the sections, which is to provide taxpayers convenient access to the IRS to resolve their tax matters.

### The Main Toll-Free IRS Phone Lines Do Not Help Taxpayers Reach the Right Person.

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**TAS twice inquired of the IRS in a formal information request whether it considers the 3709 lines to be “helplines” for the purpose of section 3705(d) of the IRS Restructuring and Reform Act, which would require them to have an option to speak with a live person. TAS also asked what lines the IRS does consider to be helplines. Twice, the IRS declined to answer these questions.**

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One result of the IRS’s reorganization as part of RRA 98, when it went from being structured geographically to being organized based on the type of taxpayer (e.g., small business, tax-exempt, etc.),<sup>33</sup> is that taxpayers’ issues are often not handled by their local offices but instead by employees in centralized, remote locations. In addition to publishing the numbers for the 3709 lines, the local phone books often include the IRS’s main toll-free number, as well as some other primary numbers, such as the main nationwide Tax Exempt/Government Entities phone number and the refund hotline.<sup>34</sup> However, these numbers do not help taxpayers reach the right person. If the taxpayer is calling for one of the most common reasons to reach the IRS—to check on a refund—then the taxpayer has a dedicated help line.<sup>35</sup> Yet, if a taxpayer is calling about a specific tax or IRS issue, he or she must navigate an extended phone tree. For example, if a taxpayer wants to talk to someone at the IRS about applying for an offer in compromise (OIC), the taxpayer must go through a number of prompts to reach a customer service representative, and if he or she is successful in reaching a person, that person may not even have expertise in offers. Taxpayers may sit on hold for an extended period prior to reaching a live assist. <sup>36</sup> TAS called the main toll-free line at approximately 6:00 p.m. Eastern Standard Time on November 10, 2014, to ascertain how long it would take to reach a customer service representative (CSR) and whether the CSR could then transfer the caller to an employee in the centralized offer in compromise unit, who would be able assist the taxpayer. Unfortunately, the caller never made it that far. The following details the phone journey:

<sup>32</sup> IRS responses to TAS research requests (Sept 19, 2014 and Oct. 29, 2014).

<sup>33</sup> See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

<sup>34</sup> In addition to the main numbers for the local IRS offices, the phone books surveyed also included the following nationwide, toll-free numbers for the IRS: Need a Tax Form; Checking on a Refund; 24-Hour Recorded Tax Help; Federal Tax Questions; TDD-TTY Telephone Service; Report Tax Fraud Violations; National Taxpayer Advocate; Taxpayer Advocacy Panel; Tax Exempt-Government Entities; Appeals; and Citizens Advocacy Panel.

<sup>35</sup> See IRS, Basic Tools for Tax Professionals, available at <http://www.irs.gov/Tax-Professionals/Basic-Tools-for-Tax-Professionals> (last visited Nov. 24, 2014).

<sup>36</sup> In FY 2014 the IRS received about 86.2 million telephone calls. Only 64.4 percent of calls seeking to reach a customer service representative got through, and those callers had to wait an average of 19.6 minutes on hold. See IRS, *Enterprise Snapshot Week Ending: September 30, 2014* (Oct. 16, 2014).

TAS called the main toll-free line at approximately 6 p.m. EST on November 10, 2014, acting as a taxpayer who has questions about filing a request for an offer in compromise, to ascertain how long it would take to reach a customer service representative (CSR) and whether the CSR could then transfer the caller to an employee in the centralized offer in compromise unit, who would be able to assist the taxpayer.

### Taxpayer dials 1-800-829-1040

Welcome to the Internal Revenue Service.  
You can also visit us at [www.irs.gov](http://www.irs.gov).



- 1 To continue in English, press 1.
- 2 Para continuar en Español, oprima dos.

### Taxpayer presses 1

Due to high demand, you may experience longer than usual wait times. If you do not need immediate assistance, please call back on Wednesday or Thursday. You may also check the status of your federal income tax refund by visiting us at [www.irs.gov](http://www.irs.gov).



- 1 For questions about your refund, or to check the status of your Form 1040X, Amended Tax Return, press 1.
- 2 For questions about your personal income taxes, press 2.
- 3 For business taxes, press 3.
- 4 To hear general information about the health care law, including how it may affect individuals, families, and employers, press 4.
- 5 For questions about your personal or business taxes as it relates to health care, press 5.
- 9 To repeat this menu, press 9.

### Taxpayer presses 2

- 7 If you are filing your return electronically, and you do not have your prior year AGI or your prior year self-selected Pin, press 7.
- 1 For questions about a form you have already submitted, your tax history, or payment, press 1.
- 2 For questions about tax rules, or for help filing a form, press 2.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

At this point the taxpayer may be confused as none of the prompts address his issue. He has questions about filing a request for an offer in compromise, but none of these prompts address his need.

### Taxpayer presses 1

- 1 For questions about your refund, or to check the status of your Form 1040X, Amended Tax Return, press 1.
- 2 If you need an account or tax return transcript, press 2.
- 3 If you only need your prior year's AGI, press 3.
- 4 For all other questions about your tax history or payment, press 4.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

The taxpayer is further confused by prompt one, because the earlier announcement already asked the taxpayer if he had questions about his refund and amended tax return, and he did not select that option.

### Taxpayer presses 4

- 1 To find out how to correct a form you already filed press 1.
- 2 For all other questions about your tax history or payment, press 2.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

### Taxpayer presses 2

Please wait.  
To access your account information, please enter the Social Security number or employer identification number for which you are calling.

### Taxpayer enters 9-digit Social Security number



This example demonstrates multiple shortcomings with the IRS's automated system. The prompts and announcements are confusing to taxpayers, whose issues may not be covered by the limited options the system provides. Nowhere during the six minute journey<sup>37</sup> detailed above did the caller have the opportunity to talk to a live person, which violates RRA 98 § 3705(d).<sup>38</sup> Clearly the IRS's main toll-free phone line is one of the "automated phone lines" that Senator Domenici was talking about when he was explaining section 3705(d).<sup>39</sup> Although the IRS provides, "In some cases, if customers are unable to navigate the menu, the system will route the call to a live assist," it is the IRS making this decision without giving taxpayers the option to choose to speak to a live person.

Furthermore, even if the taxpayer in the above example reached a live person, that person may not have been able to help the taxpayer with her offer. The IRS uses a Telephone Transfer Guide to provide customer service representatives with the correct application for transferring a call, which provides 40 options for calls in English and 24 for calls in Spanish.<sup>40</sup> The general policy is "All employees, except those assigned to Default Screener, will answer all procedural inquiries for which they have been trained."<sup>41</sup> If a taxpayer calls to speak to an employee about qualifying for an OIC, the Telephone Transfer Guide provides a specific application for the call to be transferred to. However, the taxpayer may not reach the OIC unit and instead, the call goes to an assist who trained to use the Individual Master File Balance Due Application.<sup>42</sup> This application is used for 22 other types of calls according to the Telephone Transfer Guide.<sup>43</sup> While it is helpful for the taxpayer if the assist can access his or her account and answer basic questions about applying for an offer,<sup>44</sup> the taxpayer may want to talk to an employee within the OIC unit and have trouble getting to that person.<sup>45</sup>

In some situations, the caller is transferred to a specific office or unit, but not the right one. An example involves a taxpayer whose OIC was accepted and who has made all of her payments, but whose lien has not been released or withdrawn. This taxpayer lost her OIC acceptance letter when she moved, so she looks to the IRS website for the number to call. She calls the main toll-free number, and after going through a number of prompts, she speaks to an assist who transfers her to the phone line for the Lien Unit. However, the Lien Unit then tells her she must instead contact back end processing to make sure it

<sup>37</sup> The call conducted by TAS lasted approximately six minutes and nine seconds.

<sup>38</sup> In its response to TAS, the IRS acknowledged, "The 1040 line does not advertise an option to be 'transferred to a live person'." It further stated "By offering the option of a live person to customers when it is unnecessary and an automated application is available, we would undermine our ability to effectively serve those customers who truly need live assistance."

<sup>39</sup> See earlier discussion, Legislative History of RRA 98.

<sup>40</sup> See IRS Telephone Transfer Guide (updated Oct. 30, 2014). <http://serp.enterprise.irs.gov/TTGuide/TTGuide.jsp>.

<sup>41</sup> IRS Telephone Transfer Guide (TTG) Telephone Transfer Policy, <http://serp.enterprise.irs.gov/databases/who-where.dr/ttg.dr/nav/transfer-policy.htm>.

<sup>42</sup> See IRS Telephone Transfer Guide (TTG), Accounts Management Aspect Application Information <http://serp.enterprise.irs.gov/databases/who-where.dr/ttg.dr/nav/titles.htm>

<sup>43</sup> For example, this application is also used for bankruptcy or insolvency, notice of intent to levy, and lien release. See IRS Telephone Transfer Guide (updated July 31, 2014).

<sup>44</sup> IRM 21.3.12.6.3.1, *Taxpayer is Requesting an OIC*, (Oct. 1, 2014) provides customer service representatives with limited information about submitting an offer and instructions for sending the caller Form 656-B, *Offer in Compromise Booklet*. IRM 21.3.12.6.3.2, *Taxpayer Requests Help in Preparing Form 656* (Oct. 1, 2014) advises: "The Form 656-B, Offer in Compromise Booklet, contains information and Forms that the taxpayer needs in order to prepare a complete and accurate Offer in Compromise. If taxpayer needs further clarification of the tax law or which forms to use have them contact the nearest IRS Taxpayer Assistance Center."

<sup>45</sup> If the taxpayer is inquiring about the status of an offer, and it has been 45 days or more since the taxpayer submitted the offer form, the IRM advises the employee to prepare a written referral and fax it to the Centralized Offer in Compromise Campus (COIC), and advise the taxpayer that a call-back should be received within the next 5 business days. The IRM also provides the employee with the option of providing the taxpayer the appropriate COIC toll free phone number, stating that if the taxpayer insists on contacting the COIC themselves, the written referral is not necessary. IRM 21.3.12.6.3.3, *Taxpayer Is inquiring about the status of an OIC Application* (Oct. 1, 2013).

shows that her offer is fully paid. This process could have been avoided if the IRS had a published phone directory with a centralized OIC number.

### **The IRS Needs to Adapt by Applying the RRA 98 Requirements in Light of Changing Technology, Taxpayer Demographics, and its Business Model.**

Since 1998, the IRS has changed in terms of business organization and technology, serving diverse taxpayer populations.<sup>46</sup> When the IRS was implementing RRA 98 in 2001, some phone lines could not transfer calls, and instead the assistors had to provide the taxpayer with a phone number to call back. In the current environment, the IRS should be forward-thinking in creating convenient ways for taxpayers to access the IRS to resolve their tax matters. The IRS could achieve this by creating a directory of departments that the public could access, or by establishing a call routing system similar to 311 lines used by municipalities, states, and foreign countries.

The IRS already has a public directory that it distributes to practitioners, which provides them with the phone numbers of key offices in their states.<sup>47</sup> For example, a tax professional in Connecticut dealing with a lien can use the state directory to find the national number for lien releases as well as the New England Group Advisory Manager; or a practitioner in Georgia dealing with field collection can find the numbers for the Area Director of Gulf States, the Territory Manager for Atlanta, the Territory Manager for South Georgia and the Territory Manager for the Offer in Compromise unit. The IRS should consider creating a similar directory for the public. When asked why the IRS does not provide a public directory for all taxpayers, the IRS stated, “Taxpayers are better served if contacts are made in accordance with Publication 910, *IRS Guide To Free Tax Services*, and the web pages mentioned above verses [sic] calling individual employees who may or may not have the expertise to address their concerns.”<sup>48</sup> However,

this response ignores a persistent problem with requiring most taxpayer calls to be handled by a CSR who handles a range of issues—the CSR speaking to the taxpayer may not have the expertise in the specific issue to assist the taxpayer. Furthermore, this response is illogical because if the IRS published a directory with a phone number for local Appeals personnel or OIC personnel, and a taxpayer were to call regarding one of these issues, in theory the local Appeals or OIC employee should be very knowledgeable about the issue in which he or she specializes.

Another way for the IRS to make itself accessible would be to adopt a system similar to a 311 routing system. Many municipalities in the United States have moved to 311 programs, which consolidate numerous call centers and phone numbers so a user only needs to call one number and can be routed to the

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**Nowhere during the six minute “journey” through the IRS phone system did the caller have the opportunity to talk to a live person, which violates § 3705(d) of the IRS Restructuring and Reform Act.**

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46 See National Taxpayer Advocate 2011 Annual Report to Congress, Vol. 2 36-44 (Research Study: *From Tax Collector to Fiscal Automaton: Demographic History of Federal Income Tax Administration, 1913-2011*). See also Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

47 See SB/SE, IRS Telephone Directory for Practitioners, available at <http://sbse.web.irs.gov/CL2/sl/PracDir/default.aspx> (last visited Sept. 2, 2014).

48 IRS response to TAS research request (Sept. 24, 2014).

correct agency, department, or office.<sup>49</sup> When a caller dials 311 in New York City, the caller first talks to the Interactive Voice Response System (IVR), which is recognized to be a “thin layer.” Approximately 50 percent of total calls are addressed by IVR.<sup>50</sup> Calls that are not addressed are transferred to a call center representative (CCR).<sup>51</sup> Using keywords, the CCR searches a knowledge database containing over 7,000 pieces of information about various agency services as well as other related organizations to identify the caller’s need.<sup>52</sup> Then, the CCR can:

- Provide the information requested (this occurs 40 percent of the time);
- Process a service request (24 percent of the time); or
- Transfer the call to an external agency (26 percent of the time).<sup>53</sup>

The IRS could use this system as a model, using intelligent automation to answer a significant number of calls and a combination of live interaction and an in-depth information database to address the remaining calls. The IRS’s current system does not allow the taxpayer a “one-stop shop” similar to the 311 program. If a taxpayer calls the IRS to discuss a collection due process (CDP) hearing, and there is an open control for a CDP hearing, the IRM instructs the employee *not to transfer the call* to the CDP coordinator, but instead to refer the call information to the Automated Collection System CDP coordinator, and fax an Inquiry Referral form to the Automated Collection System or CDP site that has jurisdiction over the account.<sup>54</sup> The CSR is then instructed to inform the taxpayer on the phone that someone will contact him or her in five business days.<sup>55</sup> If the IRS used a 311 system, the caller could immediately be transferred to the CDP unit where he could ask a collection employee about his or her hearing.

## CONCLUSION

The purpose behind the RRA 98 provisions regarding phones was to create ways for taxpayers to quickly and easily communicate with the right IRS employees. Publishing the phone numbers of local offices where phones are not answered and taxpayers cannot even leave a message does not make the IRS accessible. The IRS should proactively use technology to meet the needs and preferences of taxpayers so they can seamlessly find the right person to resolve their tax issues.

49 When a caller dials 311 in Prince George’s County Maryland, the caller receives a welcome message and is advised if this is an emergency call 911, for bulky trash please press 1. A Spanish language option is offered and then all other callers are asked to stay on the line for the next available person. The Maryland service does not provide a timeframe for how long a caller will be on hold, but when tested by TAS the wait time was 1 minute 15 seconds when the service was called at noon on a Monday and 2 minutes 5 seconds when tried on a Wednesday. The service hours are comparable to the IRS and are Monday–Friday from 7:00 am–7:00 pm, and 24 hours online.

50 ISPRAT, *Lessons for D115? A Review of 311 in New York City*, 7-8, available at [http://isprat.net/fileadmin/downloads/pdfs/ISPRAT\\_Projekt\\_Report\\_311\\_115\\_finales\\_Dokument.pdf](http://isprat.net/fileadmin/downloads/pdfs/ISPRAT_Projekt_Report_311_115_finales_Dokument.pdf) (last visited on Nov. 24, 2014).

51 ISPRAT, *Lessons for D115? A Review of 311 in New York City*, 8, available at [http://isprat.net/fileadmin/downloads/pdfs/ISPRAT\\_Projekt\\_Report\\_311\\_115\\_finales\\_Dokument.pdf](http://isprat.net/fileadmin/downloads/pdfs/ISPRAT_Projekt_Report_311_115_finales_Dokument.pdf).

52 New York City Independent Budget Office, *Fiscal Brief, 311 Customer Service Center: More Calls and a Growing Budget* (Apr. 2008), available at <http://www.ibo.nyc.ny.us/iboreports/311Apr08.pdf>.

53 ISPRAT, *Lessons for D115? A Review of 311 in New York City*, 9-10, available at [http://isprat.net/fileadmin/downloads/pdfs/ISPRAT\\_Projekt\\_Report\\_311\\_115\\_finales\\_Dokument.pdf](http://isprat.net/fileadmin/downloads/pdfs/ISPRAT_Projekt_Report_311_115_finales_Dokument.pdf).

54 See IRM 21.3.12.6.7.3.2, *Collection Due Process* (Oct. 17, 2011). IRM 21.3.5 (Oct. 1, 2014) provides general guidance about when to create a referral to another office, campus, or function.

55 See IRM 21.3.12.6.7.3.2, *Collection Due Process* (Oct. 17, 2011).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Provide an option for taxpayers calling the local TAC lines to speak to a live person or be transferred to another part of the IRS.
2. Provide a phone line for elderly or disabled taxpayers to call to make an appointment at a TAC, including messaging and callback service, and establish and publicize timeframes within which callbacks must occur.
3. Make the IRS Telephone Directory for Practitioners or a similar directory available to the public.
4. Institute a system similar to a 311 system where a taxpayer can be transferred by an operator to the specific office within the IRS that handles his or her issue or case.

**MSP  
#13**

## CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers

### RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division  
Debra Holland, Commissioner, Wage and Investment Division

### DEFINITION OF PROBLEM

In 1998, Congress directed that the IRS develop a procedure “to the extent practicable and if advantageous to the taxpayer” to assign one IRS employee to handle a taxpayer’s matter until it is closed.<sup>1</sup> Some IRS functions provide one employee to each case, while other IRS units have overlooked or ignored this mandate. For instance, Field Collection employees are reminded to provide their title, last name, and employee identification number during initial contact with a taxpayer.<sup>2</sup> Yet other IRS programs that involve lengthy interaction with taxpayers, such as Correspondence Examination, do not have a system for assigning cases to one employee.<sup>3</sup>

1 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998). See also Most Serious Problem: AUDIT NOTICES: The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability, *infra*.

2 IRM 5.1.10.3(7), *Initial Contact*, (June 7, 2013). The collection process is not ideal, however. By the time an account makes it to assignment in Field Collection, it has potentially gone through a lengthy assessment and collection process. For instance, it may have spent some time in the Queue. For information on the IRS’s reliance on the Queue, see National Taxpayer Advocate 2012 Annual Report to Congress 358-380 (Most Serious Problem: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations*).

3 IRS response to a TAS information request (Sept. 5, 2014). Correspondence exam often sends notices that list the department manager as a general contact or do not contain any contact information. See National Taxpayer Advocate 2011 Annual Report to Congress, Vol. 2, 78. See also National Taxpayer Advocate Blog, *Are IRS Correspondence Audits Really Less Burdensome For Taxpayers?*, available at <http://taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks>.

For purposes of this discussion, we will focus on correspondence examinations, because about 70 percent of all audits are correspondence audits.<sup>4</sup> The National Taxpayer Advocate is concerned about the following problems associated with the IRS correspondence examination process:

- The correspondence examination is designed so that any available employee may assist taxpayers but no one employee is solely responsible for the outcome of the case;
- The lack of a single employee assigned to a case burdens taxpayers with repeat calls;
- The lack of an assigned employee creates downstream costs for taxpayers and the IRS;
- The lack of an assigned employee eliminates employee accountability; and
- The IRS hampers its efforts to improve customer satisfaction by not complying with the congressional directive in RRA98 § 3705(b).

The IRS's failure to provide an assigned employee, as well as the associated downstream consequences imposed on the taxpayer, violates the taxpayer's *right to quality service*, which includes "the right to receive prompt, courteous, and professional assistance."<sup>5</sup> In particular, 62 percent of calls received in the IRS correspondence examination unit are from repeat callers, which may indicate that taxpayers are not receiving the assistance they require, and their calls are being handled inadequately by employees unfamiliar with the specific issues in the audits.<sup>6</sup>

Not only does this severely impair a taxpayer's *right to quality service*, but it harms a taxpayer's *right to be informed*, as taxpayers may not be able to obtain accurate information about their cases or what they need to do to be compliant with their tax obligations. It also impacts a taxpayer's *right to challenge the IRS's position and be heard*, as having to call back over and over without an assigned employee could indicate that no one is hearing the taxpayer or understanding their issue. Last, this problem can violate a taxpayer's *right to pay no more than the correct amount of tax*, because such a system can lead to incorrect assessments.

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<sup>4</sup> IRS, 2013 Data Book, table 9a. Similar problems arise in other areas, including identify theft and Automated Collection System (ACS) cases. See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*). In addition, the National Taxpayer Advocate testified at numerous hearings on the topic of identity theft. See, e.g., *Internal Revenue Service Oversight: Hearing Before the Subcomm. on Financial Services and General Government of the H. Comm. on Appropriations*, 113th Cong. 125-76 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *Examining the Skyrocketing Problem of Identity Theft Related Tax Fraud at the IRS: Hearing Before Subcomm. on Government Operations of the H. Comm. on Oversight and Government Reform*, 113th Cong. 19-41 (2013) (statement of Nina E. Olson, National Taxpayer Advocate). For information on problems related to ACS, see National Taxpayer Advocate 2012 Annual Report to Congress 381-402 (Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 143-48; National Taxpayer Advocate 2011 Annual Report to Congress 336-49 (Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*).

<sup>5</sup> IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

<sup>6</sup> See IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide 1* (2009) (cited by National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 at 80). See also TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit 1* (Aug. 17, 2012). The IRS has not performed any follow up studies for this measurement. IRS response to TAS information request (Sept. 5, 2014).

## ANALYSIS OF PROBLEM

### Background

RRA 98 § 3705(b) requires that the IRS develop a procedure “to the extent practicable and if advantageous to the taxpayer” for assigning one IRS employee to handle a taxpayer’s matter until it is closed.<sup>7</sup> The Senate specified two reasons for enacting RRA 98 § 3705(b): (1) it was important that “taxpayers receive prompt answers to their questions about their tax liability”; and (2) taxpayers had expressed frustration in not being able to find the appropriate IRS employee to contact.<sup>8</sup> Senator Domenici described the situation that his constituents faced in 1998:

In New Mexico, a notice can come from the Albuquerque, Dallas, Phoenix, or Ogden IRS center. Taxpayers are often left with no option but to contact my office asking for help in simply identifying who they should talk to at the IRS to settle their tax matter. The caseworkers are experts, but it would take them two days to track down the right IRS office so that the constituent could try and solve their problem. It was so commonly befuddling to constituents that my caseworkers asked that this identification provision be included in this bill.<sup>9</sup>

In response to such concerns, Congress passed RRA 98 § 3705(b). Senator Enzi describes what Congress was trying to achieve when he said, “...the IRS reform bill will bring and demand greater accountability from the more than 100,000 employees who work for the Internal Revenue Service ... Imagine that—being able to talk to the person that knows the problem.”<sup>10</sup>

Over time, TAS has seen that some cases involve transactions that can (and should be) handled with one phone call because it is advantageous to the taxpayer.<sup>11</sup> Other cases, such as an audit—which may involve problems of substantiation, interpretations of law and other guidance, and applications of law to facts—may not be resolved with one phone call.<sup>12</sup> On multiple occasions Congress and other stakeholders, including the National Taxpayer Advocate, have reported the reasons for assigning work to one employee when a case requires it.<sup>13</sup>

7 RRA 98, Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998).

8 S. REP. No. 105-174, at 103 (1998).

9 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici).

10 144 CONG. REC. S4147-01 (1998) (statement of Sen. Enzi).

11 Further, automation can be helpful in such cases. For detailed information on the benefits of automation, see TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit* 16 (Aug. 17, 2012).

12 The National Taxpayer Advocate has pointed out that when taxpayers receive a notice that is hard to understand, it may be difficult for the taxpayer to reach an IRS employee for an explanation. See National Taxpayer Advocate 2008 Annual Report to Congress 163. When this happens, the IRS misses an opportunity to educate the taxpayer. *Id.*

13 See, e.g. National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 78; National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 63-90 (Research Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2008 Annual Report to Congress 232.

In particular, the National Taxpayer Advocate has advocated for assignment of one employee in cases covering the Earned Income Tax Credit (EITC), which involves a complex statute and generally a relatively unsophisticated taxpayer.<sup>14</sup> Such an approach helps to:

- Reduce repeat taxpayer contacts;
- Reduce costs associated with reworking cases in Appeals, audit reconsideration, or through litigation; and
- Increase employee accountability.

### **The Correspondence Examination is Designed So That Any Available Employee May Assist Taxpayers But No One Employee is Solely Responsible for the Outcome of the Case.**

The IRS assigns correspondence examination cases to an employee to resolve upon receipt of correspondence or a phone call from a taxpayer.<sup>15</sup> However, the taxpayer does not necessarily have contact with this employee for the duration of the case. Instead, the IRS uses a “nationwide routing of calls,” linking multiple call centers into a “virtual” call center.<sup>16</sup> When the taxpayer subsequently calls the correspondence exam unit, the system distributes the call to the next available examiner.<sup>17</sup> For instances involving receipt of taxpayer correspondence prior to the issuance of a statutory notice of deficiency, the correspondence is assigned to an IRS employee for evaluation. If the correspondence does not resolve the issue, the case will be reintroduced to the general inventory, which means no one employee will be assigned to it.<sup>18</sup>

If the taxpayer places a phone call, the case will not be assigned if the examiner taking the call resolves the taxpayer’s concerns. For instance, if the taxpayer calls to confirm that the IRS received his or her amended return and receives an answer, then the reason for calling is resolved.<sup>19</sup> The employee who took this call is not the employee who ultimately handles the case and closes the case with an assessment, refund, or no-change letter.

When a correspondence examination employee receives a subsequent taxpayer contact, the employee who receives the contact is directed to resolve the problem himself or herself; if the taxpayer insists on reaching the specific employee, the first employee is instructed to tell the taxpayer that someone will return their call within three business days.<sup>20</sup> Unless the taxpayer requests a future date for contact, the assigned employee is expected to call the taxpayer within three business days “with the intent to resolve and close

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14 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 78. Also, issues like the sales tax deduction, while very straightforward, could require numerous receipts for substantiation and could benefit from having one assigned employee. See National Taxpayer Advocate 2008 Annual Report to Congress 233.

15 This assignment can change at any time if the assigned examiner is on leave or his or her workload is too high. IRS response to TAS information request (Sept. 5, 2014). The IRS reports that assignment of case work is treated similarly regardless of how the taxpayer initially contacts the IRS. For information on the receipt of correspondence in particular, see IRM 4.19.20.1.6, *Aging*, (Jan. 1, 2009).

16 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 9 (June 2014).

17 *Id.*

18 IRM 4.19.20.1.6.1, *Taxpayer Correspondence Received PRIOR TO the Issuance of the Statutory Notice of Deficiency Non-CPS*, (April 16, 2008).

19 IRM 4.19.19.6(2), *General Taxpayer Questions*, (Jan. 1, 2014).

20 IRM 4.19.19.3.3.1(4), CEAS Action Note, (Jan. 2, 2013). Under this IRM provision the employee is also instructed to leave a note on the taxpayer’s account to summarize the call.

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**The lack of accountability in these correspondence examination cases burdens taxpayers, wastes money, and impairs trust in the fairness and justness of the tax system.**

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the case or move to the next status.”<sup>21</sup> IRS employees are also trained to record telephone contacts in case notes so all employees can access the information if the taxpayer writes or calls back.<sup>22</sup> The taxpayer is also informed that the acceptability of documentation received can only be made by the employee reviewing the case.<sup>23</sup>

Certainly there are business reasons for adopting these automated call-routing systems. For instance, automation can enhance speed and accuracy while promoting consistency. However, concerns raised by tax practitioners indicate that in some cases, taxpayers can benefit from working with an assigned employee. In 2012, the IRS Oversight Board held a public forum to solicit comments about the correspondence exam process.<sup>24</sup> The participants universally identified contact with IRS employees as an obstacle.<sup>25</sup>

IRS customer satisfaction results validate stakeholders’ concerns. In a 2011 study, taxpayers who contacted the IRS two times or fewer before their correspondence examination cases were resolved were among the most satisfied.<sup>26</sup> Those who contacted the IRS six or more times were among the most dissatisfied.<sup>27</sup> Additionally, as shown in Figure 1.13.1, below, customer satisfaction ratings for correspondence examination in both the Small Business and Self-Employed (SB/SE) and Wage and Investment (W&I) units are comparatively low.

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21 IRM 4.19.19.3.2(1), *Replying to Taxpayer Inquiries*, (Nov. 7, 2013). Managers are required to monitor the cases to ensure the employees are taking timely action. IRM 4.19.19.3.2(3), *Replying to Taxpayer Inquiries*, (Nov. 7, 2013). And if a case is unassigned, the manager will ensure the notes are reviewed and worked. 4.19.19.3.2(4), *Replying to Taxpayer Inquiries*, (Nov. 7, 2013). However, this system may not always ensure contact. In a 2012 TIGTA report, TIGTA found that out of 150 calls that it sampled for its report, 20 calls involved either a taxpayer requesting a return call from the examiner or being promised one from the assistor. There was no evidence of a return call being made in 14 of those cases. See TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make it Easier for Taxpayers to Obtain Assistance During a Correspondence Audit* 7 (Aug. 17, 2012).

22 IRM 4.19.13.9.2(4), *Evaluating Taxpayer Responses*, (Feb. 13, 2013). See also IRM 4.19.19.2, *Call Requirements*, (March 28, 2013).

23 IRM 4.19.19.2(11), *Call Requirements*, (March 28, 2013).

24 IRS Oversight Board, *Public Forum* (Feb. 28, 2012).

25 As an example, Lonnie Gary, chair of the Government Relations Committee of the National Association of Enrolled Agents, stated to the Board “The fact that a single person is not assigned to a correspondence audit complicates swift resolution.” Lonnie Gary, *Oral Statement of Lonnie Gary, EA, USTCP Chair, Government Relations Committee National Association of Enrolled Agents Before the Internal Revenue Service Oversight Board 2* (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%201-Lonnie%20Gary.pdf>. Likewise, Patricia Thompson, chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA) identified four issues raised by AICPA members: (1) the excessive time it takes the IRS to resolve a taxpayer’s case; (2) the great difficulties taxpayers face when trying to contact the IRS to obtain information regarding the status of their correspondence audit case; (3) the numerous telephone inquiry calls taxpayers or their tax representative make to the IRS which go unreturned; and (4) the IRS employees routinely closing cases and issuing the statutory notice of deficiency (*i.e.*, the “90 day letter”) without having reviewed correspondence submitted by the taxpayer. Patricia Thompson, *American Institute Of Certified Public Accountants Statement Presented To Internal Revenue Service Oversight Board Public Meeting 3* (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%201-Thompson-AICPA.pdf>. Last, Andre L. Re, a tax controversy consultant, testified that it was a problem to have subsequent taxpayer contacts handled by a different IRS employee each time. He recommends, “perhaps once a taxpayer response is received the case should be assigned to one employee from then on who would be responsible for further contact and case resolution.” Andre L. Re, *Presentation Of Andre L. Re 1* (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%201-AndreRe.pdf>.

26 IRS, *Internal Revenue Service Customer Satisfaction Survey, Correspondence Exam (CCE) SB/SE National Report, Covering January through March 2011, with Annual Results 6* (July 2011).

27 *Id.*

**FIGURE 1.13.1. Taxpayer satisfaction outcome measures<sup>28</sup>**

Taxpayer Satisfaction	2009	2010	2011	2012	2013
SB/SE correspondence exam taxpayer satisfaction	45%	47%	47%	47%	48%
W&I correspondence exam taxpayer satisfaction	51%	50%	57%	49%	48%

**The Lack of an Assigned Employee Harms Taxpayers’ Ability to Resolve Their Cases Expeditiously, Erodes Taxpayer Rights, May Cause Taxpayers and the IRS to Incur Unnecessary Expenses, and Reduces IRS Employee Accountability.**

A taxpayer’s *right to quality service* and *right to finality* include the ability to resolve a problem efficiently the first time around, without incurring unnecessary expenses or other burden. Taxpayers may face confusion and frustration when no single employee is assigned to their correspondence exams.<sup>29</sup> In particular, as the National Taxpayer Advocate has written in previous reports, the correspondence exam process has inherent obstacles that prevent some low income taxpayers from navigating the process successfully on their own.<sup>30</sup>

***The Lack of an Assigned Employee Burdens Taxpayers with Repeat Calls.***

As noted above, 62 percent of those who call the correspondence exam unit are repeat callers.<sup>31</sup> A recent congressionally requested Government Accountability Office (GAO) audit sheds light on why taxpayers repeatedly call correspondence exam. The report observed that “[a]ll of the documentation sent by the taxpayer is maintained and managed in paper rather than electronic form … IRS does not keep these data in electronic form because its information system lacks capacity, according to IRS officials.”<sup>32</sup>

This system of document retention, combined with call routing, creates problems for taxpayers with ongoing tax problems. Without access to the taxpayer’s documentation, the first available examiner who answers the phone will likely not have sufficient information to answer the taxpayer’s question. The examiner does have access to the electronic notes from the employee who reviewed the taxpayer’s

28 IRS response to TAS information request (Sept. 5, 2014). This data is in comparison to field examination, which scored the following customer satisfaction rates: 60 percent in 2009 through 2011, 62 percent in 2012, and 63 percent in 2013. IRS, *Small Business/Self-Employed (SB/SE) Division, Field Examination Program Customer Satisfaction Survey; Final FY [sic] 2013 Annual National Report; Closed Cases April 2012–March 2013* 11 (July 13, 2013).

29 Here is one recollection from a practitioner:  
Ultimately the EA [enrolled agent] constructed not one, not two, but three large mailings, each weighing a few pounds, which she sent to Ogden. During this process, she made several calls to Ogden, which were frustrated by the fact that the staff in Ogden did not have direct extensions and the EA could not leave a direct, detailed message.

Lonnie Gary, *Oral Statement of Lonnie Gary, EA, USTCP Chair, Government Relations Committee National Association of Enrolled Agents Before the Internal Revenue Service Oversight Board* 2 (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%20201-Lonnie%20Gary.pdf>.

30 See National Taxpayer Advocate 2007 Annual Report to Congress 222-241 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 94-117 (*Research Study: IRS Earned Income Credit Audits—A Challenge to Taxpayers*); and National Taxpayer Advocate 2004 Annual Report to Congress, vol. 2 1-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

31 IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide* 1 (2009) (cited by National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 80). See also TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit* 1 (Aug. 17, 2012). This problem is compounded by the fact that in FY 2014, only 64.4 percent of taxpayers calling to speak to an IRS customer service representative could get through and the average time on hold was 19.55 minutes. IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2014).

32 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 19 (June 2014).

The Senate specified two reasons for enacting § 3705(b) of the IRS Restructuring and Reform Act of 1998: (1) it was important that “taxpayers receive prompt answers to their questions about their tax liability”; and (2) taxpayers had expressed frustration in not being able to find the appropriate IRS employee to contact.

information (if the review has taken place).<sup>33</sup> However, the case notes left by one employee may not make sense to the next, preventing that person from answering the taxpayer’s question correctly.<sup>34</sup> Lastly, taxpayers may be calling repeatedly because they do not get consistent information from one tax examiner to the next.<sup>35</sup> With no concrete way of knowing when and by whom the review of their records will occur, or if they have sufficiently complied with IRS requests for information, it is understandable that taxpayers repeatedly call for updates.

In 2012, TAS reviewed a sample of cases where taxpayers petitioned the Tax Court for review of IRS disallowance of the Earned Income Tax Credit (EITC) and where the IRS conceded the EITC issue in full without trial (hereafter the 2012 EITC study). The study found that of the cases reviewed, 63 percent of the taxpayers tried to resolve their issues by calling the IRS before filing their petitions, calling five times on average.<sup>36</sup> Even with multiple contacts, the taxpayers still had to go to Tax Court to get the right answer. The lack of accountability in these correspondence examination cases burdens taxpayers, wastes money, and impairs trust in the fairness and justness of the tax system.

The high volume of repeat calls erodes the taxpayer’s *right to be informed* because taxpayers cannot obtain answers about what they need to do to comply with tax laws. Likewise, the taxpayer’s *right to quality service* is harmed because taxpayers are denied prompt service. If one employee is assigned to a taxpayer’s case, that employee can give a definitive answer as to when the taxpayer should expect an update and answer questions specific to that case. The taxpayer may wait longer to speak to the assigned employee but the overall process would improve because the taxpayer would have contact with the correct employee who would also be accountable. Moreover, the taxpayer would not have to repeatedly explain his or her situation because the assigned employee would be familiar with the taxpayer’s case and the preceding discussions. This approach supports the taxpayer’s *right to challenge the IRS’s position and be heard*.

### ***The Lack of an Assigned Employee Creates Downstream Costs for Taxpayers and the IRS.***

Both the taxpayer and the IRS incur expenses that may be related directly to not having an employee assigned earlier in the case. When a taxpayer cannot reach an employee during an examination to get an answer or to follow up with documentation, mistakes may happen and the taxpayer may appeal a proposed assessment.<sup>37</sup> Taxpayers must either hire representatives or work with the IRS on their own, while the IRS must provide trained Appeals staff to rework the cases.

If the taxpayer does not exercise his or her appeal rights, Examination may issue a statutory notice of deficiency (SNOD).<sup>38</sup> The SNOD provides the taxpayer with the only opportunity to have judicial review of the case without prepaying the assessment. To exercise this right, the taxpayer must file a petition in

33 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 19 (June 2014).

34 See National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 79.

35 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 18 (June 2014). The GAO obtained this information as a result of a tax examiner focus group interview.

36 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 77.

37 Treas. Reg. § 601.105(b)(4). This is a statement of procedural rule, which provides guidance but is not codified.

38 See IRC § 6212.

the United States Tax Court—so again, taxpayers must either retain representatives during litigation or develop cases on their own; while the IRS incurs the expense of providing Counsel for its representation. The additional costs incurred through Appeals and litigation undermine the *right to a fair and just tax system.*

Taxpayers who do not agree with the audit outcome may also pursue an audit reconsideration, which allows taxpayers to submit information not previously considered in the examination.<sup>39</sup> In FY 2013, Correspondence Exam conducted 1,060,779 exams.<sup>40</sup> In FY 2013, the IRS also conducted 69,037 audit reconsiderations stemming from correspondence exams.<sup>41</sup> Audit reconsiderations are important to measure because these are cases where the IRS is reworking the same issue a second time.

In FY 2014, the IRS performed 857,410 correspondence examinations on individual taxpayers,<sup>42</sup> and TAS worked 17,373 correspondence examination cases involving individuals.<sup>43</sup> Each TAS case that involves a correspondence examination issue represents an instance where two IRS employees are needed to resolve the taxpayer's problem. Many of the TAS correspondence exam cases may result from the IRS's failure to assign one employee who is responsible for and knowledgeable about the facts and issues in the case.

### *The Lack of an Assigned Employee Reduces Employee Accountability.*

The lack of an assigned employee eliminates or reduces IRS employee accountability, which contributes to the problems previously identified. As the National Taxpayer Advocate has pointed out, under current procedures “[n]o one employee must follow up on his or her actions or decisions with respect to a case or speak with the taxpayer about those decisions.”<sup>44</sup> The absence of accountability impairs the taxpayer's *right to a fair and just tax system*, which provides that the IRS employee will consider the taxpayer's specific facts and circumstances.

The lack of accountability has real costs for both the taxpayer and the IRS. As discussed above, the 2012 EITC study shows that a majority of taxpayers in the study population attempted to work with the IRS earlier in the process. These cases were resolved once a Tax Court petition was filed and IRS Counsel conceded the case without going to trial. Some taxpayers must wait until this lengthy process ends to obtain their refunds. In fact, the 2012 EITC study showed that almost 39 percent of the taxpayers had to wait an average of almost one and a half years for the refund to which they were entitled.<sup>45</sup> The IRS could avoid this long wait by providing more accountability earlier in the process.

Lack of accountability also contributes to increased costs for the IRS, as higher-paid employees must rework the same cases. In particular, the 2012 EITC study highlighted the fact that the IRS incurs cost in employing higher-grade employees when the correct answer is missed earlier in the process.<sup>46</sup> In 20 percent of the cases reviewed, a higher-graded employee in Appeals or Chief Counsel accepted

39 For information on audit reconsiderations generally, see IRM 4.13.1.1, Overview, (Oct. 1, 2006).

40 IRS, FY 2013 Data Book, Table 9a. This represents 75.5 percent of all examinations on individual tax returns. IRS, FY 2013 Data Book Table 9a.

41 IRS, Individual Master File and the Audit Information Management System, closed case database.

42 Audit Information Management System Closed Case Data on the IRS Compliance Data Warehouse.

43 There were an additional 953 taxpayers who had both a correspondence examination and a non-correspondence examination. This number does not include correspondence examinations of businesses. TAMIS data (Nov. 3, 2014).

44 See National Taxpayer Advocate Blog, *Are IRS Correspondence Audits Really Less Burdensome For Taxpayers?*, available at <http://taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks>.

45 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 77.

46 *Id.*, vol 2 75.

documentation from a taxpayer that the examiner rejected.<sup>47</sup> In addition, in over one third of the cases, the IRS paid interest on the delayed refunds, averaging approximately \$200 per return.<sup>48</sup>

### The IRS Has Misplaced Its Efforts to Improve Customer Satisfaction by Overlooking Congressional Intent Behind RRA 98 §3705(b).

The IRS explains that its decision to not adopt an “exclusive assignment of cases” is the result of research showing that universal access to work papers and case histories allows any tax examiner to assist a taxpayer.<sup>49</sup> However, as practitioner feedback, the GAO study, and customer satisfaction ratings demonstrate, taxpayers do not always receive appropriate service from the first available examiner. While the IRS has studied how to improve the correspondence exam process, its studies do not consider the benefits of assigning one employee to cases once the taxpayer has engaged with the IRS or the amount of rework created by not assigning one employee.<sup>50</sup>

In 2008, the IRS initiated the Phone Optimization Project (POP) team to improve taxpayer satisfaction in correspondence examination. The team focused on:

- Ease of getting through to the right person;
- Length of correspondence exam process;
- Providing consistent information about the case;
- Length of time to get through by phone; and
- Explanation of adjustments.<sup>51</sup>

Most of these issues can be addressed (or even eliminated) by assigning an employee to certain cases. Perhaps the length of time to get through by phone would not be improved with an assigned employee because taxpayers may need to leave a message and wait for a call-back. However, because the taxpayer would not need to call multiple times or repeat the same information over and over to different employees, and because the assigned employee would be familiar with the facts of the case and knowledgeable what is *specifically* needed to resolve the case, overall cycle times could be reduced, and the overall experience might improve.

The POP team did not include single employee assignment once the taxpayer engages the IRS (whether through phone, mail, or fax) as a solution. Instead, the team focused on improving phone access and revising correspondence receipt and triage.<sup>52</sup> This decision may come from an underlying policy determination that any exam employee is the “right” employee for the taxpayer to call, a view that fails to consider the downstream work when taxpayers need one employee assigned to their case.<sup>53</sup>

The National Taxpayer Advocate finds this policy misguided. While universal call routing may be appropriate for industries such as airlines, the transactions one generally undertakes in those industries are

47 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 89.

48 See *id.*, vol. 2 77.

49 IRS response to TAS information request (Sept. 5, 2014).

50 See IRS, *Correspondence Examination Assessment Project (CEAP)* (Sept. 30, 2013); POP Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination, Briefing Document* (June 21, 2010).

51 POP Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination, Briefing Document 6* (June 21, 2010).

52 POP Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination, Briefing Document 9* (June 21, 2010).

53 IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide 5* (2009).

narrow, discrete tasks that usually can be completed in one call, like purchasing an airline ticket. IRS audits, on the other hand, are categorically different from purchasing an airline ticket. Audits involve issues of proof, interpretation of law and guidance, and usually result in a tax assessment that will be collected by the IRS—*i.e.*, multiple enforcement actions. Adopting an approach that works for the airline industry is inappropriate where the assessing and taking of taxpayer property is concerned.

The IRS also implemented the Correspondence Examination Assessment Project with the intent of reviewing and improving the correspondence exam process.<sup>54</sup> Initially, this review included “single point of contact” as a way to improve the correspondence exam process.<sup>55</sup> Ultimately, CEAP promoted self-assignment of cases by employees to encourage case resolution during the first interaction with a taxpayer.<sup>56</sup> This means that employees answering phone lines can assign cases to their own inventory from another campus.<sup>57</sup>

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**While universal call routing may be appropriate for industries such as airlines, the transactions one generally undertakes in those industries are narrow, discrete tasks that usually can be completed in one call, like purchasing an airline ticket. IRS audits, on the other hand, are categorically different from purchasing an airline ticket.**

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Without addressing the assignment of cases to a single employee, the IRS overlooks solutions that could improve the taxpayer experience and be “advantageous to the taxpayer.” For instance, the IRS uses Automated Correspondence Examination, a system that processes cases until a response is received from the taxpayer.<sup>58</sup> Under this system, mail is initially sorted and certain types of correspondence are removed, such as misrouted, undeliverable, or unclaimed mail.<sup>59</sup> For any mail still remaining after this sort, the IRS will research to determine if the case is assigned to an employee. If the case is unassigned, the mail is routed within five days based on local management procedure.<sup>60</sup>

The IRS could continue to automatically process cases up to the point that the taxpayer engages with the IRS—either via correspondence or via a phone call, when a case would be assigned to a specific employee. Under this recommendation, the IRS would continue to batch and assign cases to general groups of employees. However, once a taxpayer contacts the IRS on an unassigned case, either by correspondence or by calling, local management procedure could dictate that the employee who receives the contact would thereafter “own” the case. That employee would familiarize himself or herself with the case, be accountable for the case outcome, and serve as the contact for any future interactions with the taxpayer. If the initial taxpayer contact completely resolves the issue, the employee would close the case.

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54 IRS, *Correspondence Examination Assessment Project (CEAP) 4* (Sept. 30, 2013). This initiative developed in response to critical feedback about the correspondence exam program from stakeholders including the National Taxpayer Advocate. GAO, *Report to the Committee on Finance, U.S. Senate, IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 11 (June 2014).

55 IRS, *Correspondence Examination Assessment Project (CEAP) 16* (Sept. 30, 2013).

56 IRS, *Correspondence Examination Assessment Project (CEAP) Executive Briefing 7-8* (April 1, 2014). The GAO pointed out that the CEAP effort to promote self-assignment of cases was not clearly defined or tracked. As a result, the benefits of this effort may not be realized. GAO, *Report to the Committee on Finance, U.S. Senate, IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 35 (June 2014). The IRS claims that assignment of one employee was not eliminated, but was “clarified to be more about resolution than providing a specific name.” IRS response to TAS information request (Oct. 23, 2014).

57 For information on self-assignment of cases, see IRM 4.19.19.3.5(1), *Self-Assign General*, (Jan. 1, 2014).

58 See IRM 4.19.20.1, *Automated Correspondence Exam Overview*, (May 21, 2013).

59 See IRM 4.19.21.2(9), *Processing Incoming Correspondence*, (July 30, 2013).

60 See *id.*

Additionally, the IRS could expand use of virtual service delivery (VSD), which includes videoconferencing technology, to mitigate the delays caused by repeat calls.<sup>61</sup> The taxpayer could make an appointment, similar to an office audit, and even if the VSD appointment did not resolve all issues, the taxpayer would walk away knowing what else he or she needs to do. If a taxpayer is offered a virtual office audit, the employee handling the videoconference would then “own” the case until resolution.

## CONCLUSION

Automation can assist both the IRS and taxpayers. However, the IRS must use automation in a way that benefits taxpayers and respects taxpayer rights. Systems such as universal call routing may allow a taxpayer to reach an IRS employee relatively quickly, but as described above, the system may not provide the appropriate assistance taxpayers need in audits or collection matters. Taxpayers often require ongoing assistance to resolve their correspondence examinations, particularly because the tax code is so complex. These are the cases Congress had in mind when it passed RRA 98 § 3705(b)—cases where it would be “advantageous to the taxpayer” to assign one employee.

However, the IRS currently treats all correspondence exam cases as if they can be resolved with one contact or by the next available employee. The IRS has chosen to stick with systems that do not meet the needs of taxpayers instead of developing procedures to identify when a taxpayer would benefit from having a single assigned employee. This business practice fails to adhere to the congressional intent of § 3705(b), creates downstream costs for both the IRS and the taxpayer, and undermines *the right to quality service, the right to be informed, the right to challenge the IRS’s position and be heard, and the right to a fair and just tax system*. The IRS can follow the intent expressed in § 3705(b) by reviewing its current practices in light of downstream consequences and using technological advances that have occurred since the passage of the law.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Analyze the additional work caused by the current approach taken in correspondence exam. Based on that review, develop procedures and staffing models that enable cases to be assigned to one employee once the taxpayer has contacted the IRS.
2. Allow the taxpayer to individually choose service options to his or her advantage, such as leaving a voicemail for the employee owning the case or speaking with the next available employee.
3. Design extension routing capabilities to enable taxpayers to reach the employee assigned to their cases.
4. Include an option for single employee assignment in all technology developments, including VSD.

<sup>61</sup> In RRA 98, Congress intended the IRS to utilize technology to enhance taxpayer services. For more information, see 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, infra*.

**MSP  
#14****AUDIT NOTICES: The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM<sup>1</sup>**

Concerned about taxpayers being unable to reach IRS employees both knowledgeable about and accountable for the taxpayers' cases, in § 3705(a) of the IRS Restructuring and Reform Act of 1998 (RRA 98) Congress required the IRS to include the name, telephone number, and unique employee identification number in any "manually generated correspondence."<sup>2</sup> The IRS has failed to meaningfully implement the requirements of § 3705(a).<sup>3</sup> The IRS does not include appropriate employee contact information on most computer-generated notices, even when a particular employee has worked on the case.<sup>4</sup>

The National Taxpayer Advocate has identified the following concerns about IRS audit notices:

- The IRS failed to include contact information for a specific employee on any letter in the sample, even in the five percent of letters where an IRS employee had obviously customized the letter for the specific taxpayer, based on a review of a sample of 100 Letter 105-Cs, *Notice of Claim Disallowance*.<sup>5</sup>
- Where the IRS includes a "name" on most correspondence, it is either so generic as to be meaningless, such as "Tax Examiner," or is a person so high in the chain of management that a taxpayer cannot reach an individual employee who is personally knowledgeable about the case even after the IRS proposes changes to the account;<sup>6</sup> and

1 This Most Serious Problem acts in concert with the Most Serious Problem: CORRESPONDENCE EXAMINATION: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *supra*. The two pieces must be read together and for true accountability the recommendations from both should be implemented in tandem. The companion Most Serious Problem focuses on Pub. L. No. 105-206, § 3705(b) (1998) and discusses the burden imposed on both the IRS and taxpayers as a result of the IRS's failure to assign a single employee to correspondence exams where the taxpayer has contacted the IRS.

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

3 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998* (May 28, 2014). The report shows that the IRS took 57 actions to comply with § 3705 of RRA 98. Of those 57 actions, only seven can be reasonably construed as addressing contact information on correspondence or attempting to assist a taxpayer in reaching a specific IRS employee. Many of the actions taken to implement § 3705 involve creating unique employee identification numbers or determining how to provide assistance in Spanish.

4 Internal Revenue Manual (IRM) 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

5 Sample set of Letter 105-Cs on file with TAS Attorney Advisor Group.

6 IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013). See, e.g., Letter 105-C, *Claim Disallowed*, and Letter 106-C, *Claim Partially Disallowed* (containing contact information for a high level IRS official and Letter 525, *General 30 Day Letter*, containing general contact information for the generic "Tax Examiner").

- Employees can generate notices anonymously, particularly in correspondence audits, which can erode accountability for actions taken or not taken in a case.<sup>7</sup>

While it may be unnecessary or impractical to include contact information for a specific employee on all notices, particularly before a case is assigned, failing to do so after a taxpayer has communicated with the IRS may violate the law and contradict the IRS's own Internal Revenue Manual. At a minimum, campus correspondence procedures fail to address Congress' concerns regarding the inability of taxpayers to contact an IRS employee who is knowledgeable about and accountable for the case. This situation also erodes several essential taxpayer rights—*the right to quality service, the right to be informed, and the right to a fair and just tax system*—articulated in the Taxpayer Bill of Rights.<sup>8</sup>

## ANALYSIS OF PROBLEM

### Background

As a starting point for restructuring the IRS, the National Commission on Restructuring the Internal Revenue Service produced a report, *A Vision of a New IRS*, wherein it set forth a fundamental starting point for reform:

As a guiding principle, the Commission believes that taxpayer satisfaction must become paramount at the new IRS and that the IRS should only initiate contact with a taxpayer if the agency is prepared to devote the resources necessary for a proper and timely resolution of the matter.<sup>9</sup>

The text of RRA 98 demonstrates that this guiding principle was at the forefront of § 3705(a), where Congress attempted to remedy the inability of taxpayers to reach an IRS employee familiar with their case.<sup>10</sup> The Joint Committee on Taxation reported the reason for this change to the law was so taxpayers could receive prompt answers to questions about their tax liabilities, as many expressed frustration at not knowing which employee to contact.<sup>11</sup>

### *Members of Congress Were Concerned About Taxpayers' Access to IRS Employees with Knowledge of Their Cases.*

Before RRA 98 was enacted, taxpayers who received notices without specific contact information for the employees handling their cases were sometimes left with no alternative but to seek help from members

7 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013) ("Using the ACE [Automated Correspondence Examination], Correspondence Examination can process specified cases with minimal to no tax examiner involvement until a taxpayer reply is received. Because the ACE system will automatically process the case through creation, statutory notice and closing, tax examiner 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.") For a detailed discussion of the National Taxpayer Advocate's concerns regarding assigning one IRS employee to handle a taxpayer's matter until it is closed, see Most Serious Problem: CORRESPONDENCE EXAMINATION: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *supra*.

8 The IRS adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

9 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 5 (1997).

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

11 J. Comm. on Tax'n, *General Explanation of Tax Legislation Enacted in 1998*, 128 (1998).

of Congress in finding them. Senator Domenici of New Mexico spoke to this point during the debate leading up to RRA 98:

In New Mexico, a notice can come from the Albuquerque, Dallas, Phoenix, or Ogden IRS center. Taxpayers are often left with no option but to contact my office asking for help in simply identifying who they should talk to at the IRS to settle their tax matter. The caseworkers are experts, but it would take them 2 days to track down the right IRS office so that the constituent could try and solve their problem. It was so commonly befuddling to constituents that my caseworkers asked that this identification provision be included in this bill.<sup>12</sup>

Senator Domenici further stated: “I can’t believe we have to pass a Federal statute to accomplish this next task but apparently we do. The bill requires all IRS notices and correspondence to include the name, phone number, and address of an IRS employee the taxpayer should contact regarding the notice.”<sup>13</sup>

IRS stakeholders, including the American Institute of Certified Public Accountants (AICPA), proposed similar requirements for IRS notices as early as 1988.<sup>14</sup> Twenty-six years later, stakeholders are still expressing similar, and valid, sentiments. For example, during a 2012 IRS Oversight Board Public Forum panel discussion, the National Association of Tax Professionals voiced concerns about IRS employee accountability where no single employee is assigned to a correspondence exam and the extra burden this causes taxpayers when they need to explain their case to a new employee on each subsequent IRS contact.<sup>15</sup>

### *Members of Congress Were Also Concerned About IRS Employee Accountability for Actions on Taxpayer Cases.*

Hearings leading up to RRA 98 focused on taxpayer experiences with IRS employees.<sup>16</sup> During a panel hearing, the Senate heard the testimony of four taxpayers<sup>17</sup> who spoke of intimidation, threats, not knowing who they were talking to since employees did not sign their names to notices, paying taxes they knew they did not owe, the inability to get the same answer twice from employees, and not being able to talk to the same employee.<sup>18</sup> During the same set of hearings, Senators Moynihan and Grassley referred to accountability for IRS employees with Senator Grassley stating, in regards to the behavior described by the taxpayer panel, that “when heads roll, then it sends a clear signal to other people that this sort of action will not be tolerated.”<sup>19</sup>

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12 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici).

13 *Id.*

14 *Serious Problems Exist in the Quality of IRS Correspondence with Taxpayers: Hearing Before a H. Subcomm. of the Comm. on Government Operations*, 100th Cong. 108 (1988) (statement of Ida Bergman, Chairman of the Tax Administration Subcommittee of the AICPA). Mr. Bergman stated: “One example [of lack of sufficient information on correspondence] is the necessity to have on the notice the name of the person at the Internal Revenue Service with whom to correspond after the first response by the taxpayer. Getting effective communication with the Service, without knowing the person to speak to, is most frustrating.”

15 See also National Association of Tax Professionals (NATP), *IRS Oversight Board Public Forum: Panel 1: How Can Correspondence Audits Be More Effective for the IRS and Less Burdensome for Taxpayers?* (Feb. 28, 2012). The NATP noted concerns about IRS employee accountability when no single employee is assigned to a correspondence exam and the burden on taxpayers when they need to explain their case to a new employee on each IRS contact.

16 *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997).

17 *Id.*

18 *Id.*

19 *Id.* at 97 (1997) (statement of Sen. Grassley).

After the taxpayers concluded testifying, the Senate Finance Committee called then-Acting Commissioner Dolan to testify. Senator Roth, Chairman of the Senate Finance Committee, questioned Acting Commissioner Dolan about employee accountability.<sup>20</sup> The Chairman asked Acting Commissioner Dolan if indeed the IRS intended to hold employees accountable going forward, then wouldn't their names need to be included on future notices?<sup>21</sup> The Acting Commissioner acknowledged that notices needed work, that a series of notices were not signed, and some contained only a phone number.<sup>22</sup> These hearings emphasize the importance Congress placed on employee accountability in the debate leading to RRA 98.

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**The IRS reports it took 57 actions related to § 3705 of the IRS Restructuring and Reform Act of 1998, but none involved a comprehensive review of correspondence to determine which notices should be considered manually generated and contain employee contact information.**

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#### *Congress Did Not Define the Phrase “Manually Generated.”*

The final text of RRA 98 contains the words “manually generated” in § 3705(a).<sup>23</sup> However, the act does not define the phrase “manually generated,” nor do the words appear in any discussion involving § 3705(a). The original Senate discussion framing the section addressed a bill that would have required all IRS notices and correspondence to contain employee contact information.<sup>24</sup>

While the available record is silent on how the term “manually generated” arose, Senate Finance Committee hearing testimony shows that Acting Commissioner Dolan stated that he would like to come back to Chairman Roth and talk about the entire universe of notices and draw distinctions between types of notices.<sup>25</sup> This suggests a conversation about types of notices may have occurred off the record or in correspondence that remains sealed.<sup>26</sup> It is possible that if this discussion occurred or letters were written about the IRS notice process, the IRS may have clarified to the Senate its procedures for sending automatic notices before an employee would have looked at a case, resulting in the reference to “manually generated.”

#### **The IRS Has Not Adequately Implemented Section 3705(a) or Addressed Congress’s and Stakeholder Concerns About Access to the IRS and Employee Accountability.**

Following the enactment of RRA 98, the IRS Office of Legislative Affairs tracked all actions the IRS took to comply with the implementation of the law.<sup>27</sup> The IRS reports it took 57 actions related to § 3705 of RRA 98,<sup>28</sup> but none involved a comprehensive review of correspondence to determine which notices

20 *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997).

21 *Id.* at 214 (1997) (testimony of Michael Dolan, Acting Commissioner of the Internal Revenue Service).

22 *Id.*

23 Pub. L. No. 105-206, § 3705(a) (1998). The words “manually generated” did not appear until the Conference version of the bill in June 1998. 144 CONG. REC. H5100-01 (1998).

24 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici). See also S. REP. NO. 105-174, 103 (1998) (“The provision requires that all IRS notices and correspondence contain a name and telephone number of an IRS employee whom the taxpayer may call.”).

25 *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance*, 105th Cong. 105-190, at 214 (1997) (testimony of Michael Dolan, Acting Commissioner of the Internal Revenue Service).

26 S. Res. 474, 96th Cong. (1980) (enacted) “Sec. 2. (a) Subject to such rules and regulations as the Secretary of the Senate may prescribe, any other records of the Senate or any committee of the Senate which are so transferred may be made available for public use—(2) in the case of all other such records, when such records have been in existence for twenty years.”

27 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998*, (May 28, 2014).

28 *Id.*

should be considered manually generated and contain employee contact information.<sup>29</sup> Nor did the IRS seek an official legal opinion from the Office of Chief Counsel regarding the requirement to include contact information on manually generated notices. Of the actions, only seven could be reasonably interpreted as providing employee contact information on correspondence or assisting a taxpayer in finding a specific employee on a subsequent contact.<sup>30</sup> Four actions included awareness memos to employees about the requirement to include employee contact information on notices, two involved procedures on locating employees by badge or name on subsequent employee contacts, and one involved including tax examiner information on a specific class of real property tax notices.<sup>31</sup>

The IRS's implementation of § 3705(a) highlights concerns about the IRS audit process as it stands today. Notices in the audit process often request a time-sensitive response from the taxpayer or trigger a taxpayer's legal rights, including the right to an appeal and the right to petition the Tax Court.<sup>32</sup> Particularly where notices are legally significant, such as with Statutory Notices of Deficiency, the taxpayer should be provided with a specific employee to contact.<sup>33</sup>

The IRM on correspondence exam notices provides that 69 letters mailed on cases from the Campus Correspondence Examination inventory (the part of the IRS that audits a taxpayer's return solely via letter) "will include the appropriate BOD (business operating division) corporate toll free number, 'Tax Examiner' as the person to contact and the site specific identification number."<sup>34</sup> This instruction covers both cases where the taxpayer has not responded and others where the taxpayer either wrote to the IRS or spoke with an employee, yet subsequent correspondence to that taxpayer still does not contain contact information for the employee who read the first letter or spoke with the taxpayer by phone.<sup>35</sup>

The IRS automatically issues millions of notices every year.<sup>36</sup> Assigning an individual employee to each of these cases is not necessarily practical. At the least, however, once a taxpayer has written to or called the IRS, the contact information of the employee who reviews that correspondence or answers the call should appear on all future correspondence regarding that issue.<sup>37</sup>

Instead, the current IRS practice is to put taxpayers back into the IRS Automated Correspondence Exam (ACE) program for automatic case aging and processing even if the taxpayer has contacted the IRS.<sup>38</sup>

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29 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998*, (May 28, 2014).

30 *Id.* Actions AT-2009-13272, AT-2009-13276, AT-2009-13284, AT-2009-13300, AT-2009-13301, AT-2009-13307, and AT-2009-13327 address including contact information on notices or assisting taxpayers in finding a specific IRS employee.

31 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998* (May 28, 2014). Actions AT-2009-13272, AT-2009-13276, AT-2009-13284, AT-2009-13300, AT-2009-13301, AT-2009-13307, and AT-2009-13327.

32 See, e.g., Letter 531, *General Statutory Notice of Deficiency*.

33 See *id.*

34 IRM 4.19.10.1.6, *Correspondence Examination Letters* (Jan. 1, 2013). Sixty-nine letters are included in IRM 4.19.10.1.6(2) which are generated from the Campus Correspondence Examination inventory and will only contain a generic contact.

35 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013). "Once a taxpayer reply has been considered, the case can be reintroduced into ACE for automated Aging and Closing in most instances."

36 IRS Compliance Data Warehouse (CDW), Notice Delivery System, fiscal year (FY) 2014 (Nov. 2014).

37 We discuss the assignment of a single employee to correspondence exam cases in the companion Most Serious Problem. Most Serious Problem: CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers, *supra*. The recommendations in both pieces should be implemented in tandem for full accountability. As with the recommendation to assign an employee to a case once the taxpayer has contacted the IRS, similarly, not all correspondence exams require an employee assignment. However, once a taxpayer has engaged with the IRS, the employee who answered the phone call or correspondence should be assigned to the case until the issue is resolved, improving employee accountability and providing a taxpayer with an employee knowledgeable about the case.

38 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013).

This practice does not facilitate taxpayer access to the employee knowledgeable about his or her case. Nor does it foster accountability of IRS employees who close those cases without communicating with the taxpayer or addressing concerns.

### The IRS's Systems Seem to Be Set to Ignore the IRM Definition of "Manually Generated Correspondence" and as a Result Most Audit Correspondence Does Not Contain Specific Employee Contact Information.

The IRS definition of manually generated correspondence, where the contact information of the IRS employee working the case should be included, includes correspondence where the employee has exercised judgment in working or resolving the case.<sup>39</sup> However, even where correspondence is generated only because of an IRS employee working and making decisions on a taxpayer's case, the correspondence still does not contain the name and contact information for the employee.<sup>40</sup>

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Twenty-six years after the enactment of the IRS Restructuring and Reform Act of 1998, tax professionals continue to voice concerns about IRS employee accountability where no single employee is assigned to a correspondence exam and the burden on taxpayers when they need to explain their case to a new employee on each IRS contact.

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The IRS ACE program exists solely to conduct examinations with little or no human involvement.<sup>41</sup> Notices and letters are sent automatically via a computer program without specific contact information, even if an employee exercised judgment in the case or is requesting information, in seeming violation of the IRM. These letters notify taxpayers that their refunds have been frozen, deductions have been disallowed, further information is required to verify the return, and more.<sup>42</sup>

TAS pulled a sample of Letter 105-C, *Claim Disallowance*, which notifies taxpayers that their claim for a refund or tax credit has been disallowed.<sup>43</sup> Of the sample of 100 letters, none were signed by an individual employee who would have worked on the case; instead, all were stamped with the signature of a high-level manager or even program director.<sup>44</sup> While most of the letters contain standard paragraphs, that either an employee or the computer can select as a letter is generated, five of the letters contained specific, non-standardized information about the taxpayers' particular situations.<sup>45</sup>

One letter even referred to correspondence that a taxpayer submitted to substantiate the credit claimed, which would have required an employee to review the correspondence and decide if it was valid to support the claim.<sup>46</sup> In these cases, it is clear that an employee worked the case and exercised discretion to determine

39 IRM 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007). The IRS defines "manually generated correspondence" in the IRM as "correspondence issued as a result of an IRS employee exercising his/her judgment in working/resolving a specific taxpayer case or correspondence, or where the employee (Tax Examiner, Revenue Agent, Revenue Officer, etc.) is asking the taxpayer to provide additional case-related information." The IRS defines "non-manually generated correspondence" in the same IRM: "Non-manually generated correspondence may be issued as a result of the taxpayer filing a return, using an automated system, or requesting information about an account or tax law matter either by telephone or in writing. This correspondence does not require the name of a specific employee to whom the taxpayer needs to talk in connection with the letter received."

40 See IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013). Sixty-nine letters are listed which will only contain generic contact information when issued on campus exam inventory.

41 IRM 4.19.20.1, *Automated Correspondence Examination Overview* (May 21, 2013).

42 See, e.g., Letter 565, *Acknowledgement and Request for Additional Information*.

43 IRS, Letter 105-C, *Claim Disallowance*.

44 Sample set on file with TAS Attorney Advisor Group.

45 IRS, Letter 105-C, *Claim Disallowance*.

46 Sample set on file with TAS Attorney Advisor Group.

the validity of the taxpayers' claims, yet the letters still only contain the signature of a high level manager, not the contact information for the employee who made the decision and is familiar with the case.<sup>47</sup>

Although the IRS has issued over 560,000 105C letters in FY 2014 and many are standardized due to a mismatch of information between what a taxpayer has reported on a tax return and what the IRS has on file from third party reporters, it is clear that not all 105C letters are automatically generated.<sup>48</sup> In cases where these notices are issued by an employee who reviewed a taxpayer's account and made a decision, according to its own IRM, the IRS should provide that specific employee's name and contact information.<sup>49</sup> Failure to do so leaves the taxpayer with no way to contact an employee accountable for the decision. It also fails to address Congress' concerns that taxpayers be able to reach an IRS employee both knowledgeable and accountable for the taxpayer's case.

### **The IRS's Failure to Include Employee Contact Information on Campus Correspondence Burdens Taxpayers, Erodes Employee Accountability, and May Delay Case Resolution.**

Lacking an initial specific employee to contact, a taxpayer may call the generic IRS number printed in the notice. As the IRM states, "Any employee answering the Toll-Free number should be able to respond appropriately."<sup>50</sup> Each time taxpayers call the IRS, they must explain their situation again to the new employee who answers the general toll-free line.<sup>51</sup>

While taxpayers have indicated in focus groups that their desire to speak to an employee is greater than their desire to speak to the specific employee who made the decision on their case, this only holds true so long as the employees are "on the same page" and "know what they are doing."<sup>52</sup> However, employees are not always on the same page. A taxpayer who needs to contact the IRS more than once usually never speaks to the same person twice and the employee who answers the phone on a subsequent call will have to interpret notes, if any, that the previous employee has recorded.<sup>53</sup> Employees are expected to take notes while on a call with the taxpayer.<sup>54</sup> Taxpayers complain that they are frustrated with talking to tax examiners who do not have their files, having to resubmit paperwork, not having documentation acknowledged, having to repeat conversations, not receiving return calls, and not being able to get their cases resolved while on the phone.<sup>55</sup> Notably, 62 percent of calls received in the IRS correspondence examination unit are from repeat callers, which may indicate that taxpayers are not receiving the assistance they require, and their calls are being handled inadequately by employees unfamiliar with the

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47 Sample set on file with TAS Attorney Advisor Group.

48 IRS, CDW, Notice Delivery System FY 2014 (Nov. 2014). For FY 2014, the IRS has issued 564,008 105-C letters.

49 IRM 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

50 *Id.*

51 For a detailed discussion of the National Taxpayer Advocate's concerns regarding assigning one IRS employee to handle a taxpayer's matter until it is closed, see Most Serious Problem: CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers, *supra*.

52 Pacific Consulting Group, *Compliance Center Examination (CC Exam) SB/SE National Report, January Through March 2008* (July 2008).

53 IRM 4.19.19.2(17), *Call Requirements* (Mar. 28, 2013).

54 *Id.*

55 Phone Optimization Project (POP) Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination Briefing Document* (June 21, 2010).

specific issues in the audits.<sup>56</sup> Repeat calls for the same issue creates rework for the IRS and contributes to taxpayer frustration.

### *Lack of Specific Employee Contact During Correspondence Exams May Contribute to Taxpayer Burden and Dissatisfaction.*

While correspondence exams and automation of the examination process allow the IRS to conduct many additional exams, the IRS must balance technology with customer service. Taxpayers fare worse in correspondence exams than in field or office audits.

Correspondence exams have lower “agreed to” rates, where the taxpayer accepts the IRS’s findings, than field and office exams. Only about 26 percent of correspondence exams were closed as “agreed to” in comparison to almost 63 percent of field and office exams.<sup>57</sup> This may be due in part to difficulty in communicating with an anonymous examiner who may have drafted letters specifically requesting information or informing the taxpayer of decisions that do not include his or her contact information.

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### **The Lack of Contact Information for a Specific IRS Employee Knowledgeable About and Accountable for the Correspondence Sent to the Taxpayer Violates Taxpayer Rights.**

Failing to include the contact information of an employee with whom the taxpayer may discuss his case violates the *right to quality service*, the *right to be informed*, and the *right to a fair and just tax system* contained in the Taxpayer Bill of Rights.<sup>58</sup> The *right to quality service* should ensure that a taxpayer can reach an employee who is knowledgeable about his or her case, preferably the same employee each time, to resolve the issue timely and with the least burden to the taxpayer.

Taxpayers have the *right to be informed* in clear and easily understandable language about actions taken on their accounts and to have an employee familiar with the case provide the explanation the taxpayer requires. Under the *right to a fair and just tax system*, taxpayers have the right to have information particular to their situations considered in resolving account issues. When a taxpayer does not know who to contact and cannot reach the employee who made a preliminary determination or requested additional information from them, they may need to explain their issue multiple times to different employees and may receive different responses each time.

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Sixty-two percent of calls received in the IRS correspondence examination unit are from repeat callers, which may indicate that taxpayers are not receiving the assistance they require, and their calls are being handled inadequately by employees unfamiliar with the specific issues in the audits.

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56 See IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide 1* (2009) (cited by National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 80). See also Treasury Inspector General for Tax Administration, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit 1* (Aug. 17, 2012). The IRS has not performed any follow-up studies for this measurement. IRS response to TAS information request (Sept. 5, 2014).

57 IRS, CDW, Audit Information Management System (AIMS) Closed Case Database FY 2014 (Nov. 20, 2014). The IRS closed 26.2 percent of correspondence exams as agreed and 62.9 percent of field and office exams as agreed in FY 2014.

58 IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

## CONCLUSION

While technological advances have permitted the IRS to automatically generate and send many notices and letters to taxpayers that were previously sent by employees, the IRS must strike a balance between technology and customer service. Given the volume of notices issued by the IRS and the technology that allows the IRS to automatically identify many errors in tax returns, it would be impractical to assign an employee to every piece of correspondence. However, where an actual employee has looked at a taxpayer's account and made a decision about that account, that employee's name and specific contact information should appear on the notice that communicates that decision. Contact information should also be provided where an employee has looked at a case as a result of taxpayer correspondence or phone calls. Failing to include specific contact information for employees on such notices puts the IRS right back to where it was when Senator Domenici could not believe that a statute had to be passed to accomplish such a basic task.<sup>59</sup>

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that:

1. All audit notices and correspondence currently sent to taxpayers, including those generated by Examination software, should be reviewed to ensure compliance with § 3705(a) of RRA 98.
2. Where an employee has reviewed a case, letters generated by that review should contain the employee's name and contact information even if the letter is generated with the assistance of automated systems or software.
3. If a notice is generated automatically through a program such as ACE, but has legal impact on the taxpayer, such as a Statutory Notice of Deficiency (SNOD), the contact information for a manager should be included on such notices to facilitate call-routing and case assignment.
4. Once a taxpayer has communicated with the IRS, either by correspondence or via a phone call, contact information for the employee who reviews that correspondence or answers the telephone call should appear on subsequent correspondence.

59 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici).

**MSP  
#15****VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

Over 15 years ago, Congress recognized the opportunities for effective tax administration presented by videoconferencing and similar technologies.<sup>1</sup> As a result, in RRA 98, Congress directed the IRS to “consider the use of the videoconferencing of appeals conferences between appeals officers and taxpayers seeking appeals in rural or remote areas.”<sup>2</sup>

Virtual service delivery (VSD) is an indispensable means of facilitating such important taxpayer rights as *the right to quality service, the right to challenge the IRS’s position and be heard, and the right to a fair and just tax system.*<sup>3</sup> The National Taxpayer Advocate has consistently championed VSD’s benefits, including:

- The ability to transmit and discuss documents in real time;
- The improvement of communication and interaction between the IRS and taxpayers; and
- The reduction of costs for all parties.<sup>4</sup>

Without access to VSD, taxpayers living in remote areas and in states where no Appeals or Settlement Officers are present have limited options for obtaining face-to-face interactions with IRS personnel, which can be especially important in communicating complex matters, raising objections, providing additional documentation, and assessing credibility. Face-to-face interactions have been shown to enhance taxpayer

1 Hereafter referred to collectively as “virtual service delivery” (VSD).

2 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465(c) (July 22, 1998).

3 National Taxpayer Advocate 2013 Annual Report to Congress 5-19. To its great credit, the IRS on June 10, 2014, adopted the Taxpayer Bill of Rights (TBOR) that the National Taxpayer Advocate has long recommended, pulling together in one basic statement the substantive rights scattered throughout the Internal Revenue Code. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

4 See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 462-68; National Taxpayer Advocate 2012 Annual Report to Congress 302-18.

satisfaction and to increase taxpayer responsiveness during audits.<sup>5</sup> Despite these clear benefits and some initial steps by the IRS to implement this technology, the IRS has not yet developed a comprehensive approach to virtual service delivery, in either brick and mortar locations or over the Internet.<sup>6</sup>

## ANALYSIS OF PROBLEM

In passing RRA 98, Congress envisioned the increased use of technology, including VSD, as a means of improving taxpayers' experience with the IRS.

The National Commission on Restructuring the IRS (Restructuring Commission) contemplated a new IRS operating like a customer-focused business, as competently and smoothly as a bank, credit card company, or utility.<sup>7</sup> The Restructuring Commission recognized that skillful use of enhanced technology would be a key element of this service model, which emphasized efficiency and customer focus.<sup>8</sup>

The IRS must update its technology and treat taxpayer information as a strategic asset to improve its customer service and compliance functions ... Advancements in technology will make it easier for the IRS to resolve taxpayer problems quickly, thereby reducing the intrusive-ness of the government.<sup>9</sup>

Reflecting this vision, Senator Roth, Chair of the Senate Finance Committee, articulated some of the goals underlying the legislation as making "IRS employees more accountable," giving "the Commissioner the tools necessary to bring the IRS into the next century," and offering "greater due process to taxpayers who are trying to comply with our complex tax laws."<sup>10</sup> In furtherance of these goals, the Committee instructed that "[t]he Commissioner of Internal Revenue shall consider the use of the videoconferencing of appeals conferences between appeals officers and taxpayers seeking appeals in rural or remote areas."<sup>11</sup>

### **Other government agencies, such as the Social Security Administration (SSA) and the Department of Veterans Affairs (VA), have improved and enhanced their services through VSD.**

Like the IRS, the SSA and the VA are charged with fulfilling widespread customer service obligations in an environment of contracting financial resources. These agencies have made substantial progress in employing videoconferencing to reduce wait times and improve accessibility for those who reside in remote locations or have critical needs.

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5 IRS National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012); National Taxpayer Advocate, Briefing for the Enforcement Committee, *Examination Strategy: The Impact of Increasing Automation*, slide 15 (Apr. 23, 2012). In addition to options presented by virtual face-to-face technology, the availability of in-person interactions should always be preserved. For a more in-depth discussion regarding the importance of in-person interactions between taxpayers and the IRS, see *Most Serious Problem: APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *supra*. See also *Legislative Recommendation: ACCESS TO APPEALS: Require That Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, infra*.

6 For a suggestion from the National Taxpayer Advocate regarding congressional intervention as a means of solving this problem, see *Legislative Recommendation: Virtual Service Delivery (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet, infra*.

7 Report of the National Commission on Restructuring the IRS, 8 (June 25, 1997). RRA 98 was based on the Commission's findings and recommendations.

8 *Id.* at 6.

9 *Id.*

10 144 CONG. REC. S4182 (1998) (Remarks by Senator Roth).

11 RRA 98, Pub. L. No. 105-206, Title III, Subtitle E, § 3465(c) (July 22, 1998).

**Eighty-three percent of taxpayers responding to an IRS study indicated they were likely to use the IRS website, while 72 percent said they probably would use email to send questions directly to the IRS. Further, over half of the respondents (53 percent) stated they would be likely to use two-way video communications.**

Employing over 400 video units in field offices across the country, the SSA completed over 70,000 video calls and more than 115,000 video interviews with field office customers between July 2011 and July 2012.<sup>12</sup> Moreover, in 2012, SSA held almost 25 percent of its hearings by video, compared to less than five percent in 2004.<sup>13</sup>

The VA uses videoconferencing for a variety of applications ranging from primary care treatment to speech pathology services to mental health support.<sup>14</sup> Generally, the health services are delivered to community-based outpatient clinics (CBOC) from traditional VA health care facilities by clinical videoconferencing equipment using highly encrypted transmissions.<sup>15</sup> The VA operates over 700 CBOCs with videoconferencing capacity for veterans who lack easy access to VA hospitals.<sup>16</sup> The VA provided approximately 140,000 remote mental health visits alone to approximately 55,000 veterans in fiscal year (FY) 2011.<sup>17</sup>

#### **The potential benefits of videoconferencing in brick and mortar locations and over the Internet have yet to materialize for either taxpayers or the IRS.**

Notwithstanding the insights of the Restructuring Commission, the directives of RRA 98, and the success of other agencies, the IRS is still operating as a 20th century business, primarily relying on postal correspondence, telephone conversations, and taxpayer visits to brick and mortar locations.<sup>18</sup> This model places unnecessary limits on the accessibility of the IRS, along with the types of interactions that are available, and is increasingly costly to administer.

Extended delays surrounding correspondence with the IRS, lengthy hold times when telephoning for IRS assistance and long lines at Taxpayer Assistance Centers (TACs) have combined to frustrate and anger taxpayers.<sup>19</sup> These shortcomings in taxpayer services run counter to the Congressional intent underlying RRA 98, but can be mitigated to the extent that the IRS makes effective use of VSD. Societal comfort

12 See Social Security Administration, Service Delivery Plan, 14-15 (Feb. 20, 2013), available at [www.ssa.gov/open/SDP/SDP\\_022013.pdf](http://www.ssa.gov/open/SDP/SDP_022013.pdf).

13 *Id.*

14 See Real-Time Clinic Based Video Telehealth (Jan. 16, 2014), available at <http://www.telehealth.va.gov/real-time/index.asp>.

15 Deen, Godleski, and Fortney, *A Description of Telemental Health Services Provided by the Veterans Health Administration in 2006–2010*, 63 PSYCHIATRIC SERV. No. 11 (Nov. 1, 2012), available at <http://journals.psychiatryonline.org/article.aspx?articleid=1386903>; For Veterans with PTSD, *Videoconferencing Proves Effective for Delivering Therapy*, VA RESEARCH CURRENTS, May 2013, available at <http://www.research.va.gov/currents/may13/may13-02.cfm>.

16 See *Real-Time Clinic Based Video Telehealth* (Jan. 16, 2014), available at <http://www.telehealth.va.gov/real-time/index.asp>.

17 *Using Technology to Improve Access to Mental Health Care*, Veterans Health Administration News Features (Aug. 13, 2012), available at <http://www.va.gov/health/newsfeatures/20120813a.asp>.

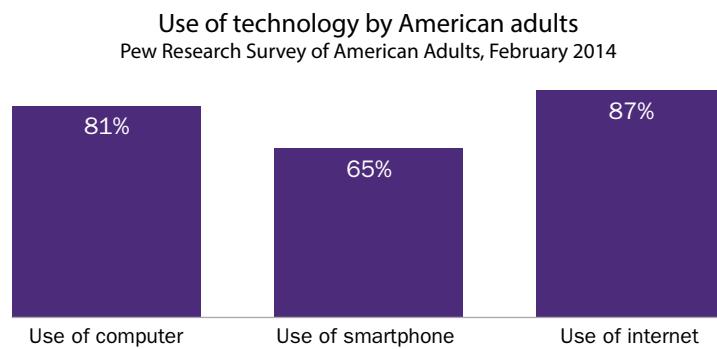
18 The exception to this circumstance is electronic filing of tax returns, the prevalence of which can be directly traced to the Congressional mandate established in RRA 98. See RRA 98, Pub. L. No. 105-206, Title II, Subtitle A, § 2001 (Jul. 22, 1998). Similar progress has not been made in other areas, however. For example, Taxpayer Assistance Centers and the services they offer are contracting rather than expanding. For a more in-depth discussion of this topic, see *Most Serious Problem: VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*, *supra*.

19 National Taxpayer Advocate 2013 Annual Report to Congress 20-39; Government Accountability Office, GAO-12-176, 2011 Tax Filing: Processing Gains, but Taxpayer Assistance Could Be Enhanced by More Self-Service Tools (Jan. 17, 2012).

with computer technology in general, and virtual service delivery in particular, has grown to such a degree that many taxpayers would embrace this option, especially if it saved them time or expense.<sup>20</sup>

The scope of this opportunity is demonstrated in a study conducted by the Pew Research Center's Internet and American Life Project, which indicates that 81 percent of adult Americans use a computer on at least an occasional basis.<sup>21</sup> Further, approximately 65 percent of the individuals surveyed reported having a smartphone. Eighty-seven percent of adult Americans use the Internet occasionally, with 82 percent of the survey respondents stating they had done so within the last day. Ninety percent of this latter group reported going online from home.<sup>22</sup>

**FIGURE 1.15.1**



The IRS Oversight Board has also noted the increased comfort with, and use of, computer technology, and the resulting opportunities for VSD. Eighty-three percent of taxpayers responding to an IRS study indicated they were likely to use the IRS website, while 72 percent said they probably would use email to send questions directly to the IRS.<sup>23</sup> Further, over half of the respondents (53 percent) stated they would be likely to use two-way video communications.<sup>24</sup> As summarized by the study, “[r]esults show indications of upward trends in the likely use of these more technology-based service options.”<sup>25</sup> This openness to the use of computer technology is illustrated in the following chart.

20 U.S. taxpayers living abroad would particularly benefit from the ability to utilize virtual face-to-face technology as a means of interacting with the IRS. See National Taxpayer Advocate 2012 Annual Report to Congress, 462-68.

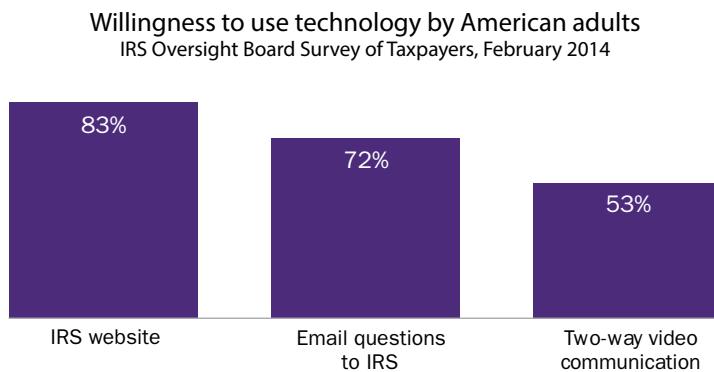
21 Pew Research Center, *The Web at 25 in the U.S.* (Feb. 27, 2014) (conducted January 2013) available at <http://www.pewinternet.org/2014/02/25/the-web-at-25-in-the-u-s>.

22 *Id.*

23 IRS Oversight Board, 2013 Taxpayer Attitude Survey (conducted Aug. 2013), available at [http://www.treasury.gov/IRSOB/reports/Documents/IRSOB\\_TAS%202013.pdf](http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_TAS%202013.pdf).

24 *Id.*

25 *Id.*

**FIGURE 1.15.2**

In passing RRA 98, Congress urged the IRS to adopt a course of action that likely would have yielded VSD progress comparable to that achieved by the SSA and the VA. Although Congress articulated the desired VSD exploration in the context of Appeals, technological innovation on that front presumably would have migrated to other IRS divisions. More than 15 years after the enactment of RRA 98, however, the desire reflected in and the opportunity presented by Congress' videoconferencing directive have yet to be achieved. The IRS is taking strides toward making the benefits of VSD available to taxpayers, but the potential and need for substantial and necessary progress remain.

***VSD represents an important means of expanding the reach of brick and mortar locations.***

The most traditional type of VSD is associated with a public facility, such as a TAC, and employs a high-definition monitor with the capacity for two-way audio interchange between the taxpayer and the IRS. In some locations, the monitor is paired with a high-resolution camera that allows IRS personnel to view documentation provided by taxpayers. That equipment, which is hard-wired into a given facility, provides secure connectivity between taxpayers and the IRS.

A significant impediment to the growth of VSD use in such facilities, however, is the limited activity that can be undertaken by taxpayers in conjunction with videoconferencing. Taxpayers generally cannot:

- Fax or otherwise electronically submit documents;<sup>26</sup>
- Make payments;
- File returns; or
- Obtain account transcripts.<sup>27</sup>

26 Eight VSD Partner Sites are outfitted with physical fax machines that can send and receive faxes. User & Network Services (Network Services) supplemental response to TAS research request (Aug. 25, 2014).

27 *Id.* Taxpayers using VSD to speak with TAS can obtain all the services they would be able to receive in any TAS field office where face-to-face contact is offered, with the exception of making a payment. Additionally, four TAS Campus offices provide VSD assistance to remote taxpayers. For security reasons, taxpayers are not allowed to walk into IRS Campuses. Nevertheless, VSD provides a mechanism for TAS customers to obtain face-to-face assistance from TAS employees located in campus offices who would not otherwise be accessible.

**Societal comfort with computer technology in general, and virtual service delivery in particular, has grown to such a degree that many taxpayers would embrace this option, especially if it saved them time or expense.**

The IRS is exploring technology that will allow taxpayers to accomplish these and other routine tasks, with multiple IRS organizations sharing the technology and routing video to the correct location.<sup>28</sup> Nevertheless, until the IRS develops such expanded capacity, taxpayers will be less likely to embrace videoconferencing in brick and mortar locations.

The IRS has installed videoconferencing technology at only 49 taxpayer-facing locations around the country.<sup>29</sup> As this relatively small number of locations would indicate, videoconferencing still exists within the IRS largely on a conceptual basis, rather than as a day-to-day mechanism for serving customers. Despite positive initial results, the IRS has not yet moved beyond the piloting phase of videoconferencing on a large scale.<sup>30</sup> Of the 49 locations currently outfitted for videoconferencing, only 37 appear to offer such services to taxpayers on an ongoing day-to-day basis, with the remaining 12 reporting zero taxpayers served for FY 2014.<sup>31</sup>

This relatively slow progress is attributable to a variety of obstacles. Currently, videoconferencing does not take place within the IRS firewall, which limits the use of the equipment and does not allow the IRS to fully utilize its functionality.<sup>32</sup> Because of concerns about data security, no information personally identifiable to taxpayers can be transferred on the network now in operation.<sup>33</sup>

On the human capital end of the spectrum, the IRS has also experienced difficulty in staffing the videoconferencing facilities, which require at least some personnel coverage for opening and closing the facility, maintaining the equipment, and answering essential questions regarding its operation. Often the most desirable facilities are, by definition, in remote areas, where the IRS has encountered challenges in finding employees who are available and willing to staff these sites consistently.

As in so many areas, insufficient funding is a contributing cause of the IRS's inability to move more quickly in this aspect of taxpayer service. The IRS budget for FY 2014 originally requested approximately \$4,000,000 for the deployment of 100 new videoconferencing units.<sup>34</sup> Ultimately, however, nothing was allocated, and no VSD funding is expected to be available for FY 2015 or beyond.<sup>35</sup>

The IRS has shifted much of its emphasis to the provision of VSD over the Internet. Nevertheless, the continued development of VSD in brick and mortar locations is essential for taxpayer populations that do not have access to home computer technology or who are not proficient in its use. The requisite

28 National Taxpayer Advocate 2012 Annual Report to Congress 465.

29 Network Services response to TAS research request (Aug. 6, 2014).

30 E.g., in a limited pilot conducted by W&I between October 2011 and June 2012, 87 percent of taxpayers reported they were satisfied, to very satisfied, with this service, and 91 percent would use it again. W&I Response to TAS Fact Check Request (Nov. 4, 2014).

31 Network Services response to TAS research request (Aug. 6, 2014).

32 *Id.*

33 *Id.*

34 Dep't of the Treasury, *Budget in Brief, Internal Revenue Service, FY 2014*, 10, Doc. 9940 (Rev. 4-2013).

35 Network Services response to TAS research request (Aug. 6, 2014).

maintenance and expansion of traditional VSD, however, cannot occur in the absence of sufficient funding, which has yet to be provided by Congress or shifted from other programs within the IRS.<sup>36</sup>

The IRS should begin employing all of its videoconferencing-enabled locations on a day-to-day basis. For example, Appeals has had a number of videoconferencing-ready locations that did not “go live” until near the end of the 2014 fiscal year.<sup>37</sup> Additionally, the IRS can achieve substantial strides by enhancing the scope of activities that can be undertaken by taxpayers in conjunction with videoconferencing. The increased utilization resulting from expanded functionality will not only establish the value proposition of VSD with respect to the IRS, but also will help demonstrate the benefits and existence of videoconferencing facilities to taxpayers.

As a further means of maximizing the efficient provision of VSD, the Treasury Inspector General for Tax Administration (TIGTA) has suggested that the IRS establish a process to identify the best locations for VSD, without limiting the inquiry to those sites where TACs already exist.<sup>38</sup> The need for strategic location of VSD sites, together with personnel who can provide appropriate assistance, is especially great for low-income populations that may lack the technological skills or comfort level to fully utilize the benefits of VSD.<sup>39</sup> As a result, the IRS should seek additional opportunities to partner with local organizations and government agencies, such as the U.S. Postal Service, as a cost-effective way of bringing VSD and the necessary staffing to all taxpayers.<sup>40</sup>

***VSD over the Internet presents a separate approach with enormous potential benefits for both taxpayers and the IRS.***

The provision of VSD at brick and mortar locations will always have its place as a means of assisting taxpayers who lack home computing facilities or capabilities. Nevertheless, the bulk of U.S. taxpayers and

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36 Also recognizing the value of VSD, TIGTA has recommended that the IRS develop a long-term plan to provide virtual face-to-face assistance to as many taxpayers as possible through the use of VSD in brick and mortar locations. TIGTA has further recommended that the cost savings and benefits related to VSD be quantified and reported as part of the budget request process. TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

37 To its credit, Appeals has established procedures for making VSD available for Campus Appeals in situations where Appeals personnel are co-located with VSD equipment and the taxpayer or representative is located within 100 miles of a VSD taxpayer-facing location. See Memorandum for Appeals Employees, *Implementation of Virtual Service Delivery*, John Cardone, Director, Policy, Quality and Case Support (July 24, 2014). To this point, however, the lack of customer-facing locations that are publicized and available places a significant limitation on the ability of taxpayers to utilize this option. As these locations did not come online until September 29, 2014, TAS cannot currently evaluate the extent to which taxpayers are encouraged and able to utilize this technology. See Appeals’ Response to TAS Fact Check Request (Nov. 3, 2014).

38 TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

39 A Taxpayer Advocate Service study of taxpayers eligible to use low-income tax clinics (LITCs) indicated, among other things, that although 70 percent of the taxpayers surveyed had a computer with an internet connection at home, only 13 percent of LITC-eligible taxpayers reported they would feel comfortable discussing their income tax situation by video from a designated location with an assigned IRS representative. Only 25 percent of Spanish-speaking taxpayers said they would feel comfortable holding such a videoconference. See TAS Survey of Taxpayers Eligible to use LITCs conducted by Russell Research (July 2014). These results reinforce the caution previously articulated by the National Taxpayer Advocate that VSD should not be viewed as a replacement for face-to-face conferences, which were preferred by 77 percent of the LITC-eligible taxpayers. Similarly, the results suggest that the availability of personal instruction and guidance with respect to VSD equipment likely is an important element of full utilization of that equipment even by a segment of those taxpayers possessing computer and internet-capability at home.

40 Mobile van units represent an additional potential means of bringing technology directly to taxpayers, particularly those located in low-income and rural areas. For a more in-depth discussion of this topic, see *Most Serious Problem: IRS Local Presence: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

all tax professionals likely would interact with the IRS via home or office computer or smartphone if they had the chance, just as they now do with a wide range of businesses and related enterprises.

As a result, the IRS is also attempting to develop a comprehensive, Internet-based VSD platform that taxpayers can access using their own technology. Central to this initiative, known as taxpayer digital communications (TDC), is a secure messaging portal. This portal would provide taxpayers with web access to certain functionalities including one-way/two-way communication via secure webmail, and electronic document upload, transfer, and receipt capacity.<sup>41</sup> Later in the TDC development process, taxpayers would have online text chat, click to call, online video meeting, and co-browsing capability.<sup>42</sup> Ultimately, taxpayers also would be able to undertake most of these interactions with the IRS directly from their smartphones.<sup>43</sup>

Virtually all of this TDC functionality, however, is aspirational, as many of the platform features are still in the planning stage. Only the secure messaging capability, which is scheduled to begin piloting in FY 2015, is nearing release and procedures for secure authentication are still under discussion.<sup>44</sup> The IRS has no estimate for when the other functionalities will become available.<sup>45</sup> Widespread interchange between taxpayers and the IRS via smartphone remains a goal, but without definitive parameters or timetables.<sup>46</sup>

TDC has vast potential for delivering services to taxpayers in ways that are more accessible, convenient, and cost effective for taxpayers. Moreover, the use of such technology can revolutionize tax administration in terms of resource allocation, cost savings, and enhanced quality of service. Such benefits, both to taxpayers and to the IRS, are fully consistent with Congress' vision expressed in RRA 98 in general, and in § 3465(c) in particular.

The IRS is to be commended for its recent efforts in this regard. Nevertheless, substantial progress remains to be made and the National Taxpayer Advocate urges that continued development and implementation of TDC be a high priority of the IRS.

## CONCLUSION

As an element of RRA 98, Congress envisioned the increased use of technology, including VSD, as a means of improving taxpayers' experience with the IRS. More than ever, taxpayers and the IRS would benefit from the cost-savings and improved customer service that would be generated by VSD. Other governmental agencies, such as the SSA and the VA, have had notable success in improving and enhancing customer services through the implementation of VSD. Such benefits, however, have not yet materialized for taxpayers and the IRS either through the provision of videoconferencing in brick and mortar locations or through the use of TDC.

<sup>41</sup> Online Services (OLS) response to TAS research request (Aug. 18, 2014).

<sup>42</sup> OLS: Taxpayer Digital Communications Executive Summary (Aug. 18, 2014).

<sup>43</sup> OLS response to TAS research request (Aug. 18, 2014).

<sup>44</sup> *Id.* As currently formulated, these secure authentication procedures could potentially exclude taxpayers who do not have a bank account or who do not own a home from access to TDC. TAS looks forward to continued collaboration with OLS and other stakeholders to develop an effective and inclusive authentication mechanism that works for all taxpayers.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.* SB/SE Field Collection has recently initiated a Smartphone pilot in its Tampa, FL and Oakland, CA Territories. Eventually, SB/SE Field Collection plans to have Revenue officers use Smartphones to facilitate activities such as electronic payment and GPS Mapping. See Smartphone Technology – The Wave of the Future for the IRS (Sept. 17, 2014) available at <http://www.mysbse.web.irs.gov/default.aspx>.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Maximize the benefits of VSD in brick and mortar locations currently equipped for videoconferencing by offering VSD services from all such facilities on a day-to-day basis and by enhancing the scope of activities that taxpayers can undertake in conjunction with videoconferencing.
2. Establish development and implementation of TDC as one of its highest ongoing priorities.
3. Develop and publish a definitive plan for the continued rollout of both VSD in brick and mortar locations, including non-IRS facilities, and TDC, and articulate concrete dates for implementation at different stages.
4. Allocate funding, or seek funding from Congress, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations and over the Internet.

**MSP  
#16****MATH ERROR NOTICES: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

Under Internal Revenue Code (IRC) § 6213(b) and (g), the IRS is authorized, in specific instances, to assess tax without first issuing the statutory notice of deficiency (SNOD) that allows taxpayers access to the prepayment forum of the U.S. Tax Court. Previously this provision applied only to mathematical errors (*e.g.*,  $2 + 2 = 5$ ).<sup>1</sup> In 1976, acting on a request made by the IRS, Congress expanded math errors to include “clerical errors” (*e.g.*, inconsistent entries).<sup>2</sup>

Congress was concerned about granting the IRS this expanded authority and specifically directed that when the IRS makes a summary assessment for a mathematical error, the taxpayer must be given an explanation of the adjustment.<sup>3</sup> The explanation of the adjustment in the math error notice is critical to the taxpayer’s ability to challenge the adjustment and preserve his or her right to petition the U.S. Tax Court by requesting abatement within 60 days of the notice being sent.<sup>4</sup>

Although nearly four decades have passed since Congress instructed the IRS to explain math error adjustments to taxpayers, the explanations are often unclear, complex, and leave taxpayers confused. This makes it difficult for taxpayers to determine what, specifically, has been corrected on their returns and whether they should accept the adjustment or request a correction. Such confusion may drive the taxpayers to seek clarification of the notice by calling the IRS. However, reaching an employee might take days, since Accounts Management,<sup>5</sup> the IRS function responsible for answering these calls, answers less than two-thirds of incoming calls, thereby using at least a portion of the taxpayer’s 60 days to request an abatement of the adjusted tax.<sup>6</sup>

When the explanation of the math error adjustment is unclear, and the taxpayer spends valuable time seeking further guidance, the taxpayer’s *right to appeal an IRS decision in an independent forum* and the *right to be informed* are compromised, and the *right to challenge the IRS’s position and be heard* may be

<sup>1</sup> Revenue Act of 1926, enacting IRC § 274(f). See H.R. Rep. No. 69-1, at 10-11 (1926).

<sup>2</sup> Pub. L. No. 94-455, § 1206(b) (1976), enacting IRC § 6213(f)(2).

<sup>3</sup> S. Rep. No. 94-658, 94th Cong., 2d Sess. 375 (1976); H. Rep. No. 94-658, 94th Cong., 2d Sess. 289 (1976).

<sup>4</sup> IRC § 6213(b).

<sup>5</sup> Internal Revenue Manual (IRM) 21.1.1.2, *Accounts Management Responsibilities* (Oct. 2014). The Accounts Management organization is responsible for taxpayer relations by answering tax law/account inquiries and adjusting tax accounts. In addition, it is responsible for providing taxpayers with information on the status of their returns/refunds, and for resolving the majority of issues and questions to settle their accounts.

<sup>6</sup> Joint Operations Center (JOC), *Enterprise Snapshot Report*, FY 2014 (Oct. 16, 2014) (showing 64.39 percent Level of Service). In some cases the IRS has authority to make abatements on requests beyond the 60-day statutory period. See generally IRM 21.5.4, *General Math Error Procedures* (Oct. 1, 2014).

lost.<sup>7</sup> These problems may be compounded as further expansions of IRS math error authority are proposed, making it even more important for math error notices to follow the 1976 congressional directive.<sup>8</sup>

## ANALYSIS OF PROBLEM

### Background

#### *Deficiency Procedures*

Generally when the IRS identifies an error on a taxpayer's return that will result in an understatement of tax, the IRS notifies the taxpayer of the proposed deficiency. It first provides the taxpayer with a report, including the items to be adjusted and the tax, if any, reported on the original return and the correct tax according to the IRS. The taxpayer has 30 days to accept this proposed adjustment or request an administrative appeals conference with an Appeals Officer.<sup>9</sup>

If the taxpayer does not respond to the initial report, or does not prevail in the appeals conference, the IRS will issue a SNOD that sets forth the proposed deficiency in tax. It informs the taxpayer that he or she has 90 days from the date of the notice to file a petition to challenge the proposed deficiency in the

U.S. Tax Court, the only judicial forum in which a taxpayer can challenge a tax liability before paying the liability in full.<sup>10</sup> The SNOD provides important procedural rights and protections. If the taxpayer does not timely file a petition with the Tax Court, the IRS will assess the proposed deficiency.<sup>11</sup>

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The explanation of the adjustment in the math error notice is critical to the taxpayer's ability to challenge the adjustment and preserve his or her right to petition the U.S. Tax Court by requesting abatement within 60 days of the notice being sent.

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#### *Mathematical or Clerical Error Procedures*

Congress has given the IRS authority to circumvent these normal deficiency procedures in certain circumstances. IRC § 6213(b) authorizes the IRS to make a summary assessment of tax due where that addition is the result of a mathematical or clerical error on a return. To make this summary assessment, the IRS must explain the error to the taxpayer.<sup>12</sup> The taxpayer has 60 days from the date of the notice to request that the IRS abate the tax.<sup>13</sup> The IRS cannot begin to collect the tax due until the taxpayer has agreed to it or until the 60 days have passed.<sup>14</sup> If the taxpayer requests the tax be abated, the IRS must first use the deficiency procedures under IRC § 6212, described above, to increase the tax shown on the return.<sup>15</sup> It is also the

7 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014). Unclear notices may undermine the following taxpayer rights: the right to be informed, the right to pay no more than the correct amount of tax, the right to challenge the IRS's position and be heard, the right to privacy, and the right to a fair and just tax system.

8 IRC §§ 45R and 36C, and IRS Briefing, Overview of the Accelerated Refund Assurance Program (ARAP) (Oct. 6, 2011), on file with TAS. This briefing sets out areas where the IRS is considering requesting Congressional expansion of its math error authority. See also General Explanation of the Administration's Fiscal Year 2015 Revenue Proposals, Department of Treasury Greenbook (Mar. 2014), available at [http://www.treasury.gov/resource-center/tax-policy/Pages/general\\_explanation.aspx](http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx).

9 See IRS Publication 3498-A, *The Examination Process (Audits by Mail)* (Jan. 2014), available at <http://www.irs.gov/pub/irs-pdf/p3498a.pdf>. For times for requesting appeals conferences, see SERP IRM 4.19.13.14.2(2), *Transfer to Appeals* (Aug. 29, 2014).

10 IRC § 6213(a).

11 *Id.*

12 IRC § 6213(b)(1).

13 IRC § 6213(b)(2)(A).

14 IRC § 6213(b)(2)(B).

15 IRC § 6213(b)(2)(A).

only way for the taxpayer to preserve the right to challenge the adjustment in the Tax Court—the only prepayment judicial forum.<sup>16</sup>

### *The History of Math Error Authority*

Math error authority was first granted in 1926, when Congress authorized the Commissioner to make an assessment and collect the tax due because of a mathematical error that was apparent on the face of the return. This authorization also denied the taxpayer a right to appeal to the Board of Tax Appeals without defining what “mathematical error” means.<sup>17</sup> However, the courts generally limited the scope of math error authority to arithmetic errors.<sup>18</sup>

In 1976, Congress expanded the summary assessment authority to include clerical errors in addition to mathematical errors. The Tax Reform Act of 1976 set forth for the first time a definition of the phrase “mathematical or clerical error:”

- An error in adding or subtracting on the return;
- An incorrect use of a table related to the return;
- Inconsistent entries on the same return;
- Omitted information that is required to substantiate an entry on the return; and
- An entry that claims a deduction or credit amount in excess of the statutory limit, where that limit is described as a specific monetary amount or as a percentage, ratio or fraction.<sup>19</sup>

The House Ways and Means Committee noted that these changes were in response to IRS’s request to expand math error authority. The IRS justified this request by explaining that expanded authority would be useful, because the deficiency notice procedure was significantly more costly than the math error procedure, in terms of personnel and processing costs, as well as in collection delay costs.<sup>20</sup>

While understanding the IRS’s justification for requesting expansion of its summary assessment authority, the Joint Committee on Taxation explained Congress’ concerns about removing more situations from the deficiency procedures and placing them under the summary assessment procedures.<sup>21</sup> To address concerns raised by both the Joint Committee on Taxation and the Senate, Congress enacted IRC § 6213(b)(1),

16 IRC § 6213(b)(1).

17 Revenue Act of 1926, enacting IRC § 274(f). See also H.R. Rep. 69-1, at 10-11. The U.S. Tax Court was originally established in 1924 as the Board of Tax Appeals. Revenue Act of 1924, ch. 234 §§ 900(a), (k), 43 Stat. 336, 338. In 1969, the U.S. Tax Court was established as a legislative court under Article 1 of the Constitution. The Tax Reform Act of 1969, Pub. L. No. 91-172, § 951, 83 Stat. 730 (1969).

18 See, e.g., *Farley v. Scanlon*, 13 A.F.T.R.2d 932, 933 (E.D.N.Y. 1964) (interpreting mathematical error as “an error in computing the tax on what the return itself concedes to be income”); *Repetti v. Jamison*, 131 F. Supp. 626, 628 (N.D. Cal. 1955) (stating “the term... was meant to refer to errors in arithmetic” and noting that “Congress did not provide for a petition by the taxpayer to the Board of Tax Appeals in the case of such error... due to the fact that there can be no dispute as to a matter of arithmetical computation.”).

19 Pub. L. No. 94-455, § 1206(b) (1976), enacting IRC § 6213(f)(2). See also IRC § 6213(g)(2).

20 H.R. Rep. 94-658, at 289.

21 Joint Committee on Taxation, JCT 33-76, Assessments in Case of Mathematical or Clerical Errors (sec. 1206 of the Act and sec. 6213 of the Code) (Dec. 29, 1976). See also H.R. Rep. 94-658, at 289 and S. Rep. No. 94-938(I), 94th Cong., 2d Sess. 375 (1976) (Both provided that the IRS should phrase a notice to the taxpayer regarding inconsistent entries on the returns as to include questions designed to show why the IRS has chosen a particular entry. For example, if the taxpayer enters six exemptions, but then calculates for seven exemptions, the IRS should phrase its notices to show whether the taxpayer indeed is entitled to the greater number of exemptions rather than the lesser number.).

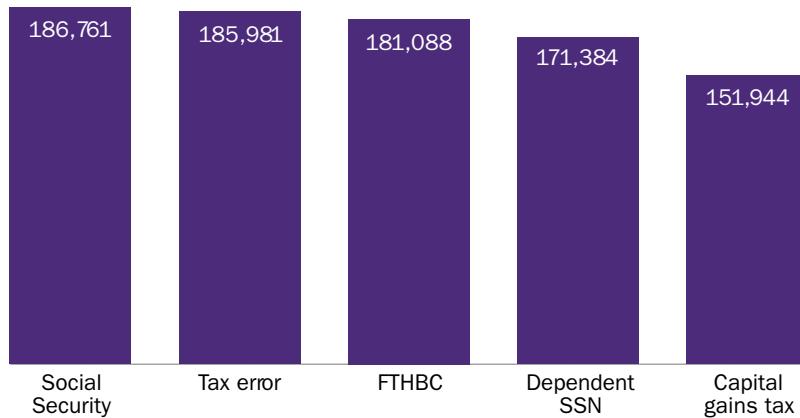
requiring that “[e]ach notice under this paragraph shall set forth the error alleged and an explanation thereof.”<sup>22</sup>

***The IRS Issues Millions of Math Error Notices, Impacting a Large Number of Low Income and Disadvantaged Taxpayers.***

The average annual math error volume from 2008 through 2014 was 7.5 million.<sup>23</sup> Between January 1, 2014 through November 2014, the IRS assigned 2,717,208 math errors to individual taxpayers. The most common adjustments include taxability of Social Security benefits, the First-Time Homebuyer Credit (FTHBC), and mismatches between the dependent’s name and Social Security number. The chart below shows the five most frequently issued math errors.

**FIGURE 1.16.1<sup>24</sup>**

**Most common math errors, January-November 2014**



An analysis of the most common math error adjustments shows the issues are complex and affect a diverse group of taxpayers. Many of these notices are sent to low income taxpayers who often face unique challenges when attempting to understand IRS correspondence. Specifically, between January through November 2014, the IRS mailed over 160,000 Earned Income Tax Credit (EITC) math error notices and over 92,000 Child Tax Credit (CTC) math error notices.<sup>25</sup> The EITC population particularly has a

22 S. Rep. No. 94-938(I), 94th Cong., 2d Sess. 375 (1976). See discussion above in footnote 21, which gives an example from the committee reports of how Congress expected these notices to read.

23 IRS, *Math Error Reports* 480-62-11 (2008-2014), totaling over 52,700,000 math errors.

24 See IRS, *Document* 6209 (Jan. 2014), at 9-10, describing taxpayer notice codes (TPNC):  
TPNC 131—We recalculated the taxable amount of your Social Security benefits;  
TPNC 209—The tax shown on your return was incorrect;  
TPNC 648—The First-Time Homebuyer Credit Repayment installment was added to your tax;  
TPNC 605—Because the dependent’s name does not match SSN records, the exemption was disallowed;  
TPNC 211—The capital gains tax shown on your return was incorrect. For numerical data, see IRS, *Math Error Report* (December 4, 2014).

25 IRS, *Math Error Report* (Dec. 4, 2014). TPNC 285 (Vol. 104,153) and TPNC 743 (55,991) are EITC notices, as are TPNCs 284, 286, 287, 288, 290, 291, 292, 293, 701, 702, 741 and 745; TPNC 251 (25,452), TPNC 252 (46,529), and TPNC 295 (20,417) are CTC or Additional CTC notices.

unique set of attributes, setting these taxpayers apart from the average taxpayer. For example, the average low income taxpayer may have:

- Limited English proficiency;
- Limited computer access;
- Low literacy rates;
- Low education levels; and
- Disabilities.<sup>26</sup>

When considering these variables, low income taxpayers are at higher risk of not understanding the explanation in the notice, and may not know how to challenge the adjustment.

### *Some Math Error Notices Remain Confusing Nearly Four Decades After Congress Directed the IRS to Make Them Clear.*

A TAS review of common math error notices, conducted in conjunction with this critique, has shown that math error notices lack clarity and make it hard for taxpayers to decide whether to accept the adjustment or request abatement. As discussed above, unique characteristics of the low income taxpayer population makes these taxpayers more vulnerable to confusion associated with math error notices. Vague and confusing explanations of math error adjustments may compromise the taxpayer's *right to challenge the IRS's position and be heard* because the taxpayer may be unable to effectively raise objections and provide additional documentation in response to an IRS proposed adjustment. Unclear explanations may also undermine the taxpayer's *right to be informed*, which includes the ability to know what is required to comply with tax laws.<sup>27</sup> Below are several examples of standardized math error explanations that are vague or confusing, and do not ensure that these rights are being adequately protected.

**Example One:** "We limited your total itemized deductions on your Schedule A, *Itemized Deductions*, because certain deductions on Schedule A are limited, if your adjusted gross income is more than the maximum amount."<sup>28</sup>

This explanation is too vague to be easily understood. It is unclear what on Schedule A is being limited—medical expenses on line 4, miscellaneous expenses, on line 27, or the total amount of itemized deductions, on line 29?

**Example Two:** "We refigured your tax on page 2 of your tax return using the tax table, tax rate schedules, or capital gains tax computations. Because of an error on another part of your tax return we were unable to compute your tax on Form 8615, *Tax for Certain Children Who Have Investment Income*."<sup>29</sup>

This explanation lacks both clarity and specificity. It does not tell the taxpayer what the error is on the return or even on what part of the return the error is located, and thus leaves the taxpayer to review the entire return in order to locate the error the notice is referencing.

26 See National Taxpayer Advocate 2009 Annual Report to Congress 110 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).

27 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014); Publication 1, *Your Rights as a Taxpayer* (June 2014).

28 TPNC 186 (Document 6209).

29 *Id.*

By contrast, the following example taken from the legislative history illustrates just how clear, specific, and simply worded Congress expected an explanation of a math error assessment to be:

**Example:** A notice regarding an inconsistency in the number of dependents listed on the taxpayer's return might read as follows: "You entered six dependents on line x but listed a total of seven dependents on line y. We are using six. If there is one more, please provide corrected information."<sup>30</sup>

Yet, the IRS's current math error notice for this issue (*i.e.*, inconsistent number of dependents on the return) falls short by not specifying the discrepancy. The current notice states:

We changed your total exemption amount on page 2 of your tax return because there was an error in the number of exemptions provided on lines 6a, 6d, and/or computation of your total exemption amount.<sup>31</sup>

The IRS should organize a team, which would include TAS, to review and rewrite explanations of math error adjustments, where necessary, to ensure congressional intent is being met. This would reduce confusion among taxpayers and save limited IRS resources used for rework associated with unclear notices.

#### ***Notice Review Procedures Need Improvement to Ensure Clarity and Consistency.***

Math error notices are generally written, updated, and cleared using the same process as any other notice, which involves several layers of review.<sup>32</sup> The Wage and Investment (W&I) Submission Processing Division creates the content for the math error notices, then works with the Office of Taxpayer Correspondence (OTC) to develop the language for each math error notice using plain writing principles. Once the OTC creates a prototype of a notice and the business unit concurs, the notice is sent to the IRS Office of Chief Counsel for legal sufficiency review, and other stakeholders are given the opportunity to review and comment. However, the TPNC review process does not include TAS.<sup>33</sup>

The IRS has not evaluated whether its notice review process results in effective math error notices.<sup>34</sup> The OTC has conducted math error notice studies, but these studies are focused on the rate of taxpayer response after receiving a math error notice and not necessarily on the clarity of the notices. Taxpayers may fail to respond to a math error notice because they do not understand what is being communicated, not because they agree with a math error adjustment. A recent report by the Treasury Inspector General for Tax Administration (TIGTA) showed that the process for reviewing letters and notices does not always ensure that they are written in plain language.<sup>35</sup> Specifically, the report showed that about 50 percent of

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30 See H.R. Rep. No. 94-658. 94th Cong., 2nd Sess. (1976). See also Joint Committee on Taxation, JCT 33-76, Assessments in Case of Mathematical or Clerical Errors (sec. 1206 of the Act and sec. 6213 of the Code) (Dec. 29, 1976).

31 IRS, Document 6209 (2014), TPNC 200.

32 IRS response to TAS information request (July 31, 2014).

33 *Id.*

34 W&I has not conducted research studies or taxpayer focus groups to gauge the effectiveness of its notices in explaining the adjustment.

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

the letters and 66 percent of the notices reviewed were determined not to be clearly written or did not provide sufficient information.<sup>36</sup>

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**When the explanation of the math error adjustment is unclear, and the taxpayer spends valuable time seeking further guidance, the taxpayer's right to appeal an IRS decision in an independent forum and the right to be informed are compromised, and the right to challenge the IRS's position and be heard may be lost.**

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In certain circumstances, when the IRS examiner determines there is no standard explanation to insert in the math error notices for the particular situation, the examiner can insert his or her own explanation of the adjustment.<sup>37</sup> These "*ad hoc*" explanations are not subject to the same review process as the standard ones. While the Internal Revenue Manual provides for a review by a peer of the examiner,<sup>38</sup> without further guidance this limited review may not ensure that the explanation of the adjustment is clear and that similar explanations are provided to taxpayers in similar situations.

Between January 1, 2014, and December 4, 2014, examiners exercised the option to use non-standard explanations 14,477 times.<sup>39</sup> This means that over 14,000 math error explanations that went out to taxpayers, in large part, escaped scrutiny about whether the notice was clear and provided taxpayers with an adequate explanation of the proposed adjustment. Considering that the specified IRM provides examiners no clear instructions on how to write these *ad hoc* explanations,<sup>40</sup> and given the insufficient amount of training IRS employees receive on writing in general, these *ad hoc* explanations may fall short of the directive to provide clear explanations, and may instead confuse taxpayers.<sup>41</sup>

To improve math error notice review procedures the IRS should design and conduct research studies and focus groups with taxpayers that measure taxpayers' understanding of the adjustment. Additionally, the IRM should set forth a template of explanations to be used when an examiner is deviating from a standard explanation. The template could provide an outline of the elements to be included in the explanation, with examples. TAS should be included in the development of such a template.

#### ***Unclear Math Error Notices May Harm Taxpayers' Ability to Timely Exercise Their Rights.***

Notices that are not clearly written or do not contain sufficient information erode a taxpayers' *right to challenge the IRS's position and be heard*.<sup>42</sup> Specifically, if notices are not simple and clear, taxpayers

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36 TIGTA, Ref. No. 2014-40-076, *Processes Are Needed to Ensure that Letters and Notices Are Written in Compliance with the Plain Writing Act* (Sep. 12, 2014). TIGTA's evaluation of statistically valid samples of 18 letters and 38 notices that were revised or redesigned during Fiscal Year 2013 identified that nine (50 percent) of the letters and 25 (66 percent) of the notices are not clearly written and structured or do not provide sufficient information. This report did not focus on math error notices specifically, but its findings are applicable to all IRS notices, including math error notices.

37 See IRM 3.14.1.6.17.12, Key 100—Non-Standard TPNC Explanations Not Computer Generated (Jan. 1, 2014) (referencing TPNC 100).

38 See IRM 3.14.1.6.17.12(7), Key 100—Non-Standard TPNC Explanations Not Computer Generated (Jan. 1, 2014) (i.e., a cursory quality review within Submission Processing only. Ad hoc notices are not reviewed by the IRS Office of Chief Counsel or the OTC).

39 IRS, *Math Error Report* 480-62-11 (Dec. 4, 2014).

40 IRM 3.14.1.6.17.12, Key 100—Non-Standard TPNC Explanations Not Computer Generated (Jan. 1, 2014) (referencing TPNC 100). The only guidance provided to examiners on how to develop these *ad hoc* explanations is as follows: "When none of the standard TPNCs adequately describe an error condition on the return, the ERS tax examiner selects TPNC 100 and attaches a 3 x 5 slip of paper containing a specific math error explanation (or a unique number) to the tax return (or ELF print on an electronically filed return)."

41 National Taxpayer Advocate 2013 Annual Report to Congress 40 (Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission*).

42 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014).

cannot understand the rationale for the change to their returns and fail to request abatement within 60 days, thereby forfeiting their opportunity to contest the assessment in Tax Court, compromising their *right to appeal an IRS decision in an independent forum*. As a result, affected taxpayers may face IRS collection action.

Additionally, taxpayers can no longer depend on getting through to the IRS's toll-free line within a reasonable amount of time to get a question answered regarding a notice. The level of service (LOS) on Accounts Management's phone lines was less than 65 percent for October 2013 through September 2014.<sup>43</sup> This low level of service makes it difficult for taxpayers to get their questions answered and the abatement requests completed in time. For example, if a taxpayer spends 45 days of the 60-day period trying to get through to the IRS to find out *why* it has assessed additional tax, he or she might not have time to collect needed documentation to request an abatement of the tax within 60 days, ultimately losing access to the Tax Court.<sup>44</sup> This may be particularly harmful to taxpayers for whom a prepayment forum is most critical (*i.e.*, low income taxpayers who cannot afford to pay the tax in full and then file a claim for refund).

Even though the taxpayer is not required to provide documentation to substantiate the abatement request, the option of submitting the request without documentation is not clearly set out in math error notices.<sup>45</sup> Sending the taxpayer a clear initial notice with a simple explanation of the adjustment, and clarifying that the taxpayer can request abatement without supporting documentation, would mitigate the need for the taxpayer to attempt calling the IRS, and would reduce taxpayer burden.

### *Expansion of Math Error Authority Into More Complicated Areas of Tax Law May Further Increase the Challenge for the IRS to Provide Clear Explanations.*

Over the past several years, Congress has expanded the IRS's math error authority to more complicated areas of tax law, such as the Earned Income Tax Credit (EITC) and First-Time Homebuyer Credit (FTHBC), making it more difficult to develop simple explanations of adjustments.<sup>46</sup> This challenge may increase as the President's budget proposal for fiscal year 2015 contains a recommendation that would create an entirely new category called "correctable errors." The passage of this recommendation would permit the IRS to correct errors where:

- The information provided by the taxpayer does not match information in government databases;
- The taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or

43 JOC, Enterprise Snapshot Report, FY 2014 (Oct. 16, 2014).

44 Not all IRS math error notices plainly disclose to taxpayers that the right to contest the assessment may be exercised without submitting proof. See, e.g., IRS Letter CP 12. See also Systemic Advocacy Management System (SAMS) 31192, requesting that IRS disclose IRC § 6213(b)(2)(A) rights in IRS Letter CP 10.

45 See, e.g., IRS Letter CP 12 which states: "If you are unable to provide us additional information that justifies the reversal and we believe the reversal is in error, we will forward your case for audit. This step gives you formal appeal rights, including the right to appeal our decision in court."

46 Besides the five "mathematical or clerical" error types listed in IRC § 6213(g)(2)(A) through (E), math error authority also includes mistakes such as missing Taxpayer Identification Numbers (TINs) for dependency exemptions or EITC, and missing verification of the FTHBC, in IRC § 6213(g)(2)(F) through (P). See National Taxpayer Advocate 2011 Annual Report to Congress 74 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*). In the 2011 Annual Report, the National Taxpayer Advocate discussed the challenges expanded math error authority imposes on the IRS and made a legislative recommendation to Congress that would require an IRS analysis, in conjunction with the National Taxpayer Advocate, before any such expansion could be enacted. National Taxpayer Advocate 2011 Annual Report to Congress 524 (Legislative Recommendation: *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

- The taxpayer has failed to include with the return documentation that is required by statute.<sup>47</sup>

This proposal goes beyond the initial grant of mathematical or clerical error authority. With such an expansion of IRS's math error authority a possibility, the need to live up to the original congressional directive regarding clear explanations of adjustments becomes even more critical, because more taxpayers may become subject to the summary assessment procedures.

## CONCLUSION

In 1976, in exchange for granting the IRS expanded math error authority, Congress instructed the IRS to provide taxpayers with an explanation of any math error adjustment. Nearly four decades later, some math error notices remain vague and ambiguous, leaving affected taxpayers confused as to what has been changed on their returns and what they need to do next. Attempting to clarify the notice by calling the IRS toll-free line may take days, since it only answers slightly more than half its calls, thereby eating away at the taxpayer's 60 days to request an abatement of the adjusted tax. Unclear math error notices increase taxpayer burden and jeopardize the taxpayer's *rights to be informed, to challenge the IRS's position and be heard, and to appeal an IRS decision in an independent forum.*

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Organize a team, which would include TAS, to review all current explanations of math error adjustments, and rewrite where necessary, to ensure the congressional directive is being met.
2. Set forth an IRM template for non-standard math error adjustment explanations that provides an outline of the elements to be included in the explanation, with examples. The IRM should also require that these explanations be developed and approved by the OTC, Chief Counsel, and the National Taxpayer Advocate or delegate.
3. Update math error notices to clearly disclose that the taxpayer may request abatement without providing an explanation or substantiating documentation.

<sup>47</sup> General Explanation of the Administration's Fiscal Year 2015 Revenue Proposals, Department of Treasury Greenbook (Mar. 2014), available at [http://www.treasury.gov/resource-center/tax-policy/Pages/general\\_explanation.aspx](http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx).

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

Debra Holland, Commissioner, Wage and Investment Division  
Karen Schiller, Commissioner, Small Business/Self-Employed Division

**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).<sup>1</sup> Some IRS notices include an explanation that is too short or too vague for the taxpayer to learn the specific reasons for the disallowance.<sup>2</sup> Other explanations are not written in language that the taxpayer can easily understand.<sup>3</sup> 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.”<sup>4</sup> 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.<sup>5</sup> 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.”<sup>6</sup> The legislative history for section 3505 shows Congress intended the IRS to go beyond just a general explanation. In this regard, the

<sup>1</sup> 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).

<sup>2</sup> 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).

<sup>3</sup> 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).

<sup>4</sup> JCT, General Explanation of Tax Legislation Enacted in 1998, JCS-6-98, 117 (Nov. 24, 1998).

<sup>5</sup> IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

<sup>6</sup> 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).<sup>7</sup> The legislative history also shows Congress meant for the IRS to provide information “so that the taxpayer may appropriately respond to the IRS.”<sup>8</sup>

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.<sup>9</sup> However, the Internal Revenue Manual (IRM) reflects that the IRS uses notices of claim disallowance to meet the Section 3505 requirement.<sup>10</sup> When RRA 98 was enacted, the IRS issued multiple memos to employees, reinforcing the requirement to explain a claim disallowance.<sup>11</sup> 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.<sup>12</sup> 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.”<sup>13</sup>

### *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.<sup>14</sup> Notices mailed pursuant to IRC § 6532(a), known as “statutory notices of claim disallowance,” can be stand-alone notices<sup>15</sup> or be combined with another notice.<sup>16</sup> 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

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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-2009-13242, 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.<sup>17</sup> 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.<sup>18</sup> In this Most Serious Problem, we also look at notices disallowing claims for innocent spouse relief<sup>19</sup> under the category of statutory notices of claim disallowance, although these notices provide a different time period and venue for challenging the disallowance.<sup>20</sup>

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.<sup>21</sup>

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

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- 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,<sup>22</sup> because with a refund hold notice, the taxpayer eventually receives a statutory notice of claim disallowance in most circumstances.<sup>23</sup> 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.<sup>24</sup> To identify the most common letters and analyze the explanations received most frequently by taxpayers, TAS attempted to find the volume for each letter<sup>25</sup> and the frequency of different standard paragraphs used.<sup>26</sup> 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.<sup>27</sup> Furthermore, once notices are sent, employees face difficulty obtaining a copy of the actual letter sent to see the specific language.<sup>28</sup> 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.

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- 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/lanca/pmta2009-024.pdf](http://www.irs.gov/pub/lanca/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 TAS<sup>29</sup>**

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

<sup>29</sup> 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 disallowance<sup>30</sup> that multiple IRS functions use to fully or partially deny claims for refund.<sup>31</sup> 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.<sup>32</sup> 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.<sup>33</sup>

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.<sup>34</sup> Specifically, 30 letters included language that was not clear and written in plain language,<sup>35</sup> 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

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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.<sup>36</sup> 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.<sup>37</sup> 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.<sup>38</sup> 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,<sup>39</sup> 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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<sup>36</sup> 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).

<sup>37</sup> 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.

<sup>38</sup> 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.”

<sup>39</sup> 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,<sup>40</sup> 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.<sup>41</sup> 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,<sup>42</sup> 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*.<sup>43</sup>

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

<sup>41</sup> 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.

<sup>42</sup> 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.

<sup>43</sup> 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.<sup>44</sup>

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."<sup>45</sup> 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.<sup>46</sup> Exam sends this letter with a form asking the taxpayer to waive the right to a statutory notice of claim disallowance.<sup>47</sup> 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.<sup>48</sup> 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.<sup>49</sup>

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."<sup>50</sup> 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.

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**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.**

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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.<sup>51</sup> 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.<sup>52</sup>

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.<sup>53</sup> 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

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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,<sup>54</sup> 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.”<sup>55</sup>

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,”<sup>56</sup> or “You didn’t meet the basic eligibility requirements because ...”<sup>57</sup>

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 claim<sup>58</sup> when he or she should have submitted an injured spouse claim,<sup>59</sup> 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.

<sup>58</sup> See Form 8857, *Request for Innocent Spouse Relief*.

<sup>59</sup> 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.

**MSP  
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## **COLLECTION DUE PROCESS: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections**

### **RESPONSIBLE OFFICIALS**

Kirsten B. Wielobob, Chief, Appeals

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### **DEFINITION OF PROBLEM**

The recently adopted Taxpayer Bill of Rights (TBOR) provides, among other rights, that taxpayers have *the right to appeal an IRS decision in an independent forum, the right to challenge the IRS's position and be heard, the right to privacy, and the right to a fair and just system.*<sup>1</sup> In the collection arena, these rights become concrete, meaningful, and significant through Collection Due Process (CDP).<sup>2</sup>

Prior to the IRS Restructuring and Reform Act of 1998 (RRA 98), taxpayers did not have the right to post-assessment and pre-collection review.<sup>3</sup> CDP procedures are designed to “increase fairness to taxpayers.”<sup>4</sup> The constitutional principle of due process “serves the greater purpose of engaging taxpayers and making them feel heard in a meaningful way, regardless of the outcome, it helps ease the sense among many taxpayers that the government acts in arbitrary ways.”<sup>5</sup> The procedural fairness that forms the basis of due process serves as the foundation for CDP. Congress believed “the IRS should afford taxpayers adequate notice of collection activity and a meaningful hearing before the IRS deprives them of their property,” and intended CDP to provide these protections.<sup>6</sup>

An integral component of the CDP analysis is the balancing test, which requires the IRS Appeals Officer (AO) to weigh the issues raised by the taxpayer and determine whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any

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

2 IRC §§ 6320; 6330.

3 Collection Due Process hearings were created by RRA 98. See RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998). See also IRC §§ 6320; 6330. Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. See *United States v. National Bank of Commerce*, 472 U.S. 713, 719-722 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

4 S. Rep. 105-174, at 67 (1998).

5 Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, The Tax Lawyer, 63 TAX LAW. 227, 234 (2010).

6 S. REP. NO. 105-174, at 67 (1998). See also J. Comm. on Tax'n, General Explanation of Tax Legislation Enacted in 1998, JCS-6-98 (Nov. 24, 1998).

collection be “no more intrusive than necessary.”<sup>7</sup> The balancing test is central to a CDP hearing because it instills a genuine notion of fairness into the process from the perspective of the taxpayer.<sup>8</sup> The balancing test also validates the taxpayer’s right to privacy by taking into account the invasiveness of enforcement actions and the due process rights of the taxpayer.<sup>9</sup>

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**The balancing test is central to a Collection Due Process hearing because it instills a genuine notion of fairness into the process from the perspective of the taxpayer.**

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A TAS review of applicable CDP procedures and case law reveals that the Office of Appeals is not giving proper attention to the balancing test, especially to legitimate concerns of taxpayers regarding the intrusiveness of the proposed collection action, and is often using *pro forma* statements that the balancing test has been conducted. These issues contribute to the appearance that Appeals is simply “rubber stamping” prior determinations made by Collection.<sup>10</sup>

The lack of detailed and specific procedures describing how to conduct the balancing test, along with inadequate training of Appeals and Collection employees on how to apply such a test, undermines the Appeals mission of fair and impartial decision-making based on congressionally mandated principles and could violate core taxpayer rights. The effective implementation of the balancing test is imperative to realizing taxpayer rights and improving voluntary compliance.<sup>11</sup>

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7 IRC § 6330(c)(3)(C); IRM 8.22.4.2.2 (Sept. 25, 2014). See also H.R. REP. NO. 105-599, at 263 (1998) (Conf. Rep.). For simplicity, we use the term “proposed collection action” referring to both the actions taken and proposed. IRC § 6330 requires the IRS to notify the taxpayer of the right to request a CDP hearing not less than 30 days before issuing the first levy to collect a tax. Pursuant to IRC § 6320 the taxpayer is notified of the right to request a CDP hearing within five business days after the first Notice of Federal Tax Lien (NFL) for a tax period is filed. Thus, Treasury Regulations under IRC § 6320 require a Hearing Office to consider “whether the continued existence of the filed Notice of Federal Tax Lien (NFL) represents a balance between the need for the efficient collection of taxes and the legitimate concern of the taxpayer that any collection action be no more intrusive than necessary.” See Treas. Reg. § 301.6320-1(e)(3), A-E1(vi). Similarly, a levy action can be taken before a hearing in following situations: collection of the tax was in jeopardy; levy on a state to collect a federal tax liability from a state tax refund; disqualified employment tax levies, or a federal contractor levy under the Federal Payment Levy Program (FPLP). See IRC 6330(f); IRM 8.22.4.2.2 (Sept. 25, 2014).

8 “This final balancing factor is novel in American tax law and injects into the calculus an equitable consideration for the taxpayer and his concerns.” *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 625 (6th Cir. 2005). See also Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, The Tax Lawyer, 63 TAX LAW. 227 (2010); TAS, TASCast, Roadmap to Tax Controversy, Level One – Part Three, available at <http://tasnew.web.irs.gov/video/Production/TAScasts/RoadmapToTaxControversy/LevelOnePartThree.html>.

9 The Right to Privacy provides: Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be *no more intrusive than necessary*, and *will respect all due process rights*, including search and seizure protections and will provide, where applicable, a collection due process hearing. (emphasis added). IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights#privacy>.

10 “In most cases, reviewing courts have merely affirmed the Appeals Officer’s determination that [the Appeals Officer] conducted the balancing test and that he found the results to be consistent with the decision to proceed with levying the property.” *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 627 (6th Cir. 2005).

11 TAS research has shown that factors related to trust in government and fairness appear to have significant influence on the taxpayer compliance behavior of self-employed taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, Vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*).

## ANALYSIS OF PROBLEM

### Background and the early seeds of the Taxpayer Bill of Rights (TBOR)

Testimony delivered in the Senate Finance Committee hearings preceding RRA 98 laid the foundation for CDP hearings. One commentator, Michael Saltzman, a tax attorney with over 33 years of experience and the author of a seminal treatise on tax practice and procedure,<sup>12</sup> made the following recommendations for enhanced due process protection in tax collection in response to questions from Senator Roth:

As your hearings have confirmed, revenue officers in IRS district Collection Divisions have enormous discretion in taking collection action against taxpayers, including the filing of notices of federal tax liens against their property, serving levies, and seizing and selling their property. Taxpayers are deprived of their property without due process because there is no statutory procedure for any independent review of the revenue officer's collection decision ...

Accordingly, I recommend adoption of the following procedures:

- a. There should be a statutory procedure for the review of IRS collection action.
- b. The model for this review procedure should be Section 7429, which permits a taxpayer to obtain administrative and judicial review of a jeopardy assessment or jeopardy levy ...
- c. I believe that threatened liens and levies should be reviewed by an Appeals officer.

Unlike the jeopardy levy review procedures, I recommend that judicial review be conducted by special trial judges of the Tax Court, who will hear the case on an expedited basis.<sup>13</sup>

Congressional testimony further explained, “Many people were shocked to learn that a number of the due process protections Americans take for granted in other legal proceedings do not apply to actions involving the IRS.”<sup>14</sup> This notion of procedural fairness, originating from the constitutional principles of due process, laid the theoretical foundation for CDP. The CDP balancing test requirement is critical to due process and fairness of tax administration—it does not dictate the outcome, but it does weigh the impact of the proposed collection action on the taxpayer with the government’s interest for efficient collection of taxes. The balancing test recognizes the Supreme Court’s maxim in *Bull v. United States* that “taxes are the lifeblood of the government,”<sup>15</sup> but also acknowledges that it is the taxpayers who provide that lifeblood.<sup>16</sup>

Likewise, judicial review of CDP hearings strives to maintain transparency and accountability of the IRS to the taxpayer.<sup>17</sup> For these reasons, Congress created CDP to provide extra measures of protection for

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<sup>12</sup> See Michael I. Saltzman, Leslie Book, *IRS Practice and Procedure*, Thomson Reuters Tax and Accounting (Rev. 2nd ed. 2009-2013).

<sup>13</sup> *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong. 376 (1998) (Testifying Attorney Michael Saltzman’s responses to questions from Senator Roth).

<sup>14</sup> 144 Cong. Rec. 4, 190 (1998) (statement made on the Senate Floor by Senator Enzi of Wyoming).

<sup>15</sup> 295 U.S. 247, 259 (1935).

<sup>16</sup> Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *The Tax Lawyer*, 63 TAX LAW. 234 (2010).

<sup>17</sup> *Id.* at 235.

taxpayers against abuse in the collection arena and included the balancing test among the three major elements of a CDP hearing to ensure that any collection be “no more intrusive than necessary.”<sup>18</sup>

These principles were incorporated into the TBOR adopted by the IRS. The IRS has acknowledged the taxpayer’s *right to privacy*, which provides that any IRS enforcement action will comply with the law and be *no more intrusive than necessary*, and that the IRS will respect all due process rights of taxpayers.

### **Hearing officers are provided little guidance or training on how to perform the balancing test.**

Hearing Officers<sup>19</sup> are required by law to consider three areas in a CDP determination:<sup>20</sup>

1. Verify that the requirements of any applicable law or administrative procedures are met;
2. Consider any relevant issues raised; and
3. Conduct the balancing test.<sup>21</sup>

The Internal Revenue Manual (IRM) describing the balancing test recommends that employees consider the following three factors:

- a. The taxpayer’s actions or inaction;
- b. The taxpayer’s compliance history; and
- c. The taxpayer’s financial circumstance.<sup>22</sup>

There is nothing in the IRM that elaborates on the balancing test or advises employees how to analyze the factors. There is no mention of purpose of the balancing test or the role it plays in ensuring due process and fairness in tax administration. In total, employees are provided five points of instruction coupled with four examples. Three of the four examples contain the following sentence: “It is my judgment that the [Notice of Intent to Levy or Notice of Federal Tax Lien] balances the efficient collection of taxes with your legitimate concern that the collection action be no more intrusive than necessary.” This is the only IRM guidance available to Hearing Officers when considering the appropriate use of the balancing test. As explained above, Hearing Officers are required to write a determination in the form of an Appeals Case Memo (ACM) in which they should document that balancing was considered.<sup>23</sup> There is little guidance on how to actually perform the balancing test in a meaningful way to ensure that the collection action is no more intrusive than necessary.

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18 IRC § 6330(c)(3)(C). See also H.R. REP. No. 105-599, at 263 (1998) (Conf. Rep.); S. REP. No. 105-174, at 68 (1998) (stating that “a proposed collection action should not be approved solely because the IRS shows that it has followed appropriate procedures.”).

19 The term “hearing officer” is an umbrella term to describe a group of employees who deal with taxpayers and resolve disputes. An Appeals hearing officer is any Settlement Officer, Appeals Officer, Appeals Account Resolution Specialist or other employee holding hearings, conferences or who otherwise resolves open case issues in Appeals. This term refers to individuals who conduct or review administrative hearings or who supervise hearing officers. Appeals Judicial Approach and Culture (AJAC) principles apply to hearing officers. IRS, AJAC FAQs, available at <http://appeals.web.irs.gov/about/ajac-faq.htm#General> (updated July 7, 2014).

20 IRC § 6330(c).

21 IRM 8.22.9.6.4 (Nov. 13, 2013).

22 IRM 8.22.9.6.7 (1) (Nov. 13, 2013).

23 IRM 8.6.2.1 (Mar. 21, 2012); 8.22.9.6.7(1) (Nov. 13, 2013). See also Form 5402, Appeals Transmittal and Case Memo.

In its response to the TAS information request, Appeals stated, “CDP cases can be reviewed by the Tax Court, but only for abuse of discretion, not on actual case resolution.”<sup>24</sup> The Tax Court applies this standard pursuant to legislative history.<sup>25</sup> Under the abuse of discretion standard, the Tax Court must give deference to an IRS Appeals determination unless it is “arbitrary, capricious, clearly unlawful, or without sound basis in fact or law.”<sup>26</sup> The abuse of discretion standard is consistent with the general principle that courts should not be in the business of second-guessing day-to-day government management; thus, the courts only overrule IRS CDP determinations where there are clear abuses.

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**The courts’ abuse of discretion standard of judicial review does not provide Appeals a carte blanche to make a *pro forma* or boilerplate determination avoiding any analysis of balancing factors intended by Congress ...  
Congress inserted the balancing test at the Appeals hearing level to prevent arbitrary, capricious, clearly unlawful, excessive, and harmful collection actions, and to enhance taxpayer protections; not just to provide deference to the IRS collection action.**

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However, the courts’ abuse of discretion standard of judicial review does not provide Appeals a carte blanche to make a *pro forma* or boilerplate determination avoiding any analysis of balancing factors intended by Congress. Nor does the abuse of discretion mean that the IRS should not learn from the courts’ analysis of balancing the government’s interest to collect taxes with legitimate concerns of the taxpayer that the proposed collection action is no more intrusive than necessary. In a number of cases, some of which are discussed below, even where the abuse of discretion standard is not met, the courts noted where the IRS had not done balancing of factors properly and remanded for further consideration.<sup>27</sup>

As stated above, Congress inserted the balancing test at the Appeals hearing level to prevent arbitrary, capricious, clearly unlawful, excessive, and harmful collection actions, and to enhance taxpayer protections; not just to provide deference to the IRS collection action.

Heavily relying on this standard of review and case law favorable to the government, IRM 8.22.4.2.1 states the “Tax Court’s standard of review for non-liability CDP determinations is to consider whether Appeals’ factual and legal conclusions reached at a CDP hearing are reasonable, *not whether they are*

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24 National Taxpayer Advocate 2013 Annual Report to Congress 155-64. See also IRS Office of Chief Counsel, Memorandum CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* (May 5, 2014).

25 “Where the liability is not properly at issue, the appeals officer’s determinations should be reviewed for an abuse of discretion.” H.R. Rep. No. 105-599, at 266 (1998) (Conf. Rep.); see also *Gozza v. Comm’r*, 114 T.C. 176 (2000). The application of the balancing test is also subject to abuse of discretion review. *Richter v. United States*, 2002-2 USTC 50,607 (C.D. Cal. 2002). In its review of CDP case law, TAS found the majority of cases discussing the balancing test favorable to the IRS. See, e.g., *Dalton v. Comm’r*, 682 F.3d 149 (1st Cir. 2012) (reversing the Tax Court and holding that a deferential standard of review is appropriate).

26 See *Duarte v. Comm’r*, T.C. Memo 2014-176 at \*10. See also *Bartley v. United States*, 343 F. Supp. 2d 649, 652 (N.D. Ohio 2004); *Robinette v. Comm’r*, 123 T.C. 85, 93 (2004), rev’d, 439 F.3d 455 (8th Cir. 2006); *Woodral v. Comm’r*, 112 T.C. 19, 23 (1999); *Blondheim v. Comm’r*, T.C. Memo. 2006-216.

27 See, e.g., *Budish v. Comm’r*, T.C. Memo 2014-239; *Eichler v. Comm’r*, 143 T.C. No. 2 (2014); *Isley v. Comm’r*, 141 T.C. 349 (2013); *Crosswhite v. Comm’r*, T.C. Memo. 2014-179; *Lofgren Trucking Service, Inc. v. United States*, 508 F. Supp. 2d 734 (D. Minn. 2007).

**...Congress intended that Appeals “provide a place for taxpayers to turn when they disagree with the determination of frontline employees” by taking “a fresh look at taxpayers’ cases, rather than merely rubber-stamping the earlier determination.”**

*correct; and, the reasonableness of Appeals ultimate decision” (emphasis added).<sup>28</sup> In contrast, Appeals liability cases use “hazards of litigation” to determine settlement options. “A ‘hazards’ settlement is an intermediate resolution of an issue based on the fact that there is substantial uncertainty in the event of litigation.”<sup>29</sup> It appears that the IRS considers the risk that it will not prevail on a particular issue at trial (or “hazards of litigation”) only “in a small percentage of [non-liability] cases.” Finally, in its response to the National Taxpayer Advocate’s 2013 recommendation to require all AOs, Settlement Officers, and Appeals Account Resolution Specialists to take updated training on conducting the balancing test and applying the hazards of litigation, the IRS Office of Appeals maintains it already trains its employees on the recommended topics.<sup>30</sup>*

TAS’s analysis of Appeals IRM provisions reveal a lack of guidance as to specific factors that should be considered when applying the balancing test. As a result, the IRS does not give the balancing test proper emphasis as intended by Congress in RRA 98. In addition, the lack of specific guidance may cause inconsistencies in applying the balancing test, erode core taxpayer rights, and could undermine future compliance.<sup>31</sup> Thus, Appeals should identify specific factors for the application of the balancing test. Ideally, these factors would be developed from an analysis of court decisions and legislative history discussing the balancing test, would consider all available evidence from taxpayers, and should verify that the Collection function gave all proper considerations prior to an appeal.

### **Appeals should revise its current procedures that allow deference to collection.**

The Appeals IRM lacks guidance regarding administrative policies and procedures for determining the appropriateness of collection actions and considering alternatives to enforced collection in CDP cases. Appeals employees are advised to use the Collection IRM to:

- Verify whether administrative procedures were followed in issuing a Notice of Intent to Levy and/or filing a Notice of Federal Tax Lien (NFLT);
- Review Collection case actions and decisions, taking into account any special circumstances; and
- Evaluate alternatives to collection action or challenges to appropriateness of collection.<sup>32</sup>

While it is reasonable for Hearing Officers to review the Collection IRM to ensure Collection follows proper administrative procedures, Appeals needs its own separate and detailed guidelines when reviewing CDP cases, particularly guidelines for the application of the balancing test. Congress specifically required

28 IRM 8.22.4.2.1(2) (Nov. 5, 2013).

29 *Hazards of Litigation – Settlement Practice*, Appeals Training 22924-002 (May 2007) at 15.

30 National Taxpayer Advocate FY 2015 Objectives Report to Congress, Vol. 2, at 64 (IRS Responses and National Taxpayer Advocate’s Comments Regarding Most Serious Problems Identified in 2013 Annual Report to Congress).

31 The analysis of appropriate factors during performance of the balancing test is even more important during equivalent hearings because the taxpayer cannot receive judicial review of the equivalent hearing, except for innocent spouse issues, abatement of interest issues, and the timeliness of the CDP hearing request. See Treas. Reg. 301.6330-1(i). A taxpayer who does not request a CDP hearing under IRC § 6330 within the 30-day period is not entitled to a CDP hearing, but is entitled to an equivalent hearing with Appeals. *Id.*

32 See Memorandum for Appeals Employees, Control No. Ap-08-0713-03, *Implementation of the Appeals Judicial Approach and Culture* (AJAC) Project (July 18, 2013) (revising IRM 8.22.4.2.1). See also IRM 8.22.4.2.1(5) (Nov. 5, 2013).

an independent Appeals Officer (AO) to review the case.<sup>33</sup> RRA 98 established an Office of Appeals that would not “be influenced by tax collection employees and auditors.”<sup>34</sup> Further, Congress intended that Appeals “provide a place for taxpayers to turn when they disagree with the determination of frontline employees” by taking “a fresh look at taxpayers’ cases, rather than merely rubber-stamping the earlier determination.”<sup>35</sup> By saying an independent AO should look at the case and by defining specific elements to look at, Congress wanted Appeals to bring a different perspective—a Due Process perspective, not just a revenue raising or collection perspective. In other words, Congress wanted something more from the AO than merely following the Collection IRM.

The National Taxpayer Advocate recommended in her 2013 Annual Report to Congress that Appeals draft its own guidance on how to evaluate the appropriateness of proposed collection actions.<sup>36</sup> Appeals responded by claiming IRM 8.22 already contains the recommended guidance.<sup>37</sup> But directing Appeals employees to the Collection IRM contributes to the appearance that Appeals is “rubber stamping” prior determinations made by Collection, because Collection does not contemplate the factors under the balancing test. The IRS files many NFTLs systemically, pursuant to “business rules” that require automatic NFTL filing or a lack of substantive human review.<sup>38</sup> In FY 2014 alone, Collection filed 535,580 liens and issued 1,995,987 levies.<sup>39</sup> The Appeals mission cannot be accomplished if, in either fact or appearance, it is an extension of the Examination or Collection divisions. It is critical that Appeals not be viewed by taxpayers as an adversary seeking to reaffirm Collection determinations.

### **The IRS Should Incorporate the Balancing Test Analysis into the Collection IRM.**

Four sections of the Collection IRM now mention the concept of balancing as a result of TAS negotiations with the IRS Collection function, and as a part of meaningful incorporation of TBOR provisions

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33 Section 1001(a)(4) of RRA 98 provides that the Commissioner’s plan to reorganize the IRS shall “ensure an independent appeals function within the Internal Revenue Service.” RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998). See also IRC §§ 6159(e) and 7122(e) (providing for an “independent administrative review” of installment agreements and offers in compromise that the IRS has construed as meaning an opportunity for a hearing with Appeals).

34 144 Cong. Rec. S4182 (1998) (statement of Sen. Roth) (stating also that “the taxpayers who get caught in the IRS hall of mirrors have no place to turn that is truly independent and structured to represent their concerns.”).

35 144 Cong. Rec. S7639 (1998) (statement of Sen. Jeffords). See, e.g., *Budish v. Comm'r*, T.C. Memo 2014-239 (stating that the Appeals Officer “felt constrained to require a notice of lien filing by virtue of what she erroneously considered the mandate of the IRM and that the inclusion of her statement that petitioner “failed to show” that not filing of a notice of lien would be in the Government’s best interest and facilitate collection was, in effect, surplusage or boilerplate, included merely for the sake of completeness.”).

36 National Taxpayer Advocate 2013 Annual Report to Congress 155-64.

37 National Taxpayer Advocate FY 2015 Objectives Report to Congress, Vol. 2, at 64 (IRS Responses and National Taxpayer Advocate’s Comments Regarding Most Serious Problems Identified in 2013 Annual Report to Congress).

38 See Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS’s Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98* and need to select *infra*. Lien filing is subject to dollar liability thresholds. IRM 5.12.2.6 advises that, in general, liens should be filed when the aggregate unpaid balance of assessment is \$10,000 or more. Collection does not consider individual facts and circumstances. See also IRM 5.19.4.5.3.2 (Aug. 4, 2014). In FY 2011, the IRS modified the criteria used in filing NFTLs, issued expanded guidance enabling more taxpayers to request and obtain lien withdrawals, expanded the criteria under which small businesses may pay past due taxes in installments, and formalized the “streamlined” offer in compromise (OIC) procedures used by the IRS’s centralized OIC operation. IR-2011-20, Feb. 24, 2011.

39 IRS, Collection Activity Report 5000-25, Liens Report (Dec. 2014) and Collection Activity Report 5000-24, Levy and Seizure Report (Sept. 2014).

into the IRM.<sup>40</sup> For instance, IRM 5.1.9.3.10 explains the Appeals determination process using the “Big Three” review. IRM 5.12.2.3 provides pre-filing considerations when making a lien determination and specifically states:

IRC § 6320 requires the IRS to insure collection actions, including the decision to file an NFTL, balance the need for efficient collection of the tax with legitimate concerns of the taxpayer that actions be *no more intrusive than necessary*. To that end, review the factors contained in this IRM section and related subsections to reach the appropriate decision.<sup>41</sup>

These revisions are a positive step toward protecting taxpayer rights. The IRS should continue to revise all appropriate Collection IRM sections to include the balancing test and require the analysis of balancing test factors during consideration of enforced collection actions.<sup>42</sup>

By incorporating the balancing test into the Collection IRM:

- Balancing test factors can be addressed earlier in the collection process;
- Collection actions will not be taken where they are more intrusive than necessary;
- It will be evident to taxpayers that TBOR is a focal point for the IRS;
- Future Appeals workloads will be reduced; and
- Appeals will find it easier to verify that Collections has taken the proper steps.

#### Courts’ analyses of the balancing test could be a starting point for developing proper balancing test procedures.

In its review of CDP case law, TAS found the vast majority of balancing test related cases ruled in favor of the IRS notwithstanding the IRS merely stated (without elaboration or proper analysis) in these cases

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40 See IRM 5.14.1.4, *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014); 5.19.4.5.1, *Notice of Federal Tax Lien Filing Determinations* (Aug. 4, 2014); 5.1.9.3.10, *Appeals Determination* (Feb. 7, 2014); and 5.12.2.3, *Notice of Federal Tax Lien Filing Determination (Pre-filing Considerations)* (Oct. 14, 2013). In 2013, the National Taxpayer Advocate convened a Taxpayer Rights IRM Review Team to undertake a comprehensive audit of all non-administrative IRM sections and to recommend revisions to enhance taxpayer rights. On June 10, 2014, the IRS adopted the TBOR that the National Taxpayer Advocate has long advocated, pulling together in one basic statement the principles that underlay the substantive rights scattered throughout the Internal Revenue Code.

41 The National Taxpayer Advocate addressed most serious problems facing taxpayers as a result of IRS lien filing policies in her 2009, 2010, 2011, 2012, and 2013 Annual Reports to Congress. See National Taxpayer Advocate 2013 Annual Report to Congress 84-93; National Taxpayer Advocate 2012 Annual Report to Congress 403-25; National Taxpayer Advocate 2011 Annual Report to Congress 109-28; National Taxpayer Advocate 2010 Annual Report to Congress 85-97; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. See also Most Serious Problem: MANGERIAL APPROVAL FOR LIENS: The IRS’s Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98 *infra*.

42 In 2015, the National Taxpayer Advocate’s Taxpayer Rights IRM Review Team, in conjunction with TAS Internal Management Documents Single Point of Contact (IMD SPOC), will continue to review the IRM subsections identified as “high impact” and recommend revisions to strengthen taxpayer rights. National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 12-21.

**...Congress wanted Appeals to bring a different perspective—a Due Process perspective, not just a revenue raising or collection perspective. In other words, Congress wanted something more from the Appeals Officer than merely following the Collection Internal Revenue Manual.**

that the balancing test had been performed.<sup>43</sup> There was little scrutiny or in-depth review, if any, from most courts regarding Appeals' analysis, which the National Taxpayer Advocate believes should set forth in each case precisely how an AO balanced the taxpayer's concerns with the government's interest to collect.<sup>44</sup> TAS believes this result is largely due to the abuse of discretion judicial standard of review discussed in more detail above.

However, in a few opinions, the courts applied scrutiny to the performance of the balancing test and sought to determine whether the IRS engaged in a proper analysis of the test.<sup>45</sup> Noteworthy was *Mesa Oil, Inc. v. United States*,<sup>46</sup> where the court held the balancing test had not been properly conducted by the IRS because the Appeals Officer's determination letter lacked any description of the analysis performed.<sup>47</sup> The court firmly rejected a "blank recitation" that the balancing test had been performed, deemed the entire Appeals record insufficient for judicial review, and remanded the case to Appeals.<sup>48</sup> Similarly, in *Lofgren Trucking Serv., Inc. v. United States*,<sup>49</sup> the court noted that the AO did not cite any balancing factors, and did not provide basis for his summary rejection of the installment agreement proposed by the taxpayer. As a result, the court concluded the taxpayer "was deprived of its right to a fair hearing under [IRC] § 6330(b)" and remanded the case to Appeals.<sup>50</sup>

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- 43 See *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 625 (6th Cir. 2005) ("Judicial review of collection due process hearings presents a real problem for reviewing courts. Congress overlaid the Restructuring and Reform Act on a previous system that involved very little judicial oversight. The result is a surprisingly scant record, comprised almost exclusively of the parties' appellate briefs and the Notice of Determination letter. No transcript or official record of the hearing is required and, accordingly, one rarely exists. Since normal review of administrative decisions requires the existence of a record, [case citations omitted] ... Congress must have been contemplating a more deferential review of these tax appeals than of more formal agency decisions. This might explain why, of six collection due process cases reviewed by the Sixth Circuit, five have been disposed of under our Court's Rule 34 and all six have been unpublished. None has overturned the IRS decision or required a remand."). See also *Robinette v. Comm'r*, 439 F.3d 455 (8th Cir. 2006) (concluding that the balancing test had been performed because Appeals Officer specifically referred to it in his memorandum); *Elliott v. United States*, 98 A.F.T.R.2d (RIA) 8182 (S.D. Tex. 2006) (following *Robinette*'s conclusion in regards to the balancing test); *Eby v. Comm'r*, 97 A.F.T.R.2d (RIA) 1747 (S.D. Ohio 2006).
- 44 See, e.g., *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 627 (6th Cir. 2005) (stating that "[i]n most cases, reviewing courts have merely affirmed the Appeals Officer's determination that [Appeals Officer] conducted the balancing test and that he found the results to be consistent with the decision to proceed with levying the property.").
- 45 See *Mesa Oil, Inc. v. United States*, 86 A.F.T.R.2d 2000-7312 (D. Colo.) (unpublished); *Cox v. United States*, 345 F. Supp. 2d 1218 (W.D. Okla. 2004); *Lofgren Trucking Serv., Inc. v. United States*, 508 F. Supp. 2d 734 (D. Minn. 2007); *Isley v. Comm'r*, 141 T.C. 349 (2013); *Fifty Below Sales & Marketing, Inc. v. United States*, 497 F.3d 828 (8th Cir. 2007).
- 46 86 A.F.T.R.2d 2000-7312 (D. Colo.) (unpublished). *Mesa Oil*, however, did not set a wide case law precedent and remains an unpublished opinion.
- 47 86 A.F.T.R.2d 2000-7312 (D. Colo.) (unpublished) at \*4.
- 48 *Id.* (stating that "The [Appeal Officer's] Determination's blank recitation of the statute gives no indication that the statutory goal of a "meaningful hearing" was accomplished, or that actual balancing occurred. Instead, the sparse [Appeals Officer's] determination gives every indication that the "proposed collection action was approved solely because the IRS show[ed] that it ha[d] followed appropriate procedures." The Senate committee report emphasized, "a proposed collection action should not be approved solely because the IRS shows that it has followed appropriate procedures." S. REP. NO. 105-174, at 68 (1998). In a more recent 2014 lien and levy case, *Duarte v. Comm'r*, T.C. Memo. 2014-176, the Tax Court also remanded a case to Appeals for presenting an insufficient record regarding negotiations over an offer-in-compromise and whether it had been properly considered as a collection alternative.
- 49 508 F. Supp. 2d 734 (D. Minn. 2007).
- 50 508 F. Supp. 2d 739-40 (D. Minn. 2007). The court found the AO "failed to meet his obligation to adequately consider whether plaintiff's proposed installment agreement balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary" [under 26 U.S.C. § 6330(c)(3)(C)] and "[i]n doing so, [the Appeals Officer] clearly abused his discretion, rendering his decision improper." (internal citations omitted).

Albeit a CDP case with an IRS victory, *Fifty Below Sales & Marketing, Inc. v. United States* contains a good depiction of what the balancing test might entail.<sup>51</sup> The opinion discussed the balancing test at length and provided at least four factors Appeals Officers should contemplate in conducting the balancing test, namely:

1. The taxpayer's ability to pay in accordance with the taxpayer's proposal;<sup>52</sup>
2. The size of the taxpayer's liability;
3. The taxpayer's record of fulfilling obligations under any previous collection alternative agreements; and
4. The taxpayer's compliance with current obligations.

In an important recent decision in *Budish v. Commissioner*, the United States Tax Court further developed the factors to be considered in conducting the balancing test.<sup>53</sup> The court remanded the case to Appeals for a supplemental CDP hearing with directions to perform the balancing of factors required by law before determining the appropriate collection action, including:

1. The impact of a proposed collection action [notice of federal tax lien] on the taxpayer's ability to remain in business and generate sufficient income to not default on the proposed installment agreement;
2. The value of the taxpayer's assets and the amount of cash flow;
3. Any reasonable alternatives to the proposed collection action [*e.g.*, a bond in lieu of the NFTL] under the circumstances; and
4. The validity and the priority of the lien and whether it will attach to the taxpayer's assets.<sup>54</sup>

These court opinions are a good starting point for developing meaningful balancing test factors that would address the inconsistencies, vagueness of application, and emphasize the significance of taxpayers perceiving the CDP hearing as fair and impartial analysis from the Office of Appeals as intended by Congress. The National Taxpayer Advocate believes Appeals would benefit from analyzing court decisions, such as the ones cited above, to identify what factors should contribute to a Hearing Officer's proper performance of the balancing test, and incorporate those factors into Appeals (and Collection) IRMs. TAS offers its assistance to Appeals in defining these factors.

51 *Fifty Below Sales & Marketing, Inc. v. United States*, 497 F.3d 828 (8th Cir. 2007). In this case, the taxpayer, an Internet marketing and design firm behind on its employment taxes, appealed two District Court decisions permitting the IRS to levy. The taxpayer argued the IRS failed to consider the taxpayer's current ability to make payments on a new installment agreement and did not properly balance competing interests as required by the balancing test. The court disagreed. The court found the Appeals Officer did not rely on erroneous facts, did consider the taxpayer's current and past compliance histories, considered the multi-million dollar size of the liability, and provided an adequate analysis in the Notice of Determination. The IRS levies were sustained.

52 TAS believes this element would include special facts and circumstances analysis similar to innocent spouse or effective tax administration offer in compromise analysis. See, *e.g.*, IRM 5.8.11, *Offer in Compromise, Effective Tax Administration* (Nov. 26, 2013).

53 T.C. Memo 2014-239.

54 *Budish v. Comm'r*, T.C. Memo 2014-239.

**Appeals' Judicial Approach and Culture (AJAC) initiative provides an opportunity for developing training on the CDP balancing test.**

To address increasing internal (including the National Taxpayer Advocate) and external (from taxpayers and their representatives) concerns regarding the independence of Appeals, the IRS recently created the Appeals Judicial Approach and Culture (AJAC) initiative. AJAC consists of a multi-functional project team, convened to review existing policies and procedures.<sup>55</sup> AJAC is tasked with emphasizing the “quasi-judicial” role of Appeals, so that Appeals employees can more easily focus on its core mission, which is fair and impartial decision-making.

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The balancing test recognizes the Supreme Court's maxim in *Bull v. United States* that “taxes are the lifeblood of the government,” but also acknowledges that it is the taxpayers who provide that lifeblood.

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AJAC attempts to achieve this goal by clarifying the separation between Examination and Collection on the one hand, and Appeals on the other hand. AJAC's provisions are intended to highlight the distinctions between Appeals and other IRS functions by carefully articulating and segregating the activities to be performed by Appeals. In this way, Appeals can more transparently focus on its role of negotiating appropriate, unbiased resolutions of the controversies that come before it.<sup>56</sup>

Despite its stated goal of enhancing the independence of Appeals and impartial decision-making, the National Taxpayer Advocate is increasingly concerned about how AJAC is being used as an excuse for Appeals not to engage with the taxpayer. Appeals appears to be using its self-declared “quasi-judicial” label to justify using the narrow abuse of discretion standard in its own CDP hearings, contrary to congressional directive. Because IRS Collection personnel frequently issue premature CDP notices without appropriate fact-finding and analysis,<sup>57</sup> under AJAC taxpayers end up bouncing back and forth like ping-pong balls between Appeals and Collection. Accordingly, the National Taxpayer Advocate has identified AJAC as a potential Most Serious Problem facing taxpayers for the 2015 Annual Report to Congress and is looking forward to working with the IRS on revising the initiative to avoid harm to taxpayers. For a start, Appeals should seize the opportunity to integrate the analysis of the CDP balancing test factors into the AJAC initiative.

## CONCLUSION

Congress intended for the IRS to provide meaningful CDP hearings to taxpayers weighing their concerns that any collection action be no more intrusive than necessary with the government's need for the efficient collection of taxes. By not applying the balancing test consistently, the IRS is missing opportunities to improve compliance, enhance taxpayer trust and confidence, and relieving undue burden on taxpayers, giving true meaning to TBOR. The lack of consistent guidance in the application of the balancing test undermines the Congressional intent to enhance taxpayer protections through CDP hearings and is eroding core taxpayer rights. The National Taxpayer Advocate urges the IRS to re-evaluate its approach to applying the balancing test, as well as further defining the factors considered, and to use this opportunity to give TBOR real meaning through the development of specific guidance and by delivering this training to employees as a part of AJAC.

<sup>55</sup> IRS intranet, *What is AJAC?*, available at <http://appeals.web.irs.gov/about/what-is-ajac.htm> (updated Oct. 24, 2013).

<sup>56</sup> IRS intranet, *Overall AJAC Talking Points*, available at <http://appeals.web.irs.gov/about/ajac.htm> (updated July 2, 2014).

<sup>57</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 157.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, formulate a policy statement on the CDP balancing test based on congressional intent.
2. In collaboration with TAS, develop specific factors for the application of the CDP balancing test based on an analysis of case law and legislative history for use by both Appeals and Collection.
3. Revise the IRM to specifically prohibit *pro forma* statements that the balancing test has been performed, and instead require a description of what factors were considered and how they apply in the particular taxpayer's case.
4. Integrate any newly developed factors for the application of the CDP balancing test into the Appeals IRM and train all Appeals Officers, Settlement Officers, and Appeals Account Resolution Specialists on applying the balancing test consistently.
5. Incorporate balancing test analysis into the Collection IRM and provide necessary training to Collection employees.

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#19**

## **FEDERAL PAYMENT LEVY PROGRAM: Despite Some Planned Improvements, Taxpayers Experiencing Economic Hardship Continue to Be Harmed by the Federal Payment Levy Program**

### **DEFINITION OF PROBLEM**

The Federal Payment Levy Program (FPLP) is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. Internal Revenue Code (IRC) § 6331 allows the IRS to issue continuous levies for up to 15 percent of federal payments due to these taxpayers who have unpaid federal liabilities.<sup>1</sup>

In January 2011, at the insistence of the National Taxpayer Advocate, the IRS began applying a low income filter (LIF) to the FPLP to screen out taxpayers whose incomes are below 250 percent of the federal poverty level.<sup>2</sup> The purpose of this filter is to protect low income taxpayers from economic hardship due to a levy on their Social Security old age or disability benefits, or Railroad Retirement Board benefits. The filter was implemented after research by the Taxpayer Advocate Service (TAS) demonstrated that the FPLP program levied on taxpayers who were experiencing economic hardship.<sup>3</sup> The filter ensures the IRS does not issue levies it would be required by law to release because of the taxpayer's economic hardship.

However, under current LIF exclusion criteria, if IRS records indicate the taxpayer has an unfiled delinquent tax return (or returns) indicator on their account (*i.e.*, a tax delinquency investigation (TDI) indicator),<sup>4</sup> the account will bypass the LIF and leave the taxpayer subject to the FPLP.<sup>5</sup> In fiscal year (FY) 2014, 30,177 taxpayers whose income fell below 250 percent of the federal poverty level bypassed the LIF and were subjected to the FPLP for this very reason.<sup>6</sup> The median income for these taxpayers fell far below 250 percent of the federal poverty level. The median income for these taxpayers was \$17,515 as compared to the 2014 income level of \$29,175 for a single person at or below 250 percent of the federal poverty level.<sup>7</sup> Additionally, the records that indicate an unfiled return are not always accurate. In

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1 IRC § 6331(h)(2)(A), as prescribed by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1024, authorizes the IRS to issue continuous levies on certain federal payments. The Bureau of the Fiscal Service (BFS) (formed from the consolidation of the Financial Management Service and the Bureau of the Public Debt) is the Department of Treasury agency that processes payments for various federal agencies. Payments subject to FPLP include any federal payments other than those for which eligibility is based on the income or assets of the recipients.

2 Department of Health and Human Services (DHHS), *The 2014 HHS Poverty Guidelines*, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>. The federal poverty level is set by the DHHS. For calendar year 2014, an individual who makes \$11,670 or less is in poverty. This number is then multiplied by 250 percent to determine the 250 percent federal poverty threshold. See also Internal Revenue Manual (IRM) 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (June 23, 2014). The poverty level is based on household size, computed from the number of exemptions claimed on the tax return. Household size is set to one if a current return is not filed.

3 National Taxpayer Advocate 2008 Annual Report to Congress Vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

4 IRM 5.19.2.1, *What Is the Return Delinquency Program?* (Sept. 11, 2012). The IRS does not place all unfiled return modules in TDI status.

5 IRM 5.11.7.2.2.3, *Low Income Filter (LIF) Exclusion* (Aug. 28, 2012).

6 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.

7 *Id.* DHHS, *The 2014 HHS Poverty Guidelines*, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>.

fact, of all the accounts that had a TDI indicator, 21 percent did not actually have a delinquent return.<sup>8</sup> Thus, it is possible that the IRS incorrectly excluded more than a fifth of the taxpayers from the LIF because of incorrect input of the unfiled return indicator. Moreover, excluding these taxpayers from the LIF and failing to consider their financial circumstances is contrary to the IRS's own pre-levy determination guidance, which requires IRS employees to consider hardship before issuing a levy.<sup>9</sup> When the IRS fails to consider taxpayers' financial circumstances by having them bypass the LIF, it undermines their *right to privacy* and their *right to a fair and just tax system*.<sup>10</sup>

The IRS justifies excluding taxpayers with unfiled returns from the LIF by noting that:

- The IRS equates the determination of economic hardship with the taxpayer's eligibility for a collection alternative, which requires taxpayers to file delinquent returns before entering into an installment agreement or an offer in compromise. The National Taxpayer Advocate believes this explanation improperly conflates the determination of economic hardship with the eligibility for a collection alternative.
- In the absence of a return, the IRS cannot determine the taxpayer's income level.<sup>11</sup> However, the IRS routinely uses third-party information to determine taxpayer's income to assess additional tax against a taxpayer.

The IRS has recently improved the FPLP process, most notably by agreeing to exclude all Social Security Disability Insurance (SSDI) payments from the FPLP program.<sup>12</sup> The IRS also recommended a change that would apply the Low Income Filter (LIF) to taxpayers with one or more TDI indicators on their account when the taxpayer: 1) is over 65 years of age, 2) has filed an income tax return for at least one of the last three tax years, and 3) the IRS has not identified a potential delinquent return after the last filed return.<sup>13</sup> This recommendation would only apply to about ten percent of taxpayers who have income below 250 percent of the federal poverty level and who have a TDI indicator on their account being included in the LIF.<sup>14</sup> Therefore, the National Taxpayer Advocate remains concerned that the unfiled return

<sup>8</sup> IRS, Collection Activity Report, NO-139, *Delinquent Return Activity Report* (Sept. 2014). This percentage was determined using modules. Therefore, the exact percentage of taxpayers with a TDI on their account is uncertain. Note: a taxpayer may be liable for tax, even though the TDI account was closed as "not liable." For example, the IRS may place a TDI on the taxpayer's account, because it never received an individual tax return from the taxpayer, which he or she has filed in past years. However, the taxpayer filed a joint return as the secondary taxpayer. In this case, the TDI will be closed as "not liable," but the taxpayer may have in fact had a liability, but it was associated with the joint return.

<sup>9</sup> IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014).

<sup>10</sup> See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

<sup>11</sup> Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, Taxpayer Advocate Directive (TAD) 2012-2, *Low Income Filter in the Federal Payment Levy Program* (Dec. 20, 2013).

<sup>12</sup> SSDI pays benefits to individuals and certain members of their families, if the individual worked long enough and paid Social Security taxes. See Social Security, Benefits for People with Disabilities, available at <http://www.ssa.gov/disability/>. On October 6, 2014, the IRS formally requested that BFS exclude SSDI recipients from the FPLP Program. See Memorandum from Darren John Guillot, Director, Enterprise Collection Strategy, to Wanda Rogers, Deputy Commissioner, Bureau of the Fiscal Service, *Discontinuation of Offset of Disability Portion of Old Age, Survivor and Payments Against Outstanding Federal Debt* (Oct. 6, 2014). IRM 5.11.7.2.1.1, *IRS/FMS Interagency Agreement-Federal Payments Subject to the FPLP* (Aug. 28, 2011). Supplemental Security Income (SSI) payments, payments to disabled adults and children who have limited income and resources, are not subject to the FPLP. See also Supplemental Security Income (SSI) Benefits, available at <http://www.ssa.gov/disabilityssi/ssi.html>.

<sup>13</sup> Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, *Low Income Filter in the Federal Payment Levy Program* (Mar. 25, 2014).

<sup>14</sup> IRS, *Federal Payment Levy Program: Augmentation Proposals for the Low Income Filter (LIF) for Taxpayers with TDI Modules* (Jan. 7, 2014).

exclusion criterion continues to subject a large number of low income taxpayers to the FPLP, even if they are experiencing economic hardship.<sup>15</sup>

## ANALYSIS OF PROBLEM

### Background

The IRS has the authority to issue a continuous levy on a variety of federal sources of income, including Social Security and Railroad Retirement Board benefits, and since 2000 has automatically levied on these sources pursuant to the FPLP.<sup>16</sup> The IRS has long recognized most FPLP levy payments come from the Social Security benefits, and while acknowledging this population is particularly vulnerable, avoids levying on Social Security payments to low income taxpayers through implementation of the LIF.<sup>17</sup> Congress has also recognized the need to limit IRS collection authority for financially struggling taxpayers by passing IRC § 6343(a)(1)(D), which requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Further, the Tax Court has held that IRS cannot refuse to release such a levy merely because a taxpayer who is experiencing economic hardship hasn't filed all returns.<sup>18</sup>

### *The FPLP Has a Sweeping Effect on Social Security Recipients.*

As mentioned above, the majority of revenue collected by the FPLP program is from Social Security payments, which significantly reduces a taxpayer's monthly Social Security benefit. For example:

- In FY 2014, 76 percent of all FPLP dollars collected were from Social Security beneficiaries.
- 31 percent of all FPLP levies were on SSDI beneficiaries.<sup>19</sup>
- Taxpayers receiving SSDI income paid nearly \$108 million of over \$413 million of FPLP payments (or 26 percent).<sup>20</sup>

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15 The National Taxpayer Advocate expressed concerns about how the IRS applies LIF exclusions in prior Annual Reports to Congress. See National Taxpayer Advocate 2013 Annual Report to Congress 84 (Most Serious Problem: *Hardship Levies: Four Years After the Tax Court's Holding in Vinatieri v. Commissioner, the IRS Continues to Levy on Taxpayers It Acknowledges Are in Economic Hardship and Then Fails to Release the Levies*); National Taxpayer Advocate 2011 Annual Report to Congress 350 (Most Serious Problem: *The New Income Filter for the Federal Payment Levy Program Does Not Fully Protect Low Income Taxpayers from Levies on Social Security Benefits*). National Taxpayer Advocate 2007 Annual Report to Congress; National Taxpayer Advocate 2006 Annual Report to Congress 110-29, 141-56; National Taxpayer Advocate 2005 Annual Report to Congress 123-35; National Taxpayer Advocate 2004 Annual Report to Congress 246-63; National Taxpayer Advocate 2003 Annual Report to Congress 206-12; National Taxpayer Advocate 2001 Annual Report to Congress 202-09.

16 IRC § 6331(h)(2); IRM 5.11.7.2.1.1(2), *IRS/FMS Interagency Agreement–Federal Payments Subject to the FPLP* (Aug. 28, 2012). Unlike other levies, a continuous levy on taxpayer's Social Security old age or disability benefits, or Railroad Retirement Board benefits has a continuing effect. It attaches to future payments until the levy is released. All other levies, except for levies on wages and salary under IRC § 6331(e), only attach to property and rights to property that exist at the time the levy is served.

17 The IRS's first attempt at a filter was removed in 2005. General Accounting Office (GAO, now the Government Accountability Office), GAO 03-356, *Tax Administration, Federal Payment Levy Program Measures, Performance and Equity Can Be Improved* 13-15 (Mar. 6, 2003). The GAO in 2003 questioned the effectiveness of the filter, because the IRS filter did not recognize that taxpayers may not have recently filed a return, making data potentially dated and unreliable, and did not consider the possibility the taxpayer could have assets that could be used to pay the liability.

18 In *Vinatieri v. Comm'r*, 133 T.C. 392 (2009) the Tax Court held that it was an abuse of discretion for the IRS to proceed with a levy against a taxpayer who has unfiled returns if the taxpayer has shown he or she is in economic hardship.

19 Information Returns Master File Form 1099-SSA/RRB and Individual Master File on the IRS Compliance Data Warehouse.

20 *Id.*

- In 2014, the average amount levied on a taxpayer's SSDI payment each month was \$113.21 and the average monthly benefit payment for disabled workers was \$1,162.<sup>21</sup>

### *Recognizing the Impact FPLP Levies Have on Social Security Recipients, the IRS Adopted a Low Income Filter.*

**When the IRS fails to consider taxpayers' financial circumstances by having them bypass the low income filter, it undermines their right to privacy and their right to a fair and just tax system.**

As these figures illustrate, a FPLP levy can significantly reduce a taxpayer's Social Security payments, thereby impacting his or her financial circumstances. Recognizing this impact, the IRS, in 2011, implemented a low income filter. Its design was based on a TAS study, which tested a model that identified low income taxpayers who would experience economic hardship (*i.e.*, inability to pay basic living expenses) as a result of the levy and removed them from the FPLP.<sup>22</sup> Once economic hardship has been established, these taxpayers would be entitled to immediate levy release under IRC § 6343(a)(1)(D).<sup>23</sup> These findings suggested that without a filter a significant number of taxpayers could not afford a basic standard of living when subject to a levy on their Social Security Administration (SSA) benefits.<sup>24</sup>

After accepting the findings from the TAS study, the IRS designed a filter that excluded taxpayers whose incomes fall below 250 percent of the federal poverty level. These taxpayers are presumed to be experiencing an economic hardship as defined by IRC § 6343(a)(1)(D).<sup>25</sup> However, the IRS decided the filter would not cover all low income taxpayers. Taxpayers whose account(s) showed an unfiled return and a TDI indicator would bypass the LIF and be subject to the FPLP.<sup>26</sup>

21 Social Security Administration (SSA), Publication No. 13-11700, *Annual Statistical Supplement to the Social Security Bulletin* (Feb. 2014), available at <http://www.socialsecurity.gov/policy/docs/statcomps/supplement/>. This report only provided an average monthly SSDI payment for 2012. Therefore, TAS adjusted for inflation to reach an estimated monthly SSDI payment for 2014. Bureau of Labor Standards Inflation Calculator available at [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm)

22 IRC § 6343(a)(1)(D) requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Treas. Reg. § 301.6343-1(b)(4) specifies that an economic hardship exists if a taxpayer cannot pay his or her basic living expenses.

23 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*). The TAS model applied the IRS's formula for determining economic hardship to all taxpayer delinquent account cases subjected to an FPLP levy during the first six months of FY 2007. To identify low income taxpayers, the TAS model, in addition to using taxpayers' income information from tax returns, used third-party documents supplied to the IRS to estimate the taxpayers' incomes. The model then used other tax return data to estimate Allowable Living Expenses (ALE) (living expenses the IRS routinely allows when determining a taxpayer's ability to pay). TAS then performed additional analyses to explore the availability of other taxpayer assets to satisfy the liability and investigated whether IRS databases are sufficient to detect such available assets.

24 *Id.* at 57.

25 The IRS believed a more administrable measure, such as a minimum dollar amount of income, or income as a percentage of the federal poverty level, was needed as a proxy for economic hardship, rather than using an automating algorithm like the one TAS used in its research study to determine economic hardship. Therefore, the IRS proposed using 250 percent of the federal poverty level as the threshold for a filter in a meeting on October 6, 2009. IRS PowerPoint presentation, *Federal Payment Levy Program: Proposed Process to Implement Low Income Filter for Social Security and Railroad Retirement* (Sept. 29, 2009), presented to the National Taxpayer Advocate on Oct. 6, 2009. Note that 250 percent of federal poverty level is also the threshold Congress adopted in its definition of "low income taxpayers" for purposes of identifying taxpayers eligible for assistance from Low Income Taxpayer Clinics pursuant to IRC § 7526.

26 IRM 5.11.7.2.2.3, *Low Income Filter (LIF) Exclusion* (Aug. 28, 2012).

From the outset, the National Taxpayer Advocate had reservations with this final LIF design.<sup>27</sup> After unsuccessfully urging the IRS to eliminate the unfiled return exclusion, the National Taxpayer Advocate issued a Taxpayer Advocate Directive (TAD) on January 12, 2012. This directive instructed the IRS to adopt the following policy: “[t]axpayers whose incomes are below 250 percent of the federal poverty level set by the Department of Health and Human Services and who receive Social Security or Railroad Retirement Board Benefits should be screened out of the Federal Payment Levy Program, regardless of unfiled returns or outstanding business debts.” Almost two years after the National Taxpayer Advocate issued the TAD, the Deputy Commissioner for Services and Enforcement sustained the appeal of the portion of the TAD pertaining to unfiled returns, refusing to adopt the National Taxpayer Advocate’s position that the low income filter should cover these accounts.<sup>28</sup>

As a result, the IRS’s refusal to eliminate the LIF exclusion criteria for accounts with a TDI indicator has harmed thousands of taxpayers whose income falls below 250 percent of the federal poverty level. In FY 2014, 30,177 taxpayers with income levels below 250 percent of the federal poverty guidelines were excluded from the LIF and were subjected to the FPLP due to a TDI indicator on their accounts.<sup>29</sup> Additionally, the median income for these taxpayers was \$17,515.<sup>30</sup> This income is significantly below 250 percent of the federal poverty level, which is about \$29,175 for a single person in 2014.<sup>31</sup>

### **The TDI Indicator Exclusion from the LIF Is Contrary to Pre-Levy Determination Guidance and May Have Been Improperly Implemented.**

*Excluding Low Income Taxpayers from the LIF Because of a TDI Indicator on Their Accounts Is Inconsistent with IRS Levy Policy and Compromises a Taxpayer’s Right to a Fair and Just Tax System.*

Excluding taxpayers from the filter when their incomes fall below 250 percent of the federal poverty guidelines and they have a TDI indicator on their accounts is inconsistent with IRS levy policy. In the pre-levy consideration guidance for Revenue Officers (ROs), the IRS acknowledges that taxpayers have *the right to a fair and just tax system*, which means they can expect the tax system to consider facts and circumstances that might affect their ability to pay.<sup>32</sup>

To protect this right, Revenue Officers (ROs) are instructed to exercise good judgment when making the determination to levy, *i.e.*, to consider the taxpayer’s financial condition. In fact, prior to levying against any of these 30,177 taxpayers’ payments,<sup>33</sup> an RO would have to adhere to this guidance and properly consider the taxpayer’s facts and circumstances (*e.g.*, whether the levy would cause economic hardship). In contrast, in the context of an FPLP levy, the IRS does not consider the taxpayer’s particular facts and

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27 National Taxpayer Advocate 2011 Annual Report to Congress 350 (Most Serious Problem: *The New Income Filter for the Federal Payment Levy Program Does Not Fully Protect Low Income Taxpayers from Levies on Social Security Benefits*); National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*); Taxpayer Advocate Directive 2012-2 (Jan. 12, 2012).

28 See Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, TAD 2012-2, *Low Income Filter in the Federal Payment Levy Program* (Dec. 20, 2013). Although the IRS has declined to eliminate the criteria excluding taxpayers with an unfiled return from the LIF, it has agreed to eliminate the criterion that excludes taxpayers who have a business debt. The IRS is working on the programming for this removal.

29 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.

30 Information Returns Master File and the Individual Master File.

31 DHHS, *The 2014 HHS Poverty Guidelines*, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>.

32 IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014).

33 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.

circumstances when a taxpayer has a TDI indicator on his or her account (*i.e.*, the IRS does not consider whether the taxpayer's income falls below 250 percent of the federal poverty guidelines).

### ***It is Unclear Whether the IRS Has Properly Implemented the Current LIF Exclusion, Resulting in Unintended Consequences to Low Income Taxpayers Who Do Not Have a TDI Account.***

A recent IRS study raised questions about why certain taxpayers had been excluded from the LIF while others were not.<sup>34</sup> In an attempt to answer this question, the TAS research team reviewed accounts excluded from the filter for the period ranging from January to August 2013. At the time of this writing, TAS has reviewed about 150,000 accounts, and has identified over 1,000 accounts excluded from the LIF for unknown reasons. TAS Research is continuing to analyze this data in hopes of identifying the precise reasons why these accounts were excluded from the LIF.

The IRS, in certain situations, will place a TDI code on a taxpayers account when they have not filed a return and information shows the taxpayer received income. The IRS places the TDI code on the account and initiates an investigation.<sup>35</sup> However, in many of these investigations, the TDI is eventually closed as "not liable" or "little or no tax due." In FY 2014, the IRS closed 2,270,677 TDI modules.<sup>36</sup> Of these, 16 percent (371,030) were closed as "not liable."<sup>37</sup> Another five percent were closed as "return filed" (115,502), which means the investigation discovered a return had in fact been filed.<sup>38</sup> This means 21 percent of the taxpayers did not have a delinquent return.<sup>39</sup> Because 21 percent of returns with a TDI code are not actually nonfilers or owe only little to no tax, the TDI indicator is not a reliable way to identify taxpayers who have an unfiled return on their account. Therefore, the TDI code should not be used to filter out taxpayers from the LIF filter—the risk of harming low income taxpayers is too great.

### ***IRS Justification for Excluding Taxpayers with Unfiled Returns from the LIF Is Unsound.***

Despite the above concerns regarding the LIF, the IRS has remained unwilling to eliminate the LIF's unfiled return exclusion criteria.<sup>40</sup> In its response to the Taxpayer Advocate Directive, the IRS raised two objections to including in the filter the accounts of taxpayers whose income is below 250 percent of the federal poverty guidelines but who have a TDI indicator on their accounts:

1. Failing to file a return and comply with filing requirements is a threshold requirement that disqualifies taxpayers from consideration in other collection programs, such as installment agreements (IA) or offers in compromise (OIC).
2. When a taxpayer does not file a return, the IRS does not have the information to determine if his or her income is less than 250 percent of poverty level.<sup>41</sup>

First, equating the determination of economic hardship with compliance requirements for a collection alternative is not appropriate. When accepting an OIC or an IA, the IRS is agreeing to an alternative

<sup>34</sup> SB/SE Finance, Research and Strategy Project DEN0206 Federal Payment Levy Program (FPLP) and Low Income Taxpayers (May 2013).

<sup>35</sup> IRM 5.19.2.1, *What Is the Return Delinquency Program?* (Sept. 11, 2012).

<sup>36</sup> IRS, Collection Activity Report, NO-5000-4, *Delinquent Return Activity Report* (Sept. 2014).

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, TAD 2012-2, *Low Income Filter in the Federal Payment Levy Program* (Dec. 20, 2013).

<sup>41</sup> *Id.*

payment arrangement, or settling the outstanding liability. In exchange, it is reasonable for the IRS to expect the taxpayer to abide by his or her current tax obligations. However, the purpose of including taxpayers in the LIF is to protect low income taxpayers from economic hardship and keep the IRS from issuing levies it would be required, by law, to release if challenged by the taxpayer (*i.e.*, when a taxpayer provides a financial statement showing economic hardship).

Second, the IRS argues filed returns are crucial to accurately determine if the taxpayer meets criteria for being filtered out of the FPLP (*i.e.*, did income fall below 250 percent of the federal poverty level). This argument is unconvincing in light of current IRS practices.

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**Since the IRS generally has third-party information on taxpayers and already relies on such information in certain circumstances to construct returns, the IRS's claim that it cannot determine a taxpayer's income level without a filed return is unsound.**

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For instance, when a taxpayer has not filed a return but has a filing requirement, the IRS uses third-party information to establish an Automated Substitute for Return (ASFR) to determine income and liability.<sup>42</sup> In fact, 96,156 taxpayers in FY 2014 were subject to a FPLP levy as a result of an ASFR assessment.<sup>43</sup> This illustrates that the IRS has no reservations about using the same data to establish ASFR assessments.<sup>44</sup> Moreover, there is nothing excluding liabilities associated with an ASFR from the FPLP, so these liabilities may be subject to the FPLP.<sup>45</sup> Furthermore, since ASFRs are closed as "return secured," and do not have a TDI indicator on the taxpayer's account, it appears these taxpayers could be processed through the LIF.<sup>46</sup> Since the IRS determined the income on the ASFR by considering third-party information, the IRS will ultimately be relying on third-party information when the account is being processed through the LIF. In other words, the IRS is excluding taxpayers from FPLP where it used third-party information to construct an ASFR return and the taxpayer's income falls below 250 percent of the federal poverty level. Therefore, since the IRS generally has third-party information on taxpayers and already relies on such information in certain circumstances to construct returns, the IRS's claim that it cannot determine a taxpayer's income level without a filed return is unsound.

### Recent Agreements and Ongoing Negotiations to Improve the LIF.

After the IRS sustained the appealed portions of TAD 2012-2, thereby rejecting the National Taxpayer Advocate's recommendation to eliminate the LIF's unfiled return exclusion criteria, it further analyzed the FPLP program and sent the National Taxpayer Advocate a memorandum stating: "Based on the analysis

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42 IRM 5.18.1, *Automated Substitute for Return (ASFR) Program* (June 21, 2013). The ASFR program is the key compliance program that enforces filing compliance of taxpayers who have not filed individual tax returns, but owe a significant liability. ASFR determines and assesses the tax liability, relying on the same third-party information the IRS is reluctant to rely on in the context of the LIF.

43 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.

44 Pub. L. No. 110-289, 122 Stat. 2654 (2008). Section 3091 of the Housing and Economic Recovery Act of 2008 added § 6050W to the IRC which requires banks or organizations who make contractual payments to merchants in settlement of third-party payment card transactions (*i.e.*, transactions made by debit or credit card) to report such payments to the IRS. This reporting was designed to assist the IRS in matching income from sales to income reported on tax returns. See also IRM 21.7.4.4.24, Form 1099-K, *Payment Card and Third-Party Network Transactions—Reporting Requirements* (May 28, 2014). If third-party documentation is so unreliable, it is questionable why the IRS sought out legislative authority to develop a compliance program that solely relies on such documentation.

45 IRM 5.11.7.2.2.2, *Exclusions* (Aug. 12, 2011).

46 IRM 5.18.1.7.11.51, Status 105: CLOSED, Post 90 Day Letter, Return Secured (Sept. 5, 2013).

conducted to date, SB/SE has recommended a change that would apply the Low Income Filter (LIF) to taxpayers with one or more TDI indicator when the taxpayer is:

- Over 65 years of age,
- Has filed an income tax return for at least one of the last three tax years, and
- The IRS has not identified a potential delinquent return after the last filed return.”<sup>47</sup>

After applying these three criteria to taxpayer accounts, only about ten percent of taxpayers who have income below 250 percent of the federal poverty guidelines and who have a TDI indicator on their account are included in the LIF.<sup>48</sup> The remaining 90 percent of low income taxpayers with a TDI indicator on their accounts are left unprotected and are subject to an FPLP levy.<sup>49</sup>

However, the Commissioner has recently agreed to a meaningful change to the FPLP program by excluding SSDI (Disability) recipients from the FPLP Program.<sup>50</sup> The decision was made in large part because of the particular demographics pertaining to SSDI recipients and the hardship an FPLP levy could cause. Specifically:

- The earnings limit for a taxpayer on disability is \$1,070 per month, or \$12,840 per year.<sup>51</sup>
- The median adjusted family income for someone on disability is \$13,323 per year. If the recipient is married, it is \$16,686 per year.
- The family income for 80 percent of people receiving SSA disability payments is not more than \$35,057 per year.<sup>52</sup>

In FY 2014, 79,277 out of 252,424 taxpayers with FPLP payments—or 31 percent—appeared to have disability income,<sup>53</sup> and 13,021 of the 79,277 taxpayers had income below 250 percent of the federal poverty level, but bypassed the LIF because they had a TDI indicator on their account.<sup>54</sup> On average, these taxpayers had about \$113 levied from their SSDI benefit each month.<sup>55</sup> Thus, about one-third of the taxpayers subjected to FPLP will be excluded from the program once the change is implemented. The National Taxpayer Advocate recognizes this as a significant change that will help tens of thousands of taxpayers each year, and encourages the IRS to work with all affected stakeholders to implement the change as quickly as possible.<sup>56</sup> Since the inception of FPLP in 2002, the IRS has been actively harming

<sup>47</sup> Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, *Low Income Filter in the Federal Payment Levy Program* (Mar. 25, 2014).

<sup>48</sup> IRS, *Federal Payment Levy Program: Augmentation Proposals for the Low Income Filter (LIF) for Taxpayers with TDI Modules* (Jan. 7, 2014).

<sup>49</sup> *Id.*

<sup>50</sup> On October 6, 2014, the IRS formally requested that BFS exclude SSDI recipients from the FPLP Program. See Memorandum from Darren John Guillot, Director, Enterprise Collection Strategy, to Wanda Rogers, Deputy Commissioner, Bureau of the Fiscal Service, *Discontinuation of Offset of Disability Portion of Old Age, Survivor and Payments Against Outstanding Federal Debt* (Oct. 6, 2014).

<sup>51</sup> SSA, Publication No. 05-10003, ICN 451385 (Jan. 2014), available at <http://www.ssa.gov/pubs/EN-05-10003.pdf>.

<sup>52</sup> SSA, Office of Research, Evaluation, and Statistics, *Income of Disabled-Worker Beneficiaries* (Released Jan. 2014), available at [http://www.socialsecurity.gov/policy/docs/chartbooks/income\\_workers/](http://www.socialsecurity.gov/policy/docs/chartbooks/income_workers/).

<sup>53</sup> Information Returns Master File Form 1099-SSA/RRB and Individual Master File on the IRS Compliance Data Warehouse. This data was obtained by reviewing 1099s for tax year 2013.

<sup>54</sup> Information Returns Master File and the Individual Master File.

<sup>55</sup> These taxpayers paid nearly \$108 million of over \$413 million of FPLP payments in FY 2013 (or 26.0 percent).

<sup>56</sup> IRS response to TAS information request (Sept. 29, 2014). To implement this programming change, the IRS will work with both the BFS and the SSA to determine how to identify the SSDI payments.

this vulnerable group of taxpayers via the program, and it should now move with all due speed to cease the harm.

## CONCLUSION

The National Taxpayer Advocate has consistently stated that the current LIF exclusion criteria fails to protect low income taxpayers and urged the IRS to eliminate the unfiled return exclusion. The IRS's refusal puts the IRS at odds with its own guidance and compromises taxpayers' *right to privacy* and the *right to a fair and just tax system*. The IRS's explanation for not eliminating this criterion is unjustified and its unwillingness to eliminate the unfiled return exclusion will only continue to harm low income taxpayers.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS should:

1. Eliminate the LIF exclusion for unfiled returns.
2. Expedite programming to exclude taxpayers receiving SSDI payments from the FPLP.
3. In collaboration with TAS, SB/SE should review the FPLP program requirements and ensure that the correct taxpayers are bypassing the LIF.

**MSP  
#20****OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise****RESPONSIBLE OFFICIALS**

Karen Schiller, Commissioner, Small Business/Self-Employed Division  
Kirsten B. Wielobob, Chief, Office of Appeals

**DEFINITION OF PROBLEM**

An offer in compromise (OIC) is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed. The IRS has authority to accept offers pursuant to Internal Revenue Code (IRC) § 7122.<sup>1</sup> Treasury Regulations provide three grounds for an offer:

- A. Doubt as to liability;<sup>2</sup>
- B. Doubt as to collectability;<sup>3</sup> and
- C. Effective tax administration (ETA).<sup>4</sup>

Legislators have long viewed the OIC as a viable and reasonable collection alternative.<sup>5</sup> The IRS Restructuring and Reform Act of 1998 (RRA 98) introduced the Effective Tax Administration offer and provided specific guidance to the IRS on accepting such offers.<sup>6</sup> However, IRS policies and procedures do not foster flexible use of the OIC.<sup>7</sup>

In fiscal year (FY) 2014, the IRS received 66,155 offers and accepted 26,924.<sup>8</sup> The number of accepted offers decreased approximately 13 percent compared to FY 2013, when the IRS received 71,644 new offers and accepted 30,840 offers.<sup>9</sup> Meanwhile, the IRS continues to place billions of dollars' worth of accounts in its collection "Queue" and other inactive statuses.<sup>10</sup> As of September 30, 2014, the Queue held

1 See Treas. Reg. 301.7122-1(b)(1).

2 See *id.* Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability.

3 See Treas. Reg. 301.7122-1(b)(2). Doubt as to collectability exists in any case where the taxpayer's assets and income are less than the full amount of the liability.

4 See Treas. Reg. 301.7122-1(b)(3). There are two grounds for ETA offers: 1) If the Secretary determines that, although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship within the meaning of Treas. Reg. § 301.6343-1 and; 2) If there are no grounds for an offer under the other OIC criteria, the IRS may compromise to promote effective tax administration where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability. Compromise will be justified only where, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.

5 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 (1998); H.R. Conf. Rep. 599, 105th Cong., 2d Sess. 288-289 (1998).

6 H.R. Conf. Rep. No. 105-599 at 289 (1998).

7 See National Taxpayer Advocate 2012 Annual Report to Congress 354-355. See also Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure, infra*.

8 IRS, *OIC Executive Summary Report* (Sept. 2014). The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

9 *Id.* The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

10 Taxpayer Delinquent Accounts (TDAs), IRS NO-5000-2, *Taxpayer Delinquent Cumulative Report*, Part 1 (July 2014).

3,097,401 taxpayer delinquent account (TDA) modules valued at \$57.7 billion.<sup>11</sup> As of September 30, 2014, cases in “shelved” status totaled 1,777,346 TDAs with a value of \$8.3 billion.<sup>12</sup>

With the current system, the IRS is not only gradually losing the ability to collect any revenue on aging collection inventory, but is denying taxpayers a timely resolution of their tax problems, thereby violating the *right to finality*.<sup>13</sup> Additionally, when the IRS unreasonably denies an OIC and resumes collection activity, it may violate the taxpayer’s *right to privacy* which ensures that any IRS enforcement action be *no more intrusive than necessary* (emphasis added).<sup>14</sup> Lastly, the IRS approach to OICs may deny offers to eligible taxpayers by not considering all the facts and circumstances affecting an underlying liability, thereby undermining the *right to a fair and just tax system* and harming future compliance.<sup>15</sup>

## ANALYSIS OF PROBLEM

### Congress Envisioned a Flexible OIC Program that Could Improve Compliance.

The Senate intended that the IRS would adopt a “liberal acceptance policy for [offers] to provide an incentive for taxpayers to continue to file tax returns and continue to pay their taxes.”<sup>16</sup> This view was also adopted in the conference report for RRA 98:

The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.<sup>17</sup>

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<sup>11</sup> Taxpayer Delinquent Accounts (TDAs), NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2014). For information on the Queue, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70, (Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).

<sup>12</sup> Taxpayer Delinquent Accounts (TDAs), NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2014). “Shelved” cases are accounts that are not actively assigned, or are removed from active inventory due to their relatively low case assignment priority. See National Taxpayer Advocate 2013 Annual Report to Congress 124. See also Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2006-30-030, *High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, But Some Unassigned Accounts Need Management’s Attention* 16 (2006). Unlike “shelved” cases, the Queue holds cases until they can be assigned to Collection function employees. Cases in the Queue may end up being put in shelved status.

<sup>13</sup> IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. The right to finality provides that “[t]axpayers have the right to know the maximum amount of time they have to challenge the IRS’s position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.” (emphasis added). The collection industry estimates that the probability of collecting unpaid accounts falls to 70 percent after three months, 52 percent after six months, and 23 percent after a year. See, e.g., TIGTA, Ref. No. 2011-30-112, *Reducing the Processing Time Between Balance Due Notices Could Increase Collections* 8 (2011) (citing collectability statistics based on a survey conducted by the Commercial Collection Agency Association).

<sup>14</sup> In the collection arena, the right to privacy becomes meaningful and significant through Collection Due Process (CDP). IRC §§ 6320, 6330. Congress created CDP rights to provide extra measures of protection for taxpayers against abuse in the collection arena and included the balancing test among the three major elements of a CDP hearing to ensure that any collection action be “no more intrusive than necessary.” IRC § 6330(c)(3)(C). See also H.R. Rep. No. 105-599, at 263 (1998) (Conf. Rep.); S. Rep. No. 105-174, at 68 (1998).

<sup>15</sup> TAS research has shown that factors related to trust in government and fairness appear to have significant influence on the taxpayer compliance behavior of self-employed taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*).

<sup>16</sup> S. Rep. No. 105-174 at 88 (1998).

<sup>17</sup> RRA 98, Pub. L. No. 105-206 (1998); H.R. Rep. No. 105-599, at 288-89 (1998) (Conf. Rep.).

In particular, Congress provided direct guidance to the IRS in its desire to see the implementation of ETA offers with RRA 98:

...[T]he conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration. The conferees anticipate that ... the IRS may utilize this new authority to resolve longstanding cases by forgoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability.<sup>18</sup>

### The OIC Program Benefits Taxpayers and the IRS Alike by Improving Compliance and Bringing Finality to Accounts.

With a flexible offer program, the IRS wins by receiving money that it could not have collected through other means and achieving a promise of voluntary tax compliance from the taxpayer (at least for the next five years, which is long enough to create long-term change in noncompliant behavior).<sup>19</sup> If the taxpayer does not follow the terms of the agreement, the OIC defaults and the debt is reinstated.<sup>20</sup> Offers accepted in FY 2013 have a 2013 compliance rate of 95.2 percent while the 2013 compliance rate for offers accepted in FY 2009 is 88.1 percent.<sup>21</sup> The FY 2009 rate, which is the compliance rate after five years, is significantly higher than the comparable voluntary compliance rate for tax year (TY) 2009 for the individual taxpayers with tax delinquent accounts, which is 42 percent.<sup>22</sup> For the taxpayer who has been noncompliant in the past, an accepted offer may become a fresh start. For the IRS, the OIC converts a noncompliant taxpayer into a compliant one. Overall, a flexible OIC program promotes effective and just tax administration.<sup>23</sup>

Other IRS collection practices cannot claim the same positive outcomes. In 2011, TAS research showed that taxpayers with liens filed against them are less likely to reduce their initial liabilities and file required tax returns.<sup>24</sup> A 2012 TAS research study found 80 percent of taxpayers in currently not collectible (CNC) hardship status who also had offers had no tax liability at the end of the study, compared to about 20 percent of CNC hardship taxpayers without offers.<sup>25</sup>

<sup>18</sup> H.R. REP. No. 105-599, at 289 (1998) (Conf. Rep.).

<sup>19</sup> IRS, Form 656-B, *Offer In Compromise* 5 (Jan. 2014).

<sup>20</sup> See Internal Revenue Manual (IRM) 5.8.9.3, *Potential Default Cases*, (April 15, 2011); IRS, Form 656-B, *Offer In Compromise* (Jan. 2014).

<sup>21</sup> IRS response to fact check (Nov. 26, 2014). The compliance rate is computed as {1-(default OICs/accepted OICs)}.

<sup>22</sup> TAS computed compliance rates with the following formula: (1- noncompliance rate). The noncompliance rate for tax years for individual taxpayers with delinquent tax accounts was computed by identifying those who had any tax delinquent accounts or delinquent tax investigations for subsequent tax years and dividing it by individual taxpayers with delinquent tax accounts for that year. Individual Taxpayers with TDAs Compliance rates, TAS Research (2014-12), Compliance rate for TY 2009 is [1 - {(1,878,396 taxpayers with TDAs or TDIs) divided by (3,255,566 taxpayers with TDAs)}], which equals 42.3 percent.

<sup>23</sup> One attorney who testified before Congress regarding RRA 98 called the IRS's handling of offers "the biggest scandal in American taxation today." The attorney observed, "The IRS is willing to force an otherwise productive taxpayer into bankruptcy rather than to accept a fair offer in compromise." *IRS Restructuring, Hearings Before the S. Comm. on Finance*, 105th Cong. 129 (1998) (statement of Robert Schriebman, Tax Attorney).

<sup>24</sup> See National Taxpayer Advocate 2011 Annual Report to Congress, vol 2 94. However, lien filing may have a positive effect on future payment. The study points out that it is unclear if the lien filing improved future payment or if lien filing merely reduces the likelihood that a taxpayer will report a subsequent liability. See National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 91-112 (Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

<sup>25</sup> See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 123.

However, to be effective the OIC program must analyze the facts and circumstances particular to each taxpayer submitting an offer. A study commissioned by the IRS found that lack of flexibility and consistency in evaluating the overall financial situation of the taxpayer was a recurring perception among study participants.<sup>26</sup>

### In Practice, Many Taxpayers Experience Significant Hardship Due to Underuse of the OIC Program.

In FY 2014, the IRS received 66,155 new offers and accepted 26,924.<sup>27</sup> Accepted offers declined by approximately 13 percent from the same period in FY 2013, when the IRS received 71,644 new offer cases and accepted 30,840 OICs.<sup>28</sup> Figure 1.20.1 shows received and accepted OICs since FY 2010.<sup>29</sup>

**FIGURE 1.20.1. OIC receipts, acceptances, and receipts by taxpayer type<sup>30,31,32,33</sup>**

Fiscal year	Receipts	Receipts less transfers to Appeals	IMF and BMF taxpayers receipts	Acceptances
2010	56,539	n/a	52,211	13,886
2011	59,411	n/a	54,786	19,562
2012	63,801	n/a	59,515	23,628
2013	74,217	71,644	69,385	30,840
2014	69,735	66,155	61,882	26,924

Meanwhile, the number of taxpayers in CNC hardship status has risen from 2.5 million to 2.8 million, or 11 percent, between September 2007 and September 2014.<sup>34</sup> The CNC inventory now holds \$82.5 billion in inventory, a 70 percent increase from September 2007.<sup>35</sup>

26 MITRE Corporation, *Offer in Compromise Study: Achieving Increased Offer in Compromise (OIC) Program Participation Requires New Approaches* (Jan. 29, 2010). The IRS engaged the MITRE Corporation to study the OIC application process and “provide an independent perspective on the decline in OIC applications.” As one part of the study, MITRE interviewed more than 40 internal and external stakeholders.

27 IRS, *OIC Executive Summary Report* (Sept. 2014). The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

28 *Id.*

29 IRS response to TAS research request (July 31, 2014). The number of receipts includes processable receipts. Accepted offers are based on year of receipt.

30 IRS, *OIC Executive Summary Report*, (Sept. 2010–2014), Receipts (New Cases).

31 *Id.* Receipts Less Transfers to Appeals (Net Receipts). IRS began reporting in FY 2013.

32 IRS response to fact check (Nov. 26, 2014), IMF and BMF taxpayers’ receipts.

33 IRS, *OIC Executive Summary Report*, (Sept. 2010 - 2014), Accepts.

34 IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2007); IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (June 2014). The 2,515,349 CNC hardship taxpayers increased to 2,794,869 taxpayers from September 2007 to September 2014.

35 *Id.* The CNC inventory went from \$48,690,826,891 in September 2007 to \$82,538,709,904 in September 2014.

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With a flexible offer program, the IRS wins by receiving money that it could not have collected through other means and achieving a promise of voluntary tax compliance from the taxpayer (at least for the next five years, which is long enough to create long-term change in noncompliant behavior).

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When the IRS determines that a taxpayer cannot afford to pay his or her debt but chooses CNC over an offer as the suitable solution, it denies a prompt resolution for both the taxpayer and the IRS. The IRS can consider offers for low income taxpayers because employees are instructed to not reject an offer solely based on the amount.<sup>36</sup> In fact, one 2010 study estimated that \$8.5 million in additional revenue could be obtained by targeting taxpayers facing economic hardship.<sup>37</sup> However, several factors are preventing a flexible use of offers.

#### *Lack of Appropriate Staffing Precludes a Thorough Review of Submitted Offers.*

Since 2000, the OIC program and OIC-related issues have appeared consistently as a Most Serious Problem in the National Taxpayer Advocate's Annual Report to Congress.<sup>38</sup> One area of concern is the inadequate staffing for the OIC program.<sup>39</sup> In fact, OIC receipts increased steadily from FY 2010 to FY 2013, with a decrease of about 11 percent in FY 2014.<sup>40</sup> Total OIC staffing has remained virtually constant since 2007 and is approximately half of what it was in 2004, as shown in Fig 1.20.2.

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36 See IRC § 7122(d)(3)(A). The National Taxpayer Advocate, who at the time was executive director of the Community Tax Law Project in Richmond, Virginia, testified that "There should be no minimum amount for an offer and compromise based as to doubt as to collectability... Any other policy allows certain taxpayers to buy piece of mind while others cannot." *IRS Restructuring, Hearings Before the S. Comm. on Finance*, 105th 125 Cong. (1998) (statement of Nina E. Olson, Executive Director, Community Tax Law Project).

37 This measurement is an estimate based on 5 percent of 300,000 taxpayers in CNC status. See IRS, *IRS Collection Process Study, Final Report* 141-142 (Sept. 30, 2010).

38 See National Taxpayer Advocate 2000-2013 Annual Reports to Congress.

39 TIGTA, Ref. No. 2012-30-033, *Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers* (Mar. 30, 2012).

40 IRS Collection Report NO-5000-108, Monthly Report of OIC Activity, Cumulative Through September, 2008-2014. Processable OIC receipts increased an average of 10.5 percent from FY 2008 to FY 2013. The change in processable receipts for FY 2014 from FY 2013 was -10.8 percent.

**FIG. 1.20.2<sup>41</sup>**

OIC staffing and OIC processable receipts and acceptances, FYs 2001-2014



The Treasury Inspector General for Tax Administration (TIGTA) recently recommended that in light of the growth in delinquent accounts and the reduction in IRS staffing, it is “essential that the field inventory selection process identifies the cases that have the highest risk and potential for collection.”<sup>42</sup> TIGTA also reported that because the probability that revenue will be collected is not “fully considered” when cases are selected for inventory, a large number of cases are assigned to field collection that involve taxpayers who have no ability to pay or cannot be found.<sup>43</sup> Since the revenue officers working these cases are already conducting the financial analysis to determine CNC status, a flexible approach to OIC consideration prior to putting a case in CNC status could further Congress’s intent and protect taxpayer rights.

#### *Reliance on the Queue Discourages Use of the OIC.*

The Queue is where the IRS holds aging accounts until they are paid, written off, or pulled for assignment to the Collection Field function (CFF). In theory, the assignment of a case to the Queue is a temporary condition; cases reside in the Queue until the CFF has resources to work them.<sup>44</sup> In practice, the Queue is not “temporary;” rather, the backlog has become an institutionalized segment of the IRS

41 Staffing counts are as of the beginning of the fiscal year, except for the staffing count in 2014, which is as of June 2014. IRS response to TAS research request (July 31, 2014). There is another group of Field OIC staff that the IRS started tracking in 2013. We have limited the discussion to field offer specialists and centralized OIC staff since there is no earlier history on the third group. We are unable to say how the change has occurred over time, since the IRS was not tracking them as it had with the field offer specialists and centralized OIC staff. Also, prior to August 2001, all offers regardless of complexity were handled in the field by revenue officers. In that month, the IRS commenced a new approach to processing offers, the Centralized OIC (COIC) initiative. The initial processing of all offers, and complete processing of wage earner offers is now handled in two campus locations. As a result, the number of revenue officers working offers is sharply reduced as of 2002. See National Taxpayer Advocate 2002 Annual Report to Congress 15.

42 TIGTA, Ref. No. 2014-30-068, *Field Collection Could Work Cases With Better Collection Potential* 4 (Sept. 12, 2014).

43 *Id.* at 5-7 (Sept. 12, 2014). The report shows that 40 percent of TDAs closed by field collection are determined to be CNC.

44 For more information on the Queue, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70 Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*.

collection process.<sup>45</sup> The Queue's inventory has increased 26 percent since 2006; as of September 30, 2014, the Queue held 3,097,401 TDA modules, valued at \$57.7 billion.<sup>46</sup>

Recently, the IRS has also been placing Automated Collection System (ACS) cases in a "shelved" status, closed as CNC, as another means of moving cases from active collection status.<sup>47</sup> The cases in this status have risen from 1.5 million TDAs in September 2007 to 1.8 million in September 2014, an increase of roughly one fifth.<sup>48</sup> However, the dollar amount in inventory has jumped from \$3.6 billion in September 2007 to \$8.3 billion in September 2014, an increase of 130 percent.<sup>49</sup> This is a large increase in potentially lost revenue.

Figure 1.20.3, below, shows the growth of inventories in the Queue and shelved status between FYs 2003 and 2014. In particular, the Queue experienced growth between 2005 and 2009, and then declined in FY 2010, followed by increases in fiscal years 2011 and 2012. The Queue decreased in FY 2013, and was flat in FY 2014. The cases in shelved status increased from FY 2008 to FY 2011, but have been in a decline since.

**FIGURE 1.20.3<sup>50</sup>**

Queue inventory and shelved (surveyed TDAs), modules, FYs 2003-2014



- 45 The National Taxpayer Advocate concluded in 2012 that the "use of the Queue appears to have heavily contributed to the indifference of the IRS to the aging of collection accounts, and to the negative outcomes that the delays in case processing have for taxpayers and the IRS's business results." See National Taxpayer Advocate 2012 Annual Report to Congress 370.
- 46 IRS, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Oct. 2006); IRS, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2014). Queue inventory went from 2,453,556 cases in September 2006 to 3,097,401 cases in September 2014.
- 47 For information on shelved status, see National Taxpayer Advocate 2013 Annual Report to Congress 124. See also TIGTA, Reference No. 2006-30-030, *High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, But Some Unassigned Accounts Need Management's Attention* 16 (Feb. 2006).
- 48 IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2007); IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2014).
- 49 *Id.* The dollar amount in TDA inventory went from \$3,632,927,063 in September 2007 to \$8,342,735,676 by September 2014.
- 50 IRS, Queue Inventory: Collection Report No. 5000-2, *Taxpayer Delinquent Account Cumulative Report, Part 1 - TDA'S (2003-2014)* and IRS, Shelved (Surveyed TDAs): IRS Collection Report No. 5000-149, *Recap of Accounts Currently Not Collectible Report* (2003-2014).

The number of accepted offers decreased approximately 13 percent compared to fiscal year 2013, when the IRS received 71,644 new offers and accepted 30,840 offers. Meanwhile, the IRS continues to place billions of dollars' worth of accounts in its collection "Queue" and other inactive statuses.

The primary reason for rejected and returned offers since 2010 has been the IRS's determination that the taxpayer can pay in full.<sup>51</sup> However, a 2004 IRS study showed that reliance on this determination can lead to the IRS rejecting an offer and then ultimately not collecting anything from the taxpayer.<sup>52</sup> The study found that in 31 percent of the rejected OIC cases reviewed, the IRS collected less than 10 percent of the offered amounts and in 21 percent the IRS collected nothing at all.<sup>53</sup> Similar to our measurements today, this study reported that "in most situations the decision to reject an OIC was based on a determination by the IRS that it could collect more than the offer amount."<sup>54</sup> Yet the 2004 study shows that in a significant number of cases, the IRS did *not* collect more revenue and walked away from dollars that were actually offered.<sup>55</sup> The study also found that of the rejected or withdrawn offers in CNC status, 27 percent of individual offers and 49 percent of business offers were in CNC status while the offer was being considered.<sup>56</sup> Since the taxpayer was not collectible, it is likely the taxpayer was offering funds that were supplied by someone who has no liability for the tax debt, *e.g.*, a parent, a friend, or a church or charity. By rejecting or requiring withdrawal of the offer, the IRS turned down funds that it could not otherwise reach. These 2004 observations are relevant today, given the growth in CNC inventory.

#### *The IRS Discourages a Flexible Use of the ETA Offer.*

The ETA offer allows the IRS to consider the circumstances that led to a delinquency and weigh the long-term benefits of allowing an otherwise viable taxpayer to become compliant.<sup>57</sup> ETA offers are allowed even if the IRS could achieve full collection when that full collection would create an economic hardship for

51 IRS response to TAS research request (July 31, 2014). The IRS relies on IRM 5.8.4.3 when determining if a taxpayer can full pay. IRM 5.8.4.3, *Doubt as to Collectibility*, (May 10, 2013).

52 In FY 2003, SB/SE and the Office of Program Evaluation and Risk Analysis (OPERA) analyzed the OIC program to study, among other things, the ultimate collection outcomes of offers that had been closed as either rejected, withdrawn, or returned. OPERA, *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program* 2-6 (Sept. 2004). The study highlighted the fact that the value of an accepted offer is more than the actual money generated from the offer but that "potentially lost revenue can be 'protected' by correcting the delinquent behavior, and getting these taxpayers on the right taxpaying track."

53 *Id.* at 11. The study involved analysis of every closed OIC during the period of October 1998 through July 2003. See also National Taxpayer Advocate 2006 Annual Report to Congress 106.

54 *Id.* at 8.

55 *Id.* at 9. The study reported that offers accepted between 1995 and 2001 had a 60 percent compliance rate, and this could go to 80 percent when taxpayers with first collection notices are excluded. This compliance rate is much higher than the 39 percent compliance rate for rejected cases that either full paid or entered into an installment agreement. Acceptance of these rejected offers could have generated greater compliance and payments received.

56 OPERA, *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program* 9 (Sept. 2004).

57 For information on how the low ETA offer acceptance rate affects business taxpayers in particular, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply With the Law Regarding Victims of Payroll Service Provider Failure, infra*; National Taxpayer Advocate 2013 Annual Report to Congress 134-146 (Most Serious Problem: *COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue*); National Taxpayer Advocate 2012 Annual Report to Congress 348-357 (Introduction: *The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes*). See also National Taxpayer Advocate 2012 Annual Report to Congress 426-444 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

the taxpayer.<sup>58</sup> The IRS also accepts ETA offers when the taxpayer identifies “compelling public policy or equity considerations.”<sup>59</sup>

In light of the growth in the Queue, shelving, and CNC, we should see more ETA offers being accepted. The acceptance rate rose from 40 percent in 2010 to 52.9 percent in 2014.<sup>60</sup> The acceptance rate of non-economic hardship (NEH) ETA offers increased from 31.4 percent in FY 2010 to 58.4 percent in FY 2014.<sup>61</sup> Figure 1.20.4 shows the ETA and NEH ETA offers received and accepted by the IRS between FYs 2010 and 2014.<sup>62</sup>

**FIGURE 1.20.4, ETA and NEH ETA offers received and accepted<sup>63</sup>**

Fiscal year	ETA Offers			NEH-ETA Offers			
	Receipts	Dispositions	Accepted	Receipts	Dispositions	Accepted	Accepted other than NEH
2010	1,457	1,136	460	61	51	16	5
2011	1,553	1,479	602	76	89	27	3
2012	2,086	1,841	826	56	67	21	7
2013	2,336	2,352	1,147	77	59	26	4
2014	1,486	2,019	1,069	100	89	52	7

The regulations require the taxpayer submitting an ETA offer on public policy grounds to “demonstrate circumstances that justify compromise even though a similarly situated taxpayer may have paid his liability in full.”<sup>64</sup> Based on this guidance, the IRS has implemented procedures that may discourage the acceptance of ETA offers. For instance, the IRS acknowledges that when considering an ETA offer on public policy or equity grounds, “the compromise … will often raise the issue of disparate treatment of taxpayers who can pay in full and whose liabilities arose under substantially similar circumstances.”<sup>65</sup> A taxpayer seeking an OIC under this category bears the burden of demonstrating “circumstances that are compelling enough to justify compromise notwithstanding this inherent inequity.”<sup>66</sup>

58 See Treas. Reg. § 301.7122-1(b)(3)(i).

59 See Treas. Reg. § 301.7122-1(b)(3)(ii).

60 IRS response to fact check (Nov. 26, 2014). Acceptance rate is computed as accepted ETA offers divided by ETA dispositions.

61 *Id.* Acceptance rate is computed as accepted NEH-ETA offers divided by NEH-ETA dispositions.

62 IRS response to TAS research request (July 31, 2014). Offers submitted under NEH-ETA may also be accepted under doubt as to collectability criteria.

63 IRS response to TAS fact check (Nov. 26, 2014).

64 Treas. Reg. § 301.7122-1(b)(3)(ii).

65 IRM 5.8.11.2.2(3), *Public Policy or Equity Grounds*, (Sept. 23, 2008).

66 *Id.*

In cases involving non-hardship ETA offers, “[t]he circumstances of the case must be such that other taxpayers would view the compromise as a fair and equitable result.”<sup>67</sup> The IRM goes on to say that “it should not appear to other taxpayers that the result of the compromise places the taxpayer in a better position than they would occupy had they timely and fully met their obligations” (emphasis added).<sup>68</sup> This language does not appear in the regulations. Under the regulations, ETA offers based on public policy or equity may not be entered into if compromise of the liability “would undermine compliance by taxpayers with the tax laws.”<sup>69</sup> Factors that could support a determination that compromise would undermine compliance include:

- The taxpayer has a history of noncompliance with filing and payment requirements;
- The taxpayer has taken deliberate actions to avoid the payment of taxes; and
- The taxpayer has encouraged others to refuse to comply with the tax laws.<sup>70</sup>

While achieving a “fair and equitable result” per the IRM is a commendable goal, the IRS’s requirement that the OIC should not be perceived by other taxpayers as placing the noncompliant taxpayer in a better position goes beyond the requirements in the regulations. It may lead to subjective determinations by IRS employees who are not in position to assume the perceptions of other taxpayers.<sup>71</sup> If the IRS persists in requiring this subjective assessment, it should revise its procedures to have the National Taxpayer Advocate, as the voice of taxpayers within the IRS, determine whether other taxpayers would view the compromise as fair and equitable.

ETA offers submitted by businesses are specifically treated with caution to avoid “providing financial advantages through the forgiveness of tax debt.”<sup>72</sup> As a result, the IRS has adopted an inflexible approach that “generally” requires an OIC submitted by an operating business provide for payment of the full amount of tax, exclusive of interest and penalties.<sup>73</sup> This is an illogical distinction to draw for offers submitted by businesses,<sup>74</sup> as individual taxpayers can also benefit from the acceptance of offers. For instance, if an individual satisfies a liability through an offer, the person may then be able to take vacations or buy cars whereas a taxpayer who has a debt and does not submit an offer or who has consistently paid all of his or her taxes may be struggling.

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<sup>67</sup> IRM 5.8.11.2.2(3), *Public Policy or Equity Grounds*, (Sept. 23, 2008).

<sup>68</sup> *Id.* The taxpayer must also have remained in compliance since incurring the liability and overall their compliance history should not weigh against compromise. The taxpayer must have acted reasonably and responsibly in the situation giving rise to the liabilities.

<sup>69</sup> Treas. Reg. § 301.7122-1(b)(3)(iii).

<sup>70</sup> Treas. Reg. § 301.7122-1(c)(3)(ii). While the regulations point out that this list is not exhaustive, there is no mention of other taxpayers as a factor.

<sup>71</sup> NEH ETA OIC denials based on IRS employees’ subjective determinations of other taxpayers’ potential perceptions may be viewed as arbitrary and capricious, and as such, may violate a taxpayer’s *right to a fair and just tax system*. For taxpayers who cannot access the OIC as a collection alternative, these procedures can undermine the *right to finality*.

<sup>72</sup> IRM 5.8.11.4.3(2), *Determining an Acceptable Offer Amount*, (Sept. 23, 2008). For information on how this impacts businesses that have been victimized by fraudulent payroll service providers, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply With the Law Regarding Victims of Payroll Service Provider Failure, infra*.

<sup>73</sup> IRM 5.8.11.4.3 (Sept. 23, 2008).

<sup>74</sup> See National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 19-25; National Taxpayer Advocate 2013 Annual Report to Congress 134-146 (Most Serious Problem: *COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue*); National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2011 Annual Report to Congress (Legislative Recommendation: *Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers that Impose Economic Hardship*). In the context of trust fund recovery penalty, one court noted that the financially struggling business should be allowed “minimum working capital ... to maintain operations and avoid liquidation of the business.” See *In re Rossiter*, 167 B.R. 919 (C.D. Cal. 1994).

These procedures implicate the *right to a fair and just tax system*, which is officially described as the “right to expect the tax system to consider facts and circumstances that might affect [the taxpayer’s] underlying liabilities [and] ability to pay.”<sup>75</sup> Under the current IRS approach, taxpayers’ circumstances are not the focus of the analysis—rather it is some subjective perception on the part of the IRS about competitive “advantage.” These procedures also go against the clear congressional intent of a flexible OIC program.

### The Underutilization of the OIC Program Undermines Taxpayers’ Rights.

Proper and flexible use of OICs is important for taxpayer rights such as *the right to be informed, the right to quality service, the right to finality, and the right to a fair and just tax system*.<sup>76</sup> Without access to OICs, many taxpayers lose an opportunity to settle their debt in a definitive way, as envisioned by Congress in RRA 98. Business taxpayers may be unable to resolve liabilities and may be forced to cease operations.<sup>77</sup> The *right to a fair and just tax system* means the IRS should consider the facts and circumstances of each taxpayer during the offer process. Thus, proper and timely consideration of OICs would promote taxpayer rights and result in improved compliance.

## CONCLUSION

Congress intended for a flexible use of the OIC program. By not taking a flexible approach to OICs, the IRS is missing opportunities to improve compliance, collect revenue, and support the nation’s economy, including the following:

- The IRS is not following Congress’s mandate to effectively use the OIC as a viable compliance tool for all taxpayers;
- The IRS has greatly underutilized the ETA offer for all taxpayers, but Business Master File taxpayers in particular; and
- The IRS could enhance collection revenue using the OIC as an alternative to CNC status, shelved status, and the Queue.

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<sup>75</sup> IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

<sup>76</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *TAXPAYER RIGHTS: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*). To its credit, the IRS on June 10, 2014, adopted the Taxpayer Bill of Rights (TBOR) that the National Taxpayer Advocate has long recommended, pulling together in one basic statement the substantive rights scattered throughout the Internal Revenue Code.

<sup>77</sup> For instance, when a payroll service provider goes out of business for misappropriating its clients’ funds, the employers remain liable for the unpaid payroll tax, interest, and penalties that they have already paid. See National Taxpayer Advocate 2012 Annual Report to Congress 426-444 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Increase staffing in the OIC program to 2001 levels and train employees to evaluate complex offers. Staffing available to work offers can be increased by allowing all Revenue Officers to review and accept OICs as part of working their inventory.
2. Expand use of the Effective Tax Administration offer for both individual and business taxpayers with an emphasis on flexibility in evaluation of the taxpayer's circumstances.
3. Proactively identify cases that would be viable candidates for offers and reach out to those taxpayers prior to placing accounts in currently not collectible status, the Queue, or shelved status.
4. Increase the information and training about the OIC program provided to the Automated Collection System so employees can identify good offer candidates; and share more information with the Stakeholder Partnerships, Education and Communication unit, the Low Income Taxpayer Clinics, and the Volunteer Income Tax Assistance program.
5. Revise IRM 5.8.11.2.2(4) to remove the economic competition argument as it is irrelevant and violates the taxpayer's *right to a fair and just tax system*.
6. In the case of non-economic hardship ETA offers, if the IRS persists in requiring the subjective assessment of whether other taxpayers would view the compromise as a fair and equitable result, it should revise its procedures to have the National Taxpayer Advocate, as the voice of taxpayers within the IRS, determine whether other taxpayers would view the compromise as fair and equitable.

**MSP  
#21****OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure****RESPONSIBLE OFFICIAL**

Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

Outsourcing payroll and related tax duties to third-party payroll service providers (PSPs) is a common business practice, especially for small business owners. PSPs can help employers meet filing deadlines and deposit requirements by withholding, reporting, and depositing employment taxes with state and federal authorities on behalf of the employer. If a PSP mismanages or embezzles funds that should have been paid to the IRS or state tax agency, the client employer remains responsible for unpaid tax, interest, and penalties. PSP incompetence or fraud often results in significant hardship for the business, which (from its perspective) must pay the tax twice—once to the failed PSP, and again to the IRS.

For the past decade, the National Taxpayer Advocate has recommended numerous administrative and legislative actions to assist victims of PSP failure.<sup>1</sup> Congress recently enacted legislation that incorporates two of these recommendations. The Consolidated Appropriations Act of 2014 requires the IRS to:

1. Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address); and
2. Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.<sup>2</sup>

Notwithstanding significant improvements to the IRS's approach to these taxpayers, the National Taxpayer Advocate has the following concerns with the IRS response to this congressional mandate:

- While the IRS has stated its intention to start issuing dual address change notices by January 2015, it is unclear whether the IRS will meet this commitment.
- The IRS has not embraced its effective tax administration (ETA) OIC authority as a viable collection alternative and has consistently underutilized this tool to provide relief to victims.
- The proposed interim guidance on offers is inadequate.

1 See National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 337-54 (Most Serious Problem: *Third Party Payers*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

2 Consolidated Appropriations Act, Pub. L. No. 113-76, Division E, Title I, § 106 (2014).

## ANALYSIS OF PROBLEM

### Dual Address Change Notices Can Alert Employers of Potential PSP Fraud.

Unscrupulous PSPs may wish to change their clients' addresses of record with the IRS without their clients' knowledge, which could keep an employer from learning it has delinquent tax deposits for months or even years. To prevent such an occurrence, the National Taxpayer Advocate recommended in her 2012 Annual Report to Congress that the IRS promptly issue dual address change notices to alert employers when a PSP initiates a change.<sup>3</sup> The address change notice would be sent to the taxpayer's new and old address, giving the employer an opportunity to contact the IRS if it did not initiate the change of address. That way, the employer will receive IRS correspondence about any penalties and interest that result from the PSP failing to make timely payments.

The IRS website recommends that the employer not change its address of record to that of the PSP.<sup>4</sup> However, the IRS has not yet adopted the National Taxpayer Advocate's recommendation to issue dual notices, despite the mandate from Congress to do so. As noted above, the Consolidated Appropriations Act of 2014 *requires* the IRS to issue a notice of confirmation of any address change relating to an employer making employment tax payments, and send such notice to both the employer's former and new addresses.<sup>5</sup>

On May 8, 2014, the IRS Commissioner sent a letter to the House and Senate appropriations committees, which stated that "dual notice language has been drafted and a programming change has been submitted" to allow notices to go to the old and new addresses, to be implemented by January 2015.<sup>6</sup> While the National Taxpayer Advocate commends the IRS for its initial steps to respond to this mandate, she will monitor the process to ensure that the IRS is on track to issue dual notices by the date promised.

### The IRS Should Embrace Its Authority to Compromise the Tax Liability of Victims of PSP Failure, Based on Effective Tax Administration.

Employers remain liable for unpaid payroll taxes when a PSP diverts employers' funds without paying the IRS the taxes due. When this occurs, employers may suffer a severe financial toll. Though they have complied with the tax laws by paying withholding and payroll taxes to their PSPs, these employers will be required, through no fault of their own, to pay the taxes a second time, along with interest and penalties. Some small businesses may be unable to recover from such a setback and be forced to shut down and lay off employees.

<sup>3</sup> National Taxpayer Advocate 2012 Annual Report to Congress 444 ("establish ascertainable timeframes for beginning the use of dual address change letters alerting employers that a PSP has initiated a change of address, including email or text message notifications to taxpayers who so consent in a special field on employment tax returns"). See also National Taxpayer Advocate 2007 Annual Report to Congress 341 ("establish a procedure to send duplicate notices to the employer and the third party payer" and "notify affected employers when it becomes aware of a defunct third party payer").

<sup>4</sup> See IRS, *Outsourcing Payroll Duties*, available at <http://www.irs.gov/Businesses/Small-Businesses-& Self-Employed/Outsourcing-Payroll-Duties> (last visited Nov. 18, 2014).

<sup>5</sup> Consolidated Appropriations Act, Pub. L. No. 113-76, Division E, Title I, § 106 (2014).

<sup>6</sup> Letter from John A. Koskinen, IRS Commissioner, to U.S. Senate and House Committees on Appropriations (May 8, 2014). See also IRS, Unified Work Request 99807 (Dec. 30, 2013) (setting scheduled implementation for January 23, 2015). On January 2, 2015, the IRS issued SERP Alert 15A0001, *Dual Notices of Address Change*, stating that: "Beginning Jan. 23, 2015, when an address change occurs on an EIN reflecting Employment Tax FRCs (Form 94X series), a CP 148A will generate to the taxpayer's new address and a CP 148B will generate to the taxpayer's previous address."

In March 2013, the press widely reported that AccuPay, a Maryland-based payroll service provider, failed to remit taxes it collected from 500 to 600 clients.<sup>7</sup> AccuPay filed for Chapter 7 federal bankruptcy protection after clients claimed in lawsuits that some \$465,000 entrusted with AccuPay was not remitted to tax authorities.<sup>8</sup> TAS worked to alert former AccuPay clients of potential IRS collection action, and how to deal with the IRS regarding unpaid payroll taxes and unfiled returns.

TAS also coordinated with the IRS to forestall collection activity on the accounts of the affected clients while TAS works with the taxpayers to resolve their individual issues. The IRS designated a specific Criminal Investigations agent to deal with inquiries from victims of AccuPay.<sup>9</sup> In many cases, TAS successfully advocated to abate penalties for failing to timely deposit payroll taxes and accept installment agreements to pay the tax liability over time. However, TAS has been less successful in working with the IRS to compromise the underlying tax liability.

### *Authority to Accept Offers in Compromise Based upon Effective Tax Administration*

Under the Taxpayer Bill of Rights (TBOR), taxpayers have the *right to a fair and just tax system*. That is, taxpayers have the right to expect the system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. In recognition of this important taxpayer right, the IRS Restructuring and Reform Act of 1998 (RRA 98) introduced the concept of accepting OICs based on effective tax administration (ETA).<sup>10</sup> The Conference Report accompanying RRA 98 provides this additional guidance:

[T]he conferees believe that the *IRS should be flexible* in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer in compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.<sup>11</sup> (emphasis added)

Offers in compromise based on ETA provide the IRS the flexibility to consider all of the circumstances that led to a delinquency. The IRS can accept ETA offers even if it could achieve full collection when such collection would create an economic hardship for the taxpayer or when “compelling public policy or equity considerations” are identified by the taxpayer.<sup>12</sup>

In her 2012 Annual Report to Congress, the National Taxpayer Advocate reiterated her recommendation that the IRS promote the use of offers in compromise as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances.<sup>13</sup> In practice, the IRS has

<sup>7</sup> See Lorraine Mirabella, *Payroll Firm Accupay Is Investigated for Allegedly Stealing Clients' Tax Payments*, BALT. SUN, Mar. 4, 2013, available at [http://articles.baltimoresun.com/2013-03-04/business/bs-bz-accupay-investigation-20130304\\_1\\_tax-payments-tax-collectors-potential-victims](http://articles.baltimoresun.com/2013-03-04/business/bs-bz-accupay-investigation-20130304_1_tax-payments-tax-collectors-potential-victims); Angus Loten, *Tax Surprises Can Follow When Payroll Firms Implode*, Wall St. J., Apr. 24, 2013, available at <http://online.wsj.com/news/articles/SB10001424127887324743704578442901672516758>.

<sup>8</sup> *Id.*

<sup>9</sup> IRS, SERP Alert 13A0213, *Contact Regarding AccuPay* (May 14, 2013).

<sup>10</sup> For an in-depth discussion of the IRS's OIC authority, see Most Serious Problem: OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise, *supra*.

<sup>11</sup> H.R. CONF. REP. No. 105-599, at 289 (1998).

<sup>12</sup> See Treas. Reg. § 301.7122-1(b)(3)(ii).

<sup>13</sup> National Taxpayer Advocate 2012 Annual Report to Congress 444 (“revise the IRM and training materials to promote the use of ETA OICs as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances”). See also National Taxpayer Advocate 2007 Annual Report to Congress 342 (“interim guidance regarding the use of the ETA authority should do more to encourage IRS personnel to compromise tax liability in these situations”).

**The IRS does not track the number of Payroll Service Provider victims, but even considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, accepting 54 non-economic hardship Effective Tax Administration offers over the past two years is hardly the “flexible” use that Congress intended.**

not embraced its ETA OIC authority and has consistently underutilized this tool to provide relief to victims. For example, in fiscal years (FYs) 2013 and 2014, the IRS accepted only 54 non-economic hardship ETA offers submitted by victims of PSPs.<sup>14</sup> The IRS does not track the number of PSP victims, but even considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, accepting 54 non-economic hardship ETA offers over the past two years is hardly the “flexible” use that Congress intended.

Unsatisfied with the lack of the IRS’s interest in the use of its ETA OIC authority for victims of PSPs, Congress included language in the Consolidated Appropriations Act of 2014 specifically mandating that the IRS “shall give special consideration to an offer in compromise from a taxpayer who has been the victim of fraud by a third party payroll tax preparer.”<sup>15</sup> It is clear that Congress wants the IRS to do more to assist victims of PSP failure.

Yet in its response to this congressional directive, the IRS fails to even acknowledge these taxpayers as victims who need special assistance. The Commissioner’s May 2014 letter simply states that an “employer’s use of a PSP does not relieve the employer of its employment tax obligations or liability for employment taxes.” The IRS does not acknowledge that the taxpayers’ specific facts and circumstances may warrant a compromise of those obligations or liabilities, as Congress directed the IRS to do and as the TBOR promises.

### *Interim Guidance in Response to Congressional Directive*

During the summer of 2014, TAS worked with the IRS to develop an interim guidance memorandum (IGM) that supplements its Internal Revenue Manual (IRM) section on OIC.<sup>16</sup> Its stated objective is to:

allow the offer specialist to investigate and process offers submitted by taxpayers impacted by the fraudulent acts of a PSP in the most expeditious manner possible. The attached procedures require taxpayers to submit the least amount of documentation necessary to complete the offer investigation and allow for a resolution which is in the interest of both the taxpayer and the government.<sup>17</sup>

Though skeptical of the term “expeditious” and noting that it is often interpreted as “most convenient for the IRS” rather than “effective” or “correct,” the National Taxpayer Advocate is generally pleased with the additional guidance. While there is no “silver bullet” solution for this problem, this IGM provides Collection employees much more flexibility to use ETA authority in these cases.

<sup>14</sup> See IRS response to TAS information request (Aug. 8, 2014); IRS response to TAS information request (Aug. 11, 2014); IRS response to fact check (Dec. 8, 2014). While the IRS does not systematically track the number of OICs submitted by victims of PSPs, it stated that it knew of 33 such offers received in FY 2013 and 57 in FY 2014. See IRS response to fact check (Nov. 26, 2014).

<sup>15</sup> Consolidated Appropriations Act, Pub. L. No. 113-76, Division E, Title I, § 106 (2014).

<sup>16</sup> Memorandum from Rocco A. Steco, Acting Director, Collection Policy, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014). This guidance supplements the procedures found in IRM 5.8.11.2.2.1, *Public Policy or Equity Compelling Factors* (Sept. 23, 2008), IRM 5.8.11.5, *Documentation and Verification* (Sept. 23, 2008), IRM 5.8.4.22.1, *Trust Fund Liabilities* (May 10, 2013), and IRM 5.8.8.4, *Closing a Case as an Acceptance* (Aug. 8, 2014), and will be incorporated into the next revision of these IRM sections.

<sup>17</sup> *Id.*

From the outset, the IGM acknowledges that these taxpayers are victims of a crime. This is the perspective that the National Taxpayer Advocate believes Congress intended the IRS adopt. The IGM takes a more taxpayer-favorable approach than before in discussing how to determine if the victims acted in a reasonable manner in selecting a PSP. For example, whether the PSP was licensed and bonded is just one of many factors to consider, not a dispositive factor.

Most significantly, Collection has backed away from requiring full payment of the outstanding tax balance (exclusive of penalty and interest), as the minimum offer amount. In other words, the IRS will compromise tax under certain conditions—which shows a significant commitment to treating taxpayers harmed by PSPs as victims. Furthermore, the guidance allows for acceptance of an ETA OIC without financial analysis if the taxpayer can and will agree to offer the tax balance (exclusive of penalty and interest).

Once the Collection employee has determined the PSP victim acted reasonably and its failure to comply is directly due to the actions of a third party, the IGM provides an expanded set of factors to consider in determining a reasonable offer amount in these cases. For example:

- Will payment of the full reasonable collection potential (RCP) or the remaining tax balance (exclusive of penalty and interest):
  - Negatively impact the ability of the taxpayer to pay current and future expenses in a timely manner?
  - Potentially result in the need for the taxpayer to lay off employees?
  - Reduce the goods or services provided to the community?
  - Impair the ability of the taxpayer business to remain operational?
  - Negatively impact the local economy if the business fails?
- Will payment of less than the calculated RCP or the remaining tax balance (exclusive of penalty and interest):
  - Result in providing a financial gain for the taxpayer?
  - Be generally perceived within the community as a fair and equitable solution?

The National Taxpayer Advocate believes the inquiry of whether the offer amount will result in a financial gain for the taxpayer is irrelevant to offer acceptance. This factor indicates that the IRS is still thinking that somehow, by relieving a PSP victim of the employment tax liability, the taxpayer will obtain some economic advantage over its competitors. Yet the very fact that the taxpayer has already paid the PSP the amount of the tax means that the taxpayer will be economically *disadvantaged*, vis-à-vis its competitors, by paying the amount twice.

Given this underlying emphasis on enforcement, the National Taxpayer Advocate is concerned that the IRS is not comfortable with making an objective assessment of whether an accepted offer would be perceived as fair and equitable by the community. One possible solution to this concern is for the National

Taxpayer Advocate, as the voice of the taxpayer within the IRS, to make this assessment.<sup>18</sup> The relevant inquiries are:

- Whether the taxpayer exercised good judgment in utilizing this particular PSP;
- Whether the taxpayer timely paid the payroll taxes and withholding to the PSP; and
- Whether the taxpayer took appropriate steps to mitigate its loss (including paying over any insurance proceeds received as a result of the loss).

The National Taxpayer Advocate continues to have concerns about both the substance and implementation of the new guidance, as discussed above. After decades of treating ETA OICs as a rare occurrence—recall that the IRS accepted only 54 OICs based on ETA from victims of PSPs in FYs 2013 and 2014—it will be a challenge to change the culture of the organization to provide special consideration of OICs for victims of PSPs. This message should be reiterated by top-level executive communications from Small Business/Self-Employed Division (SB/SE) leadership.

Once the IRS has revised its guidance and approach, it must develop and deliver comprehensive training to its staff, including all Revenue Officers and Centralized OIC employees. Revenue Officers must be directed to forward OICs submitted by victims of PSP failure for ETA consideration as soon as they are identified. Without the appropriate training to supplement the revised guidance, it will be difficult to achieve the culture change.

The guidance in this IGM will be the basis for a new section of IRM 5.8.11 that specifically addresses the PSP issue. In addition, the IRS should update IRM 5.7, *Trust Fund Compliance*, to include a discussion of the use of ETA OICs in these cases. IRM 5.7 should direct Revenue Officers to assist PSP victims in submitting OICs, and getting them to the Centralized OIC group without delay.

Finally, SB/SE executives must continue to monitor activity in this area to ensure that employees actually follow the new guidance. For example, if the IRS accepts only a few dozen ETA OICs on this issue in FY 2015, we would be concerned that the IRS is only giving lip service to Congress with respect to victims of PSP malfeasance.

## CONCLUSION

Many small businesses rely upon payroll service providers to meet their employment tax reporting and payment obligations. Unfortunately, there have been many instances where PSPs have failed to remit the proper amount of tax deposits on behalf of their clients. The IRS has been reluctant to take steps to (1) reduce the likelihood of the fraud by issuing dual notices whenever an address change is requested, and (2) exercise the full extent of its authority to accept offers in compromise based upon effective tax administration principles. Unsatisfied with the lack of IRS action, Congress mandated in January 2014 that the IRS issue dual notices for address changes and give special consideration to OICs submitted by victims of PSP fraud. The IRS Commissioner assured Congress that the IRS would comply with the mandate. The National Taxpayer Advocate will continue to work with the IRS to ensure it addresses both mandates.

<sup>18</sup> See Legislative Recommendation: *OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable,” infra..*

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that SB/SE:

1. Amend its interim guidance and IRM to incorporate the changes suggested by the National Taxpayer Advocate.
2. Develop and deliver comprehensive training to all Revenue Officers and Centralized OIC employees on the new guidance for reviewing and processing ETA OICs submitted by victims of PSP failure.
3. Update IRM 5.7, *Trust Fund Compliance*, instructing Revenue Officers to pass on OICs submitted by PSP victims to the centralized OIC group without delay.

**MSP  
#22**

## **MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98**

### **RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division

### **DEFINITION OF PROBLEM**

One of the IRS's most significant powers is its authority to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes. The NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders.<sup>1</sup> Unlike most other creditors, the IRS does not need a judgment from a court to file an NFTL.<sup>2</sup> When properly applied, the IRS's lien authority can be an effective tool in tax collection. However, when improperly applied, NFTLs can needlessly harm taxpayers and undermine long-term tax collection.

Specifically, filing an NFTL can significantly harm the taxpayer's creditworthiness and thus impair his or her ability to:

- Obtain financing for a home or other major purchase;
- Find or retain a job;
- Secure affordable housing or insurance;<sup>3</sup> and
- Ultimately pay the tax debt.<sup>4</sup>

Badly damaging the taxpayer's financial circumstances in this way may even require the government to provide welfare benefits to the taxpayer, such as unemployment benefits or food stamps.

Aware of the serious impact and hardship NFTLs can cause in a taxpayer's life,<sup>5</sup> Congress enacted § 3421 of RRA 98 to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."<sup>6</sup> The law requires the IRS to adopt procedures in which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor and to set out disciplinary actions when such approval is not obtained.<sup>7</sup>

1 Internal Revenue Code (IRC) §§ 6321, 6322, and 6323(a).

2 IRC §§ 6321, 6322, and 6323(a). IRS collection actions are either taken by the Automated Collection System (ACS) or Revenue Officers (ROs). ROs work in field offices and can send letters, issue liens and levies, and answer calls. ACS is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies.

3 Heather Struck, *A Bad Credit Score Affects A Lot More Than Credit*, FORBES, Jul. 20, 2011, available at <http://www.forbes.com/sites/heatherstruck/2011/07/20/credit-score-fico-can-hurt-you/>.

4 Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

5 *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong., (1998) (see, e.g., statements of Nina E. Olson, Executive Director of the Community Tax Law Project in Richmond, Virginia).

6 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998). See also S. REP. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02 (statement of Sen. Roth).

7 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

Aware of the serious impact and hardship that lien filings can cause in a taxpayer's life, Congress enacted section 3421 of the IRS Restructuring and Reform Act of 1998 to preclude the IRS from "abusively using its liens-and-seizure authority."

The IRS has deemed that it is rarely "appropriate" to require such approval, because it has made virtually no adjustments to its procedures along the lines of what Congress directed in enacting § 3421 of RRA 98. In fact, the IRS has adopted a collection strategy that often relies on *broad* use of its lien authority.<sup>8</sup> Notably, the IRS has eased previous restrictions on NFTL filings by allowing lower-graded employees to file NFTLs without managerial approval.<sup>9</sup> The IRS also flipped Congress's intent on its head by requiring employees to obtain managerial approval if they determine *not* to file an NFTL or defer filing in many circumstances.<sup>10</sup> Further, the IRS never established appropriate disciplinary actions for employees who fail to secure managerial approval to file an NFTL when such approval is required (*i.e.*, Revenue Officers (RO) below GS-9).<sup>11</sup>

The National Taxpayer Advocate has conducted several significant research studies which show not only that this lien filing approach is ineffective in terms of collecting revenue but that it actually impairs current and future payment compliance and the taxpayer's earnings, and has particularly harmful effects on taxpayers whom the IRS has classified as "currently not collectible" (CNC) because of economic hardship.<sup>12</sup>

A meaningful implementation of Congress's directive would not only better protect the taxpayers' right to a fair and just tax system, but would also prevent further harm to taxpayers experiencing economic hardship, while establishing a more effective approach to collecting outstanding liabilities.<sup>13</sup>

## ANALYSIS OF PROBLEM

### Background

#### *A Federal Tax Lien is a Powerful Collection Tool.*

A Federal Tax Lien (FTL) arises when the IRS assesses a tax liability, sends the taxpayer notice and demand for payment, and the taxpayer does not fully pay the debt within ten days.<sup>14</sup> An FTL is effective as of the date of assessment and attaches to all of the taxpayer's property and rights to property, whether real or personal, including those acquired by the taxpayer after that date.<sup>15</sup> This lien continues against the taxpayer's property until the liability either has been fully paid or is legally unenforceable.<sup>16</sup> This

8 Internal Revenue Manual (IRM) 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013).

9 IRM 1.2.44.5, *Delegation Order 5-4* (May 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFTL Requires Approval* (Aug. 4, 2014).

10 IRM 5.12.2.5.3, *NFTL Do-Not-File and Filing Deferral Determination Approvals* (Oct. 14, 2013); 5.19.4.5.2.1, *Do Not File Approvals* (Aug. 4, 2014).

11 IRS response to TAS information request (July 31, 2014) and IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

12 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS's Use of Notices of Federal Tax Lien*). Taxpayer accounts are reported as currently not collectable when the taxpayer has no assets or income, which by law, are subject to a levy. IRM 1.2.14.1.14, *Policy Statement 5-71* (Nov. 19, 1980).

13 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

14 IRC §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed. IRC § 6303 provides that within 60 days of the assessment the IRS must provide notice and demand for payment to any taxpayer liable for an unpaid tax.

15 See IRC § 6321; IRM 5.12.1.3, *Creation and Duration* (Oct. 14, 2013).

16 IRC § 6322.

statutory lien is sometimes called the “secret” lien, because third parties—and usually the taxpayer—have no knowledge of the existence of this lien or the underlying debt, and the taxpayer may not understand the significance of this statutory lien.<sup>17</sup>

However, the FTL does not give the IRS priority over other creditors. The IRS must file an NFTL in the county or similar jurisdiction where a taxpayer’s property is located, such as with a register of deeds, to put third parties on notice and establish the priority of the government’s interest in the taxpayer’s property against subsequent purchasers, secured creditors, and junior lien holders.<sup>18</sup>

The IRS is required to release a lien not later than 30 days after the underlying liability either is fully satisfied through full payment of tax or becomes legally unenforceable (typically, upon expiration of the statutory period for collecting the tax).<sup>19</sup> Once the certificate of release is issued and filed in the same office as the related NFTL, the tax lien is conclusively extinguished.<sup>20</sup>

### ***NFTL Filing Has Significant Consequences for the Taxpayer.***

As mentioned above, the NFTL filing negatively impacts a taxpayer’s credit history,<sup>21</sup> having the potential of reducing a taxpayer’s credit score by 100 points,<sup>22</sup> and has a long-lasting effect on the taxpayer’s financial viability. For example, the existence of the NFTL filing, and the information contained in the notice, are included in the consumer (credit) reports,<sup>23</sup> which can impair a taxpayer’s ability to obtain financing,<sup>24</sup> find or keep a job,<sup>25</sup> and secure affordable housing or insurance.<sup>26</sup> It can also hamper the taxpayer’s ability to stay compliant and obtain credit needed to pay preexisting tax debts.<sup>27</sup>

The taxpayer may experience effects of the NFTL filing long-term, because a NFTL filing will remain on a taxpayer’s credit report for years, or even indefinitely. Specifically, “paid tax liens” appear on credit

17 IRC § 6321. The IRM refers to this statutory lien also as the “assessment” or the “silent” lien. See IRM 5.12.1.2, *Introduction to Liens* (Oct. 14, 2013).

18 IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.1.4, *Purpose and Effect of Filing a Notice of Federal Tax Lien (NFTL)* (Oct. 14, 2013).

19 IRC § 6325(a)(1).

20 IRC § 6325(f).

21 It is difficult to speculate as to the degree to which an NFTL will affect a taxpayer’s credit score, because every individual’s situation is different, and there are many different credit scoring systems. Therefore, the impact on one system could be very different from another because the numeric scales are different. See Experian, *A World of Insight*, available at <http://www.experian.com/ask-experian/20080903-tax-liens-and-credit-scores.html> (last visited Dec. 12, 2014). However, a recent IRS study conducted by Experian found that NFTLs have a minimal impact on many consumers’ credit scores. See IRS and Experian Decision Analytics, *Federal Tax Lien Impact Study* (Mar. 31, 2014).

22 Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

23 The term “consumer report” is defined in the FCRA, § 603(d), 15 USC § 1681a(d). Hereinafter, we will use the more commonly used term “credit report.”

24 Some lenders decline to extend credit to a taxpayer if the IRS has filed an NFTL against the taxpayer’s property. Others will charge substantially higher rates, even if the lien is subordinated. See, e.g., GMAC Factoring Agreement, available at <http://contracts.onecle.com/arbinet/gmac.factor.2003.02.01.shtml> (last visited Dec. 13, 2014).

25 Some licensing boards require members to maintain a clean credit history and some employers require employees to do so as a condition of employment. See, e.g., Form U4, *Uniform Application for Broker-Dealer Registration*, Q14M (May 2009), available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf> (last visited Dec. 13, 2014).

26 See also IRS Pub. 594, *What You Should Know About the IRS Collection Process* 4 (Apr. 2012) (recognizing the taxpayer may not be able to get a loan to buy a house or a car, get a new credit card, or sign a lease as result of the NFTL filing).

27 See, e.g., IRC § 6323(d) (providing that security protection only extended to the lender for disbursements made within 45 days after the filing of the NFTL, or until the lender is provided actual notice of the NFTL); IRC § 3505(b) (holding a lender providing funds for the ongoing operation of a business potentially liable for unpaid withholding taxes if certain criteria are met).

reports for seven years from the date of payment,<sup>28</sup> and unpaid liens may remain on the taxpayer's credit report indefinitely, even when the underlying lien becomes legally unenforceable (*e.g.*, because the statute of limitations for collection has expired and the lien self-released or the lien is legally satisfied as a result of an accepted offer in compromise) or the IRS accepts a bond.<sup>29</sup> When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further damage his or her financial viability and generate significant downstream costs for the government.<sup>30</sup>

### ***Congress Placed Limitations on IRS Lien Filing Authority, Recognizing the Impact of NFTL on Taxpayers.***

As a result of concerns raised by Congress and leaders in the tax community regarding the IRS's use of its NFTL authority,<sup>31</sup> Congress enacted § 3421 in RRA 98.<sup>32</sup> Under this provision, where deemed appropriate, a determination by an employee to file an NFTL would be approved by an IRS supervisor who would:

- Review the taxpayer's information;
- Verify that a balance is due; and
- Affirm that the action proposed is appropriate given the taxpayer's circumstances, the amount due, and the value of the property or right to property.<sup>33</sup>

Failure to follow these procedures should result in appropriate disciplinary action against the responsible supervisor or employee.<sup>34</sup> Congress delayed the application of RRA 98 § 3421 of RRA 98 until January 1, 2001 for IRS collection actions taken under the IRS Automated Collection System (ACS).<sup>35</sup>

The recently adopted Taxpayer Bill Of Rights supports Congress' analysis and its concern that collection actions be fair, balanced, and taken after carefully considering the taxpayer's facts and circumstances. The congressional directive of RRA 98 § 3421 relates directly to the *right to a fair and just tax system*, which

28 The Fair Credit Reporting Act (FCRA), § 605(a)(3), 15 USC § 1681c(a)(3). See also Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the Fair Credit Reporting Act, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be noted on the credit report but does not necessarily impact the credit score in a significant way.

29 As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years while Equifax and Transunion credit reports reflect them indefinitely. See <http://www.transunion.com/personal-credit/credit-issues-bad-credit/what-affects-your-credit-score.page>; <http://www.experian.com/blogs/ask-experian/2007/05/16/how-long-public-records-stay-on-your-credit-report/>; <http://blog.equifax.com/credit/faq-how-long-does-information-stay-on-my-credit-report/> (last visited on Dec. 13, 2014). For example, most NFTLs are self-releasing, *i.e.*, the notice indicates that unless the IRS refiles it by the listed date, the notice operates as a certificate of release under IRC § 6325(a). IRC § 6325(a) also provides for a release of liens because the underlying liability became legally unenforceable or the IRS accepted a bond.

30 See T. Keith Fogg, *Systemic Problems With Low-Dollar Lien Filing*, 2011 TNT 194-9 (2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-128 (Most Serious Problem: *Changes to IRS Lien Filing Practices are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*). A further consequence of a lien's damage to a taxpayer's financial viability may be a need for unemployment benefits, food stamps, and the like, thus increasing societal cost.

31 The Joint Committee on Taxation observed that "the imposition of liens, levies, and seizures may impose significant hardships on taxpayers" and "that extra protection in the form of an administrative approval process is appropriate." J. Comm. on Tax'n, *General Explanation of Tax Legislation Enacted in 1998*, (1998). See also *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance* at 408, 105th Cong., 375 (1998) (written statement of Bruce Strauss, Enrolled Agent) (suggesting among other things that tax liens filings "must all be reviewed by an independent IRS quality review function prior to implementation of the decision"); *Exploring the Development of Taxpayer Bill of Rights Legislation: Hearing Before the H. Comm. On Ways and Means*, 104th Cong. (1995) (statement of Joseph F. Lane, Enrolled Agent).

32 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

33 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

34 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

35 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

means taxpayers have the right to expect that the tax system will consider facts and circumstances that might affect their ability to pay.<sup>36</sup>

### **The IRS has not implemented Congress' directive, and has embraced a broad NFTL filing policy with little managerial review.**

Since Congress enacted § 3421 in RRA 98, the IRS has:

1. Restated its policy that only ROs below the GS-9<sup>37</sup> level must receive managerial approval prior to filing an NFTL.<sup>38</sup> The IRS stated the costs and administrative burden of expanding the § 3421 protection to other situations outweighed the taxpayer's interest.<sup>39</sup> This approval requirement for ROs below the GS-9 level applies to only less than one percent of ROs.<sup>40</sup>
2. Eased managerial approval requirements for NFTL filings. Specifically, despite the fact that Congress gave the IRS more than two years to determine how to implement § 3421 of RRA 98 for ACS,<sup>41</sup> the only change the IRS made was to grant ACS employees in grades as low as GS-6 the authority to file NFTLs without managerial review.<sup>42</sup> This change was contrary to Congress's directive and more lax than prior ACS guidance, which required GS-7 employees and below to obtain approval from either a senior RO or a manager to file an NFTL.<sup>43</sup> Presently, ACS files about one third of NFTLs, and very few require managerial approval<sup>44</sup> (*i.e.*, only about 6.2 percent of ACS employees are below GS-6, so more than 90 percent of ACS employees can file NFTLs without any managerial review).<sup>45</sup>
3. Required all ACS employees and ROs, regardless of grade level, to obtain managerial approval if they determine *not* to file an NFTL in cases that meet specified criteria.<sup>46</sup>
4. Never established disciplinary action for employees who fail to secure managerial approval where required.<sup>47</sup>

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36 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014) and Publication 1, *Your Rights as a Taxpayer* (June 2014).

37 The General Schedule (GS) classification and pay system covers the majority of civilian white-collar Federal employees (about 1.5 million worldwide) in professional, technical, administrative, and clerical positions. U.S. Office of Personnel Management, available at <http://www.opm.gov/policy-data-oversight/pay-leave/pay-systems/general-schedule/> (last visited Dec. 4, 2014). Within the Collection function, a "GS-9" employee is relatively junior.

38 IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

39 Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding section 3421 does not require supervisory review of all collection actions but allows the IRS discretion to determine where such review would be appropriate); Memorandum from Chief, Branch 1, General Litigation Division to Counsel to the National Taxpayer Advocate, Ref. No. GL-122444-98 (Dec. 23, 1998) (same).

40 IRS Human Resources Reporting Center, Workforce Information by Organization Query on Revenue Officers (Dec. 9, 2013). For instance, as of July 26, 2014, less than one percent of ROs were below the GS-9 level. GS-8 and lower-graded revenue officers totaled two out of 3742 revenue officers. Also, the NFTLs issued by ROs below the GS-9 level may still not be reviewed by a manager. The IRM permits a manager to assign the NFTL review responsibility to another RO at an "appropriate" grade level. (*emphasis added*). See IRM 5.12.2.7, *Approval of Lien Filing Notice* (Oct. 14, 2013).

41 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

42 IRM 1.2.44.5, *Delegation Order 5-4* (May 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFTL Requires Approval* (Aug. 4, 2014).

43 Email from former IRS Chief Compliance Officer to the National Taxpayer Advocate (Nov. 2, 2009) (on file with TAS).

44 IRS No 5000-25, Lien Report, FY 2013 and 2014. ACS filed 204,279 and 198,682 NFTLs out of 602,005 and 535,580 total NFTL filings for FY 2013 and FY 2014, respectively.

45 IRS Human Resources Reporting Center, Position Report Query, ACS employees (no exec), All GSs and GS-5 and less, run date 11/14/2014. As of Nov. 1, 2014, 159 employees out of 2,571 ACS employees were below the GS-6 level.

46 IRM 5.19.4.5.2, *Do Not File Decisions* (Aug. 4, 2014).

47 IRS response to TAS information request (July 31, 2014).

Essentially, the IRS ignored Congress's directive and elected to adopt an even broader NFTL filing policy, rather than one that emphasizes review of taxpayers' particular facts and circumstances to ensure the NFTL will attach to assets and not cause hardship.

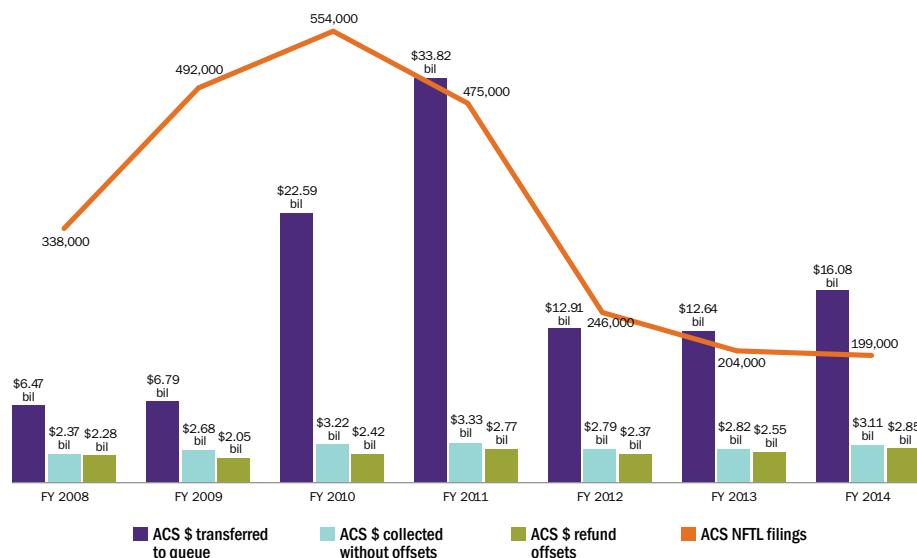
### The current NFTL filing policy has been ineffective in collecting revenue.

The IRS files many NFTLs, pursuant to "business rules" that require automatic NFTL filing or a lack of substantive human review.<sup>48</sup> The reliance on merely following business rules when filing of NFTLs has contributed to a significant increase in the number of NFTLs filed. For example, NFTL filings rose by about 219 percent from fiscal year (FY) 1999 to 2014,<sup>49</sup> yet the Collection function is collecting only slightly more in real 2014 dollars than in 1999.<sup>50</sup>

The NFTL filing strategy also has been ineffective for the ACS function. ACS systematically takes collection action when "business rules" that require automatic filing of an NFTL are met, rather than reviewing the particular facts and circumstances of each case.<sup>51</sup> As the chart below illustrates, this approach has been ineffective in collecting revenue.

**FIGURE 1.22.1<sup>52</sup>**

#### Selected ACS collection activities and number of ACS NFTLs filed, FYs 2008-2014



48 IRM 5.19.4.5.3.2, *Filing Criteria* (Aug. 4, 2014).

49 IRS Data Book, Table 16 (Nov. 19, 2014). NFTL filings were 168,000 and 535,580 for 1999 and 2014, respectively.

50 IRS Data Book, Table 16 (Nov. 19, 2014). When adjusted for inflation (converted to 2014 dollars) the IRS collected about \$32.1 billion in FY 1999 and about \$34.2 billion in FY 2014.

51 ACS Customer Service Activity Reports (CSAR), FY 2009 BOD report. See also E-mail from IRS subject matter expert (Nov. 2, 2009); IRM 5.19.4.5.3.2, *Filing Criteria* (Aug. 4, 2014).

52 Collection Report, NO 5000-2, Part 1 - TDAs, ACS/CS TDAs, FY 2008-FY 2014 and Collection Report, NO 5000-256, Lien Report, FY 2010-FY 2014. Note that the chart shows that the number of NFTLs filed by ACS has dropped dramatically since 2010, however, dollars collected have increased slightly.

ACS collected only about 5.9 percent of the dollars placed in its inventory, and this is only about a half percent more than the IRS obtained by refund offsets, which do not require an NFTL.<sup>53</sup> Nevertheless, ACS filed 198,682 liens.<sup>54</sup> Yet, ACS ultimately transfers much of its inventory to the Queue.<sup>55</sup> Thus taxpayers are harmed both by having unnecessary NFTLs filed and by being transferred to the “inactive” status in the Queue.

Despite this performance, ACS continues to automatically file NFTLs, using them to establish contact with delinquent taxpayers. Contrary to this practice, one IRS study showed establishing contact with taxpayers through letters, rather than a collection action, was a more effective approach.<sup>56</sup>

### **The current IRS NFTL filing policy harms taxpayers experiencing economic hardship and may undermine future compliance and revenue.**

Taxpayer accounts placed in CNC status because the IRS was either unable to contact or locate the taxpayer, or it determined that the taxpayer was in economic hardship, are subject to NFTLs as long as certain requirements are met (*i.e.*, the tax liability is \$10,000 or greater).<sup>57</sup> As a result of these rules, the IRS systemically files NFTLs against CNC (hardship) taxpayers who in most cases have no assets.<sup>58</sup> When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further impede the taxpayer’s financial viability and ultimately undermine tax revenue and future compliance. In addition, if the NFTL badly damages the taxpayer’s family by driving up costs or rendering the taxpayer jobless or underemployed, the government may be forced to provide a social safety net in the form of unemployment benefits, food stamps, and the like, thus increasing societal cost, raising everyone’s share of taxes, and eroding the core taxpayer *right to a fair and just tax system*.

### **TAS research studies show the IRS’s NFTL filing approach, void of human consideration, is ineffective, harms taxpayers, and damages future compliance.**

TAS Research & Analysis has conducted several in-depth studies on the IRS’s use of NFTLs and their impact on the compliance behavior of delinquent taxpayers.<sup>59</sup> One study analyzed taxpayers who had an NFTL filed against them in 2002 and taxpayers who did not have an NFTL filed against them for the same time period. The study analyzed the effects of an NFTL, or no NFTL, from 2002 through 2010

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53 In FY 2014, ACS collected \$3,107,887,286 out of \$52,254,945,879 placed in ACS in FY 2014, and this is compared to \$2,850,701,610 in refund offsets. IRS NO 5000-2, Part 1 - TDAs, ACS/CS TDAs.

54 Collection Report, NO 5000-25, Lien Report, FY 2014.

55 The Queue is a holding inventory where collection cases sit, sometimes for years, usually after being in ACS, and before being assigned to the Collection Field function or reassignment to ACS. Cases sit in the Queue based on business rules and available resources.

56 ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000). In this study conducted in 2000, the response rate for levies was about 13 percent, while the response rate for Letter 16, *Please Call Us About Your Overdue Taxes or Tax Return*, was nearly 37 percent.

57 IRM 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013). The IRM states: Currently Not Collectible—File a NFTL when BOTH of the following conditions exist: Aggregate assessed balance is at or above \$10,000 Account is being closed using unable to locate (cc03), unable to contact (cc12) or hardship (cc24 through 32) provisions.

58 *Id.*

59 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS’s Use of Notices of Federal Tax Lien*).

(the study period).<sup>60</sup> The research showed that NFTL filing was associated with negative outcomes for payment compliance behavior on the taxpayers' initial liabilities, negative filing compliance behavior, and negative impacts on the amount of income earned by taxpayers in years following the NFTL. Specifically,

- At the end of the study period (calendar year 2010), taxpayers with NFTLs owed 21 percent more on average than they owed when the NFTLs were filed, which was when they incurred their original liabilities in 2002. In contrast, where no NFTL had been filed, taxpayers owed 11 percent more than they owed on their total individual liability at the proxy lien date (2002).<sup>61</sup>
- NFTL taxpayers were less likely to file required returns, with the increased likelihood of non-filing ranging between about one and three percent during the full study period (through 2010).<sup>62</sup>
- NFTL taxpayers were less likely to have an increase in their total positive incomes (TPI) with the increased likelihood of negative outcomes starting at about 7.9 percent and gradually declining to about 5.2 percent by the end of the full study period.<sup>63</sup>

Additionally, these studies showed NFTLs were particularly ineffective when filed against CNC (hardship) taxpayers.

- For tax year (TY) 2009, TAS's analysis of NFTL filing practices showed NFTLs were responsible for only \$2 of every \$10 in payments collected from taxpayers in CNC status, while nearly \$6 of every \$10 collected from these taxpayers came from refund offsets, which occur whether a lien was filed or not.<sup>64</sup> Nonetheless, the IRS filed NFTLs against more than 72 percent of CNC taxpayers suffering economic hardship.<sup>65</sup>
- CNC hardship taxpayers, on average, ended up owing about 50 percent more to the IRS in 2010 than at the time of lien (or proxy lien) filing.<sup>66</sup>

This research also found that taxpayers with an installment agreement (IA) or offer in compromise (OIC) fared much better than others who did not secure such collection alternatives. Over 50 percent of IA

60 This analysis employed a two-phase approach. In phase 1, TAS Research analyzed a cohort of delinquent individual tax return filers (i.e., those who file Forms 1040, U.S. Individual Income Tax Return) who had any unpaid tax liabilities in 2002 and had no other liabilities at the beginning of that year. From these taxpayers, TAS identified taxpayers that the IRS filed NFTLs against and taxpayers it did not file NFTLs against from 2002-2004. TAS compared payment and filing compliance behavior of the two groups from the liabilities inception through 2010, and examined the impact the NFTLs had on taxpayers' incomes during this period. In phase 2, TAS used subsets of the lien and non-lien groups created in Phase 1 to look at the change in total tax liability of the taxpayer groups during the 2002-2010 study periods. TAS also looked at the total dollars the IRS actually collected from these taxpayer groups. National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

61 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

62 *Id.* The estimation results for the Study for lien coefficients in the current payment, future payment, future filings and future income models reported a high level of statistical significance for all models, at least at the one percent level. The lien coefficient measured the explanatory powers associated with a lien being present for delinquent taxpayers with respect to outcomes for the compliance issues or income. Negative signs indicate reduced compliance for the group, while positive signs imply more. The marginal effects were computed at the means of the sample variables.

63 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-112, (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*). It should be noted that we did not adjust dollars for inflation. Therefore, the nominal decreases taxpayers experienced in TPI at the end of the study period (i.e., 2010) relative to their 2002 TPI are greater in real terms than equivalent nominal losses experienced earlier in the period.

64 National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

65 *Id.*

66 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

**The IRS systemically files liens against taxpayers in hardship, who in most cases have no assets. When a taxpayer has little or no ability to pay and no assets from which to collect, a lien filing may further impede the taxpayer's financial viability and ultimately undermine tax revenue and future compliance.**

taxpayers and 70 percent of OIC taxpayers were out of debt to the IRS at the end of the study period (2010).<sup>67</sup> The cumulative effect of these studies show that wholesale NFLT filings are ineffective and damage taxpayer compliance, and both the IRS and the taxpayer would be better served by an IA or OIC.

In response to these studies<sup>68</sup> and other advocacy efforts,<sup>69</sup> the IRS in early 2011 announced an effort to help financially struggling taxpayers get a “fresh start.”<sup>70</sup> This initiative included several positive changes in how the IRS files and withdraws NFLTs.<sup>71</sup> As a result, NFLT filings have declined from about 1,096,376 in FY 2010 to 535,580 in FY 2014, a decrease of 51 percent.<sup>72</sup>

If the filing of NFLTs were a significant driver of revenue collection, one would expect this dramatic decline in NFLT filings to produce a similarly dramatic decline in the amount of revenue the IRS Collection function collected on delinquent accounts. Yet the percent of dollars collected on delinquent accounts by the IRS Collection function has not shown a similar decrease, even though the dollars available for collection decreased slightly from FY 2010 to FY 2014, as depicted below.<sup>73</sup>

67 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-30 (*Research Study: Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

68 See *id.* at 105-29; see also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (*The IRS’s Use of Notices of Federal Tax Lien*).

69 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 124-33 (Most Serious Problem: *Collection Strategy: The Automated Collection System’s Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 403-25 (Most Serious Problem: *Although the IRS “Fresh Start” Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*); National Taxpayer Advocate 2010 Annual Report to Congress 302-10 (Most Serious Problem: *The IRS Has Been Slow to Address the Adverse Impact of its Lien-Filing Policies on Taxpayers and Future Tax Compliance*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*). See also TADs 2010-1 and 2010-2 (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>.

70 IRS, Media Relations Office, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process*, IR-2011-20 (Feb. 24, 2011). TAS worked very closely with the Collection function in developing and clearing procedural guidance related to the “Fresh Start” initiative.

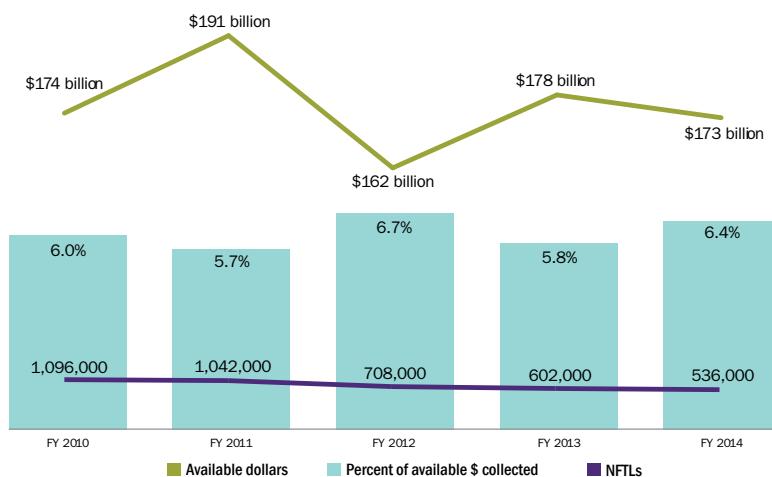
71 ACS’s systemic NFLT filing threshold was increased from \$5,000 to \$10,000, then to \$25,000 a few months later; and ACS established a systemic NFLT ‘floor’ amount on subsequent tax periods at \$2,500 or more. IRM 5.12.2.4.1, *Integrated Collection System (ICS) Documentation When Deferring the Filing of an NFLT or Choosing Do Not File* (Mar. 8, 2012); IRM 5.19.4.5.2, *Do Not File Decisions* (Mar. 14, 2012).

72 IRS Data Book, 2014, Table 16.

73 IRS Collection Reports, No 5000-2, Taxpayer Delinquent Accounts Report (Sept. 2014); No 5000-108, Monthly Report of Offer In Compromise Activity (Sept. 2014); No 5000-6, Installment Agreement Cumulative Report (Sept. 2014); and No 5000-25, Lien Report (Sept. 2014).

**FIGURE 1.22.2<sup>74</sup>**

**Available dollars, percent of available dollars collected, and NFTLs filed,  
FYS 2010-2014**



These results are fully consistent with what the TAS studies have found. Ultimately, the IRS maximizes revenue collection by filing NFTLs in the right cases—not by filing NFTLs in large numbers of cases, triggered solely by arbitrary dollar amounts.

**The IRS should require managerial approval before filing an NFTL in specific situations.**

As illustrated above, the IRS's current NFTL filing policy negatively affects collection results, taxpayers' income, and future compliance. The IRS's implementation of § 3421 of RRA 98 would better ensure that NFTLs are effective and do not create hardship. The National Taxpayer Advocate understands that requiring managerial approval prior to filing all NFTLs is not feasible or practicable. However, the IRS can identify specific situations in which requiring managerial approval would be appropriate and help to prevent useless and harmful NFTLs. These would include cases where it is likely that the lien will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax. The following three categories are situations where the lien could have such an effect.

1. **Taxpayer's income falls below 250 percent of the federal poverty level:** Prior to filing an NFTL, an employee could review available information and determine if the taxpayer's income falls below 250 percent of the federal poverty level.<sup>75</sup> By identifying these taxpayers, the IRS can presume economic hardship (*i.e.*, inability to pay basic living expenses) and consider whether the

74 IRS Collection Reports, No 5000-2, Taxpayer Delinquent Accounts Report (Sept. 2014); No 5000-108, Monthly Report of Offer In Compromise Activity (Sept. 2014); No 5000-6, Installment Agreement Cumulative Report (Sept. 2014); and No 5000-25, Lien Report (Sept. 2014).

75 To determine taxpayer's income, employees could review taxpayer's most recent tax return, or third-party information it has available, whichever is more recent. See Department of Health and Human Services (DHHS), The 2014 HHS Poverty Guidelines, available at <http://aspe.hhs.gov/poverty/14poverty.cfm> (last visited on Nov. 14, 2014). For Calendar Year (CY) 2014, an individual who makes \$11,670 or less is in poverty. This number is then multiplied by 250 percent to determine the 250 percent federal poverty threshold.

lien will only cause further hardship.<sup>76</sup> The IRS already makes such a presumption when identifying low income taxpayers to filter out of the Federal Payment Levy Program (FPLP).<sup>77</sup>

2. **Taxpayers in CNC (hardship) status:** As shown above, taxpayers in CNC (hardship) status are often crippled by tax debt, and filing NFTLs against them does little to protect the government's interest, while most likely making the taxpayer's situation even worse.<sup>78</sup> The manager can consider whether the NFTL will actually assist in collecting the tax (*i.e.*, there are assets for the lien to attach to) or will only further harm the taxpayer.
3. **Taxpayers in a non-streamlined installment agreement:**<sup>79</sup> Taxpayers in an IA make significant strides toward paying off their tax debt.<sup>80</sup> Filing an NFTL against these taxpayers may jeopardize their ability to pay, because the NFTL can hinder their earning potential by threatening their credit rating and ability to secure financing or maintain professional licenses.

Requiring managerial approval in these situations would allow a supervisor to conduct a quality review of the determination to file an NFTL. This review would ensure that IRS employees have considered whether:

1. The NFTL would attach to property;
2. The benefit to the government of the NFTL filing outweighs the harm to the taxpayer, including consideration of any special circumstances pertaining to the taxpayer; and
3. The NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.

If employees fail to secure managerial approval prior to filing an NFTL in these situations, the IRS should take disciplinary actions. A first-time violation should result in an admonishment along with the employee having to complete further training regarding when managerial approval is required before filing a NFTL. Subsequent violations should be met with stiffer consequences, including a written reprimand, or suspension.

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76 IRC § 6343(a)(1)(D) requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Treas. Reg. § 301.6343-1(b)(4) specifies that an economic hardship exists if a taxpayer cannot pay his or her basic living expenses.

77 The FPLP is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. In 2011, the IRS finalized and implemented a low income filter. This filter's design was largely based on a TAS study, which tested a filter model that identified and removed from FPLP low income taxpayers the model showed would experience economic hardship. Largely accepting the findings from the TAS study, the IRS designed a filter that excluded taxpayers from the FPLP whose income fall below 250 percent of the federal poverty level. National Taxpayer Advocate 2008 Annual Report to Congress Vol. II, 46-72 (Research Study: Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program).

78 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-130 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

79 See IRM 5.14.5.1, *Installment Agreements Overview* (May 23, 2014): 1) Guaranteed agreements: under IRC § 6159(c) taxpayers who meet certain conditions and who have a delinquency \$10,000 or less are entitled to an installment agreement. 2) Streamlined agreement: streamline agreement criteria may be secured where the aggregate unpaid balance of assessments does not exceed \$25,000 and may be paid off within a 72 month period. Taxpayers who meet these criteria do not need to provide a financial information statement to the IRS. 3) Non-streamline agreement: agreements that fall outside the parameters of the guaranteed and streamlined IA.

80 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-130 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

Requiring managerial approval before filing an NFTL in the above situations would better adhere the IRS's NFTL policy to Congress's directive. It also would protect taxpayers' *right to a fair and just tax system*, by creating an NFTL policy that considers each taxpayer's individual facts and circumstances.<sup>81</sup>

## CONCLUSION

Fifteen years after Congress determined the IRS should implement enhanced taxpayer protections in the form of managerial approval when it files NFTLs, the IRS still has not adequately changed its procedures to require such approval. To the contrary, the IRS has embraced a broader NFTL filing policy. This approach continues to harm taxpayers and yield poor collection results.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, develop and implement factors to determine situations in which managerial approval of NFTL filings is appropriate and should be required.
2. Develop and implement disciplinary actions to be taken when managerial approval prior to filing a NFTL is not secured in the specified situations.

<sup>81</sup> IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014). The IRS has emphasized the need for such judgment in the context of making a levy determination by instructing revenue officers to exercise good judgment when making the determination to levy, which means they are to consider the taxpayer's financial condition.

**MSP  
#23**

## **STATUTORY NOTICES OF DEFICIENCY: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice**

### **RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division  
 William J. Wilkins, Chief Counsel

### **DEFINITION OF PROBLEM**

Section 1102(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) provides that statutory notices of deficiency (SNODs) “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.”<sup>1</sup> However, our review of existing IRS SNODs found that more than half, or eleven out of 17 types of SNODs, fail to comply with the statutory requirements and instead include this information in a “stuffer” or insert. This noncompliance could impact millions of taxpayers. For example, the IRS issued almost 2.7 million Notices CP 3219A, *Statutory Notice of Deficiency*, in FY 2014.<sup>2</sup> While these notices are still valid, the failure of the IRS to comply with RRA 98 requirements harms taxpayers and violates the taxpayer’s *right to a fair and just tax system*.<sup>3</sup>

Congress enacted this provision of RRA 98 to ensure that taxpayers are aware of their right to contact the local office of the Taxpayer Advocate Service (TAS) at a crucial point in their tax controversy. Taxpayers need to know that they can talk to someone who is located in their state and has knowledge of the underlying local economic conditions that might affect the case. When the taxpayer receives a SNOD, the IRS has not actually assessed the additional tax, and the taxpayer still has a limited opportunity to address the issue directly with the IRS or petition the Tax Court. Seeking assistance from TAS at this juncture could prevent unnecessary burden on the taxpayer and unnecessary litigation for the IRS.

The IRS should provide the local contact information in an easily accessible and highly visible location on the face of all SNODs. Including the necessary contact information in a stuffer rather than on the face of the notice increases the risk that the taxpayer will not even see it.<sup>4</sup> Moreover, eliminating the stuffer could

1 Pub. L. 105-206, 112 Stat. 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.

2 Notice CP 3219A is used when the Automatic Underreporter (AUR) program identifies a mismatch between what is reported on an individual’s return and a third-party information report. IRS Compliance Data Warehouse (CDW), Notice Delivery System, fiscal year 2014 (Nov. 2014).

3 See Taxpayer Bill of Rights, IRS Publication 1, *Your Rights as a Taxpayer*. The statutory notice is still valid without the language required by IRC § 6212(a). *John C. Hom & Associates, Ltd. v. Comm'r*, 140 T.C. 2010 (2013).

4 TAS, 2011 IRS Nationwide Tax Forums TAS Focus Group Report: Publication 1 – Taxpayer Rights, 26-27 (2011) (overwhelming theme that taxpayers do not read the publication that is stuffed in the envelope with IRS notices).

potentially save mailing and printing costs or enable the IRS to apply those mailing and printing costs to notifying low income taxpayers about the availability of Low Income Taxpayer Clinics (LITCs).<sup>5</sup>

## ANALYSIS OF PROBLEM

### Background

The IRS issues a SNOD to notify a taxpayer that the IRS intends to assess a tax deficiency. The notice also informs the taxpayer of the right to petition the Tax Court to dispute the proposed adjustments. The taxpayer has 90 days from the date of the notice to file a petition in the Tax Court before the tax is assessed.<sup>6</sup>

Section 1102(b) of RRA 98 amended Internal Revenue Code (IRC) § 6212(a) to provide that SNODs “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.”<sup>7</sup> Furthermore, the Conference Report for RRA 98 states “The IRS would be required to publish the taxpayer’s right to contact the local Taxpayer Advocate on the statutory notice of deficiency.”<sup>8</sup>

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**By requiring the IRS to include TAS local office contact information on the Statutory Notice of Deficiency, Congress wanted taxpayers to know that they have the right to go to the local office of TAS to receive assistance at this important stage in their tax controversy.**

In response to a request for legal opinion by TAS, the IRS Office of Chief Counsel has opined that the IRS complies with § 1102(b) of RRA 98 when it provides Notice 1214, *Helpful Contacts for Your “Notice of Deficiency,”* as an insert in the SNOD. Counsel reasoned that Notice 1214 was developed by the IRS for the purpose of complying with RRA 98. In fact, the description of the notice on the IRS Forms Repository site includes the following language: “This notice is issued to conform with the IRS restructuring and reform act of 1998 section 1102(b). It was included as an insert with all statutory notices of deficiency (90-Day Letters).” Counsel also supported its opinion by stating that the SNOD includes language regarding TAS and the Notice 1214 is listed as an enclosure on the SNOD.<sup>9</sup> The National Taxpayer Advocate vigorously disagrees with the legal reasoning of Counsel’s opinion.

The IRS Legislative Analysis, Tracking, and Implementation Services (LATIS) shows the IRS attempted to bring the notices into compliance between 1998 and 2002. Initially, TAS created, Notice 1214, that includes the addresses and phone numbers of the local TAS offices, and was initially designed to be included in the envelope with the SNOD. However, to conform with the actual language of the Conference Report, the IRS and TAS later acted to include the contact language *on* the SNODs themselves.<sup>10</sup>

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5 The Printing and Postage Budget Reduction (PPBR) Implementation Team proposed eliminating all non-mandatory inserts as a way to reduce printing and postage costs. IRS Media & Publications, *PPBR Proposals Approved for Implementation* (2010). Low Income Taxpayer Clinics represent low income individuals in disputes with the IRS, including audits, appeals, collection matters, and federal tax litigation. LITCs can also help taxpayers respond to IRS notices and correct account problems. Some LITCs provide education for low income taxpayers and taxpayers who speak English as a second language (ESL) about their taxpayer rights and responsibilities. IRC § 7526.

6 If the notice is addressed to a taxpayer outside the United States, the taxpayer has 150 days after the IRS mails the notice to file a Tax Court petition. IRC § 6213.

7 Pub. L. 105-206, 112 Stat. 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.

8 H.R. CONF. REP. No. 105-599, Title I, Section D (1998).

9 Email from Office of Counsel to the National Taxpayer Advocate (Nov. 20, 2014).

10 IRS, LATIS, Action ID No. AT-2009-12065 to -12076.

## Noncompliance with RRA 98 Requirements Will Harm Taxpayers at a Critical Point in a Tax Controversy.

The tenth taxpayer right in the Taxpayer Bill of Rights is *the right to a fair and just tax system*. That means, in part, that taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.<sup>11</sup> The IRS violates this right by not complying with the RRA 98 requirement to publish current and accurate information on the taxpayer's right to contact TAS, as well as accurate contact information for the closest office.<sup>12</sup> Providing the contact information as a stuffer in the SNOD envelope is not an effective way to deliver this information.

In focus groups about “Publication 1, Do Your Clients Understand Their Rights?” conducted by the Taxpayer Advocate Service (TAS) at IRS tax forums in 2011, an overwhelming theme heard throughout the six sessions was that nobody read the publication. The IRS sends the publication to taxpayers along with notices on issues ranging from audits to collection, but the focus group participants noted that the publication usually ended up in the trash can or was never even taken out of the envelope.<sup>13</sup> Furthermore, the use of inserts did not test well with focus groups in the Department of Treasury’s Go Direct campaign to drive adoption of direct deposit.<sup>14</sup>

Congress required TAS to have at least one office in every state for two main reasons: (1) the convenience of the taxpayer and (2) the local office’s awareness of underlying economic or other conditions in that state and how they might impact the taxpayer’s case.<sup>15</sup> By requiring the IRS to include TAS local office contact information on the SNOD, Congress wanted taxpayers to know that they have the right to go to the local office of TAS to receive assistance at this important stage in their tax controversy.

Congress was very clear that it did not intend the IRS to merely give out a national contact number for TAS. Instead, by requiring the National Taxpayer Advocate to ensure that the phone numbers of the local offices are published, Congress specifically wanted taxpayers to know how to seek assistance from the local TAS office.<sup>16</sup> The Conference Report also provided further clarification by stating that the IRS should publish the information “on” the SNOD, as opposed to “with” the notice.<sup>17</sup>

The taxpayer’s receipt of a SNOD is a critical point in the audit or appeals process. The taxpayer needs information about what he or she must do to protect the right to an independent review of the proposed deficiency prior to assessment. The SNOD is a pre-assessment document, which means the taxpayer may still have the opportunity resolve the issue before going to Tax Court.

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<sup>11</sup> See Taxpayer Bill of Rights, IRS Publication 1, *Your Rights as a Taxpayer*.

<sup>12</sup> See IRS Publication 1, *Your Rights as a Taxpayer*.

<sup>13</sup> TAS, 2011 IRS Nationwide Tax Forums TAS Focus Group Report: Publication 1 – Taxpayer Rights, 26-27 (2011).

<sup>14</sup> With Treasury’s Go Direct campaign, which began in 2005, the use of inserts did not achieve desired results in terms of convincing people to transition to direct deposit. In late 2012, Treasury opted to create new inserts, many of which did not test well with focus groups. However, the campaign did find that inserts can be effective if they include a clear message and strong visual graphic tailored specifically to each target audience. Information provided by Weber Shandwick to TAS (Oct. 10, 2014) (Weber Shandwick was a contractor for Treasury and provided services for the Go Direct campaign).

<sup>15</sup> IRC § 7803(c)(2)(D)(i)(I); H.R. CONF. REP. No. 105-599, Title I, Section D (1998); *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance*, 105th Cong. 102 (1997).

<sup>16</sup> Pub. L. 105-206, § 1102, 112 Stat. 699 (1998).

<sup>17</sup> H.R. CONF. REP. No. 105-599, Title I, Section D (1998).

Case advocates in local TAS offices are trained to inform taxpayers of their rights and options once they receive a SNOD.<sup>18</sup> A case advocate can take any of the following steps to assist the taxpayer and relieve burden:

- Request that the IRS rescind the notice;<sup>19</sup>
- Explain that the Tax Court is a traveling court and the case will be heard in a location near the taxpayer (not Washington, DC, which is what many taxpayers think and may result in them not seeking judicial review);
- Direct the taxpayer to the Tax Court website, have the taxpayer pull up the petition, and explain what is needed without providing legal guidance; and
- Explain the small tax case (S case) process and how to get the Tax Court fee waived if the taxpayer cannot afford it.

Taxpayers' awareness of the Local Taxpayer Advocate (LTA) office within their community is even more important today, when so much of the IRS is centralized and remote from the taxpayer and the IRS is limiting its geographically-based interaction with taxpayers.<sup>20</sup> Most importantly, the local office can resolve some of the fear and mystery of the tax controversy process, especially with regard to petitioning the Tax Court. If TAS walks the taxpayer through the process, he or she may realize filing a petition is easier than expected. Therefore, by not clearly providing information about their right to contact a local office as well as accurate contact information in the notice, the IRS is preventing some taxpayers from seeking the assistance necessary to protect their rights.

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**Taxpayers' awareness of the Local Taxpayer Advocate office within their community is even more important today, when so much of the IRS is centralized and remote from the taxpayer and the IRS is limiting its geographically-based interaction with taxpayers.**

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The importance of this provision was illustrated in testimony by a public witness in the hearings leading up to RRA 98. Monsignor Lawrence Ballweg testified before the Senate Finance Committee (on September 24, 1997) about the obstacles he faced while trying to resolve issues related to a tax return he filed in his capacity as trustee. Two months after he filed the return, the IRS sent it back with a request to fill out additional forms. Shortly after responding to the request, Monsignor Ballweg received an IRS notice stating that he owed more than \$18,000 in taxes and penalties. Because he was away from home for an extended period and had no access to a copy of the filed return, he requested a copy from the IRS in order to respond. His attempts to obtain return copies were either ignored or met with inaccurate reasons as to why he did not have the authority to act as trustee. After he received a collection notice, he wrote a letter to Chairman Roth and his case was presented on CNN.

18 See, e.g., TAS, *Roadmap to Tax Controversy Level One*, (2012).

19 Rev. Proc. 98-54, 1998-43 I.R.B. 7; IRM 4.8.9.28 (Jul. 9, 2013).

20 See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack Of A Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

The day after the CNN story aired, he received a call from the IRS taxpayer advocate, who resolved his case within days with no additional taxes owed.<sup>21</sup> At the hearing, Monsignor Ballweg stated:

I just wanted to say that the best kept secret of the IRS is that taxpayers have an advocate. I do not know of anybody who pays taxes who ever heard of an advocate. I would not have known about the existence of such a person until that person contacted me.<sup>22</sup>

Had the first notice to Monsignor Ballweg clearly and prominently stated that he had the right to contact a Local Taxpayer Advocate, he would have saved time, reduced frustration, and resolved his issue faster. While Monsignor Ballweg did not receive a SNOD, taxpayers who receive SNODs are often in the same position—they have sent in information to the IRS, which responds with a notice of deficiency.

In 2012, TAS reviewed a random sample of Tax Court cases in which the taxpayer petitioned the court for review of IRS disallowance of the Earned Income Tax Credit (EITC) and the IRS conceded the EITC issue *in full* without trial. The objective of the study was to determine why the IRS fails to resolve cases, including full concessions, before taxpayers are forced to file Tax Court petitions.

The findings suggest that taxpayers are willing to talk with the IRS before they petition the Tax Court and can provide acceptable supporting documentation, but do not find out how to substantiate their claims in their conversations with IRS examiners. Therefore, if the SNOD contains local TAS office contact information, the taxpayer may be able to receive the assistance necessary to submit documentation the IRS will accept, and to avoid litigation.<sup>23</sup>

### **TAS Evaluated the Inventory of SNODs and Found Significant Noncompliance with RRA 98.**

TAS reviewed the IRS inventory of current SNODs to determine compliance with the requirements in RRA 98. The findings are detailed in the following figure:

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<sup>21</sup> *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance*, 105th Cong. 102 (1997). Monsignor Ballweg publicly testified about receiving assistance from the taxpayer advocate before the Senate Finance Committee and the facts cited herein are public knowledge.

<sup>22</sup> *Id.*

<sup>23</sup> National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 71-104 (*Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*).

**FIGURE 1.23.1, Findings of TAS Evaluation of IRS Inventory of SNODS**

Form number	Form title	Compliance with RRA 98?	Taxpayer Advocate Service information provided in notice
Ltr 3219 SC/CG	Notice of Deficiency – Income Tax	Yes	Includes paragraph with spaces for the LTA information
CP 3219A	Notice of Deficiency – AUR IMF	No	Includes paragraph with spaces for the LTA information. However, every notice auto-populates with TAS Austin, TX office information
CP 3219B	Notice of Deficiency – AUR BMF	Yes	Includes paragraph with spaces for the LTA information
Ltr 3219C	Notice of Deficiency – AUR (Used to remove credits if income increases)	No	Includes paragraph with spaces for the Atlanta, GA LTA information
CP 3219N	Notice of Deficiency - ASFR	No	TAS agreed to include Notice 1214 with specific addresses until IRS programming could automatically add the LTA office to the notice
Ltr 3219 SC/CG SP	Notice of Deficiency - Spanish	Yes	Paragraph included with spaces for the LTA information
Ltr 531	Notice of Deficiency (SNOD with direction on recent bankruptcy filing)	Yes	Includes paragraph with spaces for the LTA information
Ltr 531A	90-Day Letter Form 1040 or 1120 Discrepancy Adjustments	No	Contains a reference to the enclosed Notice 1214
Ltr 531B	90-Day Letter Form 5330 Excise Tax and Form 990 Tax	No	Contains a reference to the enclosed Notice 1214
Ltr 531C	Notice of Deficiency for Open Criminal Cases	No	Contains a reference to the enclosed Notice 1214
Ltr 531J	Statutory Notice of Deficiency - No Waiver Needed (Jeopardy Assessment Cases)	No	Contains a reference to the enclosed Notice 1214
Ltr 894 (CG)	Notice of Deficiency (Innocent Spouse)	Yes	Includes paragraph with spaces for the LTA information
Ltr 901 (CG)	Statutory Notice Letter (Form 1120)	Yes	Includes paragraph with spaces for the LTA information
Ltr 902 (DO)	Notice of Deficiency (Estate and Gift Taxes)	No	Contains a reference to the enclosed Notice 1214
Ltr 902 -T	Notice of Liability (Estate and Gift Taxes)	No	Contains a reference to the enclosed Notice 1214
Ltr 1384 (SC)	Notice of Deficiency (Bankruptcy)	No	Contains a reference to the enclosed Notice 1214
Ltr 3523	Notice of Determination of Worker Classification (NDWC)	No	TAS contact information is included in Publication 3953 which is sent along with Letter 3523

As shown, six out of 17 notices comply with the requirements of RRA 98, while eleven do not. We acknowledge that TAS has previously approved of the IRS's efforts to include a Notice 1214, *Helpful Contacts for Your Notice of Deficiency*, in the envelope with the SNOD.<sup>24</sup> However, this approach was

24 National Taxpayer Advocate 1998 Annual Report to Congress 6.

never intended to be a permanent solution to comply with RRA 98. The immediate focus of the first National Taxpayer Advocate in 1998 was to increase taxpayers' access to LTAs within the means available. Including Notice 1214 in the envelope with the SNOD was a feasible way to address the requirements quickly, particularly given the lead time required to program notice revisions on IRS systems. TAS has continually maintained that the IRS does not meet the requirements of RRA 98 until it places the contact information on the notice itself.<sup>25</sup> In fact, the IRS itself, in tracking post-RRA 98 actions, planned a progression from initially using the stuffer to programming systems to prepopulate the contact information on the face of the notice.<sup>26</sup>

While many SNODs have been brought into compliance since 1998, a wholesale effort is still needed to address the remaining noncompliant inventory. The IRS's tracking system LATIS shows the revision of SNODs is complete, while our own analysis reveals that many notices have not been adequately revised.<sup>27</sup> We acknowledge that the IRS regularly updates and even creates new SNODs, as need arises. Therefore, to ensure that all current SNODs accurately and consistently address this RRA 98 requirement, the IRS, in conjunction with the National Taxpayer Advocate, should develop an agreed-upon set of rules and language to appear on each SNOD.

The IRS needs to consistently populate the appropriate language and contact information onto the face of the SNOD. The inclusion of Notice 1214 as a stuffer should only be temporary as the IRS programs its systems accordingly. As the IRS revises all SNODs to comply with statutory requirements, it should program each one to auto-populate the contact information based on ZIP code to maintain consistency with how TAS aligns taxpayers to local offices.<sup>28</sup> In conjunction with these actions, the IRS should develop a method to track its progress in bringing these notices into full compliance.

## CONCLUSION

By not clearly providing information about a taxpayers' right to contact TAS, as well as placing accurate contact information on the face of the Statutory Notice of Deficiency, the IRS is preventing some taxpayers from seeking the assistance necessary to protect their rights and avoid undue burden. The IRS has made limited progress since 1998 in placing the appropriate language on less than half of the current SNODs. Taxpayers will continue to be harmed until the IRS brings the remaining notices into compliance.

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<sup>25</sup> For example, TAS had discussions with the IRS about Notice 3219N (rev. March 2014) not containing specific contact information on the face of the notice, but approved the inclusion of Notice 1214 as a stuffer until system programming changes (a Unified Work Request or UWR) could be made to the notice to automatically add the local office contact information.

<sup>26</sup> IRS, LATIS, Action ID No. AT-2009-12065 to -12076.

<sup>27</sup> *Id.*

<sup>28</sup> By including local TAS office contact information on the face of the notice instead of inserting Notice 1214 as a stuffer, the IRS could use any postage savings to include the LITC contact information as a stuffer in those SNODs with deficiencies that by definition impact low income taxpayers. LITC contact information may change from year to year but the 75 LTA offices are very stable. IRS Notice 1214, *Helpful Contacts for Your Notice of Deficiency*. We are mindful that the Printing and Postage Budget Reduction Implementation Team proposed that the IRS eliminate all non-mandatory inserts in all correspondences. IRS Media & Publications, *PPBR Proposals Approved for Implementation* (Sept. 2010). Accordingly, we have made a legislative recommendation that limits the inclusion of LITC contact information as a SNOD insert for a targeted population. See Legislative Recommendation: *Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency as well as Include Low Income Taxpayer Clinic Information with the Notices Impacting that Population, infra.*

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Evaluate every SNOD to determine which ones comply with RRA 98.
2. In conjunction with the National Taxpayer Advocate, develop an agreed-upon set of rules and language to appear on each SNOD.
3. Revise all SNODs not in full compliance with RRA 98 to include the taxpayer's right to contact TAS and the name and telephone number of the local office on the face of the notice in a way that is consistent with how TAS aligns taxpayers to local offices.
4. Require all employees involved in issuing SNODs or answering incoming calls about them to take technical training developed by TAS on issues including SNOD rescission and the taxpayers' rights to file a petition in the U.S. Tax Court and to contact their LTAs.

## INTRODUCTION: Legislative Recommendations

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Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The chart immediately following this Introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2013 Annual Reports.<sup>1</sup> The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion highlights legislative activity during the 113th Congress relating to the National Taxpayer Advocate's proposals.

During the 113th Congress, the Senate Committee on Finance and the House Committee on Ways and Means both developed session drafts on proposed tax reform legislation that contained proposals similar to ones recommended by the National Taxpayer Advocate in her Annual Reports to Congress.<sup>2</sup> The proposed legislation included the following:

- Repeal the Alternative Minimum Tax;<sup>3</sup>
- Require returns of partnerships made on the basis of the calendar year to be filed on or before March 15th following the close of the calendar year, and returns made on the basis of a fiscal year to be filed on or before the 15th day of the third month following the close of the fiscal year;<sup>4</sup>

<sup>1</sup> An electronic version of the chart is available on the TAS website at [www.TaxpayerAdvocate.irs.gov/2014-Annual-Report](http://www.TaxpayerAdvocate.irs.gov/2014-Annual-Report). The chart describes all the legislative recommendations the National Taxpayer Advocate has made since 2001, and lists each Code section affected by the recommendations.

<sup>2</sup> H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary* (Feb. 26, 2014), available at [http://waysandmeans.house.gov/uploadedfiles/ways\\_and\\_means\\_section\\_by\\_section\\_summary\\_final\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf), and S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient* (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>.

<sup>3</sup> H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 2001 (Feb. 26, 2014), available at [http://waysandmeans.house.gov/uploadedfiles/ways\\_and\\_means\\_section\\_by\\_section\\_summary\\_final\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf). See also National Taxpayer Advocate 2013 Annual Report to Congress 292-301, at 293 (Legislative Recommendation: *Repeal the Alternative Minimum Tax*) (recommending the complete repeal of the Alternative Minimum Tax); National Taxpayer Advocate 2008 Annual Report to Congress 356-62, at 361-62 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*) (recommending the repeal of the alternative minimum tax for individuals); National Taxpayer Advocate 2004 Annual Report to Congress 383-85 (Key Legislative Recommendation: *Alternative Minimum Tax*) (recommending the repeal of provisions relating to the Alternative Minimum Tax); National Taxpayer Advocate 2001 Annual Report to Congress 166-77, at 168, 175 (Key Recommendations: *Alternative Minimum Tax for Individuals*) (recommending the repeal of IRC §§ 55, 56, 57, 58, and 59 which pertain to the Alternative Minimum Tax for individuals; or, in the alternative, the individual Alternative Minimum Tax Exemptions should be indexed for inflation).

<sup>4</sup> H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 6201 (Feb. 26, 2014), available at [http://waysandmeans.house.gov/uploadedfiles/ways\\_and\\_means\\_section\\_by\\_section\\_summary\\_final\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf). See also National Taxpayer Advocate 2003 Annual Report to Congress 302-07, at 303 (Key Legislative Recommendation: *Filing Due Date of Partnership and Certain Trusts*).

- Permit a qualifying, newly incorporated small business to elect to be treated as an S corporation for any taxable year if the business makes such an election on a timely filed Form 1120S, *U.S. Income Tax Return for an S Corporation*;<sup>5</sup>
- Suspend the period to file a petition with the U.S. Tax Court for judicial review of determination of spousal relief while a person is prohibited by a bankruptcy stay from filing such a petition, and for 60 days thereafter;<sup>6</sup>
- Permit organizations that unsuccessfully seek recognition of IRC § 501(c)(4) exempt status to seek declaratory judgments;<sup>7</sup>
- Provide a safe harbor for *de minimis* errors on information returns and payee statements;<sup>8</sup>
- Develop an Internet platform for Form 1099 filings;<sup>9</sup>
- Require that electronically prepared paper returns include scannable codes;<sup>10</sup>
- Grant the IRS the authority to regulate federal income tax return preparers;<sup>11</sup>

5 H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 3606 (Feb. 26, 2014), available at [http://waysandmeans.house.gov/uploadedfiles/ways\\_and\\_means\\_section\\_by\\_section\\_summary\\_final\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf). See also National Taxpayer Advocate 2010 Annual Report to Congress 410-11, at 411 (Legislative Recommendation: Extend the Due Date for S Corporation Elections to Reduce the High Rate of Untimely Elections). The National Taxpayer Advocate recommended that Congress amend IRC § 1362(b)(1) to allow a small business corporation to elect to be treated as an S corporation by checking a box on its timely filed (including extensions) Form 1120S, *U.S. Income Tax Return for an S Corporation*.

6 H. COMM. ON WAYS AND MEANS, *Tax Reform Act of 2014: Discussion Draft Section-by-Section Summary*, § 164 (Feb. 26, 2014), available at [http://waysandmeans.house.gov/uploadedfiles/ways\\_and\\_means\\_section\\_by\\_section\\_summary\\_final\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf). See also National Taxpayer Advocate 2006 Annual Report to Congress 429-30 (Additional Legislative Recommendations: *Innocent Spouse Relief Fixes*) (recommending to suspend the period for filing a petition in Tax Court to obtain judicial review of an innocent spouse determination while a bankruptcy stay is in effect and for 60 days thereafter).

7 See National Taxpayer Advocate Special Report to Congress: *Political Activity and the Rights of Applicants for Tax-Exempt Status* 16 (June 2014). In a special report to Congress the National Taxpayer Advocate recommended that Congress consider legislation to provide applicants for exemption under IRC § 501(c)(4) with the ability to seek a declaratory judgment if denied or unanswered after nine months so that more judicial guidance can develop. Also, a declaratory judgment permits an organization to challenge in court a revocation of its exempt status or an IRS determination that it is a private foundation, rather than a public charity, before the assessment of any income taxes that might result from the loss of exempt status or any excise taxes that might result from the reclassification to a private foundation.

8 S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 2 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 69, 89, 91, 96 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). However, the proposal is for \$25, rather than \$50 as recommended by the National Taxpayer Advocate.

9 *Id.*

10 *Id.*

11 S. COMM. ON FIN., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 19 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress 61-74, at 62, 74 (Most Serious Problem: *REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69; National Taxpayer Advocate 2008 Annual Report to Congress 503-12; National Taxpayer Advocate 2006 Annual Report to Congress 197-221; National Taxpayer Advocate 2005 Annual Report to Congress 223-37; National Taxpayer Advocate 2004 Annual Report to Congress 67-88; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2002 Annual Report to Congress 216-30; *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. On Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

- Assign victims of identity theft a single point of contact;<sup>12</sup> and
- Accelerate the due dates for filing Forms W-2, *Wage and Tax Statement*, W-3, *Transmittal of Wage and Tax Statements*, and 1099 with the IRS and Social Security Administration.<sup>13</sup>

The following sections discuss bills introduced during the 113<sup>th</sup> Congress that reflect legislative recommendations made by the National Taxpayer Advocate in her Annual Reports to Congress.

### Tax Refund Theft Prevention Act of 2014

Senators Hatch and Wyden introduced the Tax Refund Theft Prevention Act of 2014, which would enact a number of the National Taxpayer Advocate's previous recommendations.<sup>14</sup> The legislation would provide taxpayers with access to real-time transcripts of third-party data to aid in return preparation.<sup>15</sup> The legislation would also establish a safe harbor for *de minimis* errors on information returns and payee statements.<sup>16</sup> The legislation contains two proposals regarding electronic filing, including establishing an Internet platform for Form 1099 filings;<sup>17</sup> and requirements that electronically prepared paper returns include scannable code.<sup>18</sup> Finally, the legislation would require the IRS to establish a single point of contact for identity theft victims and to work with the identity theft victim until all related issues are resolved.<sup>19</sup>

### Real Time Tax System

In our 2012 and 2011 Annual Reports to Congress, the National Taxpayer Advocate recommended that the IRS provide taxpayers with electronic access to third-party data to assist taxpayers in return preparation and that the IRS develop a pre-populated return option for taxpayers.<sup>20</sup> On April 15, 2013, Senator Shaheen introduced the Simpler Tax Filing Act of 2013, which would require the Secretary of the Treasury to study the feasibility of providing certain taxpayers with an optional, pre-prepared tax return.<sup>21</sup>

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12 S. Comm. on Fin., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 1 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress at 83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*).

13 S. Comm. on Fin., *Proposal to Combat Tax Fraud, Make Filing Safer, Simpler and More Efficient*, § 12 (Nov. 20, 2013), available at <http://www.finance.senate.gov/imo/media/doc/Chairman%27s%20Staff%20Discussion%20Draft%20of%20Tax%20Administration%20Reform%20Language.pdf>. See also National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 5, at 86-88 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

14 Tax Refund Theft Prevention Act of 2014, S.2736, 113th Cong. (2014).

15 S. 2736, § 12, 113th Cong. (2014). See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 69, 89, 91, 96 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

16 *Id.* However, the proposal is for \$25, rather than \$50.

17 S. 2736, § 3, 113th Cong. (2014). National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 75-76 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

18 Tax Refund Theft Prevention Act of 2014, S. 2736, § 4, 113th Cong. (National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 70, 91, 96 (Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*)).

19 S. 2736, § 5, 113th Cong. (2014). National Taxpayer Advocate 2013 Annual Report to Congress at 83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*).

20 National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

21 Simpler Tax Filing Act of 2013, S. 722, 113th Cong. (2013).

The bill also would require the Secretary of the Treasury, in consultation with the Taxpayer Advocate Service (TAS), to report to the House Committee on Ways and Means and the Senate Committee on Finance on actions necessary to achieve the goal of offering pre-prepared tax returns by tax year 2018. The report would be required to include analysis of the budgetary, administrative, and legislative barriers to achieving that goal, including the funding that it would require.<sup>22</sup>

### Taxpayer Receipt Act of 2013

To enhance taxpayer awareness of the connection between taxes paid and benefits received, the National Taxpayer Advocate recommended that Congress direct the IRS to provide all taxpayers with a “taxpayer receipt” showing how their tax dollars are being spent.<sup>23</sup> This “taxpayer receipt” could be a more detailed version of the pie chart currently published by the IRS showing federal income and outlays,<sup>24</sup> but would be provided directly to each taxpayer in connection with the filing of a tax return.<sup>25</sup> On August 22, 2013, Representative McDermott proposed legislation that would provide individual taxpayers, via U.S. mail, annual receipts for income taxes reported for the preceding taxable year. The receipt would state the amount paid, the taxpayer’s filing status, earned income, and taxable income. Additionally, the receipt would contain tables listing expenditures in various categories of the federal budget, the ten most costly tax expenditures, and related spending information.<sup>26</sup>

### Taxpayer Bill of Rights

Over the last decade, the National Taxpayer Advocate has recommended many legislative changes that would protect taxpayer rights at a time when the IRS budget is shrinking and, at times, resources were being shifted to enforcement. Among our proposals was to enact a comprehensive Taxpayer Bill of Rights (TBOR) that would explicitly detail the rights and responsibilities of taxpayers.<sup>27</sup> In June 2014, the IRS adopted a TBOR, which set out ten rights and provided taxpayers with clear explanations of their rights.<sup>28</sup> However, to cement these fundamental concepts as a permanent part of our tax system, the National Taxpayer Advocate is once again recommending that Congress codify a TBOR. Additionally, because about 16 years have elapsed since Congress last passed major tax procedure legislation, and some statutory protections are outdated or the passage of time has shown that new protections are needed, the National

22 Simpler Tax Filing Act of 2013, S. 722, 113th Cong. (2013).

23 National Taxpayer Advocate 2012 Annual Report to Congress 8 (Most Serious Problem: *The Complexity of the Tax Code*).

24 IRC § 7523 requires the IRS to include pie-shaped graphs showing the relative sizes of major outlay categories and major income categories in its instructions for Forms 1040, 1040A, and 1040EZ; see, e.g., IRS Form 1040 Instructions (2014), at 100.

25 In April 2011, the White House launched a calculator on its website titled “Your Federal Taxpayer Receipt” that allows taxpayers to enter the actual or estimated amounts of their Social Security, Medicare, and income tax payments and to see a breakdown showing how their payments are being applied to major categories of federal spending, including Social Security, Medicare, national defense, health care, job and family security programs, interest on the national debt, Veterans benefits, and education. See [www.whitehouse.gov/files/taxreceipt/](http://www.whitehouse.gov/files/taxreceipt/). While we view the availability of this calculator as a positive development, most taxpayers will not take the time to visit this website. We therefore believe a taxpayer receipt should be provided in connection with the filing of a return.

26 Taxpayer Receipt Act of 2013, H.R. 3039 113th Cong. (2013).

27 See Legislative Recommendation: *Codify the Taxpayer Bill of Rights, infra*. See also National Taxpayer Advocate 2013 Annual Report to Congress 5 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); National Taxpayer Advocate’s Report to Acting Commissioner Daniel Werfel, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), available at [www.TaxpayerAdvocate.irs.gov/2013AnnualReport](http://www.TaxpayerAdvocate.irs.gov/2013AnnualReport); National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2007 Annual Report to Congress 478-89 (Key Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payments*).

28 IR-2014-72, IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov, in Publication 1 (Jun. 10, 2014).

Taxpayer Advocate encourages Congress to enact the legislative recommendations relating to taxpayer rights detailed in this and previous annual reports. On July 22, 2013, Representative Roskam introduced the Taxpayer Bill of Rights Act of 2013,<sup>29</sup> which would amend IRC § 7803 to require the Commissioner of Internal Revenue to ensure that IRS employees are familiar with and act in accordance with taxpayer rights. These rights include the *right to be informed, to be assisted, to be heard, to pay no more than the correct amount of tax, to an appeal, to certainty, to privacy, to confidentiality, to representation, and to a fair and just tax system.*<sup>30</sup> These rights are identical to those proposed in our 2011 report. On July 31, 2013, the bill was approved by the House of Representatives, but the Senate did not act on it.

### Small Business Taxpayer Bill of Rights Act of 2013

Senator Cornyn and Representative Richmond introduced companion bills that would enact a number of the National Taxpayer Advocate's previous recommendations.<sup>31</sup> The proposed legislation would prohibit *ex parte* communications (*i.e.*, those that do not include the taxpayer or the taxpayer's representative) between Appeals officers and other IRS employees.<sup>32</sup> In addition, the proposed legislation would extend the period in which a third party can bring suit for return of levied funds or proceeds.<sup>33</sup>

The legislation also contains two of the National Taxpayer Advocate's recommendations regarding relief from joint and several liability. The bills would:

- Suspend the running of the period for filing a Tax Court petition seeking review of an innocent spouse claim for the period of time the taxpayer is prohibited by reason of the automatic stay imposed under section 362 of the Bankruptcy Code from filing such petition, plus 60 additional days;<sup>34</sup> and

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29 Taxpayer Bill of Rights Act of 2013, H.R. 2768, 113th Cong. (2013).

30 *Id.*

31 Small Business Taxpayer Bill of Rights Act of 2013, S. 725, 113th Cong. (2013) and H.R. 3479, 113th Cong. (2013). See also National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

32 S. 725, 113th Cong. § 7 (2013) and H.R. 3479, 113th Cong. § 7 (2013). See National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*) (noting the IRS Restructuring and Reform Act of 1998 prohibits *ex parte* communication between Appeals employees and other IRS employees, but recent IRS practices allowing Appeals employees to share office space with other IRS employees foster a perception of a lack of independence).

33 Both bills extend the time for third parties to sue from nine months to three years. S. 725, 113th Cong. § 9 (2013); H.R. 3479, 113th Cong. § 9 (2013). See National Taxpayer Advocate 2001 Annual Report to Congress 202-09 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

34 S. 725, 113th Cong. § 11 (2013); H.R. 3479, 113th Cong. § 11 (2013). See National Taxpayer Advocate 2004 Annual Report to Congress 490-92 (Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

- Clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.<sup>35</sup>

### The Small Business Payroll Protection Act of 2013

In recent years, a number of third party payers have gone out of business or embezzled their customers' funds. Because employers remain liable for payroll taxes, self-employed and small business taxpayers who fall victim in these cases can experience significant burden. This burden includes not only being forced to pay the amount twice—once to the third party payer that absconded with or dissipated the funds, and a second time to the IRS—but also being liable for interest and penalties. Some small businesses may not be able to recover from these setbacks and will be forced to cease operations.

This issue suggests the need for better procedures to protect businesses trying to comply with the payroll tax requirements, particularly for small business taxpayers that hire smaller third party payers. For the past decade, the National Taxpayer Advocate has recommended numerous administrative and legislative actions to assist victims of payroll service provider (PSP) failure.<sup>36</sup> More specifically, to protect taxpayers from third party misappropriation of payroll taxes, the National Taxpayer Advocate recommended in her 2012 Annual Report that Congress:

- Amend the Code to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees;
- Amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause; and

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<sup>35</sup> S. 725, 113th Cong. § 14 (2013); H.R. 3479, 113th Cong. § 14 (2013). See National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) Is De Novo*). We note that the Court of Appeals for the Ninth Circuit, in *Wilson v. Comm'r*, 705 F.3d 980 (9th Cir. 2013), held that the scope and standard of the Tax Court's review of claims for relief under IRC § 6015(f) is *de novo*. The IRS acquiesced in the *Wilson* decision. *Action on dec.*, 2012-07 (June 17, 2013). However, the National Taxpayer Advocate believes that an amendment to IRC § 6015 (the innocent spouse provision of the Code) is still necessary with respect to another issue, the issue of whether a taxpayer can raise innocent spouse relief as a defense in collection actions, and recommended that Congress address this problem in three Annual Reports to Congress. National Taxpayer Advocate 2010 Annual Report to Congress 377; National Taxpayer Advocate 2009 Annual Report to Congress 378; National Taxpayer Advocate 2007 Annual Report to Congress 549. The problem appears to persist as two district courts issued opinions recently holding that they do not have jurisdiction over IRC § 6015 claims raised as a defense in an action to reduce joint federal tax assessments to judgment or in a lien foreclosure suit. *U.S. v. Popowski*, 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012); *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012). For more detailed information, see National Taxpayer Advocate 2013 Annual Report to Congress 408-19 (Most Litigated Issue: *Relief from Joint and Several Liability Under IRC § 6015*).

<sup>36</sup> See National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 337-54 (Most Serious Problem: *Third Party Payers*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

- Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.<sup>37</sup>

On May 8, 2013, Senator Mikulski introduced the Small Business Payroll Protection Act of 2013, to amend the Code to require the Secretary to establish a registration system for payroll tax deposit agents (defined as any person that provides payroll processing or tax filing and deposit service to one or more employers). The proposal requires such agents to: (1) submit a bond or to submit to quarterly third-party certifications, (2) make certain disclosures to their clients concerning liability for payment of employment taxes, and (3) pay penalties for failing to collect or pay over employment taxes or for attempting to evade or defeat payment of such taxes.<sup>38</sup>

### **Consolidated Appropriations Act, 2014 and Consolidated and Further Continuing Appropriations Act, 2015**

Congress recently enacted legislation that incorporates two of the National Taxpayer Advocate's past recommendations.<sup>39</sup> Both the Consolidated Appropriations Act, 2014 and the Consolidated and Further Continuing Appropriations Act, 2015 require the IRS to:

1. Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address); and
2. Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.<sup>40</sup>

The National Taxpayer Advocate will monitor the process to ensure the IRS is on track to issue the dual notices by the date promised, and has concerns about how the IRS will implement its recently issued guidance on processing OICs submitted by victims of PSPs.<sup>41</sup>

### **Restrict Access to the Death Master File**

As one means to stem the growing number of tax-related identity theft cases, the National Taxpayer Advocate recommended that Congress restrict access to the Social Security Administration's death master

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37 See National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44; National Taxpayer Advocate 2004 Annual Report to Congress 394-99. Third party payer recommendations initially had included a provision to clarify that the Trust Fund Recovery Penalty applies to third party payers, which was not included here because the IRS implemented this administratively. See Interim Guidance Memorandum SBSE-05-0711-044, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer* (July 01, 2011) (also incorporated in IRM 5.1.24.5.8 (Aug. 15, 2012)). See also S. 1321, 109th Cong. (2005) (introduced by Senator Santorum), S. 3583, 109th Cong. (2006) (introduced by Senator Snowe), S. 1773, 110th Cong. (2007) (introduced by Senator Snowe), and S. 900, 113th Cong. (2013) (introduced by Senator Mikulski and discussed in more detail below) included parts of third party payer recommendations made by the National Taxpayer Advocate.

38 S. 900, 113th Cong. (2013).

39 See National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

40 See Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).

41 For a detailed discussion, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *supra*.

file (DMF).<sup>42</sup> The fiscal year 2014 budget bill, which was signed into law on December 26, 2013, contained a provision that restricts access to the DMF records of individuals who died during the previous three calendar years.<sup>43</sup>

### Consolidate Education Incentives

The National Taxpayer Advocate has suggested consolidating and simplifying various Code provisions to make compliance less difficult.<sup>44</sup> Senator Schumer and Representative Doggett introduced companion bills that include the National Taxpayer Advocate's recommendation to consolidate the education tax credits known as the Hope Scholarship and the Lifetime Learning Credits.<sup>45</sup> The proposed legislation would amend the Code to replace the two credits with a new American Opportunity Tax Credit that: (1) allows an income tax credit of up to \$3,000 of the qualified tuition and related expenses of a student who is carrying at least one half of a normal course load; (2) increases the income threshold for reductions in the credit amount based upon modified adjusted gross income; (3) allows a lifetime dollar limitation on such credit of \$15,000 for all taxable years; and (4) makes 40 percent of the credit refundable. Additionally, the bill allows an exclusion from gross income of any amount received as a federal Pell grant.

### Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes

In the 2012 Annual Report, the National Taxpayer Advocate recommended that Congress amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a "State."<sup>46</sup> Because a Native American tribe is not considered a state for purposes of the credit and cannot certify a child's special needs, taxpayers who adopt a Native American special needs child cannot claim the special needs adoption credit. On July 9, 2014, Senator Tim Johnson introduced the Tribal Adoption Parity Act, which would allow tribal governments to make the determination that a child is a child with special needs for purposes of the adoption tax credit.<sup>47</sup> On the House side, Representative Kilmer introduced the Adoption Tax Credit Parity Act of 2013 on June 12, 2013.<sup>48</sup>

### Legislative Recommendations that Have Led to Administrative Changes

Sometimes legislative recommendations made by the National Taxpayer Advocate are accomplished through the issuance of regulations or other administrative guidance. Before proposing a legislative recommendation to Congress, the National Taxpayer Advocate attempts to work with the IRS to address her concerns through the issuance of regulations or other administrative guidance, if possible. When the IRS disagrees with a change that could be accomplished administratively or would not move quickly enough, the National Taxpayer Advocate on occasion recommends that Congress take action. In some cases, the IRS has reconsidered its position and addressed issues raised in the National Taxpayer Advocate legislative recommendations through the issuance of guidance, as described below.

42 See National Taxpayer Advocate 2011 Annual Report to Congress 519-23 (Legislative Recommendation: *Restrict Access to the Death Master File*). The DMF is a database available to the public that includes decedents' full names, Social Security numbers, dates of birth, dates of death, and the county, state, and Zip code of their last addresses.

43 Bipartisan Budget Act of 2013, Pub. L. No. 113-67, § 203, 127 Stat. 1165, 1177-79 (2013).

44 See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 370-72 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*).

45 S. 835, 113th Cong. (2013) and H.R. 1738, 113th Cong. (2013).

46 National Taxpayer Advocate 2012 Annual Report to Congress 521-25 (Legislative Recommendation: *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes*).

47 Tribal Adoption Parity Act, S. 2570, 113th Cong. (2014).

48 The Adoption Tax Credit Tribal Parity Act of 2013, H.R. 2332, 113th Cong. (2013).

## Removal of the 36-Month Non-Payment Testing Period Rule for Cancelation of Debt Reporting

The 36-month “testing period” rule created by regulations issued pursuant to IRC § 6050P creates a presumption that a creditor is required to issue a Form 1099-C, *Cancelation of Debt*, even if the creditor is not actually discharging the debt.<sup>49</sup> This enables a creditor to continue to try to collect a debt while the IRS proposes additional tax due to the reported cancelation of the same debt.<sup>50</sup> This rule divorces the creditor’s reporting obligation from the question whether a debt has actually been discharged.<sup>51</sup> Because this requirement was regulatory and not statutorily required, the National Taxpayer Advocate originally sought to have the IRS amend its regulations, but when it appeared the IRS did not intend to act, she recommended that Congress amend IRC § 6050P to effectively overturn the 36-month regulatory “testing period” as a basis on which to issue a Form 1099-C.<sup>52</sup>

In October 2014, the IRS published a Notice of Proposed Rulemaking regarding the “Removal of the 36-Month Non-Payment Testing Period Rule.”<sup>53</sup> The notice said the Department of the Treasury and the IRS believe that information reporting under IRC § 6050P should coincide with the actual discharge of debt rather than non-payment for 36 months, and that removal of this rule will reduce confusion for taxpayers and increase compliance.<sup>54</sup>

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49 National Taxpayer Advocate 2010 Annual Report to Congress 383-86 (Legislative Recommendation: Remove the 36-Month “Testing Period” that May Trigger Cancelation of Debt Reporting). See IRC §§ 61(a)(12) (providing that a taxpayer’s gross income includes income from the discharge of indebtedness) and 6050P; Treas. Reg. § 1.6050P-1(a) (requiring creditors that discharge an indebtedness of at least \$600 during any calendar year to file a Form 1099-C information return with the IRS).

50 Under the 36-month non-payment testing period rule, a discharge of indebtedness is “deemed” to have occurred if (and only if) an identifiable event has occurred, “whether or not an actual discharge of indebtedness has occurred.” See Treas. Reg. § 1.6050P-1(a) (There is an exception, under Treas. Reg. § 1.6050P-1(b)(3), that a creditor may, at its discretion, report an actual discharge of indebtedness that occurs before an identifiable event occurs. The continued collection activity is relevant only where the creditor wishes to rebut a presumption that a debt has been canceled. The creditor may rebut the presumption if the creditor engaged in a significant bona fide collection activity at any time within the 12-month period ending at the close of the calendar year if the facts and circumstances existing as of January 31 of the calendar year following the expiration of the non-payment testing period indicate that the indebtedness has not yet been discharged).

51 See National Taxpayer Advocate 2010 Annual Report to Congress at 385 (Legislative Recommendation: Remove the 36-Month “Testing Period” that May Trigger Cancelation of Debt Reporting).

52 *Id.* at 383.

53 Removal of the 36-Month Non-Payment Testing Period Rule, 79 Fed. Reg. 61791 (Oct. 15, 2014). The comment period is open until January 13, 2015.

54 *Id.*

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT				
National Taxpayer Advocate 2001 Annual Report to Congress 82–100; National Taxpayer Advocate 2004 Annual Report to Congress 383–385; National Taxpayer Advocate 2008 Annual Report to Congress 356–362.	Repeal the AMT outright.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 1616	Lee	10/30/2013	Referred to the Finance Committee
	HR 243	Ross	1/14/2013	Referred to Ways & Means Committee
Legislative Activity 112th Congress	HR 86	Bachmann	1/5/2011	Referred to Ways & Means Committee
	HR 99	Dreler	1/5/2011	Referred to Ways & Means Committee
	HR 547	Garrett	2/8/2011	Referred to Ways & Means Committee
	HR 3400	Garrett	11/10/2011	Referred to Ways & Means Committee
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 820	Shelby	4/14/2011	Referred to the Finance Committee
	HR 3804	Huelskamp	1/23/2012	Referred to Ways & Means Committee
Legislative Activity 111th Congress	S 3018	Wyden	2/23/2010	Referred to the Finance Committee
	HR 240	Garrett	1/7/2009	Referred to the Ways & Means Committee
	HR 782	Paul	1/28/2009	Referred to the Ways & Means Committee
	S 932	Shelby	4/30/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	S 55	Baucus	1/4/2007	Referred to the Finance Committee
	S 14	Kyl	4/17/2007	Referred to the Finance Committee
	S 1040	Shelby	3/29/2007	Referred to the Finance Committee
	HR 1366	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
	S 2293	Lott	11/1/2007	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464
Legislative Activity 109th Congress	HR 1186	English	3/9/2005	Referred to the Ways & Means Committee
	S 1103	Baucus	5/23/2005	Referred to the Finance Committee
	HR 2950	Neal	6/16/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee

Legislative Activity 108th Congress	HR 43	Collins	1/7/2003	Referred to the Ways & Means Committee
	HR 1233	English	3/12/2003	Referred to the Ways & Means Committee
	S 1040	Shelby	5/12/2003	Referred to the Finance Committee
	HR 3060	N. Smith	9/10/2003	Referred to the Ways & Means Committee
	HR 4131	Houghton	4/2/2004	Referred to the Ways & Means Committee
	HR 4164	Shuster	4/2/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 437	English	2/6/2001	Referred to the Ways & Means Committee
	S 616	Hutchison	3/26/2002	Referred to the Finance Committee
	HR 5166	Portman	7/18/2002	Referred to the Ways & Means Committee
<b>Index AMT for Inflation</b>	If full repeal of the individual AMT is not possible, it should be indexed for inflation.			
National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3223	McConnell	9/13/2010	Placed on the Senate Calendar
	HR 5077	Hall	4/20/2010	Referred to the Ways & Means Committee
	HR 719	Lee	1/27/2009	Referred to the Ways & Means Committee
	S 722	Baucus	3/26/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	HR 703	Garrett	2/9/2005	Referred to the Ways & Means Committee
	HR 4096	Reynolds	10/20/2005	12/7/2005—Passed the House; 12/13/2005—Placed on the Senate Legislative Calendar
Legislative Activity 108th Congress	HR 22	Houghton	1/7/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/1/2002	Referred to the Ways & Means Committee
<b>Eliminate Several Adjustments for Individual AMT</b>	Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes.			
National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 336	DeMint	2/14/2011	Referred to the Finance Committee
	S 102	Kerry	1/4/2007	Referred to the Finance Committee
	S 1861	Harkin	10/7/2005	Referred to the Finance Committee
	HR 1939	Neal	5/12/2003	Referred to the Ways & Means Committee

<b>Private Debt Collection (PDC)</b>				
<b>Repeal PDC Provisions</b>				
National Taxpayer Advocate 2006 Annual Report to Congress 458–462.	Repeal IRC § 6306, thereby terminating the PDC initiative.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 796	Lewis	2/3/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	S 335	Dorgan	1/18/2007	Referred to the Finance Committee
	HR 695	Van Hollen	1/24/2007	Referred to the Ways & Means Committee
	HR 3056	Rangel	7/17/2007	10/10/2007-Passed the House; 10/15/2007 Referred to the Finance Committee
<b>Tax Preparation and Low Income Taxpayer Clinics (LITC)</b>				
<b>Matching Grants for LITC for Return Preparation</b>				
National Taxpayer Advocate 2002 Annual Report to Congress vii–viii.	Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.			
Legislative Activity 111th Congress	<b>Pub. L. No. 111-117, Div. C, Title I, 123 Stat. 3034, 3163 (2009).</b>			
Legislative Activity 110th Congress	<b>Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).</b>			
	Bill Number	Sponsor	Date	Status
	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
	S 1967	Clinton	8/2/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	S 476	Grassley	2/27/2003	Referred to the Finance Committee
	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2001	Referred to the Ways & Means Committee
	HR 7	Baucus	7/16/2002	Reported by Chairman Baucus with an amendment; referred to the Finance Committee

<b>Regulation of Income Tax Return Preparers</b>  National Taxpayer Advocate 2002 Annual Report to Congress 216–230; National Taxpayer Advocate 2003 Annual Report to Congress 270–301; National Taxpayer Advocate 2007 Annual Report to Congress 83–95 & 140–155; National Taxpayer Advocate 2008 Annual Report to Congress 423–426; National Taxpayer Advocate 2009 Annual Report to Congress 41–69.	<p>Create an effective oversight and penalty regime for return preparers by taking the following steps:</p> <ul style="list-style-type: none"> <li>◆ Enact a registration, examination, certification, and enforcement program for federal tax return preparers;</li> <li>◆ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight;</li> <li>◆ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and</li> <li>◆ Require the IRS to take steps within its existing administrative authority, including requiring a checkbox on all returns in which preparers would enter their category of return preparer (<i>i.e.</i>, attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections.</li> </ul>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006—Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006—Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004—S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
<b>Identity Theft</b>  Single Point of Contact National Taxpayer Advocates 2013 Annual Report	Designate a single point of contact for identity theft victims to work with the identity theft victim until all related issues are resolved.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 2736	Hatch	7/31/2014	Referred to Finance Committee

<b>Referrals to LITCs</b>				
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1573	Durbin	9/15/2011	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 171
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
<b>Public Awareness Campaign on Registration Requirements</b>				
National Taxpayer Advocate 2002 Annual Report to Congress 216–230.	Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006—Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004—S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

<b>Increase Preparer Penalties</b>				
National Taxpayer Advocate 2003 Annual Report to Congress 270–301.				
Legislative Activity 112th Congress		<b>Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011).</b>		
Bill Number	Sponsor	Date	Status	
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 4318	Crowley/Ramstad	12/6/2007	Referred to the Ways & Means Committee
	S 2851	Bunning	4/14/2008	Referred to the Finance Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006—Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006—Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004—S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
<b>Refund Delivery Options</b>				
National Taxpayer Advocate 2008 Report to Congress 427–441.				
Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options.				
Bill Number	Sponsor	Date	Status	
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Senate Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee

<b>Small Business Issues</b>				
<b>Health Insurance Deduction/Self-Employed Individuals</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 223; National Taxpayer Advocate 2008 Annual Report to Congress 388–389.	Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.			
Legislative Activity 111th Congress	<b>Pub. L. No. 111-240, § 2504 STAT 2560 (2010).</b>			
	Bill Number	Sponsor	Date	Status
	S 725	Bingaman	3/26/2009	Referred to the Finance Committee
	HR 1470	Kind	3/12/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	S 2239	Bingaman	10/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 663	Bingaman	3/17/2005	Referred to the Finance Committee
	S 3857	Smith	9/16/2006	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 741	Sanchez	2/12/2003	Referred to the Ways & Means Committee
	HR 1873	Manzullo Velazquez	4/30/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	S 2130	Bingaman	4/15/2002	Referred to the Finance Committee
<b>Married Couples as Business Co-owners</b>				
National Taxpayer Advocate 2002 Annual Report to Congress 172–184.	Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of subchapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.			
Legislative Activity 110th Congress	<b>Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).</b>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, with an amendment
	S 842	Kerry	4/9/2003	Referred to the Finance Committee
	HR 1640	Udall	4/3/2003	Referred to the Ways & Means Committee
	HR 1558	Doggett	4/2/2003	Referred to the Ways & Means Committee
<b>Income Averaging for Commercial Fishermen</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 226.	Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.			
Legislative Activity 108th Congress	<b>Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).</b>			

<b>Election to be Treated as an S Corporation</b>				
National Taxpayer Advocate 2004 Annual Report to Congress 390–393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, U.S. Income Tax Return for an S Corporation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 2271	Franken	3/29/2012	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
<b>Regulation of Payroll Tax Deposits Agents</b>				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Allow a small business corporation to elect to be treated as an S corporation by checking a box on its timely filed Form 1120S U.S. Income Tax Return for an S Corporation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 900	Mikulski	05/08/2013	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006—The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
<b>Issue Dual Address Change Notice</b>				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address)			
Legislative Activity 113th Congress	Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).			
<b>Special Consideration for offer in compromise</b>				
National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.			
Legislative Activity 113th Congress	Pub. L. No. 113-76, Division E, Title I, § 106, 128 Stat. 5, 190 (2014) and Pub. L. No. 113-235, Division E, Title I, § 106, 128 Stat. 2130, 2338 (2014).			
<b>Simplification</b>				
<b>Reduce the Number of Tax Preferences</b>				
National Taxpayer Advocate 2010 Annual Report to Congress 365–372.	Simplify the complexity of the tax code generally by reducing the number of tax preferences.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee

<b>Simplify and Streamline Education Tax Incentives</b>				
National Taxpayer Advocate 2008 Annual Report to Congress 370–372; National Taxpayer Advocate 2004 Annual Report to Congress 403–422.	Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221, (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer, (3) the definitions for “Qualified Higher Education Expenses” and “Eligible Education Institution” should be simplified, (4) the income level and phase-out calculations should be more consistent under the various provisions, (5) all dollar amounts should be indexed for inflation, and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 835	Schumer	4/25/2013	Referred to the Finance Committee
	HR 1738	Doggett	4/25/2013	Referred to the Ways & Means Committee
	HR 3476	Israel	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 3267	Schumer	6/6/2012	Referred to the Finance Committee
	HR 6522	Israel	9/21/2012	Referred to the Ways & Means Committee
<b>Simplify and Streamline Retirement Savings Tax Incentives</b>				
National Taxpayer Advocate 2008 Annual Report to Congress 373–374; National Taxpayer Advocate 2004 Annual Report to Congress 423–432.	Consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement plan for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
<b>Tax Gap Provisions</b>				
<b>Corporate Information Reporting</b>				
National Taxpayer Advocate 2008 Annual Report to Congress 388.	Require businesses that pay \$600 or more during the year to non-corporate and corporate service providers to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 1796	Baucus	10/19/2009	10/19/2009 Placed on Senate Legislative Calendar under General Orders. Calendar No. 184

<b>Reporting on Customer's Basis in Security Transaction</b>  National Taxpayer Advocate 2005 Annual Report to Congress 433–441.	Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B.			
Legislative Activity 110th Congress	<b>Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).</b>			
	Bill Number	Sponsor	Date	Status
	HR 878	Emanuel	2/7/2007	Referred to the Ways & Means Committee
	S 601	Bayh	2/14/2007	Referred to the Finance Committee
	S 1111	Wyden	4/16/2007	Referred to the Finance Committee
	HR 2147	Emanuel	5/3/2007	Referred to the Ways & Means Committee
	HR 3996 PCS	Rangel	10/30/2007	11/14/2007—Placed on the Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision
Legislative Activity 109th Congress	S 2414	Bayh	3/14/2006	Referred to the Finance Committee
	HR 5176	Emanual	4/25/2006	Referred to the Ways & Means Committee
	HR 5367	Emanual	5/11/2006	Referred to the Ways & Means Committee
<b>IRS Forms Revisions</b>  National Taxpayer Advocate 2004 Annual Report to Congress 480; National Taxpayer Advocate 2010 Annual Report to Congress 40.	Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
<b>IRS to Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS)</b>  National Taxpayer Advocate 2005 Annual Report to Congress 381–396.	Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006—The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614

<p><b>Study of Use of Voluntary Withholding Agreements</b></p> <p>National Taxpayer Advocate 2004 Annual Report to Congress 478–489; National Taxpayer Advocate 2005 Annual Report to Congress 381–396.</p>	<p>Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).</p>			
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006—The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336. 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
<b>Require Form 1099 Reporting for Incorporated Service Providers</b>	<p>Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.</p>			
Legislative Activity 111th Congress	<p><b>Pub. L No. 111-148 § 9006 (2010).</b> However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over \$600, but Require Reporting on Corporate and Certain Other Payments.</p>			
<b>Require Financial Institutions to Report All Accounts to the IRS by Eliminating the \$10 Threshold on Interest Reporting</b>				
National Taxpayer Advocate 2007 Annual Report to Congress 501–502.	<p>Eliminate the \$10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<b>Revise Form 1040, Schedule C to Break Out Gross Receipts Reported on Payee Statements Such as Form 1099</b>				
National Taxpayer Advocate 2007 Annual Report to Congress 40.	<p>Administrative recommendation that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<b>Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099</b>				
National Taxpayer Advocate 2007 Annual Report to Congress 40.	<p>Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: “Did you make any payments over \$600 in the aggregate during the year to any unincorporated trade or business?” and “If yes, did you file all required Forms 1099?” S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance.</p>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee

<b>Authorize Voluntary Withholding Upon Request</b>				
National Taxpayer Advocate 2007 Annual Report to Congress 493–494.	Authorize voluntary withholding agreements between independent contractors and service recipients.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<b>Require Backup Withholding on Certain Payments When TINs Cannot Be Validated</b>				
National Taxpayer Advocate 2005 Annual Report to Congress 238–248.	Administrative recommendation that the IRS require payors to commence backup withholding if they do not receive verification of a payee's TIN. (S. 3795 would require voluntary withholding on certain payments.)			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<b>Worker Classification</b>				
National Taxpayer Advocate 2008 Annual Report to Congress 375–390.	Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
<b>Taxpayer Bill of Rights and <i>De Minimis</i> "Apology" Payments</b>				
<b>Taxpayer Bill of Rights</b>				
National Taxpayer Advocate 2007 Annual Report to Congress 486–489.	Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	HR 2768	Roskam	6/22/2013	Passed the House of Representatives, and was referred to the Senate Finance Committee on 8/31/2013
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
<b><i>De Minimis</i> "Apology" Payments</b>				
National Taxpayer Advocate 2007 Annual Report to Congress 490.	Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide <i>de minimis</i> compensation to taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the IRC § 7811 definition of significant hardship.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Simplify the Tax Treatment of Cancellation of Debt Income				

<b>Simplify the Tax Treatment of Cancellation of Debt Income</b>				
National Taxpayer Advocate 2008 Annual Report to Congress 391–396.	Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 4561	Lewis	2/2/2010	Referred to the Ways & Means Committee
<b>Joint and Several Liability</b>				
<b>Tax Court Review of Request for Equitable Innocent Spouse Relief</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 128–165.	Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.			
Legislative Activity 109th Congress	<b>Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).</b>			
<b>Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court).</b>				
National Taxpayer Advocate 2004 Annual Report to Congress 490–92.	Allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Ways & Means Committee
<b>Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is <i>de Novo</i>.</b>				
National Taxpayer Advocate 2011 Annual Report to Congress 531–536.	Amend IRC § 6015 to specify that the scope and standard of review in tax court determinations under IRC § 6015(f) is <i>de novo</i> .			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee

**Collection Issues****Improve Offer In Compromise Program Accessibility**

National Taxpayer Advocate 2006 Annual Report to Congress 507–519.

Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee

**Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens**

2009 National Taxpayer Advocate Report to Congress 357–364.

Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 6439	Hastings	11/18/2010	Referred to the Ways & Means Committee

**Permit the IRS to Release Levies on Small Business Taxpayers**

2011 National Taxpayer Advocate Report to Congress 537–543.

Amend IRC § 6343(a)(1)(d) to: permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4368	McDermott	4/17/2012	Referred to the Ways & Means Committee

**Return of Levy or Sale Proceeds**

National Taxpayer Advocate 2001 Annual Report to Congress 202–214.

Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee

Most Serious Problems	Legislative Recommendations	Most Litigated Issues	Case Advocacy	Appendices
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Legislative Activity 110th Congress	HR 5719 HR 1677	Rangel Rangel	4/16/2008 3/26/2007	Referred to the Finance Committee Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528 HR 1661	Portman Rangel	6/20/2003 4/8/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991 HR 586	Houghton Lewis	3/19/2002 2/13/2001	Defeated in House 4/18/02–Passed the House with an amendment; referred to the Senate
<b>Reinstatement of Retirement Accounts</b>	National Taxpayer Advocate 2001 Annual Report to Congress 202–214.			
	Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343:			
	♦ § 401 – Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans ♦ § 408 – Individual Retirement Account, and SEP-Individual Retirement Account ♦ § 408A – Roth Individual Retirement Account			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719 HR 1677	Rangel Rangel	4/16/2008 3/26/2007	Referred to the Finance Committee Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528 HR 1661 S 882	Portman Rangel Baucus	6/20/2003 4/8/2003 4/10/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment Referred to the Ways & Means Committee 5/19/2004–S 882 was incorporated in H.R. 1528 through an amendment and HR 1528 passed in lieu of S 882
Legislative Activity 107th Congress	HR 586 HR 3991	Lewis Houghton	2/13/2001 3/19/2002	4/18/2002–Passed the House with an amendment; referred to Senate Defeated in the House
<b>Consolidation of Appeals of Collection Due Process (CDP) Determinations</b>	National Taxpayer Advocate 2005 Annual Report to Congress 451–470.			
	Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.			
Legislative Activity 109th Congress	<b>Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).</b>			

<b>Partial Payment Installment Agreements</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 210–214.	Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the IRS.			
Legislative Activity 108th Congress	<b>Pub. L. No. 108-357, § 833, 118 Stat. 1418, 1600 (2004).</b>			
<b>Waiver of Installment Agreement Fees for Low Income Taxpayers</b>				
National Taxpayer Advocate 2006 Annual Report to Congress 141–56 (Most Serious Problem: Collection Issues of Low Income Taxpayers).	Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
<b>Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State</b>				
National Taxpayer Advocate 2009 Annual Report to Congress 346–350.	Provide that each Appeals office maintains separate office space, separate phone lines, facsimile, and other electronic communications access, and a separate post office address from any IRS office co-located with the Appeals office.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
<b>Penalties and Interest</b>				
<b>Interest Rate and Failure to Pay Penalty</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 179–182.	Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
<b>Interest Abatement on Erroneous Refunds</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 183–187.	Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 726	Sanchez	2/9/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

Most Serious Problems	Legislative Recommendations	Most Litigated Issues	Case Advocacy	Appendices
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<b>First Time Penalty Waiver</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 188–192.	Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004—Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in the House
<b>Federal Tax Deposit (FTD) Avoidance Penalty</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 222.	Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
	S 1321RS	Santorum	6/28/2005	9/15/2006—The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004—Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002—Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
<b>Family Issues</b>				
<b>Uniform Definition of a Qualifying Child</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 78–100.	Create a uniform definition of “qualifying child” applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	<b>Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).</b>			
<b>Means Tested Public Assistance Benefits</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 76–127.	Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or “not married” status.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/01/2002	Referred to the Ways & Means Committee

<b>Credits for the Elderly or the Permanently Disabled</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 218–219.	Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 107th Congress	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee
<b>Electronic Filing Issues</b>				
<b>Scannable Returns</b>				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Require electronically prepared paper returns to include scanable 2-D code.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S. 2736	Hatch	7/14/14	Referred to the Finance Committee
<b>Safe harbor for <i>de minimis</i> errors returns and payee statements</b>				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96.	Safe harbor for <i>de minimis</i> errors on information			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee
<b>Direct Filing Portal</b>				
National Taxpayer Advocate 2004 Annual Report to Congress 471–477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006—Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006—Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
<b>Free Electronic Filing For All Taxpayers</b>				
National Taxpayer Advocate 2013 Annual Report to Congress Vol. 2, § 5, 70, 91, 96	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	S 2736	Hatch	7/14/14	Referred to the Finance Committee

**Office of the Taxpayer Advocate****Confidentiality of Taxpayer Communications**

National Taxpayer Advocate 2002 Annual Report to Congress 198–215.

Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to TAS.

	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

**Access to Independent Legal Counsel**

National Taxpayer Advocate 2002 Annual Report to Congress 198–215.

Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of *amicus* briefs.

	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	Referred to the Senate
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

**Taxpayer Advocate Directive**

National Taxpayer Advocate 2012 Annual Report to Congress 573–602;  
National Taxpayer Advocate 2002 Annual Report to Congress 419–422.

Amended IRC § 7811 to provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the Internal Revenue Service with respect to any program, proposed program, action, or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large.

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee

**Other Issues****Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact**

National Taxpayer Advocate 2008 Annual Report to Congress 419–422.

Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of \$100,000 per individual per year and \$200,000 per entity per year for failure to make special disclosures of a “listed transaction.”

Legislative Activity 111th Congress	<b>Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).</b>			
	Bill Number	Sponsor	Date	Status
	S 2771	Baucus	11/16/2009	Referred to the Finance Committee
	HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
	S 2917	Baucus	12/18/2009	Referred to the Finance Committee

<b>Eliminate Tax Strategy Patents</b>	National Taxpayer Advocate 2007 Annual Report to Congress 512–524. Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.			
Legislative Activity 112th Congress	<b>Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).</b>			
<b>Disclosure Regarding Suicide Threats</b>	National Taxpayer Advocate 2001 Annual Report to Congress 227. Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
<b>Attorney Fees</b>	National Taxpayer Advocate 2002 Annual Report to Congress 161–171. Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees “above the line.” Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.			
Legislative Activity 108th Congress	<b>Pub. L. No. 108-357, § 703, 118 Stat. 1418, 1546-48 (2004).</b>			
<b>Attainment of Age Definition</b>	National Taxpayer Advocate 2003 Annual Report to Congress 308–311. Amend IRC § 7701 by adding a new subsection as follows: “Attainment of Age. An individual attains the next age on the anniversary of his date of birth.”			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 4841	Burns	7/15/2004	7/21/2004–Passed the House; 7/22/2004–Received in the Senate
<b>Home-Based Service Workers (HBSW)</b>	National Taxpayer Advocate 2001 Annual Report to Congress 193–201. Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Legislative Activity 107th Congress	S 2129	Bingaman	4/15/2002	Referred to the Finance Committee
<b>Restrict Access to the Death Master File</b>	National Taxpayer Advocate 2011 Annual Report to Congress 519–523. Restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	<b>H.J. Res. 59, 113th Cong. § 203 (2013).</b>			
Legislative Activity 112th Congress	S 3432	Nelson	7/25/2012	Referred to the Finance Committee
	HR 6205	Nugent	7/26/2012	Referred to the Ways & Means Committee

<b>Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes</b>				
National Taxpayer Advocate 2012 Annual Report to Congress 521.	Amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a “State”.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 835	Johnson	7/09/2014	Referred to the Finance Committee
	HR 1738	Kilmer	6/12/2013	Referred to the Ways and Means Committee

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#1**

## Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections

### PROBLEM

Taxpayer rights are central to voluntary compliance. If taxpayers believe they are being treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the system and be less likely to comply of their own volition. By contrast, taxpayers will be more likely to comply if they have confidence in the fairness and integrity of the tax system.<sup>1</sup>

The Internal Revenue Code (Code or IRC) provides dozens of real and substantive rights that protect taxpayers from unfair and unjust treatment and provide opportunities to challenge arbitrary and capricious government actions. However, taxpayers may not avail themselves of their rights because they are unaware of them. A 2012 survey found less than half of all U.S. taxpayers believe they have rights before the IRS, and only 11 percent said they knew what those rights are.<sup>2</sup> Taxpayers have no simple way to identify or locate rights in the Code because they are scattered throughout its various sections. It is even more difficult for taxpayers to find “off-code” provisions in different pieces of legislation. Although Congress has passed multiple pieces of legislation with the title of “Taxpayer Bill of Rights,” none of these laws provide a foundational, general description of taxpayer rights.<sup>3</sup>

In response to these concerns raised by the National Taxpayer Advocate, on June 10, 2014, the IRS formally adopted the Taxpayer Bill of Rights (TBOR).<sup>4</sup> While this was a significant achievement for increasing taxpayers’ awareness of their rights, and an important first step toward integrating taxpayer rights into all aspects of tax administration, more can be done to cement these fundamental concepts as a permanent part of our tax system.<sup>5</sup> Specifically, placing a list of the ten core taxpayer rights and five taxpayer responsibilities in the Code would reassure taxpayers that these rights are a fundamental part of our tax system. Furthermore, it would reinforce the unwritten social contract between taxpayers and the IRS by laying out in clear language what is expected of taxpayers and what rights they can expect the IRS to honor.

Although codifying the TBOR would improve awareness of taxpayer rights, the TBOR itself is only as effective as the specific statutory rights that give it effect. When these underlying rights and protections are ignored, weakened, or diluted, the effectiveness of the TBOR is also diminished. There are multiple

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- 1 TAS research has shown that trust in government and fairness appear to have significant influence on the compliance behavior of self-employed taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*).
  - 2 Forrester Research Inc., *The TAS Omnibus Analysis*, from North American Technographics Omnibus Mail Survey, Q2/Q3 2012 20 (Sept. 2012).
  - 3 See Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the “Omnibus Taxpayer Bill of Rights,” also known as TBOR 1); Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998) (Title III is known as “Taxpayer Bill of Rights III” or TBOR 3). These laws create specific rights in certain instances, but they do not create a thematic, principled-based list of overarching taxpayer rights.
  - 4 See IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov, in Publication 1, IR-2014-72, (June 10, 2014). See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights#informed>.
  - 5 The National Taxpayer Advocate has recommended that Congress codify the Taxpayer Bill of Rights several times, beginning in her 2007 Annual Report to Congress. See National Taxpayer Advocate 2007 Annual Report to Congress 478-98 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payment*).

reasons this occurs. Some specific rights contain gaps in coverage and fail to protect taxpayers in all appropriate situations. Rights also become diluted over time when they are not updated to take into account the current environment or fine-tuned to reflect changes in tax administration. Another reason certain rights become ineffective is the lack of an enforceable remedy for a violation of the right. In some cases, specific taxpayer protections are not effective because they are based on administrative practice instead of a statutory direction, and thus are subject to change. Finally, a major reason specific rights are impaired is the IRS fails to properly implement and protect them. This Annual Report to Congress has focused in depth on some of the specific rights provided to taxpayers by the IRS Restructuring and Reform Act of 1998 (RRA 98) and how the IRS is not adequately applying some of the protections that Congress established. For all of the reasons discussed above, the tax system is long overdue for an overhaul to fine-tune existing rights and provide new taxpayer protections.

Since RRA 98 was passed over 16 years ago, there has been no major taxpayer protection legislation passed by both houses of Congress. Although there have been a number of significant taxpayer protection bills introduced,<sup>6</sup> none of them have received full Congressional approval. The National Taxpayer Advocate believes the time is right for taxpayer rights legislation. The passage of time has shown where new protections and remedies are needed. Without providing these specific taxpayer protections, the TBOR becomes merely a statement of principles, without any teeth to ensure that these fundamental rights are protected on a daily basis, and that taxpayers have remedies and the IRS is held accountable for any violations of these rights.

Beyond codifying the TBOR and providing specific taxpayer protections, there are two essential elements necessary for effective protection of taxpayer rights: funding and oversight. The IRS will be severely hampered in its ability to implement new policies, procedures, and systems for protecting taxpayer rights if it does not receive adequate funding. If there is agreement that taxpayers have certain basic rights, then this places on Congress and the Executive Branch the responsibility to fund the IRS so it can deliver these rights. In addition, this report illustrates what can happen in the years following significant taxpayer protection legislation if there is not regular monitoring—the rights erode over time. RRA 98 required Congress to hold annual joint hearings to review among other things the IRS's progress in meeting its objectives and improving taxpayer service and compliance.<sup>7</sup> Each hearing was conducted jointly by majority and minority members of the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight and the Senate Committees on Finance, Appropriations, and Governmental Affairs. In order to achieve lasting change, new taxpayer rights legislation should include a similar requirement for periodic hearings without the limitation of five years.

<sup>6</sup> Broad taxpayer protection legislation has been introduced in both houses, but has failed to pass either house. See e.g., S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra).

<sup>7</sup> Pub. L. No. 105-206, § 4001, 112 Stat. 685, 783 (1998). Note that the statute refers to a “joint review [to] be held at the call of the Chairman of the Joint Committee.” The legislative history, however, makes clear that there was to be “one annual joint hearing” before June 1 of each of the succeeding 5 calendar years. H.R. REP. No. 105-599, at 328 (1998) (Conf. Rep.).

## RECOMMENDATION

To promote taxpayers' awareness of their rights and increase confidence in the fairness of the tax system, the National Taxpayer Advocate recommends that Congress:

- Codify the Taxpayer Bill of Rights that sets forth the fundamental rights and obligations of U.S. taxpayers as detailed below.
- Enact past legislative recommendations as well as those from this year's Annual Report that relate to each of the core taxpayer rights.
- Provide an appropriate level of funding for the IRS so it can properly undertake, implement, and train its employees about the taxpayer right provisions.
- Require annual joint oversight hearings to help identify and address problem areas, with specific focus on how the IRS is meeting the needs of particular taxpayer segments, including individuals, small businesses, and exempt organizations and how it is protecting taxpayer rights.

## SPECIFIC LEGISLATIVE RECOMMENDATIONS FOR PROTECTING TAXPAYER RIGHTS

Over the last year, the National Taxpayer Advocate and her staff have developed a "cross-walk" listing of existing statutory taxpayer rights that maps them to the specific rights comprising the Taxpayer Bill of Rights.<sup>8</sup> As part of this process, we were able to identify gaps in taxpayer protections. While some rights, such as the *right to appeal an IRS decision in an independent forum*, have a significant number of enforceable protections, others, such as the *right to quality service*, have few.

Starting with her first Annual Report to Congress in 2001, the National Taxpayer Advocate has made legislative recommendations to Congress each year that would further the protection of taxpayer rights. Many of these recommendations have been introduced in bills by the House of Representatives or the Senate, with some being signed into law. These recommendations are necessary to strengthen existing rights as well as to create new ones. The new recommendations in this year's report focus specifically on identifying situations where the current statutory rights fall short, and need to be updated or expanded to provide rights and remedies in certain situations. Enactment of these recommendations will provide taxpayers with remedies for violations of their rights, thereby improving voluntary compliance.

### Ten Taxpayer Rights<sup>9</sup>

#### 1. The Right to Be Informed

Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

- *Amend IRC § 7701 to Provide a Definition of "Last Known Address," and Require the IRS to Mail Duplicate Notices to Credible Alternative Addresses.*<sup>10</sup> Amend IRC § 7701 to add a definition

<sup>8</sup> See Taxpayer Advocate Service, *What the Taxpayer Bill of Rights Means for You*, <http://taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights/What-the-Taxpayer-Bill-of-Rights-Means-for-You> (last visited Dec. 22, 2014).

<sup>9</sup> These rights and their descriptions were negotiated between the National Taxpayer Advocate and other divisions of the IRS and use the official language adopted by the IRS and incorporated into Publication 1, *Your Rights as a Taxpayer* (June 2014). See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

<sup>10</sup> See National Taxpayer Advocate 2012 Annual Report to Congress 525-35. See also National Taxpayer Advocate 2008 Annual Report to Congress 449-51 (Legislative Recommendation: *Mailing Duplicate Notices to Credible Alternate Addresses*).

of “last known address” that incorporates case law, including the Fifth Circuit’s holdings in the *Mulder*<sup>11</sup> and *Terrell*<sup>12</sup> cases, and current regulations. Direct the Secretary of Treasury to: (1) develop procedures for checking third-party databases for credible alternate addresses prior to sending notices that establish legal rights and obligations (*i.e.*, Statutory Notices of Deficiency, Collection Due Process notices, notices of federal tax lien, etc.); and (2) when the IRS learns that its records do not contain a taxpayer’s correct address, and the taxpayer has a credible alternate address, require the IRS to mail the notice simultaneously to the last known and credible alternate addresses (as defined by the Secretary).

■ *ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices it Sends to Taxpayers.*<sup>13</sup>

- Amend IRC § 6159 to require the IRS to provide on annual installment agreement statements sent to taxpayers, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalties, and interest.
- Amend IRC § 7524 to require the IRS to provide on annual reminder notices sent to taxpayers with delinquent accounts, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest.

■ *IRS CORRESPONDENCE: Codify § 3705(a)(1) of RRA 98, Define “Manually Generated,” and Require Contact Information on Certain Notices in All Cases.*<sup>14</sup>

- Codify RRA 98 § 3705(a)(1).
- Define the term “manually generated correspondence” as correspondence issued as a result of an IRS employee exercising his or her judgment in working or resolving a specific taxpayer case or correspondence, or where the employee is asking the taxpayer to provide additional case-related information.
- Require the IRS to provide the name, telephone number, and unique identification number of an IRS manager on notices with legal impact, such as those that start the running of a statute of limitations or trigger appeal rights (such as the Statutory Notice of Deficiency), where such notices have been automatically generated without employee review.

11 *Mulder v. Comm'r*, 855 F.2d 208 (5th Cir. 1988).

12 *Terrell v. Comm'r*, 625 F.3d 254 (5th Cir. 2010).

13 See Legislative Recommendation: *ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices it Sends to Taxpayers*, *infra*. This recommendation also relates to the *right to pay no more than the correct amount of tax*.

14 See Legislative Recommendation: *IRS CORRESPONDENCE: Codify § 3705(a)(1) of RRA 98, Define “Manually Generated,” and Require Contact Information on Certain Notices in All Cases*, *infra*. This recommendation also relates to the *right to quality service* and the *right to a fair and just tax system*.

■ *ACCESS TO THE IRS: Require the IRS to Publish a Public Phone Directory and Report on Implementing an Operator System Similar to “311” Lines.*<sup>15</sup> Require the IRS, within 180 days, to:

- Publish, on IRS.gov, its current Practitioner Directory or a similar directory that provides the same detailed information regarding the names and contact information for managers of local IRS groups or territories for different functions of the IRS, as well as managers of service and compliance functions located in IRS campuses. Require the IRS to provide an electronic or paper copy of the directory for a particular state or geographic area, if requested by a taxpayer.
- Develop a report detailing the administrative steps necessary to implement an operator system for its main toll-free phone line, similar to a 311 telephone line. Under such a system, all taxpayers would call a single nationwide toll-free phone number and answer a limited number of questions through an interactive voice response system before being transferred to an operator. If the taxpayer were requesting a specific piece of information such as an account balance or transcript, the operator would provide the information to the taxpayer. For calls regarding other IRS functions and offices, the operator would transfer the taxpayer to the specific office handling the taxpayer’s individual issue or case. Such report should be provided to the Senate Committee on Finance and the House Committee on Ways and Means.

■ *Worker Classification.*<sup>16</sup>

- Direct the Department of Treasury and the IRS to publish guidance on classification for both income and employment taxes.
- Direct the IRS to develop a program similar to the Employment Status Indicator of the United Kingdom.
- Repeal § 530 of the Revenue Act of 1978<sup>17</sup> and replace it with an IRC provision to eliminate unnecessary confusion and clearly state that it applies to both income taxes and employment taxes. Require the IRS to consult with affected industries. Lift ban on guidance and require the Secretary to issue associated guidance, including guidance with specific industry focus.
- Amend IRC § 7436 to permit workers to petition the U.S. Tax Court to review the IRS’s classification determinations.
- Require service recipients engaged in a trade or business to issue Forms 1099-MISC to S corporations (as defined in IRC 1361(a)(1)) and increase the penalties for failure to comply with the information reporting requirements of IRC 6041A.<sup>18</sup>

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15 See Legislative Recommendation: *ACCESS TO THE IRS: Require the IRS to Publish a Public Phone Directory and Report on Implementing an Operator System Similar to “311” Lines, infra*. This recommendation also relates to the *right to quality service*.

16 See National Taxpayer Advocate 2008 Annual Report to Congress 375-90. Two parts of this recommendation, regarding voluntary income tax withholding agreements and backup withholding for noncompliant Schedule C filers are omitted here because similar recommendations are made below. See National Taxpayer Advocate 2005 Annual Report to Congress 381-96 (Legislative Recommendation: *Measures to Reduce Noncompliance in the Cash Economy*). This recommendation also relates to the *right to quality service*. S. 1796, 111th Cong. (2009) (introduced by Senator Baucus) and S. 1289, 112th Cong. (2011) (introduced by Senator Carper) included parts of this recommendation.

17 Pub. L. 95-600, 92 Stat. 2763, 2885-86.

18 The original recommendation, which applied to incorporated service providers, has been amended here to only apply to S corporations.

- Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.
- Require the IRS and the Department of Labor to conduct targeted public awareness campaigns to inform workers of the comparative rights afforded to employees and independent contractors, the tax consequences associated with each classification, and the opportunity to enter into voluntary income tax withholding agreements.

## 2. The Right to Quality Service

Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

- *Direct the Treasury Department to Develop a Plan to Reverse the “Pay Refunds First, Verify Eligibly Later” Approach to Tax Return Processing.*<sup>19</sup> Direct the Treasury Department to prepare a report identifying the administrative and legislative steps required to allow the IRS to receive and process information reporting documents before it processes tax returns. The Treasury Department should be given a full year to prepare its report in light of the complexity of the issue and the actions that would be required of the IRS, the Social Security Administration, private employers, and financial institutions. The goal should be to fully implement required changes within five years from the time the report is completed.
- *Tuition Reporting: Allow TIN Matching by Colleges.*<sup>20</sup> Allow colleges and universities to verify Taxpayer Identification Numbers with the IRS prior to filing annual information returns on tuition payments.
- *Free Electronic Filing for All Individual Taxpayers.*<sup>21</sup> Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers. Alternatively, Congress could direct the Secretary to conduct a study, in conjunction with the Office of the Taxpayer Advocate, to evaluate the feasibility of providing taxpayers with both a template for use in preparing their returns and a direct filing portal for use in filing returns. The portal would also enable taxpayers to access a government-controlled database from which taxpayers could import third-party information reports, such as W-2s and 1099s, for use in preparing their returns.<sup>22</sup> The study should result in a report describing options considered and conclusions reached, and should be submitted to the House Ways and Means and Senate Finance committees within two years.

19 See National Taxpayer Advocate 2009 Annual Report to Congress 338-45.

20 See National Taxpayer Advocate 2013 Annual Report to Congress 319-23.

21 See National Taxpayer Advocate 2004 Annual Report to Congress 471-77. S. 2861, 110th Cong. (2008) (introduced by Senator Schumer) included parts of this recommendation. There have been numerous bills introduced regarding the recommendation of a direct filing portal, including: S. 1289, 112th Cong. (2011) (introduced by Senator Carper); H.R. 5801, 110th Cong. (2008) (introduced by Rep. Lampson); S. 1074, 110th Cong. (2007) (introduced by Senator Akaka); and S. 1321, 109th Cong. (2005) (introduced by Senator Santorum).

22 See National Taxpayer Advocate 2012 Annual Report to Congress 232-50.

- *Grant Program for Free Tax Preparation for Low Income Taxpayers.*<sup>23</sup> Create an IRS administered grant program for free tax preparation for low income taxpayers. Specifically, grants would be made for demonstration projects as seed money to attract other grants, much like the awards being made under the Violence Against Women Act and welfare to work legislation. The grant would be issued to an organization that is serving as the lead for a coalition of groups, including banks, city or state economic development agencies or health and human services offices, welfare groups, and other social service organizations. The programs would target a significant number of taxpayers (either in a concentrated urban area or more dispersed throughout a larger geographic area).
- *RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery.*<sup>24</sup> Require the IRS to provide return preparation for vulnerable populations (including low income, disabled, and elderly taxpayers) in Taxpayer Assistance Centers (TACs) and via virtual service delivery. Provide sufficient funding for IRS personnel to offer return preparation in TACs.
- *Refund Delivery Options.*<sup>25</sup> Require the Department of Treasury and the IRS to:
  1. Evaluate the entire refund process to determine opportunities to shorten the turnaround time;
  2. Develop a pilot program to determine how the inclusion of a Revenue Protection Indicator in the acknowledgement file will impact tax administration. Evaluate the feasibility of including such information in the current “Where’s My Refund” online application;
  3. Evaluate existing stored value card programs to distribute government benefits, with particular emphasis on the experience of the Financial Management Service’s Direct Express Program to distribute Social Security benefits;
  4. Incorporating lessons learned from existing programs, develop a stored value card program to distribute refunds to individual taxpayers before the filing season following the next filing season; and
  5. Conduct an annual public awareness campaign to provide accurate information to taxpayers regarding available refund delivery alternatives, associated turnaround times, and any other pertinent information.
- *VIRTUAL SERVICE DELIVERY (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over*

23 See National Taxpayer Advocate 2002 Annual Report to Congress vii-viii. This recommendation was made in the introduction of the 2002 report, and was not included in the list of formal legislative recommendations. However, there have been numerous bills introduced in both the House of Representatives and the Senate supporting this recommendation, and two laws have been passed relating to this recommendation. See Consolidated Appropriations Act, 2008, Pub. L. No. 110-161, Div. D, Title 1, 121 Stat. 1844, 1975-76 (2007); Consolidated Appropriations Act, 2010, Pub. L. No. 111-117, Div. C, Title 1, 123 Stat. 3034, 3163 (2009).

24 See Legislative Recommendation: *RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery, infra.*

25 See National Taxpayer Advocate 2008 Annual Report to Congress 427-41. S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3215, 111th Cong. (2010) (introduced by Senator Bingaman); H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); H.R. 4994, 111th Cong. (2010) (introduced by Rep. Lewis), included parts of this recommendation.

*the Internet.*<sup>26</sup> Establish targets and timelines for development and implementation of VSD in brick and mortar locations, including non-IRS facilities, in mobile tax assistance units, and via taxpayer digital communications over the Internet. Provide funding, or require the IRS to allocate funding, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations, in mobile tax assistance units, and over the Internet.

- *Develop a Form 1023-EZ and Reduce Costs to Taxpayers and the IRS by Implementing “Cyber Assistant.”*<sup>27</sup> Require the IRS to develop a Form 1023-EZ;<sup>28</sup> and require and provide sufficient funding for the IRS to implement Cyber Assistant for use in preparing applications for recognition of exempt status.
- *Require the IRS to Establish a Voluntary Compliance Program for Exempt Organizations.*<sup>29</sup> Require the IRS to create a broad-based, formal, and ongoing voluntary compliance program for exempt organizations similar to those offered in the areas of employee plans, tax-exempt bonds, and Indian tribal governments within 270 days.

### 3. The Right to Pay No More than the Correct Amount of Tax

Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

- *Another Marriage Penalty – Taxing the Wrong Spouse.*<sup>30</sup>
  1. Eliminate joint and several liability for joint filers. Require married taxpayers to file a split-column tax return, which identifies separate items of income, deduction, credit, and payment, similar to the combined return adopted by a number of states.<sup>31</sup>
  2. Repeal the rule of *Poe v. Seaborn*<sup>32</sup> that each spouse is taxed on one-half of any community income. Apply the federal rules for allocating a nonresident alien's community income to all couples, with slight modification.
  3. Require the IRS to exhaust efforts to collect against assets under the liable spouse's control before collecting against assets under the nonliable spouse's control, unless such efforts would be futile.

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26 See Legislative Recommendation: *VIRTUAL SERVICE DELIVERY (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet, infra.*

27 See National Taxpayer Advocate 2011 Annual Report to Congress 562-65. Part of this recommendation, requiring the IRS to allow administrative review of its conclusion that an organization's exempt status was automatically revoked, is omitted here because it is included in a recommendation below. See Legislative Recommendation: *EO JUDICIAL AND ADMINISTRATIVE REVIEW: Allow IRC § 501(C)(4), (C)(5), or (C)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status, infra.*

28 On July 1, 2014, the IRS released a revised Form 1023-EZ. See IRM 21.3.8.11.8, *Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* (Nov. 18, 2014). The new form does not require organizations to furnish any documents in support of their claim that they are tax exempt, or to even provide a narrative description of their proposed activities. They merely attest that they meet the requirements for tax exemption. Legislative direction is needed to clarify the nature and amount of information organizations should be required to provide in order for the IRS to make a determination about their tax exempt status.

29 See National Taxpayer Advocate 2007 Annual Report to Congress 537.

30 See National Taxpayer Advocate 2005 Annual Report to Congress 407-32. The National Taxpayer Advocate proposed a different version of this recommendation in 2001. See National Taxpayer Advocate 2001 Annual Report to Congress 129-45 (Legislative Recommendation: *Separate Liability Election*). This recommendation also relates to the *right to a fair and just tax system*.

31 If Congress were to enact this provision, many of the other recommendations regarding relief from joint and several liability would be moot.

32 282 U.S. 101 (1930).

- *Allow Taxpayers to Raise Innocent Spouse Relief as a Defense in Collection Action.*<sup>33</sup> Amend IRC §§ 6015 and 66 to specify that taxpayers may raise innocent spouse relief as a defense in a proceeding brought under any provision of title 26 (including §§ 6213, 6320, 6330, 7402, and 7403) or any case under title 11 of the United States Code.
- *Credits and Refunds.*<sup>34</sup> Amend IRC § 6015(g)(3) so that, when relief is granted in full or in part under IRC § 6015(c), payments made after the date of filing an innocent spouse claim can be refunded.
- *Amend IRC § 6511 to Allow Refund Claims Past the Return Statute Expiration Date (RSED) When Excess Collection is Due to IRS Error.*<sup>35</sup> Require the IRS to send out annual statements to taxpayers under continuous levy showing payments received, penalties assessed, and interest charged, along with a detailed breakout of the application of such payments to tax, penalties, and interest for all relevant tax years.<sup>36</sup> This annual statement is necessary since taxpayers who discover errors have a limited window of time to request refunds of overpayments. Alternatively, the National Taxpayer Advocate recommends that IRC § 6511 be amended to allow taxpayers two years from the date they learn of the excess collection to make refund claims if the excess collection is due to IRS negligence. This legislative recommendation would provide relief to taxpayers where the excess collection is due to IRS negligence.
- *Adjustment of Estimated Tax Penalty in Accordance with Amended Returns.*<sup>37</sup> Amend IRC § 6654 to clarify that, for purposes of the estimated tax penalty, the return for the taxable year is the original return or any subsequently filed amended return.

#### 4. The Right to Challenge the IRS's Position and Be Heard

Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

- *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights.*<sup>38</sup> Require the IRS to develop math error notices that clearly describe what is being changed and why, and tell the taxpayer what

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33 See National Taxpayer Advocate 2010 Annual Report to Congress 377-82. This recommendation also relates to the *right to challenge the IRS's position and to be heard* and the *right to appeal*. This recommendation also included a provision to amend §§ 6015 and 66 to specify that taxpayers may request equitable relief at any time before the expiration of the period of limitations on collection. This provision was omitted here because the IRS has adopted this recommendation in Rev. Proc. 2013-34. See also National Taxpayer Advocate 2009 Annual Report to Congress 378-80 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6105 and 66 as a Defense in Collection Actions*).

34 See National Taxpayer Advocate 2001 Annual Report to Congress 155-58. This recommendation also included a provision to modify IRC § 6015(g) to provide guidance to the Secretary for developing a broader interpretation of the issuance of refunds under IRC § 6015(f). This provision was omitted here because of changes made by Rev. Proc. 2013-34.

35 See National Taxpayer Advocate 2006 Annual Report to Congress 547-48.

36 See Legislative Recommendation: *ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices it Sends to Taxpayers, infra*.

37 See National Taxpayer Advocate 2001 Annual Report to Congress 220. S. 213, 107th Cong. (2002) (introduced by Senator Shaw) included parts of this recommendation.

38 See National Taxpayer Advocate 2011 Annual Report to Congress 524-30. See also National Taxpayer Advocate 2002 Annual Report to Congress 185-97 (Legislative Recommendation: *Math Error Authority*) (recommending amending IRC § 6213(g)(2) to limit the definition of mathematical and clerical error and repealing IRC § 6213(g)(2)(M), which authorizes the IRS to use math error summary assessment procedures for an entry on the return with respect to a qualifying child for the Earned Income Tax Credit, where the taxpayer has been identified as the non-custodial parent of that child by the Federal Case Registry of Child Support Orders established under § 453(h) of the Social Security Act).

steps he or she should take to contest the change. The National Taxpayer Advocate further recommends that Congress consider the following issues in connection with any future expansions of math error authority under IRC § 6213(g):

1. Confine use of math error authority to instances that are not factually complex, can be verified on accurate, reliable government databases, and do not require the IRS to analyze facts and circumstances or weigh the adequacy of information.
2. Permit the IRS to use math error authority in conjunction with private third-party databases only where the information has been identified as reliable and accurate, and thus, would not subject the IRS to constraints in litigation.
3. Restrict math error authority in situations with a high abatement rate, where the use of math error authority appears to be unduly burdening compliant taxpayers by requiring them to submit additional documentation within a 60-day timeframe compared to a 90-day timeframe when deficiency procedures are used.

To ensure that future grants of math error authority observe these limits, the National Taxpayer Advocate recommends that Congress require the Department of Treasury, in conjunction with the National Taxpayer Advocate, to evaluate and report to Congress on whether any proposed expansions satisfy these criteria. The report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs such as those for audit reconsideration and Taxpayer Advocate Service intervention, and rigorously analyze the proposed expansions for accuracy and suitability.

- *Crediting an Overpayment Against an Unassessed, Outstanding Tax Liability.*<sup>39</sup> Amend IRC § 6402 to change the term “liability” to “assessed liability,” thereby permitting the IRS to credit any overpayment only against an *assessed* tax liability.

## 5. The Right to Appeal an IRS Decision in an Independent Forum

Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals’ decision. Taxpayers generally have the right to take their cases to court.

- *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State.*<sup>40</sup>

1. Require that Appeals have at least one Appeals Officer and Settlement Officer located and regularly available within every state, the District of Columbia, and Puerto Rico, and allow taxpayers access to telephonic, correspondence, or face-to-face hearings with the local office when requested.
2. Provide that each Appeals office maintain separate office space, separate phone, facsimile, and other electronic communication access, and a separate post office address from any IRS office co-located with the Appeals office.

39 See National Taxpayer Advocate 2008 Annual Report to Congress 442-45.

40 See National Taxpayer Advocate 2009 Annual Report to Congress 346-50. This recommendation also relates to the *right to challenge the IRS’s position and be heard and the right to a fair and just tax system*. H.R. 4375, 112th Cong. (2012) (introduced by Rep. Johnson) and S. 2291, 112th Cong. (2012) (introduced by Senator Cornyn) included parts of this recommendation. See also Legislative Recommendation: ACCESS TO APPEALS: *Require that Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, infra.*

- ***EO JUDICIAL AND ADMINISTRATIVE REVIEW: Amend IRC § 7428 to Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status.***<sup>41</sup> Amend IRC § 7428 to allow taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as currently allowed for taxpayers seeking exempt status as IRC § 501(c)(3) organizations. Amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations treated as having had their exempt status automatically revoked.
- ***Allocate to the IRS the Burden of Proving It Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit.***<sup>42</sup> Amend IRC § 32(k) to provide that the IRS has the burden of proof as to whether it is appropriate to impose the two-year ban on claiming Earned Income Tax Credit.
- ***Final Determination Rights.***<sup>43</sup> Amend IRC § 6015 to allow the IRS to rescind a determination letter issued under IRC § 6015 with the agreement of the taxpayer, as permitted under IRC § 6212(d).<sup>44</sup> Amend IRC § 6015(e)(1)(A) to require the IRS to provide in the notice of final determination the last date to petition the Tax Court. Also, provide for the taxpayer to be able to petition the Tax Court by the later of the date the Secretary specifies in the notice of final determination or 90 days from the date of the notice. Include in IRC § 6015(e)(1)(A)(ii) language that would allow taxpayers outside the United States 150 days to petition the Tax Court, as is currently provided taxpayers who receive a notice of deficiency.
- ***Effect of Automatic Stay Imposed in Bankruptcy Cases Upon Innocent Spouse and CDP Positions in Tax Court.***<sup>45</sup>
  1. Amend IRC §§ 6015, 6320, and 6330 to include language similar to that contained in IRC § 6213(f), which provides that in any case under 11 U.C.S. (a bankruptcy case), the running of the time period prescribed by IRC § 6213(a) (90 day or 150 day period) for filing a petition in the Tax Court regarding a deficiency is suspended for the period of time which the debtor-taxpayer is prohibited by reason of the automatic stay from filing such petition, plus 60 days thereafter. In the alternative, Congress should amend each of those sections to include a cross-reference to IRC § 6213, which would provide that rules similar to the rules of IRC § 6213 shall apply for purposes of determining the time for filing a petition.

41 See Legislative Recommendation: *EO JUDICIAL AND ADMINISTRATIVE REVIEW: Amend IRC § 7428 to Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status, infra.* This recommendation also relates to the right to be informed.

42 See National Taxpayer Advocate 2013 Annual Report to Congress 311-15.

43 See National Taxpayer Advocate 2001 Annual Report to Congress 159-65. This recommendation also relates to the right to be informed. This recommendation also included a provision to amend IRC § 6015(e) to allow the taxpayer the right to petition the U.S. Tax Court in determinations made under IRC § 6015(f) (requests for equitable relief from joint and several liability), which was enacted by Pub. L. 109-432 § 408, 120 Stat. 2922, 3061 (2006).

44 IRC § 6015(c) provides for taxpayers who are no longer married or living together to separate their portion of tax liability for any liability which is assessed with respect to the return. IRC § 6015(g)(3) specifically states that no credit or refund shall be allowed as a result of an election under subsection (c).

45 See National Taxpayer Advocate 2004 Annual Report to Congress 490-492. H.R. 3479, 113th Cong. (2013) (introduced by Rep. Thornberry); S. 725, 113th Cong. (2013) (introduced by Senator Cornyn); H.R. 4375, 112th Cong. (2012) (introduced by Rep. Johnson); and S. 2291, 112th Cong. (2012) (introduced by Senator Cornyn) include parts of the recommendation.

2. As yet another option, the National Taxpayer Advocate recommends that Congress add a new provision to the Code to make clear that the time for filing a Tax Court petition will be tolled whenever a taxpayer is prohibited from filing such petition by reason of the automatic stay, regardless of whether a deficiency is at issue.

■ *Collection Due Process Hearing.<sup>46</sup>*

1. Retain the Collection Due Process procedure as a necessary, essential, and statutory taxpayer right.
2. Amend IRC § 6330(c)(2)(B) to provide that, regardless of whether the taxpayer actually received a statutory notice of deficiency, had an opportunity to dispute such liability, or self-assessed the liability on a tax return, the taxpayer may raise issues relating to the existence or amount of any liability that is eligible for an audit reconsideration or a Doubt as to Liability Offer in Compromise. Amend IRC § 6330(c)(3)(C) to provide that the Office of Appeals shall not issue a Notice of Determination in said case until such reconsideration and administrative appeal of the underlying liability has been concluded and the results taken into consideration in making the determination under that paragraph.
3. Amend the flush language of IRC § 6320(a)(2) to provide that the Secretary shall send the notice required under IRC § 6320(a)(1) not more than five business days after the day the notice of lien is mailed or otherwise submitted for filing. Further, amend IRC § 6320(a)(3)(B) to provide that the taxpayer has 30 days from the date the notice is provided under IRC § 6320(a)(2) to request a hearing.

■ *Restructuring and Reform of Collection Due Process Provisions.<sup>47</sup>*

1. Amend IRC §§ 6330(a)(2) and (a)(3)(C) to require the IRS to issue the CDP levy notice at the time it undertakes its first levy action with respect to a tax. Such notice shall describe the specific levy action (levy source, date levy will occur) and provide a name and contact information for the IRS employee whom the taxpayer can contact in order to otherwise resolve the tax debt.
2. Amend IRC § 6330(a)(2)(C) to clarify that when the IRS mails a Notice of Right to a CDP Hearing prior to a proposed levy, it shall send that CDP notice by certified or registered mail but not with “return receipt requested.”
3. Clarify the role and scope of Tax Court oversight of Appeals’ continuing jurisdiction over the taxpayers’ cases under IRC § 6330(d)(2). The scope of continuing judicial oversight should include review of the IRS’s authority to release levies under IRC § 6343(a) and to return levy proceeds under IRC § 6343(d).
4. Codify the IRS Collection Appeals Program (CAP).
5. Codify the IRS Audit Reconsideration process.

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<sup>46</sup> This recommendation also included a list of administrative recommendations to the IRS, which are not included here. See National Taxpayer Advocate 2004 Annual Report to Congress 451-70. Part of this recommendation, to amend IRC § 6330(d) to restrict judicial review to issues other than the underlying liability, is also not included because it was superseded by a later recommendation that would limit, but not remove entirely, the Tax Court’s authority to review the underlying liability. See National Taxpayer Advocate 2005 Annual Report to Congress 447-63 (Legislative Recommendation: *Restructuring and Reform of Collection Due Process Proceedings*).

<sup>47</sup> See National Taxpayer Advocate 2005 Annual Report to Congress 447-63. This recommendation also included a provision that would consolidate judicial review of Collection Due Process cases in U.S. Tax Court, which was enacted as part of the Pension Protection Act of 2006, Pub. L. No. 109-280, § 854, 120 Stat. 780, 1019 (2006).

6. Amend IRC § 6330(c)(2)(B) to specifically include “audit reconsideration” as an alternative to be considered *within* the CDP hearing process.
  7. Amend IRC § 6330(d)(1) to provide that where a taxpayer is precluded from raising the underlying liability because he has already received a notice of deficiency or he participated meaningfully in a prior hearing or proceeding, the Tax Court’s authority to review the underlying liability shall be limited to a determination of whether the Appeals Officer abused his discretion in failing or refusing to consider the underlying liability in the CDP hearing.
- *Collection Due Process.*<sup>48</sup> Amend IRC § 6330(a)(2) and subsection (a)(3)(b) as necessary to provide the taxpayer outside the United States an additional 30-day period to request a hearing in response to a Collection Due Process notice. Additionally, amend IRC § 6330(d) to allow an additional 30-day response period to taxpayers appealing a CDP determination from outside the United States.
  - *Collection Due Process and Uneconomical Levies.*<sup>49</sup> Amend IRC § 6330(c) to clarify that the Appeals hearing officer, prior to making his determination under IRC § 6330(c)(3), must verify that the IRS conducted the required analysis under IRC § 6331(j), and must also consider that analysis in balancing the government’s interest in efficient tax collection with the taxpayer’s legitimate concern about the intrusiveness of the proposed levy action.
  - *Authorize the IRS Office of Appeals to Rescind Notices of Determination Issued in Collection Due Process Cases.*<sup>50</sup> Amend IRC § 6330 to permit the IRS Office of Appeals, with the consent of the taxpayer, to rescind Collection Due Process Notices of Determination (NODs) in cases where the taxpayer has raised a legitimate concern regarding the NOD within the 30-day period of petitioning the Tax Court, and before the taxpayer has requested Tax Court review.
  - *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions.*<sup>51</sup> Amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to “affected third parties,” known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.
  - *APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides.*<sup>52</sup> Amend IRC § 7482(b)(1)(A) to provide that proper appellate venue for all CDP cases lies with the circuit court of appeals based on the taxpayer’s legal residency.

48 See National Taxpayer Advocate 2002 Annual Report to Congress 244.

49 See National Taxpayer Advocate 2006 Annual Report to Congress 551-52.

50 See National Taxpayer Advocate 2011 Annual Report to Congress 548-51.

51 See National Taxpayer Advocate 2012 Annual Report to Congress 544-52.

52 See Legislative Recommendation: *APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides, infra.* This recommendation also relates to the *right to be informed*.

- **STANDARD OF REVIEW:** Amend IRC § 6330(d) to Provide for a *De Novo* Standard of Review of Whether the Collection Statute Expiration Date Is properly Calculated by the IRS.<sup>53</sup> Amend IRC § 6330(d) to provide for a *de novo* standard of review by the Tax Court of whether the Collection Statute Expiration Date is properly calculated by the IRS pursuant to IRC § 6330(c)(1).

## 6. The Right to Finality

Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

- **Elimination of Lengthy Collection Statutes for Limitations Extension.**<sup>54</sup> Eliminate the IRS's inventory of lengthy Collection Statute Expiration Date (CSED) extensions by enacting legislation that will terminate all CSED extensions on accounts that were in existence before January 1, 2000 and were granted in connection with installment agreements. This provision should be similar to RRA 98 § 3461(c), which eliminated many lengthy CSED extensions as of December 31, 2002 but which did not apply to CSED extensions granted in connection with installment agreements. To ensure that taxpayers who were granted the IRS CSED extensions prior to the effective date of RRA 98 are subject to the same policies and procedures applicable to taxpayers today, a new sunset provision should be enacted to give the IRS two years to take enforcement action if it is appropriate to do so, after which the collection statute will expire.
- **Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers.**<sup>55</sup> Provide that the filing of a non-fraudulent return with the U.S. Virgin Islands (USVI) by a person claiming to be a *bona fide* USVI resident is treated as the filing of a return with the IRS so that the filing starts the statute of limitations under IRC § 6501. This change should apply to tax years after 1986. However, it should only be effective with respect to assessments made 90 or more days after it is enacted to allow the IRS time to wrap up any ongoing examinations. As a correlative matter, require the USVI to automatically provide copies of returns filed with its Bureau of Internal Revenue to the IRS within a reasonable period of time.
- **Enact a Statute of Limitations to Limit the Retroactive Effect of Revocation of an Organization's Exempt Status.**<sup>56</sup> Enact a statute of limitation for revocation of exempt status, generally for three years, that would run from the filing of the return for the year in question. As under current law, in case of substantial omission of items from the return, the statute would run for six years, but in case of fraud, tax evasion, or non-filing of the return, the statute of limitation would not run. The time-bar would apply not only to the effective date of revocation but also to the introduction of past facts from closed years as a reason for revocation. Statutory certainty regarding the period in issue would help to align revocation with assessment.

53 See Legislative Recommendation: STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a *De Novo* Standard of Review of Whether the Collection Statute Expiration Date Is properly Calculated by the IRS, *infra*. This recommendation also relates to 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 finality, and the right to a fair and just tax system.

54 See National Taxpayer Advocate 2006 Annual Report to Congress 520-56.

55 See National Taxpayer Advocate 2009 Annual Report to Congress 391-99.

56 See National Taxpayer Advocate 2010 Annual Report to Congress 391-95.

## 7. The Right to Privacy

Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

- *Impose Collection Protections on Refund Offsets for EITC Recipients.*<sup>57</sup> Amend IRC § 6402 by adding language to limit the amount of the tax refund attributable to the Earned Income Tax Credit (EITC) that the Secretary can offset pursuant to IRC §§ 6402(a) through (e). The provision should prohibit the Secretary from offsetting the refund by more than 15 percent of the portion attributable to the EITC.
- *Waiver of Levy Prohibition Under IRC § 6331(k).*<sup>58</sup> Amend IRC § 6331 to prohibit the IRS from requiring the taxpayer to waive the IRC § 6331(k) prohibition on levies as a condition precedent to the IRS's consideration or acceptance of installment payments or an Offer in Compromise.
- *Apply Uniform Limits and Extensions to Levy Actions on Social Security Benefits.*<sup>59</sup>
  1. Codify IRS administrative policy of exempting all taxpayers with incomes at or below 250 percent of the poverty level from Federal Payment Levy Program (FPLP) levies under IRC § 6331(h);
  2. Modify "specified payments" under IRC § 6331(h) to exclude amounts exempt under IRC § 6334(a)(9) due to a taxpayer's standard deduction and personal exemptions for all levies on Social Security benefits;
  3. Limit both FPLP and paper levies of Social Security benefits to 15 percent of these payments;
  4. Codify existing IRS administrative practice to require the release of FPLP levies upon expiration of the Collection Statute Expiration Date (CSED); and
  5. Prohibit the IRS's post-CSED collection by paper levy upon a taxpayer's fixed and determinable right to future Social Security benefits unless:
    - a. The taxpayer has exhibited flagrant conduct within three months of the CSED as determined by IRS personnel; and
    - b. The levy is limited to the balance due at the CSED.
- *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences.*<sup>60</sup> Amend IRC § 7403 to preclude an IRS employee from requesting that the

57 See National Taxpayer Advocate 2009 Annual Report to Congress 365-70.

58 See National Taxpayer Advocate 2008 Annual Report to Congress 446-48.

59 See National Taxpayer Advocate 2009 Annual Report to Congress 371-77. This recommendation also relates to the *right to finality*. See also National Taxpayer Advocate 2006 Annual Report to Congress 527-30 (Legislative Recommendation: *Levy Actions on Fixed and Determinable Rights*); National Taxpayer Advocate 2005 Annual Report to Congress 466-67 (Legislative Recommendation: *Social Security Levies*) (recommending Social Security payments be exempt altogether from levy).

60 See National Taxpayer Advocate 2012 Annual Report to Congress 537-43. This recommendation also relates to the *right to a fair and just tax system*. In 2013, the IRS issued interim guidance that adopted this recommendation. See IRS Interim Guidance Memorandum SBSE-05-0414-0032 (Apr. 18, 2014) (reissuing IRS Interim Guidance Memorandum SBSE-05-0413-035 (Apr. 30, 2013) (Principal Residence Suit Foreclosure Recommendations), available at [http://www.irs.gov/pub/foia/ig/spder/SBSE-05-0414-0032\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/SBSE-05-0414-0032[1].pdf). The National Taxpayer Advocate believes this recommendation should be made permanent through codification.

attorney general direct the filing of a civil action to foreclose the federal tax lien against a taxpayer's principal residence in U.S. District Court, unless the IRS employee has received executive-level approval after determining that: (1) the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, including the expenses of the proceedings; and (2) the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer.

## 8. The Right to Confidentiality

Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

### ■ *Confidentiality/Disclosure and Disclosure of Returns and Return Information.*<sup>61</sup>

- Disclosure of returns and return information should be limited to those rare instances in which an agency has demonstrated a compelling need for that information which cannot be reasonably obtained from another source. All such disclosures should be subject to the appropriate safeguards and procedures for maintaining the confidentiality of the tax information in the hands of another agency. The Code should specify limits on the amount and use of disclosed information, and make all violations of those limits subject to civil and criminal sanctions.
- Disclosure provisions should be designed so as to minimize access to such information by contractors. Where contractors must be used by an agency, the disclosures should be limited to a "fact of filing" or "match/mismatch" acknowledgement. If such a narrow disclosure provision is unworkable, then the disclosure of tax information should be limited to the number of nontax administration contractors that the IRS can adequately safeguard.
- Prior to any statutory expansion of disclosure exceptions, Treasury and the IRS should conduct a pilot of the proposed program. The pilot should be conducted for a number of years in order to measure the true impact that the proposed disclosure may have on voluntary tax compliance by the participants.
- Any initial statutory authorization should be subject to a five-year sunset provision. Prior to reauthorization, Treasury and the IRS should prepare a report assessing the impact the provision has had on taxpayer privacy and taxpayer voluntary compliance as well as whether advances in public or private sector technology have reduced the need for taxpayer information.
- Finally, every ten years, the Congress should direct the Secretary of the Treasury to review all disclosure exceptions in IRC § 6103, make recommendations about their continued necessity, including suggesting repeal where technological or private sector advances have minimized the need for the disclosure, and report such findings and recommendations to the Joint Committee on Taxation.

61 See National Taxpayer Advocate 2003 Annual Report to Congress 232-55.

- *Content-Based Disclosures of Tax Return Information Under IRC § 6103(c).*<sup>62</sup> Amend IRC § 6103(c) to limit the disclosure of tax returns and tax return information requested through taxpayer consent solely to the extent necessary to achieve the purpose for which consent was requested.
  - Additionally, IRC § 6103(p)(3)(C) should be amended to require the Secretary of the Treasury to include in the Treasury's annual disclosure report to the Joint Committee on Taxation detailed information about the number and types of disclosures pursuant to taxpayer consent. Requiring the IRS to track disclosures made through IRC § 6103(c) consent will enable the IRS to monitor how § 6103(c) consents are being used and whether increased taxpayer education or oversight are necessary to protect taxpayer information.
  - To provide a deterrent to misusing taxpayer return information obtained pursuant to a § 6103(c) consent, IRC §§ 7213A and 7431 should be amended to apply criminal and civil sanctions. Implementing criminal and civil sanctions of up to \$1,000 per violation will dissuade lenders from using tax return information for reasons outside the scope of the taxpayer's consent.
  - To ensure that lenders no longer ask individuals to sign blank or incomplete forms, IRC § 7431 should be amended to impose a civil penalty of \$500 for each attempt to obtain a signed blank or incomplete Forms 4506, 4506-T, and 2858, subject to a reasonable cause exception.
- *Filing Issues: Use and Disclosure of Tax Return Information.*<sup>63</sup> Congress should amend IRC §§ 7216 and 6713 to:
  1. Prohibit use or disclosure of tax return information for purposes other than tax preparation and filing of returns. The statutes should specifically prohibit the use or disclosure of information for the business solicitation of nontax-related products or services, including but not limited to those related to tax refund delivery and the protection from IRS audit.
  2. Specifically state the exception currently in Treas. Reg. § 301.7216-2(e), which provides that IRC § 7216(a) does not apply to a tax return preparer who is lawfully engaged in the practice of law or accountancy. This exception allows the individual to use or disclose tax return information to another employee or member of the preparer's law or accounting firm for purposes of rendering other legal or accounting services for the taxpayer.
  3. Clarify the reach of IRC § 7216(a) to include preparers of returns other than income tax returns, volunteers, individuals who perform other businesses in addition to return preparation, and contractors performing services in connection with return preparation.
  4. Specifically state that the regulations issued thereunder must require safe harbor language to include in all written consents. The safe harbor language should address the limitations and duration of the consents as well as provide detailed contact information for the taxpayers to report violations or inquire about their rights.

62 See National Taxpayer Advocate 2007 Annual Report to Congress 554-55. This report also makes an administrative recommendation for the IRS to amend Form 4506 and related forms to allow taxpayers to specify the reasons for which they are granting consent. See *id.* at 123.

63 See National Taxpayer Advocate 2006 Annual Report to Congress 496-502.

5. Prohibit the disclosure or use of information to or by any tax return preparer located outside of the United States, unless the taxpayer has provided written consent.

- *Authorize Treasury to Issue Guidance Specific to IRC § 6713 Regarding the Use and Disclosure of Tax Return Information by Preparers.*<sup>64</sup> Amend IRC § 6713 to authorize the Secretary to prescribe regulations under IRC § 6713. Specifically, Congress should amend IRC § 6713 as follows:
  1. Amend subsection (b) to read: “(b) Exceptions. — Except as otherwise provided in regulations prescribed by the Secretary under subsection (d), the rules of section 7216(b) apply for purposes of this section.”
  2. Create subsection (d) to read: “(b) Regulations. — The Secretary may prescribe such regulations and other guidance as may be necessary or appropriate to carry out this section.”
- *Protect Taxpayer Privacy in Whistleblower Cases.*<sup>65</sup> Amend IRC § 7623 or other applicable provisions to require redaction of third-party return information in administrative and judicial proceedings relating to a whistleblower claim, with an opportunity for the taxpayer to request further redactions before disclosure. The taxpayer would have a subsequent right of action for civil damages for unauthorized disclosure by the whistleblower.

## 9. The Right to Retain Representation

Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic (LITC) if they cannot afford representation.

- *Referral to Low Income Taxpayer Clinics.*<sup>66</sup> Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to Low Income Taxpayer Clinics receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance. In making such referrals, the IRS should maintain its current disclaimer language to prevent any misconception that taxpayers may be either advantaged or disadvantaged in their cases based on their decision of whether to use a clinic.
- *Designate that Attorneys' Fees Awarded Pursuant to IRC § 7430 are Ineligible for Offset to Satisfy a Litigant's Preexisting Government Debts.*<sup>67</sup> Amend IRC § 7430 to declare that attorneys' fees are ineligible for offset to satisfy a litigant's preexisting federal government debt.

## 10. The Right to a Fair and Just Tax System

Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are

<sup>64</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 547-48.

<sup>65</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 396-99.

<sup>66</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 551-53. H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); S. 1573, 112th Cong. (2011) (introduced by Senator Durbin); H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); S. 3215, 111th Cong. (2010) (introduced by Senator Bingaman); H.R. 4994, 111th Cong. (2010) (introduced by Rep. Lewis) and H.R. 5719, 110th Cong. (2008) (introduced by Rep. Rangel) included this recommendation.

<sup>67</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 406-09.

experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

### **Recommendations Related to Complexity**

- *Enact Tax Reform Now.<sup>68</sup>* Reform the tax code, based on six core principles, to eliminate tax law complexity as the most serious problem facing taxpayers. The six core principles are: (1) The tax system should not “entrap” taxpayers; (2) The tax laws should be simple enough so that most taxpayers can prepare their own returns without professional help, simple enough so that taxpayers can compute their tax liabilities on a single form, and simple enough so that IRS telephone assistors can fully and accurately answer taxpayers’ questions; (3) The tax laws should anticipate the largest areas of noncompliance and minimize the opportunities for such noncompliance; (4) The tax laws should provide some choices, but not too many; (5) Where the tax laws provide for refundable credits, they should be designed in a way that the IRS can effectively administer; and (6) The tax system should incorporate a periodic review of the tax code—in short, a sanity check. Comprehensive tax reform should eliminate all tax expenditures, unless the benefits of a particular tax incentive outweigh the complexity created by the special rule. The National Taxpayer Advocate also recommends that Congress direct the IRS to provide each taxpayer with a “taxpayer receipt” presenting a general breakdown of how federal dollars are spent.
- *Attainment of Age Definition.<sup>69</sup>* Amend IRC § 7701 by adding a new subsection as follows: “*Attainment of Age*. An individual attains the next age on the anniversary of his date of birth.”
- *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married.”<sup>70</sup>* Amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.”
- *FILING STATUS: Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure.<sup>71</sup>* Amend IRC § 6013(b)(1) by clarifying the term “separate returns” means any return that is not a joint return. Amend IRC § 6013(b)(2)(B) to allow taxpayers the right to change their filing status to married filing jointly after filing a Tax Court petition in response to a Statutory Notice of Deficiency, in accordance with rules of practice and procedure of the Tax Court or, in the alternative, eliminate IRC § 6013(b)(2)(B).
- *Community Property Laws.<sup>72</sup>* Amend IRC § 6321 to disregard state community property tax laws in applying IRC § 66.

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68 See *id.* at 365-72. See also National Taxpayer Advocate 2005 Annual Report to Congress 375-80 (Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*). S. 727, 112th Cong. (2011) (introduced by Senator Wyden) included parts of the recommendation relating to the reduction of the number of tax preferences.

69 See National Taxpayer Advocate 2003 Annual Report to Congress 308-11.

70 See National Taxpayer Advocate 2012 Annual Report to Congress 513-20.

71 See Legislative Recommendation: *FILING STATUS: Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure, infra*. This recommendation also relates to the right to pay no more than the correct amount of tax.

72 See National Taxpayer Advocate 2001 Annual Report to Congress 221.

- “*Innocent Spouse*” Relief Fixes: *Provide the Tax Court with Jurisdiction to Review Community Property Relief Determinations Under IRC § 66(c).*<sup>73</sup> Provide the Tax Court with jurisdiction to review the IRS’s community property relief determinations under IRC § 66(c).
- *Measures to Reduce Noncompliance in the Cash Economy.*<sup>74</sup>
  1. Amend IRC § 3406 to create a three-pronged reporting and payment system that encourages compliance in certain cash economy transactions by: (1) instituting backup withholding on payments to taxpayers who have demonstrated “Substantial Noncompliance”; (2) releasing backup withholding on payments to Substantially Noncompliant taxpayers who have demonstrated “Substantial Compliance,” and who agree to schedule and make future estimated tax payments through the IRS Electronic Funds Transfer Payment System (EFTPS); and (3) providing that payors will not be required to institute backup withholding on payments to taxpayers (independent contractors) who present payors with a valid IRS “Compliance Certificate.”
  2. Amend IRC § 6302(h) to require the IRS to promote making estimated tax payments through EFTPS.
  3. Amend IRC § 3402(p)(3) to specifically authorize voluntary withholding agreements between independent contractors and service-recipients (as defined in IRC § 6041A(a)(1)), and to specify that independent contractors who enter into voluntary agreements with payor service recipients will be treated as employees only to the extent specified in the agreement, and allow such independent contractors to continue to deduct ordinary and necessary business expenses under IRC § 162(a).
- *SECTION 501(c)(4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity.*<sup>75</sup> Enact an optional “safe harbor” election similar to IRC § 501(h) that would allow IRC § 501(c)(4) organizations to elect the use of a numerical test, based solely on their expenditures (*i.e.*, without counting volunteer activities), to determine the amount of political campaign activity they may engage in without jeopardizing their exempt status.

73 See National Taxpayer Advocate 2006 Annual Report to Congress 534-43. Certain parts of this recommendation are omitted here because they repeat earlier recommendations. See National Taxpayer Advocate 2001 Annual Report to Congress 159-65 (Legislative Recommendation: *Final Determination Rights*). Parts of this recommendation, which the IRS has implemented administratively are also omitted, specifically the requirement to establish a reconsideration process for innocent spouse claims (see IRM 25.15.17, Reconsiderations (July 29, 2014)) and the elimination of the two year limitation period for taxpayers seeking equitable relief under IRC § 6015 or IRC § 66 (see Rev. Proc. 2013-34).

74 See National Taxpayer Advocate 2005 Annual Report to Congress 381-96; see also National Taxpayer Advocate 2007 Annual Report to Congress 490-502 (Legislative Recommendation: *Measures to Address Noncompliance in the Cash Economy*). This recommendation also relates to the *right to a fair and just tax system*. Part of this recommendation, to amend IRC § 6041A to require third-party information reporting for applicable payments to corporations is omitted because it is included above. See National Taxpayer Advocate 2008 Annual Report to Congress 375-90 (Legislative Recommendation: *Worker Classification*). S. 1321, 109th Cong. (2005) (introduced by Senator Santorum) would require a study of the use of voluntary withholding agreements and for the IRS to promote estimated tax payments through the EFTPS. S. 3795, 111th Cong. (2010) and S. 1289, 112th Cong. (2011), both introduced by Senator Carper, would require financial institutions to report all accounts to the IRS by eliminating the \$10 threshold on interest reporting. Finally, S. 3795, 111th Cong. (2010) (introduced by Senator Carper) would authorize voluntary withholding upon request.

75 See Legislative Recommendation: *SECTION 501(c)4 POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity, infra*. This recommendation also relates to the *right to be informed*.

### **Recommendations Related to the Office of the Taxpayer Advocate**

■ *Recommendations related to Revising the Taxpayer Assistance Order (TAO) Authority Under IRC §7811 and Protecting TAS Confidentiality.<sup>76</sup>*

1. Amend IRC § 7811 to require the Commissioner or the Deputy Commissioner of Internal Revenue to raise his or her objections to a TAO issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the TAO, and to provide a detailed written explanation of the reasons for the TAO modification or rescission.<sup>77</sup>
2. If the TAO is modified or rescinded by the Deputy Commissioner, grant the National Taxpayer Advocate authority to elevate the TAO to the Commissioner of Internal Revenue and require the Commissioner to provide a detailed written response with explanation of the reasons for his or her final decision within timeframes established by the National Taxpayer Advocate in the TAO.<sup>78</sup>
3. Amend IRC § 7811 to include “impairment of taxpayer rights” as a definition of “significant hardship” for purposes of issuing a TAO.<sup>79</sup>
4. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the Code, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service (TAS) or any information provided by a taxpayer to TAS.<sup>80</sup>
5. Amend IRC § 7803(c)(4)(A) to provide that in litigation before a federal court, Local Taxpayer Advocates shall not through discovery or compulsory process be required to disclose the fact that the taxpayer contacted the Taxpayer Advocate Service or any information provided by the taxpayer to TAS, unless the court determines that such testimony or disclosure is necessary to: (a) prevent a manifest injustice; (b) help establish a violation of law; or (c) prevent harm to the public health or safety, of sufficient magnitude in the particular case to outweigh the integrity of the Taxpayer Advocate Service in general by reducing the confidence of taxpayers in future cases that their communications will remain confidential.<sup>81</sup>

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76 These recommendations are based on legislative recommendations contained in the National Taxpayer Advocate's 2011 and 2002 Annual Reports. However, some portions were modified to clarify the position of the National Taxpayer Advocate. See National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*); National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*). H.R. 1661, 108th Cong. (2003) (introduced by Rep. Rangel) and H.R. 1528, 108th Cong. (2003) (introduced by Rep. Portman and passed by the House) included the recommendations regarding confidentiality of taxpayer communications and the position of counsel to the National Taxpayer Advocate.

77 National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*) (recommendation is modified).

78 This provision was not included in the recommendations in the National Taxpayer Advocate's 2002 and 2011 Annual Reports to Congress.

79 National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*).

80 *Id.*

81 *Id.*

■ *Codify the Authority of the Office of the Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives.*<sup>82</sup> In addition to the proposals related to the TAO authority discussed immediately above, the National Taxpayer Advocate recommends that Congress:

1. Authorize the National Taxpayer Advocate to submit *amicus curiae* briefs in federal appellate litigation on matters relating to the protection of taxpayer rights that the National Taxpayer Advocate has identified as concerns in her Annual Reports to Congress.
2. Require the IRS to submit proposed or temporary regulations pre-publication to the National Taxpayer Advocate for comment within a reasonable time, and address those comments in the preamble to final regulations.
3. Authorize the National Taxpayer Advocate to appoint an independent counsel who reports directly to the National Taxpayer Advocate, to provide independent legal advice, including submission of *amicus curiae* briefs and comments on proposed or temporary regulations.
4. Grant to the National Taxpayer Advocate nondelegable authority to issue a Taxpayer Advocate Directive (TAD) with respect to any IRS program, proposed program, action, or failure to act that may create a significant hardship for a segment of the taxpayer population or for taxpayers at large, and require the Commissioner or the Deputy Commissioner of Internal Revenue to raise his or her objections to a TAD issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the TAD, and to provide a detailed written explanation of the reasons for the TAD modification or rescission.<sup>83</sup>
5. If the TAD is modified or rescinded by the Deputy Commissioner, grant the National Taxpayer Advocate authority to elevate the TAD to the Commissioner of Internal Revenue and require the Commissioner to provide a detailed written response with explanation of the reasons for his or her final decision within timeframes established by the National Taxpayer Advocate in the TAD.<sup>84</sup>
6. Amend IRC § 7811 to include “impairment of taxpayer rights” as a definition of “significant hardship” for purposes of issuing a TAD.<sup>85</sup>

■ *Enact a Uniform Federal Agency External Ombudsman Act.*<sup>86</sup> Enact a Federal Agency External Ombudsmen Act to ensure protections to and create uniformity among all future federal external ombudsmen.

<sup>82</sup> See National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*).

<sup>83</sup> National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*) (recommendation is modified).

<sup>84</sup> This provision was not included in the recommendations in the National Taxpayer Advocate’s 2002 and 2011 Annual Reports to Congress.

<sup>85</sup> National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *The Office of the Taxpayer Advocate*).

<sup>86</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 412-13.

- *CONTACT INFORMATION ON STATUTORY NOTICES OF DEFICIENCY: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population.*<sup>87</sup> Revise IRC § 6212 to require the IRS to do the following:
  1. Include language on the face of the Statutory Notice of Deficiency (SNOD) informing the taxpayer of the right to contact a local office of TAS. Such language should also provide the address and phone number of the TAS office aligned with the taxpayer's last known residence.
  2. For SNODs determined by the IRS, in consultation with the National Taxpayer Advocate, to have a significant probability of impacting low income taxpayers, include language on the face of the notice describing Low Income Taxpayer Clinics (LITCs) and provide a website link that lists contact information for all the LITCs.
  3. For SNODs that are certain to impact low income taxpayers (e.g., those proposing to assess the Earned Income Tax Credit), also include in the envelope used to mail the SNOD Publication 4134, *Low Income Taxpayer Clinic List*, which provides information on the services provided by LITCs and contact information for each clinic.
- *Clarify that the Emergency Exception to the Anti-Deficiency Act Includes IRS Activities that Protect Taxpayer Life and Property.*<sup>88</sup> Clarify that the emergency exception to the Anti-Deficiency Act includes IRS activity involving the safety of human life, including taxpayer life, or the protection of property, including taxpayer property. Alternatively, the National Taxpayer Advocate recommends that Congress clarify that the National Taxpayer Advocate's authority to issue TAOs pursuant to IRC § 7811 continues during a lapse in appropriations and includes the authority to incur obligations in advance of appropriations, and that the IRS can incur obligations in advance of appropriations to comply with any TAO issued under IRC § 7811.
- *De Minimis Apology Statement.*<sup>89</sup> Amend IRC § 7811 to grant the National Taxpayer Advocate the discretionary, nondelegable authority to compensate taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer, and the taxpayer meets the IRC § 7811 definition of significant hardship. Discretionary payments should range from a minimum of \$100 up to a maximum of \$1,000, indexed for inflation. The National Taxpayer Advocate also recommends that, unless otherwise provided by specific appropriation, authorize the Secretary of the Treasury to allocate no more than \$1 million per year to "apology" payments. Furthermore, amend IRC § 7803(c)(2)(B)(ii) to require the National Taxpayer Advocate to include in her Annual Report to Congress a section summarizing the awards made under this amendment. Finally, amend the Code to exclude these "apology" payments from gross income.

<sup>87</sup> See Legislative Recommendation: *CONTACT INFORMATION ON STATUTORY NOTICES OF DEFICIENCY: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population, infra*. This recommendation also relates to the *right to retain representation*.

<sup>88</sup> See National Taxpayer Advocate 2011 Annual Report to Congress 552-57.

<sup>89</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 478-89. S. 1289, 111th Cong. (2011) and S. 3795, 111th Cong. (2010), both introduced by Senator Carper, include parts of this recommendation.

## Recommendations Related to Tax Return Preparers and Payroll Service Providers

### ■ Federal Tax Preparers Oversight and Compliance<sup>90</sup>

1. Increase the preparer penalties under IRC §§ 6695(a) through (e) with respect to certain requirements for preparation of income tax returns for other persons, from \$50 per occurrence to \$100 per occurrence.
2. Increase the preparer penalty under IRC § 6695(f) for negotiation of a refund check from \$500 per check to \$1,000 per check.
3. Amend IRC § 6695(g) to impose a tiered penalty structure for violation of the EITC due diligence requirements: for the first year in which a penalty is imposed, the penalty would be \$100 per occurrence; for the second year, \$500 per occurrence; and for the third year, \$1,000 per occurrence. Provide for waiver, or abatement of penalties, in whole or in part, where the preparer enrolls in EITC education courses and demonstrates an ability to comply with due diligence requirements.<sup>91</sup>
4. Amend IRC § 6695(g) to require the EITC due diligence certification to be signed, under penalties of perjury, by the return preparer and attached to the taxpayer's income tax return; that it include a description of how and when the preparer obtained the information upon which he based the EITC eligibility determination (for example, from original documents, the taxpayer's statements, or from prior year's records); and that the preparer be required to certify that he or she has a system of recordkeeping for the information outlined in the regulations and a record retention policy of three years.
5. Amend IRC § 6695 to authorize the Secretary to impose a civil penalty against a tax return preparer who, by reason of intentional misstatement, misrepresentation, fraud, or deceit or any unlawful act causes a taxpayer a tax liability attributable to the Earned Income Tax Credit (EITC), in an amount equal to the tax attributable to the disallowed EITC.
6. Amend IRC § 6695 to impose a penalty of \$100 per occurrence on persons who fail to sign or include certain information on specified IRS forms prepared by them for a fee, including applications for offers in compromise, financial information statements of individuals and businesses, and similar forms.
7. Amend the Internal Revenue Code to authorize the Secretary to impose a \$1,000 penalty, in addition to other available sanctions, on Electronic Return Originators (ERO) who repeatedly fail to comply with ERO Program requirements. Where preparers, including EROs, commit violations by charging a fee for services that is a percentage of the taxpayer's refund or is based on a return item, or failing to advise the taxpayer of the fact that a Refund Anticipation Loan product is a loan and the terms of that loan, the penalty shall be the greater of \$100 per occurrence or 50 percent of the fee for such service.

90 See National Taxpayer Advocate 2003 Annual Report to Congress 270-301. This recommendation also included a provision to increase the IRC § 6694(a) preparer penalty for understatements due to unrealistic positions from \$250 to \$1,000, and the IRC § 6694(b) penalty for intentional disregard of the rules and regulations from \$1,000 to \$5,000, which were enacted by Pub. L. 110-28, § 8246(b), 121 Stat. 112, 203 (2007). Numerous bills have been introduced that would increase return preparer penalties. See, e.g., H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); S. 1219, 110th (2007) (introduced by Senator Bingaman); S. 1321, 109th Cong. (2005) (introduced by Senator Santorum); S. 882, 108th Cong. (2003) (introduced by Senator Baucus).

91 Pub. L. No. 112-41, § 501, 125 Stat. 428, 459 (2011) increased the penalty under IRC § 6695(g) from \$100 to \$500.

8. Amend the Internal Revenue Code to authorize the Secretary to impose a \$1,000 penalty per occurrence against any person who willfully and intentionally misrepresents his or her professional status on a Power of Attorney authorizing him or her to represent a taxpayer before the Internal Revenue Service, or who willfully and intentionally practices before the IRS without proper authorization, under rules prescribed by the Secretary.
9. Increase the preparer penalty under IRC § 6713 for unauthorized disclosure or use of information by preparers from \$250 to \$500 per disclosure or use, and increase the aggregate amount of penalties imposed on a preparer during any calendar year from \$10,000 to \$25,000.
10. Require the Secretary, in consultation with the National Taxpayer Advocate, to study the impact that cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance, and report the results of that study to the House Committee on Ways and Means and the Senate Committee on Finance within one year of its establishment.
11. Require the Commissioner of Internal Revenue to appoint two consumer protection advocates to the Electronic Tax Administration Advisory Committee.

■ *The Time Has Come to Regulate Federal Return Preparers.*<sup>92</sup> Enact a registration, examination, certification, and enforcement program for unenrolled tax return preparers. This program should consist of the following components:

1. Any tax return preparer as defined in IRC § 7701(a)(36) other than an attorney, certified public accountant, or enrolled agent must register with the IRS, and Congress should authorize the IRS to impose a per-return penalty for failure to register, absent reasonable cause.
2. All registered preparers must pass an initial examination designed by the Secretary to test the technical knowledge and competency of unenrolled return preparers to prepare federal tax returns. The exam can be administered in two separate parts. The first part would address the technical knowledge required to prepare relatively less complex Form 1040-series returns. The second part would test the technical knowledge required to prepare business returns, including complex sole proprietorship schedules.
3. All registered preparers must complete CPE requirements as specified by the Secretary. The Secretary should have the authority to permit preparers to satisfy such requirements by instead passing a specified examination.

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92 See National Taxpayer Advocate 2008 Annual Report to Congress 423-26; see also National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*) and National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*). This recommendation also relates to the *right to be informed* and the *right to pay no more than the correct amount of tax*. The IRS implemented many of the procedures recommended. However, some of the procedures, including the requirements that paid tax-return preparers pass an initial certification exam and complete at least 15 hours of continuing education courses each year, were found invalid under *Loving v. Commissioner*, 917 F. Supp. 2d 67 (D.D.C. 2013), aff'd 742 F.3d 1013 (D.C. Cir., Feb. 11, 2014). *Loving* held that the IRS did not have the authority to regulate tax-return preparers under 31 U.S.C.S. § 330. Since January 1, 2011, all paid tax-return preparers and enrolled agents are required to have a Preparer Tax Identification Number ("PTIN") and the *Loving* decision did not invalidate this requirement. See IRC §6109. The National Taxpayer Advocate recommends that Congress codify all of these recommendations. There have been numerous bills introduced in both the House of Representatives and the Senate incorporating aspects of this recommendation, see, e.g., S. 3355, 112th Cong. (2012) (introduced by Rep. Bingaman); H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra).

4. All registered preparers must renew their registration every year,<sup>93</sup> at which point they must show evidence of completion of CPE requirements.

5. The Secretary should be authorized and directed to conduct a public awareness campaign to inform the public about the registration requirements and offer guidelines about what taxpayers should look for in choosing a qualified tax return preparer.

■ *Assessment of Civil Penalties Against Preparers of Fraudulent Returns.*<sup>94</sup> Amend the IRC to provide that when the issuance of an erroneous refund to a return preparer is due to fraud, the IRS may impose a penalty, in addition to other penalties provided by law, equal to 100 percent of that erroneous refund.

■ *Taxpayer Protection from Third-Party Payer Failures.*<sup>95</sup>

1. Amend the Code to define “third-party payer” as any person who provides services of filing, reporting, withholding, and payment of employment taxes on behalf of client taxpayers if such person has the authority, control, receipt, custody, or disposal of client taxpayers’ funds intended by the taxpayers to be used for the purpose of making federal payroll tax deposits;
2. Amend the Code to make a third-party payer jointly and severally liable for the amount of tax collected from client employers, but not paid over to the Treasury, plus applicable interest and penalties;
3. Amend the Code to authorize the Secretary of the Treasury to require third-party payers that have the authority, control, receipt, custody or disposal of client funds intended for the purpose of making federal payroll tax deposits to: (1) register with the IRS; (2) be sufficiently bonded; and (3) provide mandatory disclosure on the form prescribed by the IRS to client taxpayers that the employer may be potentially responsible for unpaid payroll taxes and that the employer can and should periodically verify, through IRS, that their employment tax liability is satisfied in full;
4. Amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy, even when the debtor is not an individual.

■ *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes.*<sup>96</sup>

1. Amend the IRC to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that

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93 The original recommendation required renewal every three years. Currently, the IRS requires preparers to renew Preparer Tax Identification Numbers every year. See IRM 1.32.19.21.7, *Obtaining and Renewing a Preparer Tax Identification Number (PTIN)* (Nov. 8, 2012).

94 See National Taxpayer Advocate 2011 Annual Report to Congress 558-61.

95 See National Taxpayer Advocate 2007 Annual Report to Congress 538-44. This recommendation also included a provision to clarify that the Trust Fund Recovery Penalty applies to third party payers, which was not included here because the IRS implemented this administratively. See Interim Guidance Memorandum, SBSE-05-0711-044, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer* (July 1, 2011) (also incorporated in IRM 5.1.24.5.8, *Trust Fund Recovery Penalty (TFRP) Investigations* (Aug. 15, 2012)). See also National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*). S. 900, 113th Cong. (2013) (introduced by Senator Mikulski); S. 1773, 110th Cong. (2007) (introduced by Senator Snowe); S. 3583, 109th Cong. (2006) (introduced by Senator Snowe); S. 1321, 109th Cong. (2005) (introduced by Senator Santorum) included parts of this recommendation.

96 See National Taxpayer Advocate 2012 Annual Report to Congress 553-59. Part of the recommendation regarding IRC § 6672 penalties surviving bankruptcy has been omitted here because it was included above. See National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection from Third-Party Payer Failures*).

specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees.

2. Amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause.
- *OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable.”*<sup>97</sup> To address the inherent conflict with the IRS determining whether acceptance of an offer in compromise by a victim who was defrauded by a payroll service provider is fair and equitable, Congress should specify that such determination be made by National Taxpayer Advocate.

### Recommendations Related to Penalties

- *Reforming the Penalty Regime.*<sup>98</sup> Congress should have the IRS (1) collect and analyze more detailed penalty data on a regular basis, and (2) conduct an empirical study to quantify the effect of each penalty on voluntary compliance. This quantitative research should also identify changes to penalty laws and penalty administration that would improve voluntary compliance. Congress should appropriate additional funds for this research, as necessary. Without such research, any penalty analysis will be somewhat subjective and superficial. Nonetheless, the limited data and analysis that are available suggest the following changes to the major penalty provisions would promote voluntary compliance based on the principles described above:

1. Prevent IRS systems from automatically assessing accuracy-related penalties without considering all of the facts and circumstances;
2. Consider the feasibility of clarifying the definition of a “tax shelter” for purposes of the substantial understatement penalty;
3. Restructure the penalty for failure to file a “reportable transaction” information disclosure;<sup>99</sup>
4. Improve the proportionality and effectiveness of the failure to file penalty for those who are more than six months late;
5. Reduce the penalty for late filers who timely pay within a period of extension;

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97 See Legislative Recommendation: *OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable,”* *infra*.

98 See National Taxpayer Advocate 2008 Annual Report to Congress 414-18. For a more detailed discussion of this topic and each of the recommendations, see National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2 2-45 (Research Study: *A Framework for Reforming the Penalty Regime*). This recommendation also included a provision to clarify that the Trust Fund Recovery Penalty applies to third party payers, which was not included here because the IRS implemented this administratively. See Interim Guidance Memorandum, SBSE-05-0711-044, *Interim Guidance for Conducting Trust Fund Recovery Penalty Investigations in Cases Involving a Third-Party Payer* (July 01, 2011) (also incorporated in IRM 5.1.24.5.8, Trust Fund Recovery Penalty (TFRP) Investigations (Aug. 15, 2012)).

99 The Small Business Jobs Act of 2010 enacted a similar recommendation to modify the penalty for failure to include reportable transaction information with a return so that it bears a proportional relationship to the amount of any tax savings realized. Pub. L. No. 111-240, 124 Stat. 2504, 2560 (2010). See National Taxpayer Advocate 2008 Annual Report to Congress 419-22 (Legislative Recommendation: *Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact*) (also expressing concern about the lack of a “reasonable cause” exception, the “stacking” of multiple § 6707A penalties, and the potential imposition of the § 6707A penalty on taxpayers who derived no tax benefit whatsoever).

6. Reduce the number of failure to pay penalty rates and eliminate interaction with the failure to file penalty;<sup>100</sup>
7. Simplify the prior year estimated tax payment safe harbor and encourage taxpayers to use it;
8. Simplify the estimated tax penalty computation and provide an automatic waiver of *de minimis* estimated tax penalties;
9. Allow the IRS to abate estimated tax penalties for first-time estimated taxpayers who have reasonable cause; and
10. Reduce the penalty for failure to make tax deposits in the prescribed manner.

- *Revise the Willfulness Component of the Trust Fund Recovery Penalty Statute to Encourage Business Owners to Continue Operation of Financially Struggling Businesses When the Tax Liability Accrues Due to an Intervening Bad Act.*<sup>101</sup> Amend IRC § 6672 to provide that the conduct of a responsible person who obtains knowledge of trust fund taxes not being timely paid because of an intervening bad act shall not be deemed willful if the delinquent business: (1) promptly makes payment arrangements to satisfy the liability based upon the IRS's determination of the minimal working capital needs of the business, and (2) remains current with payment and filing obligations.
- *Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure.*<sup>102</sup>
  1. Cap the civil FBAR penalty at the lesser of (a) ten percent of the unreported account balance or five percent for non-willful violations (similar to the IRS's mitigation guidelines), and (b) forty percent of the portion of any underpayment attributable to the improperly undisclosed accounts (similar to the penalty for undisclosed foreign financial assets (*e.g.*, assets not reported on Form 8938) under IRC § 6662(j)).<sup>103</sup>
  2. Eliminate or waive the civil penalty for failure to report an account on an FBAR if there is no evidence the account was used in connection with a crime and:<sup>104</sup>
    - a. The account information was already provided to the IRS, for example, on a Form 8938, *Statement of Specified Foreign Financial Assets*, or by a third party (*e.g.*, a financial institution or government);<sup>105</sup>

<sup>100</sup> H.R. 1661, 108th Cong. (2003) (introduced by Rep. Rangel) and H.R. 1528, 108th Cong. (2003) (introduced by Rep. Portman and passed/agreed to in Senate with amendment) included parts of this recommendation.

<sup>101</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 400-05.

<sup>102</sup> See Legislative Recommendation: FOREIGN ACCOUNT REPORTING: *Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure, infra.* This recommendation also relates to the right to be informed, the right to pay no more than the correct amount of tax, the right to challenge the IRS's position and be heard, the right to appeal an IRS decision in an independent forum, and the right to confidentiality.

<sup>103</sup> To avoid stacking, only one penalty should apply to understatements of income from foreign financial assets not disclosed on either a Form 8938 or an FBAR.

<sup>104</sup> Under this recommendation, the civil FBAR penalty could still be waived on the basis of reasonable cause as is the case under current law.

<sup>105</sup> Because the Financial Crimes Enforcement Network (FinCEN) may not be authorized to receive all of the account information provided to the IRS by third parties, it may be advisable for legislation to distinguish between information available to the IRS and information available to FinCEN. An alternative would be to have the disclosure of account information to the IRS by third parties create a presumption that, in the absence of evidence to the contrary, a taxpayer's failure to provide the same information was due to reasonable cause and was not willful.

- b. The amount of unreported income from the account does not create a substantial understatement under IRC § 6662(d);<sup>106</sup> or
  - c. The taxpayer resides in the same jurisdiction as the account.
3. Clarify that the government has the burden to establish actual willfulness (*i.e.*, specific intent to violate a known legal duty, rather than mere negligence or recklessness) before asserting a willful FBAR penalty, and cannot meet this burden by relying solely on circumstantial evidence.<sup>107</sup>
  4. Authorize the IRS to modify closing agreements with the taxpayer's consent, particularly when necessary to promote equity or public policy (including consistency). The National Taxpayer Advocate also recommends directing the IRS to use this authority to amend offshore voluntary disclosure closing agreements to make them consistent with the terms of agreements publicly offered to similarly-situated taxpayers in subsequent IRS programs.
  5. Align the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). Specifically, increase the \$10,000 FBAR filing threshold to match the threshold applicable to Form 8938 (*i.e.*, at least \$50,000), adjust it for inflation, and change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938 (including extensions). If Congress aligns these due dates and thresholds, it should also consider requiring the Treasury Department to consolidate the reporting of foreign accounts (*i.e.*, the FBAR and Form 8938) so that taxpayers only have to report them on one form. To facilitate this change, legislation should clarify that the IRS may disclose certain account information to FinCEN without violating IRC § 6103. The legislation should require the IRS to highlight (on the new form) any information not subject to the normal confidentiality rules (*e.g.*, because it is not part of the tax return).<sup>108</sup>

■ ***MANAGERIAL APPROVAL: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence under IRC § 6662(b)(1).***<sup>109</sup> Amend IRC § 6751(b)(2)(B) to require written managerial approval prior to assessment of the accuracy-related penalty imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations under IRC § 6662(b)(1), and specify which penalties and facts or circumstances result in penalties "automatically calculated through electronic means."

<sup>106</sup> Even if the understatement is substantial, legislation could require the government to consider whether it was reasonable for the taxpayer to believe that any unreported income would be offset by foreign tax credits in connection with its reasonable cause determination.

<sup>107</sup> Under current law, the government is only required to establish willfulness by a preponderance of the evidence. See, *e.g.*, *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012) (applying the "preponderance" standard, rather than "clear and convincing," or "beyond a reasonable doubt").

<sup>108</sup> Congress might also clarify that taxpayers not otherwise required to file a tax return could, nonetheless, use the same form to satisfy their reporting obligations under the Bank Secrecy Act.

<sup>109</sup> See Legislative Recommendation: ***MANAGERIAL APPROVAL: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence under IRC § 6662(b)(1), infra.*** This recommendation also relates to the *right to quality service* and the *right to pay no more than the correct amount of tax*.

- ***ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit “Reasonable Cause” Relief.***<sup>110</sup>  
To allow for consideration of taxpayers’ facts and circumstances before imposing a penalty for erroneously claiming a credit or refund, the National Taxpayer Advocate recommends that Congress amend IRC § 6676 to permit relief from the penalty for individual taxpayers who acted with reasonable cause and in good faith.
- ***Small Business Burdens – Payroll Deposit Tax Penalties.***<sup>111</sup> Amend IRC § 6656 to clarify that: (1) the reasonable cause exception to the Federal Tax Deposit (FTD) penalty shall specifically apply to instances where a taxpayer has made a timely deposit, but failed to make the deposit in the prescribed manner and such failure was not due to willful neglect; and (2) in no circumstance shall the FTD penalty exceed two percent of the underpayment amount when a taxpayer has made a timely deposit, but failed only to make the deposit in the prescribed manner.

### Recommendations Related to Collection

- ***Offers in Compromise: Effective Tax Administration.***<sup>112</sup>
  1. ***Equitable Considerations:*** The National Taxpayer Advocate recommends that the IRS be given more specific direction to compromise tax liabilities in cases where it is inequitable to collect them, notwithstanding the fact that such amounts are legally due pursuant to a technical application of the Code and not subject to abatement under other rules. Equitable consideration offers (ECOs) would replace equity/policy Effective Tax Administration offers as a basis for compromise.<sup>113</sup>
  2. ***Hardship Considerations:*** Add new paragraph 7122(c)(5) of the Code to read as follows: “RULES RELATING TO OFFERS BASED UPON HARSHSHIP. — Notwithstanding any other provision of this title, unless the taxpayer has a recent unexplained history of noncompliance with tax filing or payment obligations, the Secretary may compromise

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<sup>110</sup> See Legislative Recommendation: *ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit “Reasonable Cause” Relief, infra*. See also National Taxpayer Advocate 2011 Annual Report to Congress 544-47 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*). This recommendation also relates to the right to challenge the IRS’s position and be heard.

<sup>111</sup> See National Taxpayer Advocate 2004 Annual Report to Congress 400. See also National Taxpayer Advocate 2001 Annual Report to Congress 222 (Legislative Recommendation: *Federal Tax Deposit (FTD) Avoidance Penalty*). Numerous bills included part of this recommendation. See, e.g., S. 1321, 109th Cong. (2005) (introduced by Senator Santorum); H.R. 1661, 108th Cong. (2003) (introduced by Rep. Rangel); H.R. 1528, 108th Cong. (2003) (introduced by Rep. Portman and passed/agreed to in Senate with amendment).

<sup>112</sup> See National Taxpayer Advocate 2004 Annual Report to Congress 433-50.

<sup>113</sup> The National Taxpayer Advocate recommended specific language as follows: Add new paragraph 7122(c)(4) of the Code to read as follows: “SPECIAL RULES RELATING TO OFFERS BASED UPON EQUITABLE CONSIDERATIONS. — Notwithstanding any other provision of this title, the Secretary shall compromise a liability when it is inequitable to collect any unpaid tax (or any portion thereof, including penalties and interest). (A) It shall be deemed inequitable to collect an income tax liability in excess of the economic benefit received from the transaction to which the liability relates. For purposes of this section, a transaction shall include all related transactions. (B) In other cases, the Secretary shall consider all of the facts and circumstances, including: i. whether the taxpayer acted reasonably and in good faith under the circumstances, such as, by taking reasonable actions to avoid or mitigate the situation; ii. whether an income tax liability is disproportionate to (even if not in excess of) the economic benefit received from the transaction to which the liability relates; iii. whether the taxpayer is a victim of a third-party bad act or other unexpected event; iv. whether the taxpayer has a recent history of compliance with tax filing and payment obligations or a reasonable explanation for noncompliance; v. whether any IRS employee has not followed standard procedures in connection with the case, including applicable published administrative guidance (such as the Internal Revenue Manual); vi. whether IRS action or inaction has unreasonably delayed resolution of the taxpayer’s case; and vii. any other relevant fact or circumstance indicating that justice, equity, or public policy justifies the compromise. No single fact or circumstance described in clause (i)-(vii), above, shall be determinative of whether to compromise a liability under subparagraph (B). This determination shall be made without regard to the taxpayer’s ability to fully pay the liability. Compromises under this paragraph 7122(c)(4) may require appropriate adjustments to basis, carryovers, or other tax attributes.

a liability if collection of unpaid tax (or any portion thereof, including penalties and interest) would cause a hardship for the taxpayer or for a third party, without regard to whether the taxpayer is a person or an entity. This determination shall be made without regard to the taxpayer's ability to fully pay the liability."

3. *Offer Processing Order:* Add new sub-paragraph 7122(c)(3)(C) of the Code to read as follows: "in the case of an offer in compromise submitted on more than one basis, the Secretary shall evaluate the taxpayer's bases for compromise in the order indicated by the taxpayer, and the Secretary's decision to compromise on one basis shall not depend on whether the Secretary would be willing to compromise on another basis; and".

- *Improve Offer in Compromise Program Accessibility.*<sup>114</sup> Modify IRC § 7122(c) so that taxpayers are not required to include a partial payment with "lump-sum" offer applications. Alternatively, modify the offer in compromise (OIC) rules as follows:

1. Provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an OIC before or after accepting it for processing. The IRS could use the existing Collection Appeals Process, which allows it to review appeals in just five days.
2. Provide an exception to the partial payment requirement for taxpayers who do not have immediate access to current income and liquid assets that could be used to fund an offer without incurring significant costs (e.g., taxable income or penalties resulting from the withdrawal of assets from a qualified retirement plan). For those taxpayers who have immediate access to such funds, the partial payment requirement should be 20 percent (for lump-sum offers) of any current income and liquid assets that could be disposed of immediately without significant cost.
3. Apply the low income exception in cases where payment of the combined OIC user fee and partial payment (or borrowing for such payments) would cause an economic hardship.

- *Waiver of Installment Agreement Fees for Low Income Taxpayers.*<sup>115</sup> Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.

- *Return of Levy or Sale Proceeds.*<sup>116</sup>

1. Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment will also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.

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<sup>114</sup> See National Taxpayer Advocate 2006 Annual Report to Congress 507-19. H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); S. 1289, 112th Cong. (2011) (introduced by Senator Carper); H.R. 4994, 111th Cong. (2010) (introduced by Rep. Lewis); H.R. 2342, 111th Cong. (2009) (introduced by Rep. Lewis), included parts of this recommendation.

<sup>115</sup> See National Taxpayer Advocate 2006 Annual Report to Congress 141-56 (Most Serious Problems). H.R. 4375, 112th Cong. (2012) (introduced by Rep. Johnson); S. 2291, 112th Cong. (2012) (introduced by Senator Cornyn) included parts of the recommendation.

<sup>116</sup> See National Taxpayer Advocate 2001 Annual Report to Congress 202-09. There have been numerous bills introduced in the House of Representatives and Senate that include parts of this recommendation. See, e.g., H.R. 5719, 110th Cong. (2008) (introduced by Rep. Rangel), and S. 882, 108th Cong. (2003) (introduced by Senator Baucus and incorporated in H.R. 1528 through an amendment, which passed in lieu of S. 882) (including the requirement to reinstate retirement accounts).

2. Amend IRC §§ 6532(c)(1) and (2) to extend the period of time within which a suit or proceeding under IRC § 7426 shall begin from nine months to two years from the date of levy or agreement giving rise to such action.<sup>117</sup>
3. Amend IRC § 6343(d) to extend the period of time within which a taxpayer shall request a return of levied funds or the proceeds from the sale of levied property to a period of four years from the date of levy or sale of the levied property where the IRS's action with regard to that levy was in reckless or flagrant disregard of established IRS rules, procedures, or regulations and the taxpayer incurred significant harm as a result of that action. Interest shall be allowed and paid with respect to such levies as permitted under IRC § 6343(c).
4. Amend the following code sections to authorize reinstatement of funds to retirement accounts and other pension plans where the IRS levied upon the plans in error or in flagrant disregard of established IRS rules, procedures, or regulations and the funds were returned under IRC § 6343(d): (1) § 401 Qualified Pension, Profit Sharing, Keogh and Stock Bonus Plans; (2) § 408 Individual Retirement Account, SEP-Individual Retirement Account; and (3) § 408A Roth Individual Retirement Account. Further, amend these code sections to provide that the IRS shall abate all tax and interest assessed as a result of the levy.

■ *Amend IRC § 6343(a) to Permit the IRS to Release Levies that Impose Economic Hardship on Business Taxpayers.*<sup>118</sup> Amend IRC § 6343(a)(1)(d) to: (1) permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business; and (2) require the IRS, in making the determination to release a levy against a business on economic hardship grounds, to consider the economic viability of the business, the nature and extent of the hardship (including whether the taxpayer exercised ordinary business care and prudence), and the potential harm to individuals if the business is liquidated, as well as whether the taxes could be collected from a responsible person under an IRC § 6672 Trust Fund Recovery Penalty (TFRP) assessment.

■ *Levy on Mutual Funds, including Money Market Funds.*<sup>119</sup> Amend IRC § 6332 to include a new paragraph (d) to read: "Special Rule for agent of mutual funds, including money market funds. Any agent for a mutual fund including money market funds shall dispose of sufficient shares at market value to satisfy the amount due on such levy up to the market value of share owned by the person against whom the tax is assessed."

<sup>117</sup> Under IRC § 7426, any person (other than the taxpayer) who claims the IRS wrongfully levied upon property he or she has an interest in or lien on, to satisfy the tax liability of another, may file a wrongful levy suit against the United States in federal district court.

<sup>118</sup> See National Taxpayer Advocate 2011 Annual Report to Congress 537-43. This recommendation also relates to the *right to privacy*. H.R. 4368, 112th Cong. (2012) (introduced by Rep. McDermott) included part of this recommendation.

<sup>119</sup> See National Taxpayer Advocate 2002 Annual Report to Congress 247.

■ *Strengthening Taxpayer Protections in the Filing and Reporting of Federal Tax Liens.*<sup>120</sup> Amend the Code to:

1. Require that prior to filing a Notice of Federal Tax Lien (NFTL), the IRS must review the taxpayer's information (including IRS and available third party information) concerning the taxpayer's assets, income, and the value of the equity in the assets; and make a determination, weighing all facts and circumstances, that (1) the NFTL will attach to property, and (2) that the benefit to the government of the NFTL filing outweighs the harm to the taxpayer and that the NFTL filing will not jeopardize the taxpayer's ability to comply with the tax laws in the future.
2. Allow a taxpayer to appeal any lien filing determination to the IRS Office of Appeals before the NFTL is filed. The IRS must notify taxpayers of their right to have an appeals officer review an NFTL determination.
3. Explicitly provide under IRC § 7432 for civil damages for improper NFTL filing or failure to make the required NFTL determination described above.
4. Clarify that under IRC § 7433, a taxpayer may bring an action for improper lien filing or failure to make the required lien determination described above.
5. Amend § 605(a)(3) of the Fair Credit Reporting Act to:
  - a. Require removal of derogatory lien filing information from credit reports six years from the "refile by" date on the lien unless the lien is refiled.
  - b. Require immediate removal of derogatory lien filing information from credit reports if the lien is released within two years from the date of filing.
  - c. Require removal of derogatory lien filing information from credit reports within two years from the date of release if released more than two years from the date of the NFTL filing.
  - d. Require immediate removal of all information about the NFTL filing if the IRS withdraws such a notice under IRC § 6323(j).

■ *MANAGERIAL APPROVAL FOR LIENS: Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations.*<sup>121</sup>

1. Codify § 3421 of RRA 98 to require IRS employees to obtain managerial approval prior to filing an NFTL where it is likely that the NFTL will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax, including the following three categories: (1) the taxpayer's income falls below 250 percent of the federal poverty level; (2) the taxpayer's account has been placed in currently not collectible status due to economic hardship; or (3) the taxpayer has entered into an installment agreement (IA) with the IRS.

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<sup>120</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 357-64. H.R. 6050, 112th Cong. (2012) (introduced by Rep. Becerra); S. 3355, 112th Cong. (2012) (introduced by Senator Bingaman); H.R. 6439, 111th Cong. (2010) (introduced by Rep. Hasting); H.R. 5047, 111th Cong. (2010) (introduced by Rep. Becerra); and S. 3215, 111th Cong. (2010) (introduced by Senator Bingaman) included parts of this recommendation.

<sup>121</sup> See Legislative Recommendation: *MANAGERIAL APPROVAL FOR LIENS: Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations, infra.* This recommendation also relates to the right to privacy.

2. Require the IRS supervisor, as part of the managerial approval process, to consider the following: (1) whether the NFLT would attach to property; (2) whether the benefit of filing an NFLT for the government would outweigh the harm to the taxpayer; and (3) whether the NFLT filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.
3. Require the IRS to take disciplinary action against employees who fail to secure managerial approval prior to filing an NFLT in the situations required by law.

- *Repeal Private Debt Collection (PDC) Practices.*<sup>122</sup> Repeal IRC § 6306, thereby terminating the PDC initiative.
- *Eliminate the Suspension of the Collection Statute During Qualified Hospitalization Resulting from Service in a Combat Zone.*<sup>123</sup> Amend IRC § 7508(a) to eliminate the suspension of the collection statute during any period of qualified hospitalization after service in a combat zone or performance of combatant activities in a contingency operation.

### Additional Recommendations

- *Direct Deposit of Income Tax Refunds.*<sup>124</sup> Amend the Code to create a process through which the IRS and financial institutions work together to identify the incorrect recipient of a direct deposit refund and request the return of the improperly deposited funds. The Right to Financial Privacy Act, 12 U.S.C. § 3401 *et seq.*, prohibits financial institutions from releasing financial records except under limited circumstances. 12 U.S.C. § 3413(c) provides an exception to the financial disclosure rules, allowing for the sharing of financial records in accordance with procedures in the Code. The Code should be amended to establish a formal procedure through which the IRS can receive limited information about an account holder who receives a misdirected direct deposit refund. The information provided to the IRS would be limited to the account holder's name, Social Security number, and necessary contact information to allow the IRS to contact the account holder and attempt to recover the misdirected funds. The National Taxpayer Advocate further recommends that Congress amend Title 31, Money and Finance, of the current U.S. Code to treat misdirected direct deposit refunds in the same manner as checks. 31 U.S.C. § 3343 provides a fund for the replacement of checks that are lost, stolen, destroyed, or defaced. There is currently no similar provision available providing a fund for the replacement of direct deposit refunds misdirected as a result of fraud.
- *Expand Definition of Taxpayer Identification Number (TIN) to Include Internal Revenue Service Number (IRSN).*<sup>125</sup> Amend IRC §§ 151(e), 32(c)(1)(F), and 32(c)(3)(D) to require a taxpayer to provide a valid TIN or IRSN in order to claim an exemption and the Earned Income Tax Credit (EITC). This recommendation would enable an identity theft victim who files a tax return using an IRSN or similar replacement number to claim an exemption or the EITC.

<sup>122</sup> See National Taxpayer Advocate 2006 Annual Report to Congress 458-62. H.R. 5719, 111th Cong. (2009) (introduced by Rep. Lewis); H.R. 5719, 110th Cong. (2008) (introduced by Rep. Rangel); H.R. 695, 110th Cong. (2007) (introduced by Rep. Van Hollen); S. 335, 110th Cong. (2007) (introduced by Senator Dorgan); and H.R. 3056, 110th Cong. (2007) (introduced by Rep. Rangel and passed by the House) included this recommendation.

<sup>123</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 381-83.

<sup>124</sup> See National Taxpayer Advocate 2005 Annual Report to Congress 464-65.

<sup>125</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 545-46.

- *Broaden Relief from Timeframes for Filing a Claim for Refund for Taxpayers with Physical or Mental Impairments.*<sup>126</sup> Amend IRC § 6511(h)(2) to define a financially disabled individual as follows:
  1. First, replace the existing requirement that the individual impairment be medically determinable with a provision that it be determined by a qualified medical or mental health professional. For this purpose, Congress should specify that a qualified medical or mental health professional is an individual who is licensed by the state in which he or she practices to provide direct medical or mental health treatment to another individual.
  2. Second, replace the existing requirement that the impairment leaves the individual unable to manage his financial affairs with the requirement that the impairment materially limits the management of those affairs.
- *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income.*<sup>127</sup> Amend IRC §104(a)(2) to exclude from gross income payments received as settlement for mental anguish, emotional distress, and pain and suffering.
- *Provide a Uniform Definition of a Hardship Withdrawal from Qualified Retirement Plans.*<sup>128</sup> Establish uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged retirement plans and arrangements.
  1. Hardship withdrawals should be permitted when a participant is faced with an “unforeseeable emergency.” Examples of an unforeseeable emergency may include: (1) expenses for medical care incurred by the employee, the employee’s spouse or dependents; (2) payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence; (3) loss of property due to casualty; or (4) severe financial hardship resulting from an extended period of unemployment.
  2. Such hardship distributions be made exempt from the ten percent additional tax imposed by IRC § 72(t).
- *IRS Authority to Issue Refunds and Credits After Entry of Small Case Tax Court Decision.*<sup>129</sup> Amend IRC § 6512 to permit the IRS to issue refunds and credits after entry of a Tax Court decision and before it becomes final. This authority should be permissive rather than mandatory so that the IRS is not required to issue the refund or credit if it expects the decision to be vacated before it becomes final.
- *Allow Individual U.S. Taxpayers Residing Abroad the Option to Choose the Currency of Their Country of Residence as Their Functional Currency.*<sup>130</sup> Amend IRC § 985 to allow individual U.S. taxpayers residing abroad: (1) to adopt the local currency as their functional currency with respect to certain activities associated with their residence in a foreign country (e.g., activities of a qualified residence unit or QRU), giving individuals the flexibility currently extended to business taxpayers; and (2) to use an average exchange rate or other reasonable method of accounting to convert foreign currency into U.S. dollars in order to determine the individual’s

<sup>126</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 302-10.

<sup>127</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 351-56.

<sup>128</sup> See *id.* at 384-90.

<sup>129</sup> See National Taxpayer Advocate 2004 Annual Report to Congress 493.

<sup>130</sup> See National Taxpayer Advocate 2011 Annual Report to Congress 566-72.

taxable income and gain for taxpayers who do not adopt the QRU and have the U.S. dollar as their functional currency for the taxable year.

- *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes.*<sup>131</sup> Amend IRC § 7871(a) to include IRC § 23 in the list of Code sections for which a Native American tribal government is treated as a “State.” If a Native American tribal government is treated as a State for purposes of IRC § 23, its determination that a child has special needs would enable adoptive parents to claim the special needs adoption credit, provided that the other requirements of the Internal Revenue Code are met.
- *LATE-FILED RETURNS: Clarify § 523(a) of the Bankruptcy Code to Provide that a Late-Filed Tax Return May Be Considered a Return for Purposes of Obtaining a Bankruptcy Discharge.*<sup>132</sup> To address conflicting judicial interpretations as to whether the “applicable filing requirements” language in § 523(a) of the Bankruptcy Code imposes a timely filing requirement, the National Taxpayer Advocate recommends that Congress clarify this language to provide that a late-filed tax return may be considered a return for purposes of obtaining a bankruptcy discharge.

## Five Taxpayer Responsibilities<sup>133</sup>

### 1. The Responsibility to Be Honest

Taxpayers have the responsibility to be truthful in preparing their tax returns and in all other dealings with the IRS.

### 2. The Responsibility to Provide Accurate Information

Taxpayers have the responsibility to answer all relevant questions completely and honestly, to provide all required information on a timely basis, and to explain all relevant facts and circumstances when seeking guidance from the IRS.

### 3. The Responsibility to Keep Records

Taxpayers have the responsibility to maintain adequate books and records to fulfill their tax obligations, preserve them during the time they may be subject to IRS inspection, and provide the IRS with access to those books and records when asked so the IRS can examine their tax liabilities to the extent required by law.

### 4. The Responsibility to Pay Taxes on Time

Taxpayers have the responsibility to pay the full amount of taxes they owe by the due date and to pay any legally correct additional assessments in full. If they cannot pay in full, they have the responsibility to comply with all terms of any full or partial payment plans the IRS agrees to accept.

### 5. The Responsibility to Be Courteous

Taxpayers have the responsibility to treat IRS personnel politely and with respect.

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<sup>131</sup> See National Taxpayer Advocate 2012 Annual Report to Congress 521-25.

<sup>132</sup> See Legislative Recommendation: *LATE-FILED RETURNS: Clarify the Bankruptcy Law Relating to Obtaining a Discharge, infra.* This recommendation also relates to the *right to finality*.

<sup>133</sup> The IRS did not include a list of responsibilities when it adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

**LR  
#2**

## **ACCESS TO APPEALS: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico**

### **PROBLEM**

Committed to the principle that “all taxpayers should enjoy convenient access to Appeals, regardless of their locality,” Congress, as part of RRA 98, required the IRS to “ensure that an appeals officer is regularly available within each State.”<sup>1</sup> The IRS maintains that this mandate is met by Appeals Officers “riding circuit” (*i.e.*, traveling into the jurisdiction to meet with taxpayers in person) at least quarterly in states lacking a permanent Appeals presence.<sup>2</sup> However, circuit riding Appeals cases often take an additional six months or more to resolve and have significantly lower levels of agreement than face-to-face Appeals cases conducted in field offices.<sup>3</sup>

The number of states without a permanent Appeals office has risen by 33 percent, from nine to 12, since 2011.<sup>4</sup> Today, approximately a quarter of the states have no permanent Appeals presence. Taxpayers in those states may be forced to travel long distances, incur additional expenses, or face delays in obtaining an in-person hearing.<sup>5</sup> Even if they persevere and obtain a face-to-face hearing, their cases may be handled by an Appeals Officer or a Settlement Officer unfamiliar with the local economy or other relevant community issues.<sup>6</sup> Further, curtailed face-to-face conferences can make it more difficult for Appeals Officers to resolve cases and can cause taxpayers to question the independence and impartiality of Appeals.

Recently, in adopting the Taxpayer Bill of Rights (TBOR), the IRS reaffirmed its commitment to a number of related principles including *the right to appeal an IRS decision in an independent forum, the right to quality service, the right to challenge the IRS's position and be heard, and the right to a fair and just tax system.*<sup>7</sup> All of these fundamental rights, which also gave rise to RRA 98, are adversely affected when a face-to-face Appeals conference is not readily and conveniently available.

1 S. Rep. No. 105-174, at 92 (1998); The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465(b), (1998).

2 *The U.S. – China Economic Relationship: A New Approach For a New China, Hearing Before the S. Comm. on Finance*, 111th Cong., 69-70 (2010) (testimony of Timothy F. Geithner, Sec. of Treasury). See also National Taxpayer Advocate 2009 Annual Report to Congress 81.

3 Appeals response to TAS information request (Aug. 5, 2014); supplemented by fiscal year (FY) 2014 data provided by Appeals on November 6, 2014. For a more in-depth discussion of the Appeals presence issue, see Most Serious Problem: APPEALS: *The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *supra*.

4 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014). The territory of Puerto Rico has also lacked a permanent Appeals office during this time.

5 See National Taxpayer Advocate 2009 Annual Report to Congress 346-350. See also *Hearing on Filing Season 2012, Hearing Before the S. Comm. on Finance*, 112th Cong. 3-12 (2012)(testimony of Teresa Thompson, Local Taxpayer Advocate, MT).

6 National Taxpayer Advocate 2009 Annual Report to Congress 76.

7 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

## EXAMPLE

A taxpayer lives in rural Montana and operates a small livestock ranch. The IRS audits the taxpayer and proposes an adjustment with which he disagrees. The taxpayer files a protest with the IRS Office of Appeals and requests an in-person conference, believing this direct contact to be essential, as the issue in controversy is factually difficult and legally complex.

Appeals does not maintain a field office in Montana. As a result, the taxpayer's request for a face-to-face conference goes to an Appeals Officer in Washington State. This assignment of the case worries the taxpayer who doubts that the Appeals Officer based in Washington will have adequate knowledge of market forces, weather conditions, and other ranching issues that are central to the tax dispute.

In addition to this concern, the taxpayer cannot afford transportation to Washington State. As a result, his remaining options are to wait for an Appeals Officer to ride circuit, which can substantially extend the length of the Appeals process, or to forgo a face-to-face conference. Wishing for a timely resolution of the tax controversy, the taxpayer reluctantly decides to proceed with the appeal, communicating with the Appeals Officer by telephone and correspondence.

Ultimately, the taxpayer and the Appeals Officer cannot reach an agreement. The taxpayer believes the presentation of his case has been prejudiced by the lack of a readily available Appeals Officer who understands ranching issues, and feels he has been denied access to justice. The taxpayer, therefore, seeks judicial review as a means of resolving the tax controversy that, in his view, could have been properly addressed through a face-to-face meeting with a well-informed Appeals Officer possessing local background.

## RECOMMENDATION

To address the lack of convenient access to Appeals, the National Taxpayer Advocate recommends that Congress pass legislation to expressly require that Appeals have at least one Appeals Officer and Settlement Officer located and permanently available within every state, the District of Columbia, and Puerto Rico.

## PRESENT LAW

Section 3465(b) of RRA 98 provides "The Commissioner of Internal Revenue shall ensure that an appeals officer is regularly available within each State."<sup>8</sup> As expressed by Senator Roth at the time RRA 98 was enacted:

With this legislation, we require the agency to establish an independent Office of Appeals—one that may not be influenced by tax collection employees or auditors. Appeals officers will be made available in every state, and they will be better able to work with taxpayers who proceed through the appeals process.<sup>9</sup>

<sup>8</sup> RRA 98, Pub. L. No. 105-206, § 3465(b), 112 Stat. 685 (1998).

<sup>9</sup> 144 CONG. REC. S7622 (1998) (Statement of Sen. Roth).

## REASONS FOR CHANGE

The IRS does not dispute that it is subject to § 3465(b) of RRA 98. Instead, the IRS argues that it meets its obligations by allowing for “circuit riding” on at least a quarterly basis to states lacking a permanent Appeals field office.<sup>10</sup>

Circuit riding, however, existed prior to the passage of RRA 98.<sup>11</sup> Nevertheless, Congress felt compelled to require that Appeals Officers be made regularly available in *all* states. Unlike some other aspects of RRA § 3465, which the legislative history explained as a codification of existing IRS procedures, the “regularly available within each State” mandate was presented as a new requirement.<sup>12</sup> Despite this legislative indication that Congress desired more convenient access and local presence than was being supplied by circuit riding, the IRS has expanded the number of states without an Appeals Officer or Settlement Officer, and has continued to maintain that circuit riding alone fulfills its post-RRA 98 obligations.

In practice, however, many taxpayers are experiencing limitations on their ability to have an in-person Appeals conference. The number of states and territories in which Appeals lacks both an Appeals Officer and a Settlement Officer has grown by 33 percent since 2011. Twelve states and Puerto Rico have no Appeals or Settlement Officers with a post of duty within their borders.<sup>13</sup> Further, the overall number of Appeals conferences held via circuit riding has progressively fallen over each of the last four years.<sup>14</sup>

The National Taxpayer Advocate is concerned that this decreasing trend in the number of circuit riding cases, and the isolation it portends for states without an Appeals presence, is not the result of taxpayer choice. Rather, it is effectively imposed on taxpayers by the expansion of states without a permanent Appeals office and by the diminishing availability of Appeals personnel who can ride circuit.

Available evidence indicates that the lack of face-to-face access to Appeals in all states is harmful to impacted taxpayers. The ability, or lack thereof, to interact on a face-to-face basis with the IRS has a significant effect on taxpayer perceptions and satisfaction. For example, an IRS survey has indicated that overall satisfaction with face-to-face examinations is much higher (71 percent) than for correspondence examinations (43 percent).<sup>15</sup> Similarly, overall dissatisfaction is more than twice as great for correspondence examinations (41 percent) than for face-to-face examinations (18 percent).<sup>16</sup>

Further, taxpayers forced to rely on circuit riding in order to obtain a face-to-face Appeals conference often must wait an additional 6 months or more to resolve their Appeals case as compared with taxpayers fortunate enough to live near an Appeals office.<sup>17</sup> Moreover, circuit riding Appeals conferences have

<sup>10</sup> National Taxpayer Advocate 2009 Annual Report to Congress 81; IRM 8.6.1.4.1.1 (June 8, 2010).

<sup>11</sup> IRM 8622 (Apr. 20, 1990).

<sup>12</sup> S. REP. NO. 105-174, at 88 (1998).

<sup>13</sup> IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014).

<sup>14</sup> Appeals does not report circuit riding data on a state-by-state basis. Appeals response to TAS information request (Aug. 5, 2014). Note that circuit riding can occur in rural areas of states that have permanent Appeals offices. Moreover, taxpayers in some states lacking a permanent Appeals presence occasionally have convenient access to a field office in a nearby state. Additionally, circuit riding can occur for reasons unrelated to geography, such as substantial books and records, high inventories, or lack of technical expertise. See IRM 8.6.1.4.1.1 (June 8, 2010). Nevertheless, in the absence of more targeted data from the IRS, analysis of circuit riding data provides the clearest insight into the status of taxpayers residing in states without a regular Appeals presence.

<sup>15</sup> IRS, National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012).

<sup>16</sup> *Id.*

<sup>17</sup> Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014.

significantly higher levels of disagreement between taxpayers and the IRS, and generate substantially lower levels of agreement than face-to-face Appeals conferences conducted in field offices.<sup>18</sup>

This evidence indicates that taxpayers located in states without a permanent Appeals presence are being inadequately served and may lack access to justice. Further, it casts doubt on the effectiveness and equity of circuit riding even when employed by the IRS in states possessing permanent Appeals field offices. Circuit riding Appeals Officers and Settlement Officers do not have the familiarity with the economic, market, geographic, and other state and local conditions necessary to adequately assess the import of facts and circumstances and the credibility of witnesses as a means of fairly and efficiently resolving cases.

## EXPLANATION OF RECOMMENDATION

As part of the fiscal year 2011 Senate Budget Resolution, Senator Enzi introduced legislation requiring redeployment of existing IRS resources “to provide at least one full-time Internal Revenue Service appeals officer and one full-time settlement agent in every State.”<sup>19</sup> Ultimately, the Budget Resolution that included Senator Enzi’s amendment was never acted upon by Congress. Nevertheless, the taxpayer service concerns giving rise to this legislation, and § 3465(b) of RRA 98, have not been remedied by the IRS.

Congress should address the lack of taxpayer access to Appeals in those jurisdictions without an Appeals field office by enacting legislation that expressly requires that at least one Appeals Officer and Settlement Officer be located and permanently available within every state, the District of Columbia, and Puerto Rico.<sup>20</sup> The IRS can achieve this expanded presence over time through attrition, rather than backfilling, of Appeals personnel currently located in IRS campus (centralized) Appeals offices.

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18 Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014. See also Most Serious Problem: APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State, *supra*.

19 See 116 CONG. REC. S2654 (2010) (statement of Sen. Enzi).

20 Although not a panacea, videoconferencing and other means of virtual service delivery represent a promising vehicle for the provision of virtual face-to-face access if properly developed, implemented, and deployed. For further discussion of this topic see 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, *supra*.

**LR****#3**

## **RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery**

### **PROBLEM**

Beginning in the 2014 filing season, the IRS eliminated tax return preparation services by IRS employees.<sup>1</sup> Low income, disabled, and elderly taxpayers were directed to use Free File or Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA/TCE) sites.<sup>2</sup> Taxpayers can no longer have a tax return prepared by an IRS employee, regardless of their income level or situation. The IRS's decision to cease free tax return preparation at Taxpayer Assistance Centers (TACs) raises the following concerns:

- Returns prepared by IRS employees were more accurate than other sources;<sup>3</sup>
- Other avenues for free return preparation, such as VITA/TCE sites, are limited with regard to the types and the scope of returns these sites can prepare compared to return preparation services previously offered at TACs;<sup>4</sup> and
- The IRS awarded seven fewer grants to VITA sites from FY 2013 to FY 2014 while the number remained the same for the TCE sites for the same period.<sup>5</sup>

Failing to provide return preparation by IRS employees undermines *the right to quality service* articulated in the recently adopted Taxpayer Bill of Rights.<sup>6</sup> Under *the right to quality service*, taxpayers are entitled to professional assistance from the IRS and to receive clear and easily understandable communications. By abandoning return preparation, the IRS has left vulnerable taxpayers to turn either to volunteer sites, who may not prepare the type of returns the taxpayers need, or to paid tax return preparers to prepare and

1 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

2 VITA/TCE sites provide free tax return preparation services for qualified individuals in conjunction with IRS assistance and direction. See IRS, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources*, available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources> (last visited Oct. 17, 2014); IRS, *Free File: Do Your Federal Taxes for Free*, available at <http://www.irs.gov/uac/Free-File:-Do-Your-Federal-Taxes-for-Free> (last visited Oct. 27, 2014). The income limitation on eligibility to use Free File changes each taxable year.

3 Generally, returns prepared by TACs, where the taxpayers have a household income of less than \$50,000 and do not use schedules E (*Supplemental Income and Loss*), or F (*Profit or Loss From Farming*), or Form 2106 (*Employee Business Expenses*), had lower Discriminant Function (DIF) scores than returns prepared by other preparers or by taxpayers, suggesting that TAC-prepared returns are less likely to understate the tax owed and are thus more accurate. Compliance Data Warehouse, *Individual Returns Transaction File: Tax Year 2010*. TAC criteria for return preparation include returns with income not in excess of \$50,000, and no schedules E, F, or Forms 2106, in addition to other requirements. The DIF score is an IRS calculated estimate of the likelihood that a tax return has understated the amount of tax owed, based on the type of return filed. The only returns that have lower DIF scores than TAC-prepared returns with the caveats listed above are those in Activity Code 272, which are returns with no Schedules C (*Profit or Loss from Business (Sole Proprietorship)*), E, F, or Form 2106 and no claiming of the Earned Income Tax Credit.

4 IRS, Publication 4012, *VITA/TCE Volunteer Resource Guide*, Scope of Service 8-10 (Oct. 2014). VITAs and TCEs generally cannot prepare IRS Form 1040 Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, complicated and advanced forms such as Schedule D, Capital Gains and Losses, and Schedule F, Profit or Loss From Farming, Form 3903, Moving Expenses, and others. Internal Revenue Manual (IRM) 22.30.1.3.10.2, after the IRM number then *Prior Year Return Preparation* (Oct. 1, 2014). Only experienced volunteer sites with the necessary software and reference materials may prepare prior year returns.

5 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014).

6 The IRS adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

file their returns, resulting in the taxpayer paying for an essential service that the government previously provided for free.

### EXAMPLE

A low income taxpayer resides in a rural area of a state. It is a one-hour drive to the closest TAC, where he has had his tax return prepared for years. The state does not have much coverage from the VITA program and the taxpayer does not qualify for TCE services. The closest VITA site to his home is hosted by a library three hours away. Since the TACs stopped preparing returns, the taxpayer stopped filing his returns. This year he decides to make the long trip to the VITA site. However, once he arrives, he finds out that VITA has no one volunteering that day who can prepare his past returns, and cannot help him with a cancellation of debt income issue. The taxpayer returns home and, because he does not feel competent to prepare his own return, seeks out a local preparer who charges a fee for return preparation that the taxpayer, in prior years, obtained for free.

### RECOMMENDATION

To provide taxpayers with access to IRS return preparation, the National Taxpayer Advocate recommends that Congress:

- Require the IRS to provide return preparation for vulnerable populations (including low income, disabled, and elderly taxpayers) in TACs and via virtual service delivery.
- Provide sufficient funding for IRS personnel to offer return preparation in TACs.

### PRESENT LAW

The IRS is not currently required to provide return preparation services in TACs or via virtual service delivery.

### REASONS FOR CHANGE

VITA and TCE sites provide a valuable service to vulnerable taxpayer populations, including low income, disabled, and the elderly; however, they are not a substitute for IRS return preparation services. Return preparation services offered by the IRS were more comprehensive than those currently available at VITA and TCE sites.<sup>7</sup> VITA and TCE sites are limited by the IRS guidelines for the types of returns they can prepare.<sup>8</sup> Generally, VITA and TCE sites cannot prepare an IRS Form 1040 with a Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, complicated and advanced forms such as Schedule D, *Capital Gains and Losses*, Schedule F, *Profit or Loss From Farming*, Form 3903, *Moving Expenses*, and certain Form 1099-C, *Cancellation of Debt* issues.<sup>9</sup>

<sup>7</sup> For a complete discussion of the National Taxpayer Advocate's concerns about VITA and TCE programs, see Most Serious Problem: *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*, *supra*.

<sup>8</sup> IRS, Publication 4012, *VITA/TCE Volunteer Resource Guide*, Scope of Service, 8-10 (Oct. 2014).

<sup>9</sup> *Id.*

In addition to return preparation services being limited in scope by IRS guidelines, services are limited by the certifications of the volunteers at the VITA/TCE sites, which can fluctuate.<sup>10</sup> The IRS offers both basic and advanced certifications to volunteers which determine what types of returns they can prepare.<sup>11</sup> The IRS also offers six specialty certifications, three of which can only be achieved by volunteers if they have first passed advanced certification.<sup>12</sup> If a taxpayer arrives at a VITA or TCE site and requires the preparation of a return that needs advanced certification or a specialty certification and no volunteers with that certification are available that day the taxpayer will be turned away. TACs could prepare a broader scope of forms and returns overall, and in earlier years allowed taxpayers to schedule appointments.

TACs could prepare current and prior year returns, as well as amended returns, until filing season 2013, when the IRS terminated the preparation of previous year returns and amended returns.<sup>13</sup> VITA and TCE sites can only prepare prior year returns at “experienced” sites if they have the necessary software and reference materials.<sup>14</sup> Leading up to the complete termination of return preparation services at TACs, the IRS made several changes to TAC return preparation, including eliminating appointments, reducing the number of days return preparation was available, and narrowing the scope of returns prepared. These service reductions led to a decrease in return preparation in TACs and have since been used to justify the discontinuance of the service entirely.<sup>15</sup>

In addition to the termination of return preparation at about 400 TACs, the number of VITA and TCE sites has decreased since the IRS ceased to offer this service, leaving nine percent fewer sites where taxpayers can seek free return preparation.<sup>16</sup> Overall, the number of returns prepared by the two programs increased by almost 12 percent between FY 2013 and FY 2104.<sup>17</sup> The IRS increased funding for the TCE sites while the number of returns prepared by these sites decreased for the first time since the program was created.<sup>18</sup> The shift of funding from VITA to TCE also decreased the dollar amount of matching funds dedicated to volunteer tax preparation by \$100,000 dollars, since TCE programs are not required to provide matching funds in return for their grants.<sup>19</sup> Moreover, since VITA programs actually increased the number of returns prepared in FY 2014 despite funding cuts, the IRS could have served more taxpayers by funding VITA programs at the FY 2013 level.<sup>20</sup> It is unclear to the National Taxpayer Advocate why the IRS chose to reduce resources available to VITA grantees and their beneficiaries, the taxpayer.

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10 Volunteers are only protected from liability by the Volunteer Protection Act of 1997, Pub. L. No. 105-19, 100 Stat. 218 (1997), if they follow all guidelines and limitations of the program as defined by the IRS. IRS, Publication 4012, *VITA/TCE Volunteer Resource Guide, Scope of Service*, 8 (Oct. 2014). If volunteers prepare returns or forms they are not certified to prepare, they are not protected from liability.

11 IRM 22.30.1.3.7.1, *Types of VITA and TCE Courses (Volunteers)* (Oct. 1, 2014).

12 *Id.*

13 IRS, *Field Assistance, FY 2013 Return Preparation in Taxpayer Assistance Centers*, Slide 5 (Jan. 17, 2013).

14 IRM 22.30.1.3.10.2, *Prior Year Return Preparation* (Oct. 1, 2014).

15 SERP Alert 12A0095 (Jan. 27, 2012).

16 IRS response to TAS research request (Aug. 15, 2014). In fiscal year (FY) 2013, the IRS had 398 TACs where taxpayers could potentially seek free return preparation if the sites were offering return preparation services in that FY. IRS response to TAS research request (Aug. 15, 2014). In FY 2013, 13,081 VITA and TCE sites offered free return preparation. Combined between TACs and VITA/TCE sites, potentially 13,479 sites offered free return preparation in 2013. IRS response to TAS research request (Nov. 26, 2014). Through June 29, 2014, free return preparation was offered at 12,319 VITA and TCE sites.

17 IRS response to TAS information request (Aug. 15, 2014). Supplemented by IRS response to TAS research request (Dec. 12, 2014).

18 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014).

19 IRS response to TAS information request (Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014).

20 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014). VITA grantees prepared 66,182 more returns in FY 2014 than in FY 2013 (1,419,615 vs. 1,353,433), while TCE grantees prepared 251,929 fewer returns over the same period (1,343,931 vs. 1,595,860).

Historically, returns prepared by TACs, where the taxpayers have a household income of less than \$50,000 and do not use schedules E or F or Form 2106, have lower Discriminant Function (DIF) scores than returns prepared by other preparers or self-prepared by taxpayers, suggesting that TAC-prepared returns are less likely to understate the tax owed and are thus more accurate.<sup>21</sup> Thus, TACs provided a wider scope of services than VITA and TCE sites and the returns prepared at TACs were more accurate.

By ceasing return preparation at the TACs, the IRS has made it more difficult for taxpayers to seek free return preparation and may cause taxpayers to not file returns or to seek assistance from paid preparers, decreasing filing compliance and imposing burden, including transportation costs and the costs of return preparation on predominantly low income, elderly, and disabled taxpayers, previously served by TACs. The IRS may leave these taxpayers with a choice of paying for a previously free service (if their returns are not covered within the scope of the services provided at the local VITA and TCE sites) or of simply ceasing to file returns. Some low income taxpayers who won't be able to prepare and file their returns will bypass credits and deductions they would be otherwise eligible for, such as the Earned Income Tax Credit (EITC)<sup>22</sup> and Child Tax Credit (CTC).<sup>23</sup>

In summary, failing to provide return preparation in TACs erodes several taxpayer rights, including *the right to be informed, the right to quality service, and the right to pay no more than the correct amount of tax*.

## EXPLANATION OF RECOMMENDATION

The IRS currently maintains 382 TACs, down from 401 in 2011 when it began making adjustments to return preparation services offered by TACs.<sup>24</sup> Since the IRS continues to close TACs or effectively close them by reducing staff to one or zero employees, requiring the IRS to provide return preparation in just TAC locations will not restore taxpayer access to return preparation. However, the IRS has been piloting the use of virtual service delivery and has established 49 virtual service sites across the country.<sup>25</sup> Return preparation offered through both virtual service sites and the remaining TAC locations would improve service to taxpayers and reduce taxpayer burden. While the IRS must continue to improve the technology available for virtual services and to develop a strategic plan to bring additional virtual service sites on line, using existing sites to provide return preparation, in concert with the TACs, will allow the IRS to reach additional taxpayers.<sup>26</sup>

21 Compliance Data Warehouse, *Individual Returns Transaction File: Tax Year 2010*. TAC criteria for return preparation include returns with income not in excess of \$50,000, and no schedules E, F, or Forms 2106, in addition to other requirements. The DIF score is an IRS calculated estimate of the likelihood that a tax return has understated the amount of tax owed, based on the type of return filed. The only returns that have lower DIF scores than TAC-prepared returns with the caveats listed above are those in Activity Code 272, which are returns with no Schedules C, E, F, or Form 2106 and no claiming of the Earned Income Tax Credit.

22 IRC § 32.

23 IRC § 24.

24 IRS response to TAS research request (Dec. 23, 2014). At the end of FY 2014, there were 382 open TACs.

25 Network Services response to TAS research request (Aug. 6, 2014). See, e.g., FL-2012-06, *Tax Help for Tampa Area Taxpayers* (May 10, 2012) (Virtual Service Delivery for taxpayers to interact with TAS); Interim Guidance Memorandum AP-08-0714-0007, *Implementation of Virtual Service Delivery (VSD)* (July 24, 2014) (Virtual Service Delivery teleconferencing in Campus Appeals).

26 For a complete discussion of the National Taxpayer Advocate's concerns regarding the IRS's implementation of virtual service delivery, see 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*, *supra*.

Since 2011, the IRS chipped away at the return preparation services provided in the TACs; however, it has not remedied this through other service avenues such as VITAs and TCEs which cannot currently provide the same level or type of service to taxpayers. The National Taxpayer Advocate recommends that Congress remedy this situation by requiring the IRS to provide return preparation in TACs and via virtual service delivery and by providing the funding to allow the IRS to fulfill this mandate.

**LR  
#4**

## **VIRTUAL SERVICE DELIVERY (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet**

### **PROBLEM**

In the deliberations leading to passage of the IRS Restructuring and Reform Act of 1998 (RRA 98), both the National Commission on Restructuring the IRS (Restructuring Commission) and Congress articulated a vision of the IRS operating as a business that used cutting-edge computer technology to increase accountability and improve taxpayer service.<sup>1</sup> Taxpayers are ready to embrace this technology.<sup>2</sup> The Social Security Administration (SSA) and the Department of Veterans Affairs (VA) have made extensive use of VSD to increase the accessibility and availability of their services.<sup>3</sup> Nevertheless, despite the vision of the Restructuring Commission and Congress, the openness of taxpayers to embrace computer technology, and the successes of other agencies, the IRS is still operating as a 20<sup>th</sup> century business, primarily relying on postal correspondence, telephone conversations, and taxpayer visits to brick and mortar locations.<sup>4</sup>

VSD in brick and mortar locations, such as Taxpayer Assistance Centers (TACs), allows taxpayers virtual face-to-face (VFTF) access to the IRS, and is particularly important for taxpayers who live in rural areas or who lack their own computer technology or proficiency in its use.<sup>5</sup> However, only 49 facilities currently provide VSD and the IRS has allocated no additional funding to expand this capacity.<sup>6</sup> Mobile tax assistance units, none of which are currently employed by the IRS, could also be equipped with VSD technology to bring VSD to strategic locations and needy populations.

Further, the provision of VSD over the Internet using taxpayer digital communications (TDC), which has the potential to revolutionize tax administration, is still in its conceptual stages.<sup>7</sup> This halting development of VSD in its various manifestations often has the effect of preventing taxpayers from face-to-face interactions with the IRS, which inhibits crucial communication and thereby infringes on *the right to quality service*, one of the core elements of the Taxpayer Bill of Rights (TBOR), recently adopted by the IRS.<sup>8</sup>

1 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 6-8 (June 25, 1997); 144 Cong. Rec. S4182.

2 IRS Oversight Board, 2013 Taxpayer Attitude Survey, (conducted August 2013), available at [http://www.treasury.gov/IRSOB/reports/Documents/IRSOB\\_TAS%202013.pdf](http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_TAS%202013.pdf) (last visited Aug. 25, 2014).

3 For a more in-depth discussion of this topic and for expanded analysis of the problem addressed by this legislative recommendation, see 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*, *supra*.

4 The exception to this circumstance is electronic filing of tax returns, the prevalence of which can be directly traced to the congressional mandate established in RRA 98. See Pub. L. No. 105-206, § 2001, 112 Stat. 685, 723 (1998).

5 See 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*, *supra*.

6 User & Network Services (Network Services) response to TAS research request (Aug. 6, 2014).

7 IRS Online Services (OLS) response to TAS research request (Aug. 18, 2014).

8 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

## EXAMPLE<sup>9</sup>

A taxpayer who lives in a rural area is the subject of a correspondence audit that raises substantiation questions and legal issues.<sup>10</sup> The taxpayer wishes to have a face-to-face meeting with the IRS agent to properly present his factual information and best explain his overall tax position. The taxpayer has a good deal of documentation, and is willing to obtain more, but is unsure what the IRS requires or would accept as substantiation for his claim.

The IRS does not maintain an office in the taxpayer's vicinity. Moreover, although the taxpayer's local community has a TAC and other public buildings such as a post office and a library, none of these sites are outfitted with videoconferencing equipment.

Because no VSD technology is available to offer a VFTF conference, the taxpayer must either travel to meet with the IRS agent, which the taxpayer cannot afford, or allow the audit to move forward without the desired face-to-face contact. Seeing no alternative, the taxpayer proceeds with the audit, communicating with the IRS solely by mail and telephone, and speaking with numerous employees.

At the conclusion of the audit, the IRS proposes a substantial income adjustment resulting in tax deficiencies and accompanying penalties. The taxpayer, frustrated and disappointed with the process as well as the outcome, walks away from the experience feeling as though he was never able to adequately convey the nuances of his facts and tax position without the ability to interact with a single IRS agent face-to-face.

## RECOMMENDATION

To address the need for enhanced and expanded virtual service delivery, the National Taxpayer Advocate recommends that Congress pass legislation to:

1. Establish targets and timelines for development and implementation of VSD in brick and mortar locations, including non-IRS facilities, in mobile tax assistance units, and via TDC over the Internet.
2. Provide funding, or require the IRS to allocate funding, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations, in mobile tax assistance units, and over the Internet.

<sup>9</sup> For a similar example relating to the lack of access to a face-to-face Appeals conference, see Legislative Recommendation: *ACCESS TO APPEALS: Require that Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, infra/supra*. See also Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State, supra*.

<sup>10</sup> Correspondence examinations are centralized and automated in large IRS campuses. These examinations use batch processing, which automates the initiation, processing, and closing of correspondence examination cases. See NTA Blog: *Are IRS Correspondence Audits Really Less Burdensome for Taxpayers?* (Mar. 13, 2012), available at <http://www.taxpayeradvocate.irs.gov/Blog/are-irs-correspondence-audits-really-less-burdensome-for-taxpayers>.

## PRESENT LAW

Section 3465(b) of RRA 98 provides “The Commissioner of Internal Revenue shall ensure that an appeals officer is regularly available within each State.”<sup>11</sup> Congress, however, recognizing that this physical presence alone may not be sufficient to meet taxpayer demand and wishing more generally to help the IRS develop the tools to function as a 21<sup>st</sup> century business, also passed § 3465(c). That section directs the IRS to “consider the use of the videoconferencing of appeals conferences between appeals officers and taxpayers seeking appeals in rural or remote areas.”<sup>12</sup>

In passing RRA 98, Congress urged the IRS to adopt a course of action that likely would have generated substantial progress in the use of VSD to improve customer service. Although Congress called for the IRS to explore VSD in the context of Appeals, technological innovation on that front presumably would have migrated to other IRS divisions. More than 15 years after the enactment of RRA 98, however, the desire reflected in and the opportunity presented by Congress’ videoconferencing directive have yet to be achieved.

## REASONS FOR CHANGE

The IRS has ample evidence to indicate that taxpayers generally favor the use of VSD. In a limited pilot conducted by the Wage & Investment (W&I) division of the IRS between October 2011 and June 2012, 87 percent of taxpayers reported they were satisfied with the services provided, and 91 percent would use VSD again.<sup>13</sup> Similarly, 83 percent of taxpayers responding to a study conducted by the IRS Oversight Board indicated they were likely to use the IRS website, while 72 percent said they were likely to use email to send questions to the IRS.<sup>14</sup>

As models for the successful implementation of VSD, the IRS can look to the SSA, which in 2012 held over 25 percent of its hearings by video, and the VA, which operates over 700 sites with videoconferencing capacity for veterans who lack easy access to VA hospitals.<sup>15</sup> Effective use of such technology would allow the IRS to deliver services outside of IRS facilities, enhance utilization of IRS resources, optimize staffing, balance workload, and increase taxpayer access to face-to-face services.<sup>16</sup>

Despite the acknowledged benefits of VSD, however, and the express urging of Congress over 15 years ago, the IRS has made only limited progress toward developing and implementing such technology. The IRS appears to have no current intention of expanding VSD in brick and mortar locations.<sup>17</sup> This decision would fall disproportionately hard on low income and elderly taxpayers, who are the most likely

<sup>11</sup> Pub. L. No. 105-206, § 3465(b), 112 Stat. 685, 768 (1998). For a discussion of RRA § 3465(b), see Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *infra/supra*; Legislative Recommendation: *ACCESS TO APPEALS: Require that Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico*, *infra/supra*.

<sup>12</sup> Pub. L. No. 105-206, § 3465(c), 112 Stat. 685, 768 (1998). See also 144 Cong. Rec. S4182.

<sup>13</sup> E.g., in a limited pilot conducted by W&I between October 2011 and June 2012, 87 percent of taxpayers reported they were satisfied, to very satisfied, with this service, and 91 percent would use it again. W&I response to TAS fact check request (Nov. 4, 2014).

<sup>14</sup> IRS Oversight Board, 2013 Taxpayer Attitude Study, available at [http://www.treasury.gov/IRSOB/reports/Documents/IRSOB\\_TAS%202013.pdf](http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_TAS%202013.pdf) (last visited Aug. 25, 2014).

<sup>15</sup> See 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*, *supra*.

<sup>16</sup> Virtual Service Delivery: *Delivering Taxpayer Services Using Video Communications Technology* (Jan. 9, 2014). Provided as part of the Network Services response to TAS research request (Aug. 6, 2014).

<sup>17</sup> Network Services supplemental response to TAS research request (Aug. 25, 2014).

to lack home computer technology or the proficiency required to use it when interacting with the IRS.<sup>18</sup> The IRS also has no plans to migrate delivery of face-to-face services to more flexible mobile tax assistance units, by which taxpayers could access VSD technology. These mobile units would enable the IRS to respond more nimbly to population shifts and natural disasters, and could be used to benefit underserved communities allowing for both pre-scheduled and walk-in visits.<sup>19</sup> Moreover, none of the projected functionalities of TDC, which will be delivered over the Internet, is in development, and most do not have projected availability dates.<sup>20</sup>

One of the fundamental rights within TBOR is *the right to quality service* which involves the right of taxpayers to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, and to receive clear and easily understandable communications from the IRS. The ability to have face-to-face interactions with the IRS is an indispensable element of this right, and is greatly constrained by the lack of VSD options currently available to taxpayers.

The following table illustrates the funding allocated by the IRS to the development of VSD:

**FIGURE 2.4.1, IRS expenditures on VSD in fiscal years 2012–2014<sup>21</sup>**

	FY 2012	FY 2013	FY 2014
VSD in brick & mortar locations	\$1,531,000	\$1,736,000	\$0
VSD in mobile tax assistance units	\$0	\$0	\$0
VSD over the Internet (TDC)	\$0	\$375,000	\$1,700,000

Since the passage of RRA 98, the IRS has devoted insufficient resources and funding to the development of VSD. As a result, the IRS suffers from a VSD gap when compared with the technological advances made by some other agencies and private businesses.

By contrast, RRA 98 also established the specific goal that, by 2007, 80 percent of tax and information returns would be electronically filed.<sup>22</sup> As part of this legislation, Congress required the IRS Oversight Board, as well as the Electronic Tax Administration Advisory Committee, to report to Congress annually on the progress toward the goal.<sup>23</sup> The IRS did not meet the target in 2007, but the 80 percent electronic filing goal was extended to 2012, at which point it was reached.<sup>24</sup>

As analyzed by the IRS Oversight Board, “Looking back over the 15 years since the passage of RRA 98, the focus created by that goal [the 10-year, 80 percent electronic filing requirement] has proven to be an

18 See 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*, *supra*. See also Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

19 For a more in-depth discussion of this topic, see Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*. See also National Taxpayer Advocate 2008 Annual Report to Congress 95.

20 OLS response to TAS research request (Aug. 18, 2014).

21 Network Services response to TAS research request (Aug. 6, 2014); OLS response to TAS research request (Aug. 18, 2014).

22 Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998).

23 *Id.* at § 2001(d), 112 Stat. 685, 723 (1998).

24 IRS Oversight Board Electronic Filing 2012 Annual Report to Congress, 5 (Dec. 2012).

effective catalyst for coordinated efforts by the IRS, the tax professional community, and Congress. This has led to tremendous progress in electronic filing.”<sup>25</sup>

## EXPLANATION OF RECOMMENDATION

The IRS would benefit from the similar catalyst of congressionally mandated goals for development and implementation of VSD in brick and mortar locations, including non-IRS facilities, in mobile tax assistance units, and via TDC over the Internet. These parameters should include targets for the expanded availability of VSD in brick and mortar locations, emphasizing the use of partner locations to reach taxpayers who most need access to and help with such equipment. In particular, Congress should consider requiring the IRS to explore partnerships with the U.S. Postal Service, which could build VSD-equipped rooms available to a number of agencies including the IRS, the SSA, and the VA. Congress should also establish timetables and reporting obligations for continued expansion of VSD in brick and mortar locations and mobile tax assistance units, and the ongoing development and implementation of TDC over the Internet.

Congressional intervention and oversight would enhance and accelerate the IRS’s VSD initiatives. As with the 80 percent electronic filing goal, Congress should consider requiring the IRS Oversight Board, the Electronic Tax Administration Advisory Committee, or other appropriate entities to report annually on the progress being made toward the applicable targets and deadlines. Funding to facilitate this essential progress, however, will need to be provided by Congress or separately allocated by the IRS pursuant to congressional directive.<sup>26</sup>

25 IRS Oversight Board Electronic Filing 2013 Annual Report to Congress, 5 (Feb. 2014).

26 The income effect of these VSD efforts cannot be adequately estimated, as the IRS does not appear to have undertaken a comprehensive cost-benefit study relating to VSD. TIGTA has recommended that the cost savings and benefits related to VSD be quantified by the IRS and reported as part of the budget request process. TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

**LR  
#5**

## **SECTION 501(c)4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity**

### **PROBLEM**

Organizations exempt from tax as Internal Revenue Code (IRC) § 501(c)(3) organizations, contributions to which may be tax deductible, are prohibited from *any* participation or intervention in political campaigns on behalf of (or in opposition to) candidates for public office.<sup>1</sup> However, these organizations are permitted to engage in lobbying activity, so long as the activity is “insubstantial.”<sup>2</sup> Subsection (h) of IRC § 501, added by Congress in 1976, is an elective “safe harbor” that allows for a determination, based solely on the electing IRC § 501(c)(3) organization’s expenditures, of whether its lobbying activities are within permissible limits.<sup>3</sup> An IRC § 501(c)(3) organization that does not make an election under IRC § 501(h) is subject to a “facts and circumstances” test to determine whether it has engaged in excessive lobbying activity.<sup>4</sup>

Unlike IRC § 501(c)(3) organizations, IRC § 501(c)(4) organizations, contributions to which are generally not deductible, may engage in substantial lobbying.<sup>5</sup> IRC § 501(c)(4) organizations may also engage in political campaign activity, but only if they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community.”<sup>6</sup> There is no statutory or regulatory quantification of the term “*primarily*” for this purpose, nor is there a statutory or regulatory “safe harbor” for determining whether an IRC § 501(c)(4) organization’s political campaign activities are within permissible limits. Section 501(c)(4) organizations engaging in political campaign activity are subject to a “facts and circumstances” test to determine whether they have engaged in impermissible political activity.

According to the Taxpayer Bill of Rights the IRS adopted on June 10, 2014, taxpayers have the *right to be informed*, i.e., “the right to know what they need to do to comply with the tax laws.”<sup>7</sup> An elective safe harbor for IRC § 501(c)(4) organizations, by establishing acceptable limits of political campaign activity and providing a method for measuring those activities, would support this right.

### **EXAMPLE**

XYZ, Inc., which engages in political campaign activity through its volunteers, applies to the IRS for recognition of its exempt status under IRC § 501(c)(4) as a social welfare organization. Neither XYZ nor the IRS can determine from statutory, regulatory, or judicial authorities:

- How to measure XYZ’s social welfare activity;

<sup>1</sup> IRC §§ 170(c) and 501(c)(3).

<sup>2</sup> IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(3)(i).

<sup>3</sup> Tax Reform Act of 1976, Pub. L. No. 94-455, § 1307, 90 Stat. 1520, 1720 (1976).

<sup>4</sup> Treas. Reg. § 1.501(h)-1(a)(4).

<sup>5</sup> See, e.g., Treas. Reg. § 1.504(c)(4)-1(a)(2)(ii), referencing “action” organizations.

<sup>6</sup> IRC § 501(c)(4)(A); Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) (emphasis added). Treas. Reg. § 501(c)(4)-1(a)(2)(ii) provides that promoting social welfare does not include participation or intervention in political campaigns.

<sup>7</sup> Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.

- Whether there is a required minimum percentage of such activity, or whether multiple factors should be considered; and if so;
- The weight to be given to these factors.<sup>8</sup>

The IRS’s “expedited” procedures would allow it to approve XYZ’s application based on XYZ’s attestations about how it allocates its time and resources. However, XYZ does not meet the requirements for “expedited” approval because it relies on volunteers whose time is “counted” in determining the portion of its resources allocated to political campaign activity. Confronted with this uncertainty, XYZ may decide to simply refrain from *any* political campaign activity, even though some level of such activity would be permissible. Alternatively, XYZ may gauge for itself the level of permissible political campaign activity and take the risk that the IRS will agree, based on all the facts and circumstances, that it guessed correctly.

## RECOMMENDATION

To provide greater certainty to IRC § 501(c)(4) organizations, the National Taxpayer Advocate recommends that Congress enact an optional safe harbor election similar to IRC § 501(h) that would allow IRC § 501(c)(4) organizations to elect the use of a numerical test, based solely on their expenditures (*i.e.*, without counting volunteer activities), to determine the amount of political campaign activity they may engage in without jeopardizing their exempt status.

## PRESENT LAW

### Congress Provided a Safe Harbor for IRC § 501(c)(3) Organizations with Respect to Their Lobbying Activities.

Organizations exempt under IRC § 501(c)(3) are prohibited from *any* participation or intervention in political campaigns on behalf of (or in opposition to) candidates for public office.<sup>9</sup> However, they may engage in lobbying activities (*i.e.*, activities to influence legislation) as long as those activities are “insubstantial.”<sup>10</sup> One practitioner described this statutory framework (as it existed prior to enactment of IRC § 501(h)) as follows:

Probably the major objection to present law is related to its uncertainty. Although the present law has been in effect for approximately 40 years, neither the courts nor the Internal Revenue Service has been able to derive a universally acceptable definition of “substantial.” The Service has refused to take a position on the meaning of substantial in quantitative terms, such as what percentage of expenditures or time devoted to lobbying activities would be deemed insubstantial. Moreover, the Service has at times attempted to view the term “substantial,” not only in undefined quantitative terms, but in undefined qualitative terms as well. A “facts and circumstances” test, apparently called for by the Regulations, takes the bewildered charities

<sup>8</sup> Moreover, if the IRS denies XYZ’s application, or approves the application but later revokes XYZ’s exempt status due to excessive political activity, XYZ may not seek a declaratory judgment IRC § 7428. See Legislative Recommendation: *Amend IRC § 7428 to Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status, infra.*

<sup>9</sup> IRC § 501(c)(3) provides that a charity may “not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”

<sup>10</sup> IRC § 501(c)(3) recognizes exempt status for an organization “organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes” only if “[n]o substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.” Treas. Reg. § 1.501(c)(3)-1(b)(3) provides that an organization “is not organized exclusively for one or more exempt purposes if its articles expressly empower it: (i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise.”

out of definable areas, such as specific financial expenditures and allocations of staff time, and into completely uncharted areas, including not only time of volunteers, but importance of the effort, and very possibly other factors. This appeared to be the case in the Service's attempt to revoke the section 501(c)(3) status of the Maryland Association for Mental Health, Inc., largely on the grounds that the association had engaged in substantial lobbying activity through the use of unpaid volunteers. While such uncertainty gives the Service flexibility, this is exactly what is objectionable to the charities. As Mortimer Caplin pointed out in his testimony before the House Committee on Ways and Means, revenue agents are normally accounting majors, not philosophy majors, and it is almost impossible to tell what one of them would decide on a given set of facts. Inconsistent enforcement of the law by the Internal Revenue Service would naturally follow.<sup>11</sup>

In 1976, "to set relatively specific expenditure limits to replace the uncertain standards of present law" Congress enacted IRC § 501(h).<sup>12</sup> The provision allows eligible organizations to elect the use of a numerical test based solely on their expenditures to determine whether they have engaged in excessive lobbying activities, thereby causing them to be subject to an excise tax or to lose tax-exempt status under IRC § 501(c)(3). This numerical test is purely elective and thus operates as a "safe harbor." Eligible organizations that do not elect the expenditure test remain subject to the "insubstantial" test, a facts and circumstances inquiry.<sup>13</sup>

Under the election, the amount of time an organization spends on an activity is not relevant except to the extent an expenditure (*e.g.*, compensation) thereby arises. Volunteer activity is relevant to the determination only to the extent it triggers an expenditure. Section 501(h) limits are determined by reference to IRC § 4911, which imposes an excise tax on "excess lobbying expenditures."<sup>14</sup> If the § 501(c)(3) organization's lobbying expenditures do not exceed the IRC § 4911(c) limits, the organization will not be taxed under § 4911 or lose its § 501(c) exemption.<sup>15</sup>

For electing organizations, permissible lobbying expenditures are calculated on a sliding scale that is a function of the organization's "exempt purpose expenditures."<sup>16</sup> For example, under IRC § 4911, an organization with exempt purpose expenditures of \$500,000 or less could spend 20 percent of its exempt

<sup>11</sup> John B. Hufaker, Esq., Pepper, Hamilton & Sheetz (Philadelphia), *Legislative Activities of Charitable Organizations Other Than Private Foundations, with Addendum on Legislative Activities of Private Foundations*, Research Papers sponsored by the Commission on Private Philanthropy and Public Needs (also known as the Filer Commission) 2917, 2920 (1977) (fn. refs. omitted).

<sup>12</sup> H.R. REP. No. 94-1210, pt. 1, at 8 (1976) and S. REP. No. 94-938, pt. 2, at 80 (1976), noting the provision "is designed to set relatively specific expenditure limits to replace the uncertain standards of present law, to provide a more rational relationship between the sanctions and the violations of standards, and to make it more practical to properly enforce the law. However, these new rules replace present law only as to charitable organizations which elect to come under the standards of the bill;" Tax Reform Act of 1976, Pub. L. No. 94-455, § 1307, 90 Stat. 1520, 1720 (1976). For a discussion of the lengthy legislative history of the provision, described as representing "a compromise on a compromise on a compromise on a compromise" see Jill S. Manny, *Nonprofit Legislative Speech: Aligning Policy, Law, and Reality*, 62 CASE W. RES. L. REV. 757 (2012).

<sup>13</sup> Treas. Reg. § 1.501(h)-1(a)(4). When final regulations under § 501(h) were issued in 1990, former IRS Commissioner Mortimer Caplin took the opportunity to advise tax practitioners: "[u]nderstanding that the decision whether to elect [the section 501(h) safe harbor] should only be made after a careful review of its implications, we are convinced that making the election will serve the interest of the great majority of eligible 501(c)(3) organizations that engage even remotely in efforts to influence legislation or public opinion or in other activities touching on public policy." ABA Sec. on Tax'n, *Open Letter*, 10 SEC. TAX'N NEWSL. 73 (1990-91).

<sup>14</sup> IRC § 501(h)(2).

<sup>15</sup> Treas. Reg. § 1.501(h)-1(a)(3).

<sup>16</sup> IRC § 4911(c)(2). IRC § 4911(e)(1)(A) provides that "the term 'exempt purpose expenditures' means, with respect to any organization for any taxable year, the total of the amounts paid or incurred by such organization to accomplish purposes described in section 170(c)(2)(B) (relating to religious, charitable, educational, etc., purposes)."

purpose expenditures on lobbying activities. An organization with exempt purpose expenditures of more than \$500,000 but not over \$1 million could spend \$100,000 plus 15 percent of its exempt purpose expenditures over \$500,000 on lobbying activities.<sup>17</sup> An organization with exempt purpose expenditures of more than \$1 million but not over \$1.5 million could spend \$175,000 plus ten percent of its exempt purpose expenditures over \$1 million on lobbying activities.<sup>18</sup> An organization with exempt purpose expenditures of more than \$1.5 million could spend \$225,000 plus five percent of the excess of the exempt purpose expenditures over \$1.5 million.<sup>19</sup> The lobbying expenditures cannot exceed \$1 million for any organization (a limit that is reached when exempt purpose expenditures equal \$17 million), and “grass roots” expenditures must always be less than or equal to 25 percent of the permissible lobbying expenditure as calculated with the sliding scale.<sup>20</sup>

### Congress Has Not Provided a Safe Harbor for IRC § 501(c)(4) Organizations with Respect to Political Campaign Activities.

As discussed above, organizations exempt under IRC § 501(c)(4) are not subject to the same restrictions on their lobbying activities as IRC § 501(c)(3) organizations.<sup>21</sup> The statutory prohibition on *any* participation or intervention in political campaigns on behalf of candidates for public office, applicable to IRC § 501(c)(3) organizations, also does not apply to organizations exempt under IRC § 501(c)(4). Thus, IRC § 501(c)(4) organizations can engage in some amount of political campaign activity, so long as they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community.”<sup>22</sup>

“Primarily,” like “insubstantial” (in the context of evaluating lobbying activities of IRC § 501(c)(3) organizations), is undefined in the statute and regulations.<sup>23</sup> The IRS uses a facts-and-circumstances test to determine if an organization has engaged in impermissible political campaign activity.<sup>24</sup> Unlike IRC § 501(c)(3) organizations, which can make a IRC § 501(h) safe harbor expenditure election with respect to their lobbying activities, IRC § 501(c)(4) organizations do not have the benefit of an elective statutory “safe harbor.”

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17 IRC § 4911(c)(2).

18 *Id.*

19 *Id.*

20 *Id.* Under IRC § 4911(c) and (d) “grass root expenditure” means expenditures for the purpose of influencing legislation “through an attempt to affect the opinions of the general public or any segment thereof” (as opposed to “communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation”).

21 A section 501(c)(4) organization may qualify for exemption even if, because of its lobbying activities, it is an “action” organization (e.g., its main objective can only be attained by legislation and its main activity is advocating for that legislation). See Treas. Reg. § 1.504(c)(4)-1(a)(2)(ii), citing the action organization regulations of Treas. Reg. § 1.501(c)(3)-1(c)(3)(ii) and (iv).

22 IRC § 501(c)(4)(A) exempts organizations operated “exclusively” for the promotion of social welfare, but Treas. Reg. § 1.501(c)(4)-1(a)(2)(i) allows exempt status to organizations “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community” (emphasis added). In any event, Treas. Reg. § 501(c)(4)-1(a)(2)(ii) provides that promoting social welfare does *not* include participation or intervention in political campaigns.

23 On Nov. 29, 2013, the Treasury Department and the IRS requested public comment on a proposed regulation that would provide guidance to tax-exempt social welfare organizations on political activities related to candidates that will not be considered to promote social welfare. Prop. Treas. Reg. § 1.501(c)(4)-1, 78 Fed. Reg. 71535 (Nov. 29, 2013), available at <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-0001>. However, on May 22, 2014, the IRS announced that “[g]iven the diversity of views expressed and the volume of substantive input,” it would revise the proposed regulation before proceeding with a public hearing. Revised proposed regulations have not been published to date.

24 Rev. Rul. 2007-41, 2007-25 I.R.B. 1421; IRS Publication 4221-NC, *Compliance Guide for Tax-Exempt Organizations (Other than 501(c)(3) Public Charities and Private Foundations)*, 5-6 (Sept. 2014), available at <http://core.publish.no.irs.gov/pubs/pdf/p4221-nc-2014-09-00.pdf>. The IRS may in some cases rely instead on an applicant’s attestations pursuant to procedures adopted in 2013, discussed below.

At the administrative level, in 2013, after the Treasury Inspector General for Tax Administration (TIGTA) reported the IRS had adopted inappropriate procedures for evaluating IRC § 501(c)(4) applications, the IRS began issuing Letter 5228, *Application Notification of Expedited 501(c)(4) Option*, to certain organizations whose applications for exempt status under IRC § 501(c)(4) indicated the organizations could potentially be engaged in political campaign intervention or be providing private benefit to a political party.<sup>25</sup> The letter offers a “safe harbor” to these organizations if they can certify, among other things, that:

- They devote 60 percent or more of both their spending and time (including volunteer time) to activities that promote social welfare as defined by section 501(c)(4); and
- Campaign intervention amounts to less than 40 percent of both their spending and time (including volunteer time).<sup>26</sup>

According to the IRS’s interim guidance to employees, organizations providing the required attestations within 45 days of the date of the letter will receive recognition of exempt status within one month.<sup>27</sup>

There is no explanation in the letter to taxpayers, in the interim guidance to employees, or elsewhere, of why the IRS decided upon the 60/40 ratio or why volunteer time is considered relevant. The procedures have not been incorporated in the Internal Revenue Manual (IRM), but even if they were, the IRS could change or remove them at any time.<sup>28</sup> The IRS has not issued any guidance such as a revenue procedure that would require it to continue to follow these procedures.

The IRS reviews the applications of organizations that are not eligible to receive Letter 5228, or that do not respond with the required attestations within 45 days, using “regular” procedures, *i.e.*, “review[ing] the facts and circumstances in the pending application and any other materials to determine if the organization is operated primary for social welfare purposes, including by evaluating the possible political issues.”<sup>29</sup>

## REASONS FOR CHANGE

The extent to which an IRC § 501(c)(4) organization may engage in political campaign activity generally requires an evaluation of the relevant facts and circumstances, yet there is little statutory, regulatory, or judicial guidance as to what facts and circumstances are relevant and how they should be evaluated in relation to each other. This creates uncertainty for taxpayers, in the same way that “inconsistent enforcement of the law by the Internal Revenue Service would naturally follow” from the absence of a safe harbor for evaluating IRC § 501(c)(3) organizations’ lobbying activities, which was the case prior to the 1976 enactment of IRC § 501(h).

<sup>25</sup> Tax Analyst, *IRS Provides Instructions for Optional Expedited Process for Some Tax-Exempt Applications*, 2013 TNT 129-15 (July 5, 2013); Interim Guidance, TEGE-07-1213-24, Request for EO Technical Assistance (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5b1%5d.pdf> (removing the requirement that the application have been outstanding for a specified number of days); Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013) available at <http://www.treasury.gov/tigta/auditreports/2013reports/201310053fr.pdf>.

<sup>26</sup> IRS Letter 5228, *Application Notification of Expedited 501(c)(4) Option* (Sept. 2013), available at <http://www.irs.gov/pub/irs-tege/letter5228.pdf>. The letter contains specific instructions explaining what types of expenditures do not promote social welfare (e.g., “direct or indirect participation or intervention in any political campaign on behalf of (or in opposition to) any candidate for public office”).

<sup>27</sup> Interim Guidance, TEGE-07-1213-24, Request for EO Technical Assistance (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5b1%5d.pdf>.

<sup>28</sup> See *Barnes v. Comm'r*, 130 T.C. 248, 255 (2008) and cases cited therein (stating that the IRM “does not have the force of law, is not binding on the Commissioner, and does not confer any rights on the taxpayer.”).

<sup>29</sup> Interim Guidance, TEGE-07-1213-24, Request for EO Technical Assistance (Dec. 23, 2013) available at <http://www.irs.gov/pub/foia/ig/spder/TEGE-07-1213-24%5b1%5d.pdf>.

Moreover, even if the IRS can decide, in an objective and consistent manner, whether organizations have engaged in too much political campaign activity to be exempt under IRC § 501(c)(4), it may not be *perceived* as doing so. Its failure to provide any rationale for establishing the 60/40 allocation in the context of its Letter 5228 procedures exacerbates the perception of arbitrariness. Further, these attestation procedures the IRS has adopted for some IRC § 501(c)(4) applicants include volunteer time in the calculus of permissible levels of political campaign activity. This disproportionately excludes organizations from exempt status when they actually spend a *smaller* portion of their expenditures on political campaign activity. Enacting an elective safe harbor for IRC § 501(c)(4) organizations would support taxpayers' *right to be informed* by setting out parameters they can reference and rely on in determining what they must do to comply with the law. By excluding volunteer time from the equation, the safe harbor provision would allow for a determination of whether amounts that were not subject to tax when contributed to an organization were *expended* in a manner consistent with exempt status under IRC § 501(c)(4).

## EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that Congress enact a provision analogous to the current elective safe harbor under IRC § 501(h), which is available to IRC § 501(c)(3) organizations. This new safe harbor would be available to IRC § 501(c)(4) organizations that engage in political campaign activity.

The provision would not only establish an acceptable level of political campaign activity that does not promote social welfare and do so with reference to an organization's exempt social welfare activity, but would also take into account the size and budget of the organization. Such a provision would quantify the amount of permissible political campaign activity by relating it to the organization's expenditures in furtherance of its exempt (social welfare) purpose. Thus, organizations holding themselves out as meeting the requirements for receiving contributions that are exempt from tax under IRC § 501(c)(4) could be evaluated on how they actually expend those contributions.

Under this analysis, as with the IRC § 501(h) election, volunteer time and activity, which do not generate taxable income for which tax exemption would be available in the first instance, would be irrelevant (except to the extent an expenditure arises as a consequence of volunteer activity, *e.g.*, amounts spent to solicit and train volunteers or transport them to rallies or shopping malls where they campaign).

**LR****#6**

## **FOREIGN ACCOUNT REPORTING: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure**

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### **OVERVIEW**

A U.S. citizen or resident with foreign accounts exceeding \$10,000 can be subject to disproportionate civil penalties for failure to report the accounts on a *Report of Foreign Bank and Financial Accounts* (or FBAR) by June 30 of the following year.<sup>1</sup> Another penalty may apply if the accounts exceed \$50,000 and the person does not report them on Form 8938, *Statement of Specified Foreign Financial Assets*, which is part of the tax return.<sup>2</sup>

Even those who inadvertently failed to file an FBAR (*i.e.*, “benign actors”) are afraid they could be hit with the elevated penalties applicable to *willful* violations because the government may rely on circumstantial evidence of willfulness or willful blindness.<sup>3</sup> Such fears have prompted some to enter the IRS’s offshore voluntary disclosure (OVD) programs and agree to pay penalties of such severity that they appear to have been designed for bad actors.<sup>4</sup> The median penalty applied to taxpayers with the smallest accounts (*i.e.*, those in the 10th percentile with accounts of \$17,368 or less) under the 2011 OVD program, is more than eight times the unreported tax—over ten times the 75 percent penalty for civil tax fraud.<sup>5</sup>

In June 2014, the IRS reduced the amount it requires certain benign actors to pay under its settlement programs.<sup>6</sup> However, it did not allow those who have already signed closing agreements to receive the same, more reasonable program terms, in effect punishing them for addressing the problem quickly.

Unexpected and disproportionate FBAR penalties may violate a taxpayer’s *rights to be informed and to a fair and just tax system*.<sup>7</sup> Because they cause some people to agree to excessive OVD settlements, they may also erode the rights to *pay no more than the correct amount of tax, challenge the IRS’s position and be heard, and appeal an IRS decision in an independent forum*, as discussed in prior reports.<sup>8</sup> These results

1 See, e.g., 31 U.S.C. §§ 5314, 5321; 31 C.F.R. §§ 1010.350, 1010.306(c); FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), [http://www.fincen.gov/forms/bsa\\_forms/](http://www.fincen.gov/forms/bsa_forms/).

2 The Foreign Account Tax Compliance Act (FATCA), enacted in 2010, created new IRC § 6038D and requires individuals to file Form 8938 with their income tax returns for tax years starting after March 18, 2010, which for most people is their 2011 tax returns filed during the 2012 filing season. See T.D. 9567, 76 Fed. Reg. 78,553, 2012-8 I.R.B. 395 (Dec. 19, 2011). U.S. residents who are single or married filing separately apply the \$50,000 threshold to the value of “specified foreign financial assets” at the end of the year. See, e.g., IRS, *Instructions to Form 8938* (2013). Higher thresholds generally apply in various other situations. *Id.*

3 See, e.g., *Williams v. Comm'r*, 489 Fed. App'x. 655, 659 (4th Cir. 2012).

4 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress, *supra* (Most Serious Problem: *The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights*); National Taxpayer Advocate 2013 Annual Report to Congress 228-237; National Taxpayer Advocate 2012 Annual Report to Congress 134-153; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29; Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011) [collectively, OVD Reports].

5 National Taxpayer Advocate 2014 Annual Report to Congress, *supra* (Most Serious Problem: *The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights*); Internal Revenue Code (IRC) § 6663 (civil fraud penalty).

6 IRS, *Streamlined Filing Compliance Procedures* (June 18, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures> [hereinafter 2014 streamlined program].

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

8 See *id.*; OVD Reports.

seem to be an unintended consequence of the civil FBAR penalty regime, which is designed to address criminal conduct.

## Background

### *The penalty for willful failure to file an FBAR was aimed at criminals.*

Congress enacted the FBAR filing requirement in 1970 after hearing testimony that criminals were using secret foreign bank accounts for illegal purposes (*e.g.*, tax evasion, securities manipulation, insider trading, evasion of Federal Reserve margin limitations, storing and laundering funds from illegal activities, and acquiring control of U.S. industries without detection by the Securities and Exchange Commission), and that U.S. law enforcement agencies had difficulty obtaining account information from foreign authorities.<sup>9</sup> Although a criminal penalty already applied to those who willfully failed to report the existence of a foreign account on a tax return, Treasury Department officials testified that a less-severe civil penalty would be easier to assert and less likely to violate the U.S. Constitution.<sup>10</sup> Thus, overlapping civil and criminal FBAR and tax penalties may apply to the willful failure to report a foreign account and any income it generated.<sup>11</sup>

### *FBAR reporting compliance was low, but the government imposed few FBAR penalties.*

In 2002, the IRS reported to Congress that the FBAR compliance rate was less than 20 percent because it had received fewer than 200,000 FBARs when one million taxpayers may have been required to file.<sup>12</sup> In the face of substantial noncompliance, the IRS cited the difficulty of proving willfulness as a reason for why the government had assessed only two civil FBAR penalties between 1993 and 2002.<sup>13</sup>

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9 See, e.g., Pub. L. No. 91-507, § 241, 242 (1970); S. REP. No. 91-1139, at 2-4, 8-9 (1970); H. REP. No. 91-975, at 12 (1970). Accord H.R. REP. No. 241-3, at 27, 50 (1970) (statement of Robert M. Morgenthau, U.S. Att'y, S.D.N.Y.) (“in addition to the usual difficulties attending to the detection of criminal conduct in financial transactions, we have here the added obstacle of the use of secret foreign accounts to avoid discovery... where criminals have made such extraordinary efforts to cover their tracks, we must respond with equal vigor to uncover them.”); *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency*, 91st Cong. 2nd Sess. at 170 (1970) (statement of Eugene T. Rossides, Assistant Secretary of the Treas. for Enforcement and Operations) (“Our overall aim is to build a system to combat organized crime and white collar crime and to deter and prevent the use of secret foreign bank accounts for tax fraud and their use to screen from view a wide variety of criminally related financial activities, and to conceal and cleanse criminal wealth.”).

10 See, e.g., *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency*, 91st Cong. 2nd Sess. at 152 (1970) (statement of Robert Cole, Special Assistant for Int'l Affairs, Treas. Dept.) (“Civil penalties can be imposed administratively and there are cases where it might be appropriate to impose a civil penalty where imposition of a criminal penalty [under IRC § 7203 or IRC § 7206(1)] would seem unduly harsh or could raise evidentiary or constitutional problems.”).

11 See 31 U.S.C. § 5321 (civil FBAR); 31 U.S.C. § 5322 (criminal FBAR); IRC § 6662 (civil tax); IRC § 7201 (criminal tax); IRC § 7203 (criminal tax); IRC § 7206 (criminal tax). See also IRC § 6038D (a relatively-new civil tax penalty, discussed below).

12 Department of the Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* 6 (Apr. 26, 2002) [hereinafter 2002 FBAR Report]; IRS Sets New Audit Priorities, FS-2002-12 (Sept. 2002).

13 2002 FBAR Report at 10 (“taxpayers generally assert to the IRS that they were not aware that they were required to file an FBAR. Often, the administrative record lacks evidence to the contrary, such as an advice letter from an accountant or financial planner or any witness to testify that the taxpayer knew of the filing requirement. In such cases, the litigation risk in assessing a penalty is substantial, particularly where, after notice from the IRS or FinCEN, the person has voluntarily backfiled the missing forms. Rather than go forward with penalty assessments based on a less than substantial record, FinCEN’s limited resources have been allocated to other compliance and enforcement efforts...”).

***Following reports of people intentionally “attempting to conceal income from the IRS,”  
Congress enacted a non-willful FBAR penalty.***

In 2004, Congress significantly increased the maximum penalty for willful violations and imposed—for the first time—a penalty for non-willful violations.<sup>14</sup> Legislative history suggests a reason for this change was the IRS’s estimate that hundreds of thousands of taxpayers were “attempting to conceal income from the IRS.”<sup>15</sup> It did not reference a concern about taxpayers inadvertently failing to file the form. Thus, even the non-willful FBAR penalty appears to have been aimed at willful violations.

Mindful that the civil FBAR penalty appears to be aimed primarily at those engaged in criminal activity, the National Taxpayer Advocate offers legislative recommendations to reduce its burden for other taxpayers, including benign actors. Specifically, these proposals would:

- Improve the proportionality of the civil FBAR penalty;
- Require the government to prove actual willfulness before imposing the penalty for willful violations;
- Treat taxpayers who correct violations early the same as (or better than) those who correct them later; and
- Reduce the burden of foreign account reporting.

These proposals should help address concerns about the existing offshore penalty programs, and also establish principles of procedural fairness that could help the government design future penalty initiatives.

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<sup>14</sup> The American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 821(a), 118 Stat. 1586 (2004) (amending 31 U.S.C. § 5321(a)(5)).

<sup>15</sup> Joint Committee on Taxation (JCT), *General Explanation of Tax Legislation Enacted in the 108th Cong.*, JCS-5-05, 377-378 (2005) (“For one scheme alone, the IRS estimates that there may be hundreds of thousands of taxpayers with offshore bank accounts attempting to conceal income from the IRS.”). See also S. REP. No. 108-11, at 101 (2003) (“attempting to conceal”); S. REP. No. 108-257, at 32 (2003) (same). Another purpose of the FBAR penalty may have been to detect criminal or terrorist financing activity. See, e.g., JCT, *General Explanation of Tax Legislation Enacted in the 108th Cong.*, JCS-5-05, 377-378 (May 2005).

## PENALTIES: Improve the Proportionality of the Civil FBAR Penalty

### PROBLEM

Civil penalties for failure to report foreign accounts on an FBAR can be disproportionate in comparison to the value of the unreported account and the amount of associated unreported income. The penalties may be severe because they are aimed at bad actors.<sup>16</sup> However, the IRS is authorized to apply them even if the taxpayer has no (or a *de minimis*) underpayment and the accounts were not used for criminal activity.<sup>17</sup> A single failure to learn about the FBAR reporting requirements can trigger multiple penalties for those who have multiple accounts or repeat the same mistake over a multi-year period.<sup>18</sup> FBAR penalties can also overlap with penalties for failure to report the same account on Form 8938, *Statement of Specified Foreign Financial Assets*, and the penalty for understatements attributable to undisclosed foreign financial assets.<sup>19</sup>

The Bank Secrecy Act (BSA) authorizes a maximum civil penalty of up to 50 percent of the maximum balance in each overseas account for each year of willful non-reporting (or, if greater, \$100,000 per violation), in addition to criminal penalties.<sup>20</sup> Even the Internal Revenue Manual (IRM) acknowledges that the maximum statutory penalty for “willful” failures to file an FBAR may “greatly exceed an amount that would be appropriate in view of the violation.”<sup>21</sup> The maximum penalty for a non-willful violation is \$10,000.<sup>22</sup> While this may seem reasonable by comparison, a taxpayer who failed to file a single FBAR form may have multiple violations each year—one for each unreported account.<sup>23</sup>

Because the statute of limitations is six years, the maximum civil FBAR penalty for large accounts is generally about three times the maximum account balance (50 percent times six, assuming a relatively constant balance).<sup>24</sup> For small accounts, the maximum penalty may be an even greater percentage. For example, someone with a total of \$10,000 in five different foreign accounts (\$2,000 in each) could be subject to a non-willful FBAR penalty of \$300,000 (six years times five accounts times \$10,000) or 30 times the account balance. If the IRS deems the violation willful, the penalty could rise to \$3 million (six years times five accounts times \$100,000) or 300 times the account balance.

Perhaps for this reason, the IRS has developed “mitigation guidelines” whereby it may impose smaller penalties—generally 5–10 percent of the account(s)—against those with accounts of \$1 million or less, provided the taxpayer meets certain threshold conditions.<sup>25</sup> Such conditions include a requirement that the taxpayer “cooperate” with the IRS during the examination (*e.g.*, the taxpayer responds to reasonable requests for documents, meetings, interviews, back-files corrected FBARs, and the IRS does not issue a

<sup>16</sup> See, e.g., JCT, *General Explanation of Tax Legislation Enacted in the 108th Cong.*, JCS-5-05, 377-378 (May 2005) (discussed above).

<sup>17</sup> 31 U.S.C. § 5321(a)(5).

<sup>18</sup> *Id.*; 31 U.S.C. § 5321(b)(1) (six-year limitations period).

<sup>19</sup> IRC § 6038D; IRC § 6662(j).

<sup>20</sup> 31 U.S.C. § 5321(a)(5)(C).

<sup>21</sup> IRM 4.26.16.4(5) (July 1, 2008). This observation appears in a section of the IRM that discusses when it may be appropriate to apply a lesser penalty.

<sup>22</sup> 31 U.S.C. § 5321(a)(5)(B).

<sup>23</sup> See, e.g., IRM 4.26.16.4 (July 1, 2008).

<sup>24</sup> A six-year statute of limitations applies to the civil FBAR penalty. See 31 U.S.C. § 5321(b)(1). Criminal penalties of up to \$500,000 and 10 years in prison may also apply. 31 U.S.C. § 5321(a)(5)(C) and 5322; 31 C.F.R. § 1010.840(b).

<sup>25</sup> See, e.g., IRM 4.26.16.4.6 (July 1, 2008); IRM Exhibit 4.26.16-2 (July 1, 2008).

summons).<sup>26</sup> Some commentators have speculated that without these guidelines, the FBAR penalty is so disproportionate it may violate the U.S. Constitution.<sup>27</sup>

### Related violations can stack penalties.

A taxpayer may also be subject to a tax penalty of \$10,000 or more per year for failing to report an account on another information return, Form 8938, *Statement of Specified Foreign Financial Assets*, which is filed with a tax return.<sup>28</sup> Although this penalty applies to the failure to file a different form, penalizing someone more than once for essentially the same mistake—failing to report a foreign account—may be considered stacking, which is generally not viewed as an effective way to promote compliance, in part because it is perceived as confusing, disproportionate, and unfair.<sup>29</sup>

Moreover, both penalties may apply even if the taxpayer has paid all U.S. taxes and the government already knows about the account. They may also apply to the failure to report accounts in the jurisdiction where the taxpayer resides. Because of the Foreign Account Tax Compliance Act (FATCA), many banks will begin reporting the foreign accounts of U.S. persons to the IRS in 2015, further reducing the usefulness of also requiring taxpayers to report the same accounts on two different forms.<sup>30</sup>

### Other information reporting penalties are proportionate.

Other information reporting penalties are more proportionate than FBAR penalties. For example, there is no penalty for failing to file a U.S. income tax return if there is no unpaid tax.<sup>31</sup> The penalty for failure to file most information returns and payee statements is generally \$100 per return, rising to 10 percent of the unreported amount for intentional violations.<sup>32</sup> By contrast, the FBAR penalty may apply even if the FBAR is one day late and even if the taxpayer has no net underreported tax (*e.g.*, because of foreign tax credits) as a result of underreporting income from the account.<sup>33</sup>

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26 See, e.g., IRM 4.26.16.4.6 (July 1, 2008); IRM Exhibit 4.26.16-2 (July 1, 2008).

27 See, e.g., Steven Toscher and Barbara Lubin, *When Penalties Are Excessive — The Excessive Fines Clause as a Limitation on the Imposition of the Willful FBAR Penalty*, J. Tax PRAC. & Proc. 69-74 (Jan. 2010).

28 For an explanation of why the IRS believed it did not have discretion to allow consolidated reporting, see T.D. 9567, 76 Fed. Reg. 78553, 2012-8 I.R.B. 395 (Dec. 19, 2011) (preamble).

29 Accuracy-related penalties generally avoid stacking. See, e.g., H.R. REP. No. 101-386, at 662 (1989) (Conf. Rep.) (establishing “a new [accuracy-related penalty] structure that operates to eliminate any stacking.”). An IRS task force concluded that penalty stacking “seems to operate illogically and serve no important policy that could not be served in a simpler way. Stacking has a haphazard impact on proportionality unless carefully coordinated and thus should be avoided.” Executive Task Force for the Commissioner’s Penalty Study, IRS, *Report on Civil Tax Penalties*, reprinted in 89 Tax Notes Today 45-36 (Feb. 27, 1989) [*hereinafter IRS 1989 Penalty Study*]. The American Institute of Certified Public Accountants (AICPA) has observed that disproportionate penalties, unrelated to the degree of misconduct or harm, which can result from stacking, threatens to “undermine faith in the fairness of the system.” See AICPA, *Penalty Reform Task Force, Report on Civil Tax Penalties: The Need for Reform*, 7 (2009). Research suggests that faith in the fairness of the tax system promotes voluntary compliance. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 34-56.

30 See, e.g., T.D. 9658 (March 6, 2014) (preamble) (summarizing the reporting and withholding regime under FATCA); Notice 2013-43, 2013-2 C.B. 113 (requiring certain financial institutions to begin providing the IRS with foreign account data under FATCA by March 31, 2015).

31 IRC § 6651.

32 See, e.g., IRC § 6721(a).

33 According to the IRS 1989 Penalty Study, penalties are proportionate if they vary based on the harm to the tax system and mitigation efforts, for example, by penalizing slightly-late filers owing little tax less than seriously-late filers (or nonfilers) owing more. The IRS currently allows certain people with delinquent FBARs who have no unreported income to file late without penalty. IRS, *Delinquent FBAR Submission Procedures* (Oct. 9, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Delinquent-FBAR-Submission-Procedures>. The FBAR statute also allows the IRS to waive the penalty if the taxpayer has reported all of the income from the account and establishes reasonable cause. See 31 U.S.C. § 5321(a)(5)(B).

Like the FBAR penalty, the penalties for failure to report foreign entities on information returns can be severe.<sup>34</sup> Unlike the process of creating foreign bank accounts, however, taxpayers typically create foreign entities with the assistance of advisors to avoid information reporting delinquencies.

**FBAR penalties are even more disproportionate when they apply to reasonable or minor mistakes.**

If the tax avoided by the failure to report an offshore account and the income from the account is too minor to trigger an accuracy-related penalty under IRC § 6662, the failure is likely to have been unintentional or due to reasonable cause, particularly if there is no indication that the account was used in connection with a crime. Similarly, the failure to report accounts that have already been reported to the IRS by third parties is likely to be inadvertent,<sup>35</sup> as is the failure to report accounts in the jurisdiction where the taxpayer lives.<sup>36</sup> Taxpayers residing offshore have legitimate non-tax reasons for opening accounts where they reside.

The reasonable cause exception does not automatically cover these situations. Moreover, taxpayers have to provide evidence of reasonable cause, but it is difficult for them to prove a negative. For example, even if the IRS does not pursue willful penalties, it is difficult for taxpayers to show reasonable cause for failure to file a tax return based on ignorance of the law or reliance, as relevant authorities suggests they are essentially presumed to know about return filing requirements.<sup>37</sup> The IRS relies on these same authorities in determining reasonable cause for failure to file an FBAR.<sup>38</sup>

**EXAMPLE 1<sup>39</sup>**

When an engineer immigrated to the United States and became a resident, he retained a joint account with his family overseas containing proceeds from the sale of the family residence. He asked the bank not to send him statements because he treated the funds as belonging to his overseas relatives. He did not disclose the account when filling out a questionnaire for his U.S. tax return preparer because it did not occur to him that the small amount of earnings it generated might be taxable to him in the U.S. As a result, his preparer did not check the box on Schedule B to indicate he had a foreign account. He repeated this error

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34 See, e.g., Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, Form 5472, *Information Return of a Foreign Owned Corporation*, Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*, Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, Form 3520-A, *Annual Return of Foreign Trust With a U.S. Owner*. The penalty for failure to file these information returns is generally \$10,000 per violation or a percentage of the funds transferred. See generally IRC §§ 6038, 6038B, 6038D, 6039F, 6048. Accord 2012 OVD FAQ #5. Another consequence of the failure to file these information returns (or Form 8938) is that the statute of limitations period for the related income tax return generally does not begin to run. See IRC § 6501(c)(8). Moreover, a 40 percent penalty may apply to the portion of any understatement attributable to a transaction involving an undisclosed foreign financial asset. IRC § 6662(j).

35 But see *United States v. Williams*, 489 Fed. Appx. 655 (4th Cir. 2012) (unpublished) (concluding an FBAR violation was willful notwithstanding evidence the government was already aware of the unreported account).

36 C.f., IRC § 6038D(h); Treas. Reg. § 1.6038D-7T (providing that Form 8938 does not need to include accounts the taxpayer reported on certain other tax forms or that are held in the U.S. possession where the taxpayer resides).

37 See, e.g., *United States v. Boyle*, 469 U.S. 241, 251-252 (1985); IRM 20.1.1.3.2.2.6(3) (Nov. 25, 2011) (ignorance of the law); IRM 20.1.9.1.1(4) (Mar. 21, 2013) (reliance on preparer). The requirement to file an FBAR is not as widely known as the requirement to file a tax return. This should make it easier to show reasonable cause for failure to file an FBAR than for failure to file a tax return. See Treas. Reg. 1.6664-4(b)(1) (“Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer.”). But, the IRM seems to suggest the opposite. See e.g., IRM 20.1.9.1.1(4) (Mar. 21, 2013).

38 See IRM 4.26.16.4.3.1 (July 1, 2008).

39 All of the examples in this discussion are hypothetical.

on all subsequent returns. The taxpayer has never filed an FBAR because he was not aware of the filing requirement. The offshore account had a relatively constant balance of about \$100,000. The taxpayer underreported a very small amount of earnings from the account—not enough to trigger the substantial understatement penalty under IRC § 6662.<sup>40</sup>

Because the statute of limitations for FBAR violations is six years, the FBAR penalty could be as high as \$600,000 (the greater of \$100,000 or 50 percent per year)—six times the balance—if the IRS deems the violation to be “willful” (and it might, as discussed below).<sup>41</sup> By contrast, the maximum non-willful FBAR penalty could be \$60,000 (\$10,000 per year).<sup>42</sup> The IRS would waive the penalty if it determined the taxpayer had reasonable cause and ultimately reported all of the income from the account.<sup>43</sup> In this case, however, the IRS does not agree that the violation was due to reasonable cause. It believes a reasonable person exercising ordinary business care and prudence would have either disclosed the account to the preparer or reviewed Schedule B, either of which would have alerted him or her to the FBAR filing requirement in the absence of any other impediment (*e.g.*, a mental impairment or malpractice by the preparer).<sup>44</sup>

FBAR penalties may apply even if the IRS was already aware of the account (*e.g.*, because of third party filings from the foreign bank). Had violations occurred after the 2011 tax year, the taxpayer could also be subject to a penalty of \$10,000 per year for failing to report the same account on Form 8938 *Statement of Specified Foreign Financial Assets*.<sup>45</sup>

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<sup>40</sup> An understatement is substantial, triggering an accuracy-related penalty, if it exceeds the greater of (i) 10 percent of the tax required to be shown on the return, or (ii) \$ 5,000. IRC § 6662(d).

<sup>41</sup> The FBAR penalty could be an even greater percentage of the balance if the account value had fallen since the end of the sixth year (or if the account were less than \$200,000, as the maximum penalty is never less than \$100,000). See 31 U.S.C. § 5321(a)(5). As this example illustrates, the FBAR penalty can be much greater than the mere forfeiture of the unreported funds. Yet, the IRS has ceased using civil forfeiture provisions that would otherwise apply when people structure cash transactions to avoid BSA reporting, presumably because they were viewed as overly harsh. See Tax Analysts, *IRS Backs off Some Civil Forfeitures After Media Inquiries*, 2014 TNT 208-1 (Oct. 27, 2014).

<sup>42</sup> *Id.*

<sup>43</sup> *Id.* Assume the IRS’s mitigation guidelines do not apply because the taxpayer did not timely respond to the examiner’s request to provide voluminous historic account statements from a foreign bank translated into English, the IRS issued a summons, and as a result, the taxpayer was not deemed to have cooperated. See IRM Exhibit 4.26.16-2 (July 1, 2008).

<sup>44</sup> See, *e.g.*, *United States v. Boyle*, 469 U.S. 241 (1985); IRM 20.1.9.1.1(4) (Mar. 21, 2013).

<sup>45</sup> See IRC § 6038D; T.D. 9567, 76 Fed. Reg. 78,553, 2012-8 I.R.B. 395 (Dec. 19, 2011).

## RECOMMENDATIONS

To address the disproportionality of the civil FBAR penalty, the National Taxpayer Advocate recommends legislation to:

1. Cap the civil FBAR penalty at the lesser of
  - (a) Ten percent of the unreported account balance or five percent for non-willful violations (similar to the IRS's mitigation guidelines), and
  - (b) Forty percent of the portion of any underpayment attributable to the improperly undisclosed accounts (similar to the penalty for undisclosed foreign financial assets (*e.g.*, assets not reported on Form 8938) under IRC § 6662(j)).<sup>46</sup>
2. Eliminate or waive the civil penalty for failure to report an account on an FBAR if there is no evidence the account was used in connection with a crime and:<sup>47</sup>
  - a. The account information was already provided to the IRS, for example, on a Form 8938, *Statement of Specified Foreign Financial Assets*, or by a third party (*e.g.*, a financial institution or government);<sup>48</sup>
  - b. The amount of unreported income from the account does not create a substantial understatement under IRC § 6662(d),<sup>49</sup> or
  - c. The taxpayer resides in the same jurisdiction as the account.<sup>50</sup>

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46 To avoid stacking, only one penalty should apply to understatements of income from foreign financial assets not disclosed on either a Form 8938 or an FBAR.

47 Under this recommendation, the civil FBAR penalty could still be waived on the basis of reasonable cause as is the case under current law.

48 Because the Financial Crimes Enforcement Network (FinCEN) may not be authorized to receive all of the account information provided to the IRS by third parties, it may be advisable for legislation to distinguish between information available to the IRS and information available to FinCEN. An alternative would be to have the disclosure of account information to the IRS by third parties create a presumption that, in the absence of evidence to the contrary, a taxpayer's failure to provide the same information was due to reasonable cause and was not willful.

49 Even if the understatement is substantial, legislation could require the government to consider whether it was reasonable for the taxpayer to believe that any unreported income would be offset by foreign tax credits in connection with its reasonable cause determination.

50 For similar proposals, see, *e.g.*, Christians, Allison, *Paperwork and Punishment: It's Time to Fix FBAR*, 73 TAX NOTES INT'L 147 (Oct.13, 2014).

## PENALTIES: Require the Government to Prove Actual Willfulness Before Imposing the Penalty for Willful FBAR Violations

### PROBLEM

Benign actors cannot be sure the IRS will not view their FBAR violations as “willful,” and attempt to impose severe penalties. This is because the government has eroded the distinction between willful and non-willful violations.

The IRS may meet its burden of proving willfulness if it establishes a “voluntary, intentional violation of a known legal duty.”<sup>51</sup> Because Schedule B of Form 1040 (*U.S. Individual Income Tax Return*) asks if the taxpayer has a foreign account and references the FBAR filing requirement, however, the government has been successful in arguing—in cases involving bad actors—that the filing of a Schedule B can turn a subsequent failure to file an FBAR into a willful violation (called “willful blindness”), at least if combined with other circumstantial evidence such as efforts to conceal the account.<sup>52</sup> It is unclear what other circumstantial evidence or factors the IRS will consider or if it will distinguish between efforts to conceal the account with the intent to evade U.S. taxes or conceal crimes,<sup>53</sup> as opposed to inadvertent concealment, or concealment based on reasonable concerns about financial privacy or fears of unwarranted persecution, seizure, or extortion by a government or others (e.g., terrorists or organized criminals).<sup>54</sup> The IRS has

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- 51 *Ratzlaf v. U.S.*, 510 U.S. 135, 142 (1994) (citing *Cheek v. U.S.*, 498 U.S. 192, 201 (1991)); IRM 4.26.16.4.5.3 (July 1, 2008). The government has the burden to prove the violation was willful by a preponderance of the evidence. See, e.g., *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012). In connection with its streamlined program, however, the IRS stated on its website: “Non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.” IRS, *Streamlined Domestic Offshore Procedures* (Oct. 9, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-in-the-United-States>.
- 52 See, e.g., *Williams v. Comm'r*, 489 Fed. App'x. 655, 659 (4th Cir. 2012) (unpublished) (“Evidence of acts to conceal income and financial information, combined with the defendant's failure to pursue knowledge of further reporting requirements as suggested on Schedule B, provide a sufficient basis to establish willfulness on the part of the defendant,” quoting *U.S. v. Sturman*, 951 F.2d 1466, 1476 (6th Cir. 1992); *U.S. v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012); IRM 4.26.16.4.5.3(6) (July 1, 2008) ([after filing a Schedule B,] “the failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness.”). Under these authorities, a person might conclude that a reckless failure to read the instructions on Schedule B is akin to willfulness. In a criminal context, a person generally may be charged with knowledge of a violation by reason of willful blindness if he or she is aware of a “high probability” of its existence, unless he actually believes that it does not exist. See, e.g., Jonathan L. Marcus, *Model Penal Code Section 2.02(7) and Willful Blindness*, 102 YALE L.J. 2231 (1993) (discussing various interpretations of the willful blindness standard).
- 53 At an American Bar Association (ABA) conference one IRS employee reportedly provided his personal view, that a person would not be deemed willful if he was concealing the account to evade foreign taxes. See Kristen A. Parillo, *ABA Meeting: More Guidance Coming on Modified OVDP and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014) (quoting John McDougal as saying “the willfulness we're trying to determine is with respect to U.S. obligations, not foreign obligations...[I]f ... I'm convinced he had no clue he had to file in the United States, then that seems to me to be the answer to the question”).
- 54 See e.g., Patrick J. Smith, *District Court Misapplies APA in Florida Bankers Association*, 142 TAX NOTES 745 (2014) (suggesting residents of some U.S. treaty partners such as China, Egypt, Indonesia, Mexico, Pakistan, Panama, the Russian Federation, and Venezuela, might reasonably fear that information provided by the U.S. government to their governments under a treaty would not remain confidential, notwithstanding the confidentiality provisions of the treaty).

declined to provide guidance to the public that would clarify its interpretation of willfulness and potentially assuage these concerns.<sup>55</sup>

For this reason, even a benign actor who inadvertently overlooked the requirement(s) cannot be sure the violation will be treated as non-willful or due to reasonable cause.<sup>56</sup> Because of this uncertainty, the OVD programs have pressured some benign actors into paying more than they would in an examination.<sup>57</sup>

Legislation to clarify that only violations that the IRS proves are actually willful (without relying solely on circumstantial evidence) are subject to a willful FBAR penalty would reduce the excessive discretion afforded the IRS in determining what penalty to assert. It would also support the taxpayer's *right to be informed*, which includes the right to a clear explanation of the law.<sup>58</sup>

## EXAMPLE 2

Assume the same facts as Example 1 (in the Legislative Recommendation: *Improve the Proportionality of the Civil FBAR Penalty*, above). The IRS asserts the willful FBAR penalty because, although it cannot prove the taxpayer intentionally violated a known legal duty (*i.e.*, was willful), it may be able to establish willful blindness (by a preponderance of the evidence) based on circumstantial evidence, including the fact that the taxpayer asked the bank to hold his account statements, did not inform his preparer of the account, and did not check the box on Schedule B of his return to indicate he had foreign account(s).<sup>59</sup> Even though his violation was inadvertent, the taxpayer may not be able to avoid the willful FBAR penalty because he cannot prove he was unaware of the FBAR filing requirement (*e.g.*, has no documentation to establish a mental impairment or that he did not read Schedule B) or reasonably relied on inaccurate advice from his tax advisor.

## RECOMMENDATION

To protect benign actors from having to prove their FBAR violations were nonwillful and to give everyone a better understanding about when a willful or nonwillful FBAR penalty applies, the National Taxpayer Advocate recommends legislation to clarify that the government has the burden to establish actual willfulness (*i.e.*, specific intent to violate a known legal duty, rather than mere negligence or recklessness) before asserting a willful FBAR penalty, and cannot meet this burden by relying solely on circumstantial evidence.<sup>60</sup>

55 See, e.g., Amanda Athanasiou, *IRS Addresses Questions About OVDP and Streamlined Filing*, 2014 TNT 212-7 (Oct. 31, 2014); Amy S. Elliott, *IRS Working with SSA on Offshore Streamlined Filing Requirement*, 2014 TNT 216-3 (Nov. 6, 2014) (“[W]e made a deliberate decision not to define’ what constitutes non-willfulness, Best [Senior Advisor to the Deputy Commissioner (International), IRS Large Business and International Division], said. She added that while the IRS has ...provided training to agents, the training didn’t include specific guidance on non-willfulness.”). However, the IRS may be forced to disclose some of this material, at least to those willing to litigate. See, e.g., Marie Sapiré, *What the OVDP Training Materials Tell Us*, 2014 TNT 230-2 (Dec. 1, 2014) (discussing redacted training materials provided to one taxpayer who had to pursue litigation to obtain them).

56 See, e.g., Caroline Ciraolo, *The FBAR Penalty: What Constitutes Willfulness?*, MD J. TAX’N (May 2013).

57 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress, *supra* (Most Serious Problem: *The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights*); National Taxpayer Advocate 2013 Annual Report to Congress 228-237.

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

59 IRM 4.26.16.4.5.3(6) (July 1, 2008).

60 Under current law, the government is only required to establish willfulness by a preponderance of the evidence. See, e.g., *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012) (applying the “preponderance” standard, rather than “clear and convincing,” or “beyond a reasonable doubt”).

## CLOSING AGREEMENTS: Authorize the IRS to Modify Closing Agreements to Treat Taxpayers Who Correct Violations Early the Same as (or Better Than) Those Who Correct Them Later

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### PROBLEM

The IRS announced in June 2014, that it would accept more favorable settlement terms from those willing to certify their FBAR violations were not willful.<sup>61</sup> When it had previously made taxpayer-favorable revisions to its OVD programs, the IRS allowed otherwise-qualifying taxpayers who had signed closing agreements to modify their agreements to benefit from the more lenient program terms.<sup>62</sup> However, the IRS did not allow otherwise-qualifying taxpayers to modify their agreements to take advantage of the more lenient terms announced in 2014. It is not clear that the IRS is legally authorized to do so.

Before the IRS changed the OVD program in 2014, it encouraged benign actors who inadvertently failed to report foreign accounts to enter various OVD settlement programs, then “opt out” and be examined.<sup>63</sup> Instead of risking an examination, many agreed to pay a significant percentage of their offshore assets (typically 20 to 27.5 percent)—sometimes more than they would have been asked to pay had they been subject to examination.<sup>64</sup>

Under OVD program changes announced in 2014, benign actors (*i.e.*, those who certify their violations were not willful) who are nonresidents may correct FBAR violations without penalty.<sup>65</sup> U.S. residents pay only five percent of the unreported account balance.<sup>66</sup>

Taxpayers who agreed to pay more under a prior OVD program than they would pay under the current program(s) felt penalized for coming forward early.<sup>67</sup> It is difficult to see how such an approach will encourage future compliance by them or anyone else. Instead, it creates an incentive for anyone facing potentially severe penalties to wait for the government to become more reasonable, which is inconsistent with the objective of promoting voluntary compliance.

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<sup>61</sup> See 2014 streamlined program (explaining that the IRS may “incorporate the streamlined penalty terms in the OVDP closing agreement,” but only for a taxpayer who applied to an OVD program before July 1, 2014 and “does not yet have a fully executed OVDP closing agreement.”).

<sup>62</sup> The IRS previously offered to amend 2009 OVD agreements for taxpayers who would qualify for the reduced 5 percent or 12.5 percent offshore penalty rates under the 2011 OVD. See 2011 OVD FAQ #52; 2011 OVD FAQ #53. Similarly, it allowed taxpayers to modify closing agreements in a manner consistent with the earlier (2012) streamlined program. See IRS, *Frequently Asked Questions Regarding the Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer Taxpayers*, FAQ #5 (Dec. 2013), <http://www.irs.gov/Individuals/International-Taxpayers/FAQReStreamlinedFilingComplianceProceduresNRNFTPs>.

<sup>63</sup> See, e.g., 2011 OVD FAQ #51.

<sup>64</sup> For a more detailed discussion of this problem, see, e.g., OVD Reports.

<sup>65</sup> See 2014 streamlined program.

<sup>66</sup> *Id.*

<sup>67</sup> See Andrew Velarde, *Practitioners Disagree on Fairness of Lack of OVDP Retroactivity*, 2014 TNT 152-2 (Aug. 7, 2014) (quoting one practitioner as saying, “[T]he OVDP has many taxpayers with closing agreements who were non-willful but who were scared to opt out...If those same taxpayers had the choice to participate in the streamlined program as it is today back then, they would have never gone into OVDP,” but offering a different view from another).

However, the IRS may not have the legal authority to modify OVD agreements. Closing agreements are generally governed by contract law principles,<sup>68</sup> under which an agreement can be modified with the consent of both parties.<sup>69</sup> However, section 7121(b) provides that closing agreements

shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—(1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States...

Accordingly, the IRM states that the parties to a closing agreement cannot rescind or modify it by consent.<sup>70</sup> Thus, legislation to clarify that the parties can modify closing agreements by consent would empower the IRS to treat those who corrected violations early the same as those who corrected them later. It would also be consistent with a taxpayer's *right to a fair and just tax system*.<sup>71</sup>

### EXAMPLE 3

Assume the taxpayer described in Example 1 (in the Legislative Recommendation: *Improve the Proportionality of the Civil FBAR Penalty*, above) entered the IRS's 2011 OVD program, which required him to amend eight returns, file six FBARs, and pay any unpaid tax, accuracy-related penalties, failure to pay penalties, and a 25 percent "offshore penalty" of \$25,000.<sup>72</sup> Although he would owe much less—perhaps nothing—outside of the OVD program, he did not opt out (*i.e.*, he accepted these terms) because he was concerned that opting out could affect his immigration status, unsure about whether the IRS would deem his violations to be willful, and concerned about the cost, burden, and stress of an IRS examination and the potential for having to appeal and litigate the examination determination(s).

The taxpayer now wishes he had not come forward to correct the problem so quickly. Under the 2014 OVD program changes, he would have qualified for the terms of the streamlined program. Had his case still been open on July 1, 2014, the IRS would have accepted a closing agreement requiring him to pay only his unreported tax plus an offshore penalty of five percent or \$500. However, the IRS will not agree to amend his closing agreement to provide him with similar terms.

### RECOMMENDATION

To empower the IRS to treat taxpayers consistently and fairly, the National Taxpayer Advocate recommends legislation to authorize the IRS to modify closing agreements with the taxpayer's consent, particularly when necessary to promote equity or public policy (including consistency). She also recommends directing the IRS to use this authority to amend OVD closing agreements to make them consistent with the terms of agreements publicly offered to similarly-situated taxpayers in subsequent IRS programs.

68 See, e.g., *U.S. v. National Steel Corp.*, 75 F3d 1146, 1150 (7th Cir. 1996); *Rink v. Comm.*, 47 F3d 168, 171 (6th Cir. 1995).

69 See, e.g., *Large v. Mobile Tool Int'l*, 724 F.3d 766, 772 (7th Cir. 2013) ("Parties are free to abrogate, change, modify, or substitute a primary contract with their mutual assent."). Treasury Regulation section 301.7121-1(b)(1) also contemplates "a series of closing agreements relating to the tax liability for a single period," but Rev. Proc. 68-16 § 3.02, 1968-1 C.B. 770 clarifies that "no such [subsequent closing] agreement may modify any matter previously determined by closing agreement except as provided by statute." See also IRM 8.13.1.1.1 (Nov. 9, 2007).

70 IRM 8.13.1.6.1 (Nov. 9, 2007).

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

72 2011 OVD FAQ #7.

## FBAR FORMS: Reduce the Burden of Foreign Account Reporting

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### PROBLEM

Foreign account reporting is unnecessarily burdensome and duplicative.<sup>73</sup> U.S. citizens and residents may be required to report foreign accounts on different forms (FBAR vs. Form 8938), at different times of the year (June 30th for FBAR vs. April 15th or September 15th for Form 8938), when they reach different thresholds (\$10,000 for FBAR vs. \$50,000 or more for Form 8938), using different definitions, and even though the government may already know about the accounts.<sup>74</sup> Requiring taxpayers to file forms on two different dates may increase preparation expenses and the chances of error, because taxpayers must remember two filing deadlines and potentially consult advisors twice.

#### The FBAR reporting threshold has declined in real terms.

Stakeholders have also argued that the FBAR reporting threshold is too low.<sup>75</sup> Although it has fluctuated over the years, today's \$10,000 threshold is the same as it was in 1970.<sup>76</sup> If indexed for inflation from 1970, \$10,000 would be more than \$61,000 in today's dollars—significantly more than the \$50,000 threshold for reporting on Form 8938.<sup>77</sup>

#### Raising the FBAR threshold to \$50,000 could eliminate nearly one third of the forms.

Because there are fewer wealthy taxpayers with large accounts than middle-class taxpayers with smaller accounts, increasing the reporting threshold could significantly reduce the number of people who have to file FBARs. Over 30 percent of the FBARs the IRS received in calendar year 2012—nearly 250,000

<sup>73</sup> TAS has repeatedly recommended that the IRS to address this unnecessary and duplicative burden. See National Taxpayer Advocate 2013 Annual Report to Congress 228-237; National Taxpayer Advocate 2013 Annual Report to Congress 238-248; National Taxpayer Advocate 2012 Annual Report to Congress 134-153; TAS Recommendations for Published Guidance under IRC §§ 6038D and 1471 (Apr. 24, 2014). The IRS has consistently declined. See, e.g., National Taxpayer Advocate 2015 Objectives Report to Congress 93-94, 99 (June 2014) (citing, in part, FinCEN's authority over the FBAR filing requirements).

<sup>74</sup> For further discussion of these overlapping reporting requirements, see Treasury Inspector General for Tax Administration (TIGTA), *New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, but Potential Issues are Being Addressed*, Ref. Num. 2010-30-125 (Sept. 2010); Government Accountability Office, GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, App. 2 (Feb. 2012); IRS, *Comparison of Form 8938 and FBAR Requirements*, at <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>. The IRS could reduce, but not eliminate, duplicative reporting by adding items reported on an FBAR to the existing list of items that taxpayers do not have to report on Form 8938. See Treas. Reg. § 1.6038D-7T. The IRS has access to the FinCEN Query System, which allows IRS employees direct electronic access to FBAR data.

<sup>75</sup> See Recommendation by the Federation of American Women's Clubs Overseas, Inc. (FAWCO), Association of Americans Resident Overseas (AARO), and American Citizens Abroad (ACA) (Feb. 2012).

<sup>76</sup> See, e.g., Form 4683, *U.S. Information Return on Foreign Bank, Securities & Other Financial Accounts* (1970) (\$10,000 threshold); Form 90.22-1, *Report of Foreign Bank and Financial Accounts* (1978) (\$1,000 threshold); Form 90.22-1, *Report of Foreign Bank and Financial Accounts* (1983) (\$5,000 threshold); 50 Fed. Reg. 42,691 (Oct. 22, 1985) (\$10,000 threshold); Bank Secrecy Act (BSA), *Electronic Filing Requirements for Report of Foreign Bank and Financial Accounts*, FinCEN Form 114 (2014) (\$10,000 threshold).

<sup>77</sup> Dep't of Labor, Bureau of Labor Statistics, *CPI Inflation Calculator*, [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm). We understand that FinCEN has opposed the suggestion to increase the FBAR filing threshold, in part, because \$10,000 may be more significant when denominated in certain foreign currencies. However, this was true in 1970 when the threshold was more than \$61,000 in today's dollars. *Id.*

forms—reported accounts of less than \$49,999.<sup>78</sup> Thus, assuming most taxpayers file only one form, coordinating the FBAR filing threshold with the Form 8938 threshold could reduce taxpayer burden by nearly one third.

In addition, if information about large offshore accounts is more useful to the government than information about those with small ones, then raising the threshold could ease taxpayer burden without significantly reducing the value of the FBAR to the government. Further, curtailing low-dollar FBAR filings would reduce the resources required to process them and help the government focus its limited resources on the higher-dollar filings—and higher-dollar non-filers.

#### **One form would be better than two, if confidentiality concerns are addressed.**

If it aligns the FBAR and Form 8938 thresholds and deadlines, Congress should also consider consolidating the reporting requirements. Indeed, between 1970 and 1977, the Treasury Department only required taxpayers to report foreign accounts under the BSA on tax returns using Form 4683, *U.S. Information Return on Foreign Bank, Securities & Other Financial Accounts*.

In 1977, after taxpayer privacy laws were expanded under IRC § 6103, the IRS required people to report these accounts on a different form—not part of the return—so it could share the information with other federal agencies such as FinCEN.<sup>79</sup> Therefore, if Congress requires the Treasury Department to combine these forms, it may also want to clarify that certain information on the combined form is not deemed part of the tax return and is not subject to IRC § 6103.

In connection with any such change, however, Congress should require the IRS to limit and prominently identify on the form, any information that may be disclosed to FinCEN.<sup>80</sup> Without transparency and specificity, some taxpayers might withhold other information from the IRS based on a concern that it could be disclosed to other agencies. Foreign account information may be distinguished from other tax-related information because it is already required to be reported to FinCEN.

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78 IRS response to TAS information request (Nov. 20, 2014) (indicating the IRS received 807,040 FBARs in CY 2012 – 248,128 (31 percent) reporting accounts less than \$49,999, 521,244 (65 percent) reporting accounts of more than \$50,000, and 37,668 (5 percent) reporting no account values). Because this data reflects the number of FBARs and not the number of taxpayers, if one taxpayer filed two FBARs, each reporting accounts of \$30,000, this would be reflected as two FBARs with account values less than \$49,999. *Id.*

79 See, e.g., Treasury Inspector General for Tax Administration (TIGTA), *New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, but Potential Issues are Being Addressed*, Ref. Num. 2010-30-125 (Sept. 2010); General Accounting Office (GAO), *Better Use of Currency and Foreign Account Reports by Treasury and IRS Needed for Law Enforcement Purposes*, GGD-79-224 3 (April 6, 1979), <http://archive.gao.gov/f0302/109024.pdf>. Because the IRS considers itself FinCEN's agent in administering the BSA, it segregates information obtained under Title 31 (e.g., the FBAR) and Title 26 (tax), and requires a "related statute" determination before allowing IRS employees to use Title 26 information in a BSA investigation under Title 31. IRM 4.26.14.2 (July 24, 2012). However, in one recent case where a taxpayer complained that the IRS opened an FBAR investigation without first making a "related statute" determination pursuant to IRS procedures, the court granted the government's motion to dismiss, concluding that the FBAR statute (31 USC § 5314) was a "related statute" for purpose of IRC § 6103. See *Horn v. United States*, 112 A.F.T.R.2d (RIA) 6271 (N.D. Cal. 2014). The court's reasoning may suggest that because the FBAR statute is a "related statute," the IRS may use tax information covered by IRC § 6103 in an FBAR investigation without first making a case-specific determination, but we are not aware of any current plans by the IRS to change its procedures.

80 This would be in accordance with the taxpayer right to be informed. IRS Pub. 1, *Your Rights as a Taxpayer* (2014). Retaining the confidentiality restrictions on the remainder of the return would also further the taxpayer right to confidentiality. *Id.*

## EXAMPLE 4

Assume the taxpayer described in Example 1 (in the Legislative Recommendation: *Improve the Proportionality of the Civil FBAR Penalty*, above) retains the foreign account. In 2015, the foreign bank reports the account to the IRS. The taxpayer is nonetheless required to report the account on Form 8938, which he files with his tax return by April 15, though an extension may be available. He must also report the account on an FBAR by June 30. No FBAR filing extension is available. Even if he has already paid for tax preparation, he may have to pay another fee to discuss any FBAR questions with his advisor.<sup>81</sup> Moreover, he may need to hire another advisor if his return preparer is not familiar with the FBAR rules.

## RECOMMENDATION

To reduce taxpayer burden, the National Taxpayer Advocate recommends aligning the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). Specifically, she recommends increasing the \$10,000 FBAR filing threshold to match the threshold applicable to Form 8938 (*i.e.*, at least \$50,000), adjust it for inflation, and change the FBAR filing due date to coincide with the due date applicable to a taxpayer's federal income tax return and Form 8938 (including extensions).

If Congress aligns these due dates and thresholds, it should also consider requiring the Treasury Department to consolidate the reporting of foreign accounts (*i.e.*, the FBAR and Form 8938) so that taxpayers only have to report them on one form. To facilitate this change, legislation should clarify that the IRS may disclose certain account information to FinCEN without violating IRC § 6103. The legislation should require the IRS to highlight (on the new form) any information not subject to the normal confidentiality rules (*e.g.*, because it is not part of the tax return).<sup>82</sup>

<sup>81</sup> TAS has been informed that this fee could be substantial, particularly for persons overseas. TAS meeting with representatives of the American Citizens Abroad (Sept. 4, 2014).

<sup>82</sup> Congress might also clarify that taxpayers not otherwise required to file a tax return could, nonetheless, use the same form to satisfy their reporting obligations under the BSA.

**LR****#7****FILING STATUS: Clarify the Definition of “Separate Return”****in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure****PROBLEM**

Internal Revenue Code (IRC) § 6013 precludes a married taxpayer who filed a “separate return,” an undefined term, from filing an amended return electing Married Filing Jointly (MFJ) status for the same tax year once either spouse has filed a Tax Court petition in response to a statutory notice of deficiency (SNOD).<sup>1</sup> In *Glaze v. United States*, the Fifth Circuit Court of Appeals held that the term “separate return” in IRC § 6013(b) means only a return filed with a status of married filing separately (MFS).<sup>2</sup> The Court of Appeals for the Eleventh Circuit follows the reasoning in *Glaze*.<sup>3</sup> The Tax Court, however, interprets the term “separate return” to mean any return except for a MFJ return.<sup>4</sup> Thus, whether a taxpayer may change his or her filing status to MFJ depends on the location of the Court of Appeals that would hear an appeal of a Tax Court decision.<sup>5</sup>

In addition, taxpayers who are unaware that the Code allows for changes in filing status, but that limitations apply, may pay taxes at a higher effective rate and experience financial hardship. Taxpayer rights, including *the right to be informed, the right to pay only the amount of tax legally due, and the right to fair and just tax system are negatively affected.*<sup>6</sup>

1 IRC§ 6013(b)(1), (b)(2)(B), and Treas. Reg. § 1.6013-2(b)(3). IRC § 6213(c) provides, “... the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the Secretary.” The SNOD currently does not inform taxpayers that they may file an amended return prior to filing a petition with the Tax Court. TAS is working with the IRS on updating the IRM and SNOD language to inform taxpayers about this rule and acting on TAS’s recommendation, the IRS has recently updated IRM 4.19.3.20.7.4 (6)(b), *Referrals*, (Nov. 4, 2014). The IRS updated the IRM adding that if taxpayers intended to change their filing status to Married Filing Jointly they must do so prior to filing their petition with the Tax Court. See Servicewide Electronic Research Program Alert 14U1560 (Nov. 04, 2014), available at <http://serp.enterprise.irs.gov/databases/irm.dr/current/4.dr/4.19.dr/4.19.3.20.7.4.htm> (last visited Dec. 6, 2014).

2 *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981).

3 The 11th Circuit adopted all prior decisions of the Court of Appeals for the 5th Circuit in *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981).

4 See, e.g., *Currie v. Comm'r*, T.C. Memo. 1986-71; *Blumenthal v. Comm'r*, T.C. Memo. 1983-737; *Saniewski v. Comm'r*, T.C. Memo. 1979-337. The Tax Court does not follow *Glaze* for appeals that would lie with courts of appeal outside the Fifth and Eleventh Circuit under the *Golsen* rule. See *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971). See also *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981), *action on dec.*, 1981-140 (June 2, 1981); CC-2006-010 (Mar. 2, 2006). The IRS Office of Chief Counsel notice took the position that the *Glaze* holding was, “inconsistent with Tax Court cases that applied the limitations under § 6013(b)(2) when a married person has erroneously filed an earlier return as a single taxpayer or head of household, and later wishes to file an amended joint return.”

5 See IRC § 7482(a) and (b) for appellate jurisdiction and venue to review the decisions of the Tax Court. The venue for an appeal of the Tax Court’s decision would generally be in the court of appeals for the circuit in which the taxpayer resides. See IRC § 7482(b)(1)(A).

6 On June 10, 2014, the IRS formally adopted the TBOR. See IRS, *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov*, in Publication 1, IR-2014-72 (June 10, 2014), available at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;-10-Provisions-to-be-Highlighted-on-IRSGov,-in-Publication-1>.

## EXAMPLE

M and F, a married non-English speaking immigrant couple with limited education and tax knowledge reside in Massachusetts<sup>7</sup> and go to a return preparer to have their 2011 tax returns prepared. The couple prepared and filed timely returns. The preparer incorrectly advised M to elect “head of household” filing status and claim his two minor children as dependents.<sup>8</sup> M also claimed an earned income tax credit (EITC) resulting in a refundable credit, which M asked to be refunded.

The IRS audited M’s return, treated M’s return status as MFS, disallowed the claimed EITC, and issued a SNOD to M.<sup>9</sup> M was unaware that he and his wife could amend their filing status to MFJ before petitioning the Tax Court, which would make M and W eligible for the disallowed credits. M filed a petition in Tax Court and thus is precluded from changing his filing status to MFJ, even though there was no dispute that M was ineligible as “head of household” and is legally married. The Tax Court treated M’s return status as Married Filing Separately (MFS,) citing the limitations of IRC § 6013(b)(1) and 6013(b)(2)(B), resulting in a deficiency rather than a refund.

## RECOMMENDATION

To address the inconsistent application of IRC § 6013 by courts, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6013(b)(1) by clarifying the term “separate returns” means any return that is not a joint return, and
- Amend IRC § 6013(b)(2)(B) to allow taxpayers the right to change their filing status to MFJ after filing a Tax Court petition in response to a SNOD, in accordance with rules of practice and procedure of the Tax Court or, in the alternative, eliminate IRC § 6013(b)(2)(B).<sup>10</sup>

## PRESENT LAW

In 1939, Congress added IRC § 51(b), which allowed a married couple that lived together to include their separate incomes “in a single return made by them jointly.”<sup>11</sup> At that time, a married couple could not file a joint return if one of the spouses had made a separate return and the time for filing the return for the other spouse had expired.<sup>12</sup> In 1948 and later years, Congress extensively revised IRC § 51(b), now IRC § 6013(b)(1), to balance the disparities between married and unmarried individuals, as well as concerns about surviving spouses of service members.<sup>13</sup> In 1951, Congress added IRC § 51(g), the

<sup>7</sup> The taxpayers reside within the Court of Appeals for the First Circuit. The First Circuit includes the Districts of Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island.

<sup>8</sup> Generally, married individuals are precluded from claiming head of household unless they meet certain exceptions not present here. See IRC § 2(b). See also IRS Pub. 504, *Divorced and Separated Individuals* 5-6 (Oct. 31, 2013).

<sup>9</sup> The funds were never released to the taxpayer; however for the deficiency calculation the EITC amount is included creating a larger deficiency balance. MFS taxpayers cannot claim the EITC. See IRC § 32(d).

<sup>10</sup> United States Tax Court, *Rules of Practice and Procedure*, available at <https://www.ustaxcourt.gov/notice.htm> (last visited Dec 5, 2014).

<sup>11</sup> Internal Revenue Code of 1939, Pub. L. No. 76-1, § 51(b), 53 Stat. 27 (1939). The return filed had joint and several liability for the couple.

<sup>12</sup> Revenue Act of 1948, Pub. L. No. 80-471, § 303, 61 Stat. 110, H.R. REP. No. 1274, at 50 (1049).

<sup>13</sup> Revenue Act of 1948, Pub. L. No. 80-471, § 202(c)(1), 203, 303, 305, 61 Stat. 110 (1948); Revenue Act of 1951, Pub. L. No. 82-183, § 312(g), 65 Stat. 488 (1951); and Internal Revenue Code of 1954, Pub. L. No. 83-591, § 6013, 68 Stat. 730 (1954). The initial change occurred in 1948 and addressed the income splitting. Later changes in 1951 and 1954 address additional concerns of disparities and fairness as well as the estate and gift tax concerns.

current IRC § 6013(b)(2)(B), with no explanation for the exception created in limiting a change of filing status after a petition with the Tax Court has been filed.<sup>14</sup>

Married taxpayers who filed returns with a status of MFS, single, or head of household are allowed to change their filing status to MFJ subject to certain limitations of IRC § 6013.<sup>15</sup> Pursuant to IRC § 6013(b), married taxpayers who do not initially file a joint return may change their filing status to MFJ as long as:

- One of the spouses filed a “separate return,” which is not defined in the statute or applicable regulations;<sup>16</sup>
- The couple was eligible to file a joint return for the tax year in which the “separate return” was filed;<sup>17</sup>
- The time limit for filing a joint return has not expired;<sup>18</sup> and
- Neither spouse has filed a Tax Court petition in response to a statutory notice of deficiency.<sup>19</sup>

The courts have reached different conclusions as to the interpretation of IRC § 6013(b). In *Glaze v. United States*, the Court of Appeals for the Fifth Circuit held that only a return filed with a filing status of MFS is a “separate return” for purposes of IRC § 6013(b).<sup>20</sup> Thus, IRC § 6013(b), including the limitations of IRC § 6013(b)(2), were inapplicable.<sup>21</sup> The Court of Appeals for the Eleventh Circuit follows the reasoning of *Glaze*.<sup>22</sup> The Tax Court, however, interprets the term “separate return” to mean any filing status other than MFJ. Thus, the Tax Court does not follow the *Glaze* decision except in cases where an

<sup>14</sup> Revenue Act of 1951, Pub. L. No. 82-183, § 312(g), 65 Stat. 488 (amended Internal Revenue Code of 1939, § 51(b), added new subsection 51(g)); H.R. Rep. No. 82-1179, at 71 (1951); S. Rep. No. 82-781, Part 2, at 25-27 (1951); H.R. Rep. No. 82-1213, at 72 (1951); and *Summary of the Provisions of the Revenue Act of 1951* (H.R. 4473) as Agreed by the Conference, Joint Committee on Internal Revenue Taxation, at 25, 82nd Cong. (1951).

<sup>15</sup> IRC§ 6013(b)(1), (b)(2)(B). See also IRS Pub. 504, *Divorced and Separated Individuals* 4 (Oct. 31, 2013).

<sup>16</sup> See IRC § 6013(b)(1), 6013(b)(2)(B), and Treas. Reg. § 1.6013-2.

<sup>17</sup> Either spouse has the option to change their status to MFJ after a separate return has been filed. IRS Pub. 504, *Divorced and Separated Individuals* 5 (Oct. 31, 2013).

<sup>18</sup> Taxpayers have three years from the due date (not including extensions) of the separate return or returns to amend their returns because the IRS cannot assess the taxpayer after three years. IRC § 6013(b)(2)(A), § 6501. See also IRS Pub. 504, *Divorced and Separated Individuals* 5 (Oct. 31, 2013). Furthermore, the taxpayer will be unable to request a refund after three years under IRC § 6511(a), but the taxpayer could file Form 656-L, *Offer in Compromise (Doubt as to Liability)* (Feb. 2012) based on the correct filing status and compromise the tax based on the calculated amount of the tax as if the amended return were filed and offering the result as a compromise of debt.

<sup>19</sup> IRC § 6013(b)(1), (b)(2)(B). Taxpayers may make this change by filing IRS Form 1040X, *Amended U.S. Individual Income Tax Return* (Dec. 2013).

<sup>20</sup> *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981). In this case, a taxpayer filed a return as a single taxpayer in 1970 (she was cohabitating with a male partner) and in 1971 the executor of her decedent partners’ estate filed a single return. The taxpayer sued in state court claiming a share of the decedent’s estate as his common law wife. It was determined that she and the decedent were in a common law marriage and in 1974 the taxpayer amended her 1970 tax return with a filing status of MFJ and requested a refund.

<sup>21</sup> *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981).

<sup>22</sup> The 11th Circuit adopted all prior decisions of the Court of Appeals for the 5th Circuit in *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981).

appeal would lie in the Fifth or Eleventh Circuits based on the *Golsen* rule.<sup>23</sup> The Court of Appeals for the Eighth Circuit is currently considering the same issue on appeal in *Ibrahim v. Commissioner*.<sup>24</sup>

## REASONS FOR CHANGE

Neither the IRC nor the regulations define “separate return,” and the case law is inconsistent as to the meaning of that phrase. Decisions differ depending on the Court of Appeals for the circuit in which an appeal from a Tax Court decision would lie, based upon the taxpayer’s legal residence.<sup>25</sup> Furthermore, the SNOD presently fails to clarify that taxpayers may change their filing status to MFJ by amending their returns prior to filing a petition with the Tax Court, which could reduce taxpayers’ confusion and burden.<sup>26</sup> The taxpayer’s *right to be informed* is impaired when taxpayers do not “know what they need to do to comply with the tax laws” and are unable to obtain “clear explanations of the laws and IRS procedures ...”<sup>27</sup> Inconsistent application of IRC § 6013(b) as to what constitutes a separate return and when the taxpayer may change filing status to MFJ, compounded by the lack of clear explanations in the SNOD, prevents taxpayers from obtaining this clear understanding of what they must do to comply with tax laws and procedures.<sup>28</sup>

The conflicts between some appellate courts and the Tax Court result in similarly situated taxpayers being treated disparately. Married taxpayers filing MFS may face certain disadvantages compared to those filing MFJ. For example, they may be generally:

- Subject to a higher tax rate;
- Entitled to a lower exemption amount for the alternative minimum tax (AMT) purposes;
- Not eligible for refundable credits, such as the child tax credit and the earned income tax credit;
- Not eligible for the exclusion or credit for adoption expenses in most cases;
- Not eligible for higher education expenses credits (*e.g.*, American opportunity and lifetime learning credits), the deduction for student loan interest, or the tuition and fees deduction; or
- Unable to exclude the interest from qualified savings bonds used for higher education expenses.

Depending on the jurisdiction, similarly-situated taxpayers may pay different amounts of tax based solely on which Circuit Court of Appeals the Tax Court is required to follow. This may force taxpayers to accept and pay the amount in the SNOD, which may be more than they would otherwise owe, but for the conflict in interpretation. Thus, taxpayers who fail to change their filing status prior to filing a petition

<sup>23</sup> *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981), action on dec., 1981-140 (June 2, 1981). See, e.g., *Currie v. Comm'r*, T.C. Memo.1986-71; *Blumenthal v. Comm'r*, T.C. Memo.1983-737; *Saniewski v. Comm'r*, T.C. Memo.1979-337. See *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), aff'd, 445 F.2d 985 (10th Cir. 1971) (the Tax Court follows its own precedent unless the Court of Appeals for the circuit to which the case would be appealable has ruled to the contrary).

<sup>24</sup> T.C. Memo. 2014-8, *appeal docketed*, No. 14-2070 (8th Cir. 2014). The issue is whether the interpretation of “separate” applies to all types of returns filed or is it limited to Married Filing Separately (MFS) filers.

<sup>25</sup> See IRC § 6013(b)(1), 6013(b)(2)(B), and Treas. Reg. § 1.6013-2. See also *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981) and *Ibrahim v. Comm'r*, T.C. Memo. 2014-8, *appeal docketed*, No. 14-2070 (8th Cir. 2014). IRC § 7482(b)(1)(A) provides that in cases where a petitioner, other than a corporation, seeks redetermination of a tax liability, venue for review by the United States Court of Appeals lies with the Court of Appeals for the circuit based upon the taxpayer’s legal residence.

<sup>26</sup> See IRC § 6013(b)(1), 6013(b)(2)(B), and Treas. Reg. § 1.6013-2.

<sup>27</sup> IRS, *Taxpayer Bill of Rights*, <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). *The Right to Be Informed* states, “Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.”

<sup>28</sup> *Id.*

with the Tax Court may end up paying more than the correct amount of tax, resulting in a violation of the *right to pay only the amount of tax legally due*.<sup>29</sup>

By adopting the National Taxpayer Advocate's legislative recommendation to clarify the term "separate return" as any return that is not a joint return, and allow taxpayers to change their filing status to MFJ after a petition has been filed with the Tax Court in accordance with rules of practice and procedure of the court, Congress would:

- Reduce burden for taxpayers unwary of the complex IRC § 6013(b)(2)(B) rule that precludes taxpayers petitioning the Tax Court in response to a SNOD from changing their filing status to MFJ;
- Achieve consistent application of the change in filing status rules across the country; and
- Provide meaning to the taxpayer's right to a fair and just tax system, specifically, that taxpayers "have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely."<sup>30</sup>

## EXPLANATION OF RECOMMENDATION

The proposal would amend IRC § 6013(b)(1) and clarify that "separate returns" include any filing status (except MFJ). The proposal would also amend IRC § 6013(b)(2)(B) to allow taxpayers who petition the Tax Court in response to a SNOD to change their filing status to MFJ in accordance with the practices and procedures of the Tax Court.<sup>31</sup> This proposal may also resolve filing status issues such as the eligibility for certain credits, exemptions, and deductions for which the taxpayer would not otherwise be eligible; thus reducing litigation.

This legislative change will also clarify and simplify the change in filing status rule, reduce taxpayer burden, and enhance the taxpayer's *right to pay no more than the correct amount of tax and to a fair and just tax system*.<sup>32</sup> Finally, the legislative recommendation will result in consistent application of the change in filing status rules across the country.<sup>33</sup>

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29 IRS, *Taxpayer Bill of Rights*, <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). *The Right to Pay No More than the Correct Amount of Tax* states, "Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly."

30 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). *The Right to Fair and Just Tax System*, "Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels."

31 Changing the language of IRC § 6013(b)(2)(B) or deleting it has the same result in our recommendation. See United States Tax Court, *Rules of Practice and Procedure*, available at <https://www.ustaxcourt.gov/notice.htm> (last visited Dec 5, 2014).

32 See IRS, *2013 Tax Table* (Oct. 10, 2014), available at <http://www.irs.gov/pub/irs-pdf/f1040tt.pdf>. As the IRS Sample Table shows a married couple with combined income of \$25,300 that file MFJ have taxable income of \$2,906; however, if the couple filed MFS their taxable income would be \$3,353, a difference of \$447.

33 Cf. *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981) and *Ibrahim v. Comm'r*, T.C. Memo. 2014-8, appeal docketed, No. 14-2070 (8th Cir. 2014).

**LR  
#8**

## **ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit “Reasonable Cause” Relief**

### **PROBLEM**

A taxpayer who claims a tax credit or refund that the IRS disallows may be liable for a penalty under Internal Revenue Code (IRC) § 6676 unless the taxpayer had a “reasonable basis” for the claim.<sup>1</sup> Section 6676 does not appear to require the IRS to take into account all the facts and circumstances, including the taxpayer’s knowledge and experience with tax law and his or her efforts to comply with the law, in determining whether there was such reasonable basis. Taxpayers may satisfy the reasonable basis standard if they have “substantial authority” for their return position, but substantial authority does not include IRS forms or accompanying instructions, IRS publications, or IRS answers to Frequently Asked Questions—materials that many individual taxpayers rely on for guidance.

While the section 6676 penalty does not apply to erroneous claims for the Earned Income Tax Credit (EITC), it may apply to disallowed claims for other social benefits, such as the additional child tax credit and the new Premium Tax Credit under the Affordable Care Act (ACA).<sup>2</sup> The rules for claiming these income-based refundable credits, available to low income taxpayers who face unique obstacles in understanding and substantiating eligibility, are complex and varied, which raises the likelihood of mistakes.<sup>3</sup> Other tax penalties, including the civil fraud penalty, contain an exception for “reasonable cause.”<sup>4</sup> Determining whether there was “reasonable cause” for a claim requires consideration of all of the taxpayer’s facts and circumstances.<sup>5</sup>

According to the Taxpayer Bill of Rights (TBOR), taxpayers have the *right to a fair and just tax system*—“the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities ...”<sup>6</sup> Subjecting taxpayers to a penalty for claiming a disallowed refund without taking into account their facts and circumstances impairs their right to a fair and just tax system. For these reasons the National Taxpayer Advocate reiterates her 2011 recommendation that Congress amend IRC § 6676 to allow a reasonable cause exception.<sup>7</sup>

1 See IRC § 6676 (a), imposing the penalty on “a claim for refund or credit with respect to income tax” made “for an excessive amount.” Under IRC § 6676(b), the amount of the penalty is 20 percent of the excessive (*i.e.*, disallowed) amount.

2 See IRC § 6676(a) (excluding the earned income tax credit under IRC § 32); IRC § 24 (providing for the child tax credit and the additional child tax credit, which is the part of the credit that is refundable); IRC § 36B (providing for the premium tax credit). There has been at least one legislative proposal to remove the exclusion of EITC claims. See H.R. 5070, 113th Cong., 2d Sess. § 6 (July 10, 2014).

3 See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2 at 93. (*Research Study: Running Social Programs Through the Tax System*); National Taxpayer Advocate 2009 Annual Report to Congress 110-13 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*) (“Although a diverse population, low income taxpayers do share common characteristics. Low income taxpayers are found more frequently among the elderly, the disabled, Native Americans, and taxpayers who may have limited English proficiency (LEP) relative to the general Wage and Investment (W&I) taxpayer population. Many require extra assistance to understand tax law changes, as demonstrated by the widespread confusion about the 2008 Economic Stimulus Payment (ESP) and the resulting flood of calls to the IRS toll-free line. Low income taxpayers tend to be more transitory than the general population, with 27.5 percent of those below the poverty level moving in 2007 while only 15 percent of the general population moved during the same time.” (fn refs. omitted)).

4 See IRC § 6664(c).

5 See, e.g., Treas. Reg. § 1.6664-4(b)(1).

6 Taxpayer Bill of Rights, available at <http://taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights#rights>.

7 National Taxpayer Advocate 2011 Annual Report to Congress 544 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*).

## EXAMPLE

During tax year 2014, X and Y, high school graduates with no significant tax law knowledge or experience, have two dependent children and household income of around \$45,000. X and Y paid a commercial return preparer to prepare their joint federal tax return for 2013, which they decide to use as a starting point for preparing their own 2014 return. X and Y learn that because both their children are under 19 in 2014, they will be responsible for the Shared Responsibility Payment (SRP) if their children do not have required health insurance.<sup>8</sup> After X and Y obtain insurance for the family, they predict the amount of their household income for the year and find that, based on their projections, they qualify for advanced premium tax credits (APTC). These credits are paid directly to their insurer throughout 2014.

As in 2013, X and Y's 2014 tax liability was paid through wage withholding, so their 2014 return properly shows no tax due. Like the 2013 return, the 2014 return claims a refund for EITC and an additional \$2,000 refund for the additional child tax credit (\$1,000 for each child). Because X and Y actually earned slightly less than the amount they projected, they are entitled to an additional premium tax credit which they calculated to be \$1,500. Thus, their total refund claim on their 2014 return is \$3,500, not counting EITC. The IRS examines the return and determines X and Y are entitled to the claimed EITC, but not the child tax credit for their child who turned 17 years old in 2014.<sup>9</sup> The IRS also determines that although X and Y are entitled to a refund for the additional premium tax credit, they miscalculated the amount, which should be \$1,000. Thus, X and Y are entitled to a total refund of \$2,000, not counting EITC. The IRS denies \$1,500 of X and Y's original \$3,500 refund claim and assesses a \$300 penalty despite the couple's good faith efforts to comply with the tax law and their lack of education, knowledge, or experience with taxes. There is no authority that would support X and Y's claim for \$1,500 of the refund shown on their tax return (and X and Y concede their error). X and Y would not be able to show they had a reasonable basis for their claim and would not be eligible for relief from the penalty under IRC § 6676. If there were a reasonable cause exception to the penalty, X and Y might be able to show that taking into account all their facts and circumstances, they are eligible for penalty relief.

## RECOMMENDATION

To allow for consideration of taxpayers' facts and circumstances before imposing a penalty for erroneously claiming a credit or refund, the National Taxpayer Advocate recommends that Congress amend IRC § 6676 to permit relief from the penalty for individual taxpayers who acted with reasonable cause and in good faith.

<sup>8</sup> Per Treas. Reg. § 1.5000A-1(c)(2), "if the nonexempt individual is a dependent (as defined in section 152) of another individual for the other individual's taxable year including that month, the other individual is liable for the shared responsibility payment attributable to the dependent's lack of coverage. An individual is a dependent of a taxpayer for a taxable year if the individual satisfies the definition of dependent under section 152, regardless of whether the taxpayer claims the individual as a dependent on a Federal income tax return for the taxable year." Under IRC § 152(c)(3), X and Y's children will be dependents until they are 19 or, if students, age 24.

<sup>9</sup> Under IRC § 24(c)(1), the term "qualifying child" for purposes of the child tax credit means a qualifying child of the taxpayer (as defined in section 152(c)) who has not attained age 17.

## PRESENT LAW

Section 6662 imposes an accuracy-related penalty applicable to underpayments of income tax.<sup>10</sup> In simplified terms, “underpayment” means the excess of a taxpayer’s actual liability over his or her reported liability—“*i.e.*, tax ‘imposed’ minus tax ‘shown’ equals ‘underpayment’.”<sup>11</sup>

The accuracy-related penalty does not apply where the taxpayer acted with reasonable cause and in good faith.<sup>12</sup> According to the applicable Treasury regulation:

[t]he determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances ... Generally, the most important factor is the extent of the taxpayer’s effort to assess the taxpayer’s proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer.<sup>13</sup>

Until 2013, the IRS successfully asserted the accuracy-related penalty with respect to disallowed credits claimed on original returns, whether the credit only reduced tax or also resulted in a claim for refund.<sup>14</sup> Taxpayers could avoid imposition of the penalty by demonstrating they had reasonable cause for claiming the disallowed credit.<sup>15</sup> As discussed below, these procedures have changed in light of the Tax Court’s decision in *Rand v. Commissioner*.<sup>16</sup>

In the meantime, in 2007 Congress filled a perceived gap in the penalty framework by enacting section 6676, which imposes a penalty of 20 percent of an excessive claim for refund or credit.<sup>17</sup> To the extent a disallowed credit other than EITC generates a refund, it may be subject to a penalty under section 6676.<sup>18</sup>

<sup>10</sup> IRC § 6662 penalizes underpayments of tax otherwise owed attributable to negligence or disregard of rules or regulations, substantial understatements of tax (*i.e.*, failing to show ten percent of the correct tax or \$5,000, whichever is more), or certain other factors. The amount of the penalty is 20 percent of the amount of the underpayment.

<sup>11</sup> *Rand v. Comm'r*, 141 T.C. 376, 399 (2013) (Gustafson, J., dissenting).

<sup>12</sup> IRC § 6664(c).

<sup>13</sup> Treas. Reg. § 1.6664-4(b)(1).

<sup>14</sup> See *Rand v. Comm'r*, 141 T.C. 376 (2013) and cases cited therein at p. 389, n. 10. See also IRS Program Manager Technical Advice (PMTA) 2012-016, 2012 TNT 163-18 (Aug. 22, 2012), explaining that the IRS would continue to seek imposition of the accuracy-related penalty for disallowed claims for refundable credits, except where the IRS did not actually pay a refund or approve the credit.

<sup>15</sup> Because deficiency procedures apply to imposition of the penalty under section 6662, taxpayers could contest liability for the penalty in the Tax Court before being required to pay it. IRC § 6665.

<sup>16</sup> 141 T.C. 376 (2013).

<sup>17</sup> According to the Department of Treasury, “[d]isallowing a refund or credit claim does not result in an underpayment. Absent a frivolous position evident on the face of the return, there is no accuracy-related penalty applicable to disallowance of a refund or credit claim.” Dept. of Treas., *Gen. Explanations of the Admin's FY 2008 Rev. Proposals* (Feb. 2007) at 82, available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2008.pdf>. Consequently, a taxpayer with a return position (such as a claim for a tax credit) believed to increase exposure to the accuracy-related penalty under section 6662 might bifurcate his or her tax reporting. An original return omitting the credit and showing zero tax due, followed by an amended return claiming the credit results in neither return containing an underpayment, even if the claimed credit on the amended return generated a refund that was paid and the credit then disallowed. See National Taxpayer Advocate 2011 Annual Report to Congress 544, 546 (Legislative Recommendation: *Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits*); Sharyn M. Fisk and Heather Kim Lee, *Section 6676 Erroneous Claim For Refund Or Credit Penalty: The Penalty Has No Reasonable Basis* 9 (prepared for the Taxation Procedure & Litigation Committees of the Taxation Sections of the State Bar of California and the Los Angeles County Bar Association), available at <http://www.lacba.org/Files/Main%20Folder/Sections/Taxation/Files/2008%20Fisk-Lee%206676%20Washington%20Paper%20Corrected%20May%202008.pdf>. IRC § 6676 was added by Pub. L. No. 110-28, § 8247, 121 Stat. 112, 204 (2007). It does not apply where the accuracy-related penalty under section 6662 applies. IRC § 6676(d).

<sup>18</sup> *Rand v. Comm'r*, 141 T.C. 376, 395 (2013).

However, section 6676 does not include a reasonable cause exception.<sup>19</sup> Rather, it provides an exception where there was a “reasonable basis” for the claim.<sup>20</sup> Neither section 6676 nor the regulations under that section define “reasonable basis,” but a regulation under section 6662 provides in pertinent part:

Reasonable basis is a relatively high standard of tax reporting, that is [sic], significantly higher than not frivolous or not patently improper. The reasonable basis standard is not satisfied by a return position that is merely arguable or that is merely a colorable claim. If a return position is reasonably based on one or more of the authorities set forth in § 1.6662–4(d)(3)(iii) (taking into account the relevance and persuasiveness of the authorities, and subsequent developments), the return position will generally satisfy the reasonable basis standard ...<sup>21</sup>

In the years following enactment of section 6676, means-tested refundable credits proliferated.<sup>22</sup> As noted above, however, the IRS continued to assert the accuracy-related penalty on disallowed refunds under section 6662 rather than asserting the penalty under section 6676.<sup>23</sup> In 2013, the Tax Court in *Rand v. Commissioner* interpreted the definition of “underpayment” in the Treasury regulations under section 6664 and held that the “amount shown as tax on the return” takes into account the EITC, additional child tax credit, and recovery rebate credit, but these refundable credits do not reduce the amount shown as tax below zero.<sup>24</sup> Thus, these erroneously claimed credits may be subject to an accuracy-related penalty under section 6662 only to the extent they reduced a tax liability. Except for disallowed EITC, they may be subject to the penalty under section 6676 to the extent they generated a refund.<sup>25</sup> While section 6676 may have filled a perceived gap in the penalty framework, it was not clear until 2013 that some disallowed refundable credits could *only* be penalized pursuant to section 6676, rather than pursuant to section 6662.

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<sup>19</sup> As originally proposed, the new penalty contained a reasonable cause exception. See Dept. of Treas., Gen. Explanations of the Admin’s FY 2008 Rev. Proposals (Feb. 2007) at 82, available at <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2008.pdf>. After enactment, the IRS Office of Chief Counsel, Procedure and Administration, recommended adding a reasonable cause exception to the section 6676 penalty in its suggestions for the U.S. Department of the Treasury’s FY 2012 Green Book, which provides explanations of the Administration’s fiscal year revenue proposals.

<sup>20</sup> IRC § 6676(a).

<sup>21</sup> Treas. Reg. § 1.6662-3(b)(3). The authorities set forth in the cited Treas. Reg. § 1.6662-4(d)(3)(iii) include “[a]pplicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes; revenue rulings and revenue procedures; tax treaties and regulations thereunder, and Treasury Department and other official explanations of such treaties; court cases; congressional intent as reflected in committee reports, joint explanatory statements of managers included in conference committee reports, and floor statements made prior to enactment by one of a bill’s managers; General Explanations of tax legislation prepared by the Joint Committee on Taxation (the Blue Book); private letter rulings and technical advice memoranda issued after October 31, 1976; actions on decisions and general counsel memoranda issued after March 12, 1981 (as well as general counsel memoranda published in pre-1955 volumes of the Cumulative Bulletin); Internal Revenue Service information or press releases; and notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin.” The list of authorities does *not* include IRS publications or instructions to IRS forms—materials average individual taxpayers would consult and rely on in preparing their returns—or even legal opinions or opinions of tax professionals.

<sup>22</sup> Credits that were enacted or made refundable after 2007 include the first-time homebuyer credit (IRC § 36), the making work pay credit (IRC § 36A), the premium tax credit (IRC § 36B), the adoption credit (IRC § 23), the American opportunity tax credit (IRC § 25A), and the recovery rebate credit (IRC § 6428).

<sup>23</sup> According to the Treasury Inspector General for Tax Administration (TIGTA), the IRS assessed only 84 erroneous refund penalties totaling \$1.9 million between May 2007 and May 2012. TIGTA, Ref. No. 2013-40-123, *The Law Which Penalizes Erroneous Refund and Credit Claims Was Not Properly Implemented* (Sept. 26, 2013), available at <http://www.treasury.gov/tigta/auditreports/2013reports/201340123fr.html>.

<sup>24</sup> For a complete discussion of the *Rand* case, see Most Litigated Issue: Accuracy-Related Penalty Under IRC § 6662(b)(1), (2), and (3), *infra*.

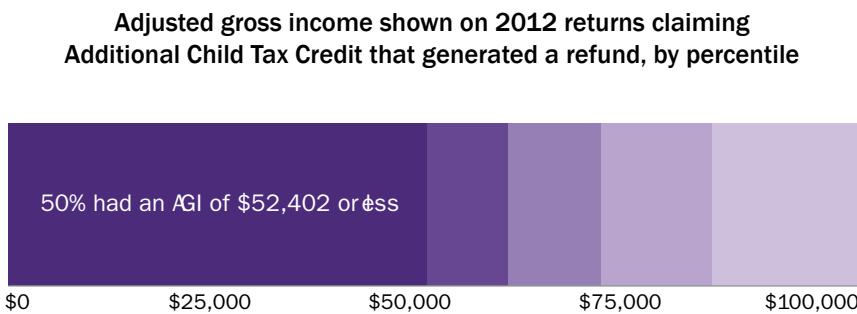
<sup>25</sup> *Rand v. Comm'r*, 141 T.C. 376, 395 (2013). As noted above, at least one congressional bill proposes removing the exclusion for EITC under section 6676. See H.R. 5070, 113th Cong., 2d Sess. § 6 (July 10, 2014).

On June 10, 2014, the IRS adopted the TBOR. Among taxpayer rights is the *right to a fair and just tax system*, which includes taxpayers' "right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely."<sup>26</sup>

## REASONS FOR CHANGE

Unlike the "reasonable cause" exception to liability under section 6662, the "reasonable basis" standard under section 6676 does not appear to require the IRS to take into account all the facts and circumstances, including the taxpayer's knowledge and experience with tax law and his or her efforts to comply with the law, and is thus inconsistent with taxpayers' right to a fair and just tax system. Section 6676 appears to contemplate a sophisticated taxpayer with access to technical authorities on which to construct a return position, who then disregards those authorities. Taxpayers who claim the benefits of at least one social program delivered through refundable tax credits, the additional child tax credit, do not generally fit this description. To begin with, as Figure 2.8.1 shows, half the 2012 returns on which taxpayers claimed the child tax credit that generated a refund showed adjusted gross income (AGI) under \$53,000.<sup>27</sup>

**FIGURE 2.8.1**



Taxpayers who claimed the additional child tax credit and whose refunds were then disallowed were even worse off. Of these taxpayers, half the 2012 returns showed adjusted gross income under \$22,000.<sup>28</sup>

26 Taxpayer Bill of Rights, available at <http://taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights#rights>.

27 TAS Research, based on data from the Individual Returns Transaction File (IRTF) on the IRS Compliance Data Warehouse (CDW), for tax year 2012 taxpayers claiming the additional child tax credit and a refund. The data for 2013 returns is similar, with AGI at the 50th percentile equal to \$52,714.

28 TAS Research, based on data from the IRTF and Exam Operational Automation Database on CDW, for tax year 2012. According to the Department of Health and Human Services, the 2014 poverty guideline for a four-person household in the 48 contiguous states and the District of Columbia is \$23,850. Dept. of Health and Human Services, Annual Update of the Poverty Guidelines, 79 Fed. Reg. 3593-3594 (Jan. 22, 2014), available at <http://aspe.hhs.gov/poverty/14poverty.cfm>.

**FIGURE 2.8.2**

Adjusted gross income shown on 2012 returns claiming Additional Child Tax Credit where refund was disallowed, by percentile



Moreover, taxpayers who erroneously claim refundable credits are subject to different standards depending on unrelated characteristics of their returns. A taxpayer who erroneously claims a refundable credit that reduces his or her tax liability but does not generate a claim of refund would be subject to the penalty under section 6662, but could avoid the penalty by demonstrating reasonable cause. A different taxpayer who erroneously claims the same refundable credit, where the credit not only reduces his or her tax liability but also results in a claim of refund, would be subject to the penalty under section 6676, and could avoid the penalty only by showing “reasonable basis” for the claim.

**EXPLANATION OF RECOMMENDATION**

The proposal would amend section 6676 to clarify that the penalty does not apply to individual taxpayers who acted with reasonable cause and in good faith in erroneously claiming a credit or refund. Taking into account all of taxpayers’ facts and circumstances in determining whether they had such reasonable cause would bring this statutory penalty into conformity with the TBOR right to a fair and just tax system. This approach reflects recent judicial interpretations of sections 6662 and 6676, is consistent with the accuracy-related penalty provisions of section 6662, avoids subjecting unsophisticated taxpayers to a penalty intended to reach taxpayers who take calculated risks in their reporting positions, and permits consistent treatment of similarly situated taxpayers.

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## **ACCESS TO THE IRS: Require the IRS to Publish a Public Phone Directory and Report on Implementing an Operator System Similar to “311” Lines**

### **PROBLEM**

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to publish the phone number and address for each local office in local phone books across the country.<sup>1</sup> Since this provision was enacted in 1998, much has changed about the way the IRS is organized and about how people find other people and businesses. RRA 98 called for the IRS to reorganize by moving away from a structure based on regions and districts to one organized around the types of taxpayers,<sup>2</sup> and so when the law was passed, it was foreseeable that local offices would handle fewer issues for taxpayers after the reorganization. However, Congress may not have anticipated how few services local offices would come to provide for taxpayers<sup>3</sup> and to the great extent taxpayers would rely on written or phone communication with offices scattered around the country.<sup>4</sup> Furthermore, there has been a movement away from using physical phone books in recent years.<sup>5</sup>

Even if the IRS meets the requirement of RRA 98 by effectively publishing the numbers for local offices in phone books, the IRS is not achieving the purpose of the provision—to make itself accessible to taxpayers. Taxpayers do not know how to reach a specific department within the IRS, if they are even able to identify the department with which they need to talk. When taxpayers call the IRS, they often must navigate an extended phone tree before being transferred, and at times, they are transferred to a recorded message without the ability to speak to a live person. Taxpayers have the *right to quality service*—to receive prompt, courteous, and professional assistance, and to speak to a supervisor about inadequate service. When taxpayers cannot find the right employee or manager to speak to about their issues, or cannot speak to an employee at all, their *right to quality service* is compromised.

1 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998) provides: “The Secretary of the Treasury or the Secretary’s delegate shall, as soon as practicable, provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area.” For a detailed discussion of the IRS’s implementation of this provision and the problems taxpayers have trying to reach the IRS, see Most Serious Problem: *ACCESS TO THE IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*, *supra*.

2 Pub. L. No. 105-206, § 1001(a), 112 Stat. 685, 689 (1998).

3 During the 2014 filing season, local walk-in sites known as Taxpayer Assistance Centers (TACs) stopped offering any kind of return preparation for taxpayers and the IRS stopped answering complex tax law questions, and stopped answering any tax law questions at all after the filing season. See IRS, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (last updated Feb. 3, 2014), available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

4 See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of Cross-functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

5 A recent survey found that almost seven out of 10 people rarely use a paper phone book and 60 percent of those surveyed had looked online for contact information. See MSN Money, *Phone books are nearly obsolete* (Feb. 19, 2013), available at <http://money.msn.com/saving-money-tips/post.aspx?post=39cb1c6f-a937-4d5f-852b-0326187c72c9> (citing a survey conducted by White Pages).

## EXAMPLE

The IRS levies the wages of a taxpayer with a balance due. The taxpayer submits a request for an offer in compromise (OIC)<sup>6</sup>, which would allow him to settle his liability for less than the full amount due and pay it in installments. When he does not hear anything in response to his offer, he calls the main IRS toll-free line.<sup>7</sup> The taxpayer spends six minutes answering questions<sup>8</sup> through an interactive voice response system. Instead of speaking to an employee in the OIC unit, the phone prompts transfer the taxpayer to a Customer Service Representative (CSR) trained to use an application that is used for not only OICs, but also 22 other types of calls according to the Telephone Transfer Guide. The CSR tells the taxpayer that his offer was rejected.

The taxpayer tries to explain that he has unique monthly expenses due to medical problems, and using the standard guidelines for basic costs of living will leave him without enough money to pay his basic expenses.<sup>9</sup> However, the phone assist, who handles a wide range of issues, incorrectly tells the taxpayer that the IRS is required to use the standard amounts for all taxpayers. The taxpayer asks to speak to a manager. The taxpayer never receives a call back from a manager. In the meantime, the IRS continues to levy the taxpayer's wages.

## RECOMMENDATION

To address the problem of taxpayers not being able to reach the right person at the IRS, the National Taxpayer Advocate recommends that Congress enact legislation to require the IRS, within 180 days, to:

1. Publish, on IRS.gov, its current Practitioner Directory<sup>10</sup> or a similar directory that provides the same detailed information regarding the names and contact information for managers of local IRS groups or territories for different functions of the IRS, as well as managers of service and compliance functions located in IRS campuses. Require the IRS to provide an electronic or paper copy of the directory for a particular state or geographic area, if requested by a taxpayer.
2. Develop a report detailing the administrative steps necessary to implement an operator system for its main toll-free phone line, similar to a 311 telephone line.<sup>11</sup> Under such a system, all taxpayers would call a single nationwide toll-free phone number and answer a limited number of questions through an interactive voice response system before being transferred to an operator. If the taxpayer were requesting a specific piece of information such as an account balance or transcript, the operator would provide the information to the taxpayer. For calls regarding other IRS functions and offices, the operator would transfer the taxpayer to the specific office handling the taxpayer's individual issue or case. Such report should be provided to the Senate Committee on Finance and the House Committee on Ways and Means.

6 See IRC § 7122.

7 1-800-829-1040 (TTY/TDD 1-800-829-4059).

8 For a detailed description of the phone prompts for a taxpayer to speak with someone about a payment plan, see Most Serious Problem: ACCESS TO THE IRS: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues, supra.*

9 Generally, when determining how much a taxpayer can pay, the IRS uses guidelines for standard allowances for cost of living expenses. However if using the guidelines would result in a taxpayer not being able to pay his or her basic living expenses, then the IRS must consider that taxpayer's actual expenses. See IRC § 7122(d)(2).

10 The Practitioner Directory is a directory of commonly used local phone numbers and websites that IRS employees can distribute to practitioners. See IRM 11.53.5.3.1 (June 24, 2013).

11 A 311 telephone line is a special phone number supported in many communities to provide access to non-emergency municipal services.

## PRESENT LAW

Section 3709 of RRA 98 requires the IRS to “provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area.”<sup>12</sup> The RRA 98 Senate Finance Committee Report reflects the intent that “every taxpayer should have convenient access to the IRS.”<sup>13</sup> Section 3705(d) of RRA 98 requires the IRS to “provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours.”<sup>14</sup> It further specifies: “The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer.”<sup>15</sup>

## REASONS FOR CHANGE

Changes in technology and the way the IRS is organized have made the RRA 98 requirement for publication in phone books outdated. Publishing the number for local offices is of little help to taxpayers because the IRS does not answer the phone calls to local offices and does not allow taxpayers to leave a message.<sup>16</sup> Furthermore, taxpayers often need to reach a specific department within a local office, such as the local examination or appeals office, and these numbers are not published. Although the IRS does not need statutory authority in order to publish its Practitioner Directory for public use, a directive from Congress is necessary to push the IRS to make this resource available to all taxpayers and ensure it does so in a timely manner.

Although section 3705(d) of RRA 98 requires the IRS to provide the option to speak to a live person on helplines, taxpayers are not given this option when they call the main toll-free line.<sup>17</sup> Even if the taxpayer is able to reach a live person, the taxpayer may not be able to talk to an employee working in the unit that handles the taxpayer’s issue, or be transferred to that unit.<sup>18</sup> The IRS’s procedure for answering, screening, and working phone calls needs to be updated to provide the taxpayer with the opportunity to speak to an employee within the office handling the taxpayer’s issue. The IRS does not need any legislative authority at this time to transition to a 311 system, but a congressional directive to prepare a report would prod the IRS to begin looking into what kinds of preparations it must undertake to implement such a system. Furthermore, congressional oversight would ensure that the system operates as intended and meets the current requirements of RRA 98.<sup>19</sup> For example, congressional oversight might encourage the IRS to define what a helpline is for the purpose of RRA 98 § 3705(d) and ensure that all such phone lines on the 311 system advertise to the taxpayer the option to speak to a live person.

<sup>12</sup> Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998). For more a more detailed discussion regarding the legislative history of this provision, see Most Serious Problem: ACCESS TO THE IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues, *supra*.

<sup>13</sup> S. REP. No. 105-174, at 106 (1998).

<sup>14</sup> Pub. L. No. 105-206, § 3705(d), 112 Stat. 685, 777 (1998).

<sup>15</sup> *Id.*

<sup>16</sup> See Most Serious Problem: ACCESS TO THE IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues, *supra*.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> For example, RRA 98 also established the specific goal that, by 2007, 80 percent of tax and information returns would be electronically filed. Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998). As part of this legislation, Congress required the IRS Oversight Board, as well as the Electronic Tax Administration Advisory Committee, to report to Congress annually on the progress toward the goal. *Id.* at § 2001(d), 112 Stat. 685, 723 (1998). The IRS did not meet the target in 2007, but the 80 percent electronic filing goal was extended to 2012, at which point it was reached. IRS Oversight Board, *Electronic Filing 2012 Annual Report to Congress*, 5 (2012).

## EXPLANATION OF RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS provide a directory of key contacts to the public. The IRS currently publishes a “Practitioner Directory” for each state, which includes key contact information for specific offices, such as the local area directors and territory managers for different departments, such as the offer in compromise unit, as well as some national numbers, such as the number for lien releases. An expanded version of this directory, including numbers and contacts for service and compliance functions within each IRS campus, could be published on IRS.gov and provided to any taxpayer who requests a copy for his or her state or geographic area.

The National Taxpayer Advocate also recommends that Congress require the IRS to prepare a report outlining the administrative steps necessary to implement a 311 telephone system, including a draft timeline for operation. Under such a system, all taxpayers would call a single nationwide toll-free phone number when calling the IRS. Callers would answer a limited number of questions through an interactive voice response system before being transferred to an operator. A 311 system has three options to handle the call: provide the information requested, process the service request, or transfer the caller to the appropriate department or function. If the taxpayer were requesting a specific piece of information such as an account balance or transcript, the operator would provide the information to the taxpayer. For calls regarding other IRS functions and offices, the operator would transfer the taxpayer to the specific office handling the taxpayer’s issue or handling the taxpayer’s individual case.

Currently, the IRS’s phone system requires callers to navigate an extended interactive voice response system. Current procedures also provide that calls are transferred to employees who are trained to use a broad application handling a number of issues, instead of to an employee in the department handling the issue. When a referral to a specific department is necessary, the employee may have to send a written referral to the department and tell the taxpayer he or she will receive a return call days later. The report would detail how these procedures would be replaced with a streamlined system to transfer calls to the appropriate department and how the IRS would track and measure response rates, effectiveness, and taxpayer satisfaction.

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## **IRS CORRESPONDENCE: Codify § 3705(a)(1) of RRA 98, Define “Manually Generated,” and Require Contact Information on Certain Notices in All Cases**

### **PROBLEM**

Concerned about taxpayer access to employees both knowledgeable about and accountable for actions taken on their cases, Congress required the IRS in the IRS Restructuring and Reform Act of 1998 (RRA 98) to include employee contact information on “manually generated correspondence.”<sup>1</sup> The IRS has failed to meaningfully implement the requirements of § 3705(a)(1) of RRA 98. Congress did not define the term “manually generated;” instead, the IRS created its own definition in the Internal Revenue Manual (IRM).<sup>2</sup> However, the IRS does not follow its own manual and fails to include appropriate employee contact information on most computer-generated notices,<sup>3</sup> even when a particular employee has worked on the case<sup>4</sup> or exercised judgment and made a decision.<sup>5</sup> Consequently, IRS correspondence procedures fail to address Congress’s concerns<sup>6</sup> about the inability of taxpayers to contact an IRS employee who is knowledgeable about, and accountable for, their case.<sup>7</sup>

In its recent adoption of the Taxpayer Bill of Rights, the IRS affirmed its commitment to many of the principles underlying the implementation of RRA 98, including rights impacted by § 3705(a)(1)—*the right to quality service, the right to be informed, and the right to a fair and just tax system.*<sup>8</sup> By not providing appropriate contact information to taxpayers who receive important IRS notices—including those that impact taxpayers’ legal rights—the IRS erodes the meaning and value of these fundamental taxpayer rights.

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- 1 Pub. L. No. 105-206, § 3705(a)(1), 112 Stat. 685, 777 (1998). For a full discussion of the National Taxpayer Advocate’s concerns regarding contact information on audit notices, see Most Serious Problem: *Audit Notices: The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*, *supra*.
  - 2 The IRM defines manually generated correspondence as “correspondence issued as a result of an IRS employee exercising his/her judgment in working/resolving a specific taxpayer case or correspondence, or where the employee (Tax Examiner, Revenue Agent, Revenue Officer, etc.) is asking the taxpayer to provide additional case-related information.” IRM 21.3.3.4.16.1(2), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).
  - 3 The IRS’s definition of manually generated correspondence is broad and includes “CORRESPONDEX letters, local letters, quick notes, and some computer generated letters.” IRM 21.3.3.4.16.1(3), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).
  - 4 IRM 21.3.3.4.16.1(2), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).
  - 5 See IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013). Sixty-nine letters are listed which will only contain generic contact information when issued on campus exam inventory.
  - 6 See, e.g., 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici), and *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) at 97, 213-14; *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) (questions of Chairman Roth) at 214.
  - 7 For a complete discussion of the National Taxpayer Advocate’s concerns regarding the failure of the IRS to include contact information on audit notices, see Most Serious Problem: *Audit Notices: The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*, *supra*.
  - 8 The IRS adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also Publication 1, *Your Rights as a Taxpayer* (2014).

## EXAMPLE

A taxpayer who has three children has moved twice during the tax year. When she files her return, the taxpayer claims all her children for the purposes of the Earned Income Tax Credit (EITC). Shortly after filing her return, she receives a CP 75 – *Exam Initial Contact Letter – EIC – Refund Frozen*, which says the IRS needs more information about her children and has frozen her EITC pending the results of the audit. It provides a form listing potential documentation the taxpayer can submit to substantiate her claim,<sup>9</sup> but does not include the contact information for a specific employee.<sup>10</sup>

The taxpayer reviews the list of acceptable documentation and sends what she thinks will show that the children lived with her and she provided more than half the cost of maintaining a household for the children since she claimed head of household status,<sup>11</sup> including school records and a current lease. However, the lease does not list her children and the school records only show partial-year attendance for one child who was not old enough to attend school in the previous school district, but was old enough in the new district.

The taxpayer then receives a Letter 105C, *Claim Disallowance*, indicating the IRS will not allow the EITC for her third child because the records submitted are not sufficient. Even though an employee had to review the documentation the taxpayer provided and input specifics about that documentation into the 105C, the letter does not list specific contact information for that employee nor does it explain why the documentation was insufficient. As a result, the taxpayer cannot reach the employee who made the decision to ask for an explanation.<sup>12</sup>

In an attempt to resolve the issue, the taxpayer calls the general operating division toll-free number listed on the 105C. The taxpayer must take time off work to make this call. After she waits on the phone for 22 minutes, she reaches an IRS employee, who indicates that he does not see any notation of what was insufficient about the records and that the taxpayer should file an appeal. The taxpayer calls the IRS again, trying to reach someone who can tell her what documentation would prove her claim, and waits another 34 minutes on the phone, only to be disconnected. The taxpayer is frustrated because she cannot afford to take more time off to make phone calls and just wants to resolve the issue, but cannot speak to the employee who made the decision on her case. She decides not to file an appeal because she is afraid she will lose her job if she takes off more time, and does not receive the EITC even though she would have been eligible had she been able to provide appropriate documentation.

## RECOMMENDATION

To provide taxpayers with access to IRS employees knowledgeable about and accountable for their cases, the National Taxpayer Advocate recommends that Congress:

- Codify RRA 98 § 3705(a)(1).
- Define the term “manually generated correspondence” as correspondence issued as a result of an IRS employee exercising his or her judgment in working or resolving a specific taxpayer case or correspondence, or where the employee is asking the taxpayer to provide additional case-related information.

9 IRS, CP 75 - *Exam Initial Contact Letter – EIC – Refund Frozen* (Feb. 2012).

10 IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013).

11 See IRC §§ 32(c)(3) and 152(c) (definitions of qualifying child).

12 For a complete discussion of the National Taxpayer Advocate’s concerns regarding explanations in refund disallowance notices, see Most Serious Problem: *NOTICES: Refund Disallowance Notices Do Not Provide Adequate Explanations*, *supra*.

- Require the IRS to provide the name, telephone number, and unique identification number of an IRS manager on notices with legal impact, such as those that start the running of a statute of limitations or trigger appeal rights (such as the Statutory Notice of Deficiency), where such notices have been automatically generated without employee review.

## PRESENT LAW

Section 3705(a)(1) of RRA 98 provides “The Secretary of the Treasury or the Secretary’s delegate shall provide that—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.”<sup>13</sup>

## REASONS FOR CHANGE

The Joint Committee on Taxation reported the reason for the inclusion of § 3705(a)(1) in RRA 98 was so taxpayers could receive prompt answers to questions about their tax liabilities, as many expressed frustration at not knowing which employee to contact.<sup>14</sup> The IRS defines the phrase “manually generated correspondence” in the Internal Revenue Manual (IRM) as “correspondence issued as a result of an IRS employee exercising his/her judgment in working/resolving a specific taxpayer case or correspondence, or where the employee (Tax Examiner, Revenue Agent, Revenue Officer, etc.) is asking the taxpayer to provide additional case-related information.”<sup>15</sup>

Although the IRS defines “manually generated” in the IRM in a manner in which it would seem taxpayers would receive such contact information, in practice, taxpayers do not receive this information on most notices, even where an employee had reviewed and made determinations on the outcome of the case. IRS practices also do not address congressional concerns about IRS employee accountability.<sup>16</sup>

TAS reviewed and analyzed a sample of 100 Letters 105C, *Claim Disallowance*.<sup>17</sup> None contained contact information for a specific employee; instead, each was “signed” by a high-level manager or program director and listed only an operating division toll-free number.<sup>18</sup> While many of these letters resulted from a mismatch between information provided by the taxpayer and information the IRS had in its systems and were issued without an employee ever looking at the case, five of the letters contained non-standardized paragraphs with information specific to the taxpayer’s situation that had to have been crafted manually by an employee.<sup>19</sup> The IRM seems to require that these notices, where an employee has worked a case and made case specific decisions, thus “exercising judgment” on the case, contain employee contact information. However, our sample suggests this information is not included despite the IRM requirement.<sup>20</sup>

<sup>13</sup> Pub. L. No. 105-206, § 3705(a)(1), 112 Stat. 685, 777 (1998).

<sup>14</sup> J. Comm. on Tax'n, *General Explanation of Tax Legislation Enacted in 1998*, 128 (Nov. 24, 1998).

<sup>15</sup> IRM 21.3.3.4.16.1(2), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

<sup>16</sup> See, e.g., *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) (questions of Chairman Roth) at 214.

<sup>17</sup> Sample on file with TAS Attorney Advisor Group.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> IRM 21.3.3.4.16.1(3), *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

Even where a taxpayer has corresponded with the IRS regarding his or her correspondence exam, IRS procedures provide that in most cases, the case can be returned for automatic processing after the correspondence has been reviewed.<sup>21</sup> The Automated Correspondence Examination (ACE) program exists solely to conduct examinations with little or no human involvement.<sup>22</sup> The result of a taxpayer continuing to receive automated correspondence with no specific employee contact information even after corresponding with the IRS fails to address Congress's concerns about access to knowledgeable and accountable employees. Where a taxpayer's audit is conducted solely through ACE, taxpayers will receive no notice with any appropriate contact information, up to and including the Statutory Notice of Deficiency (SNOD), after which the taxpayer has limited time to address the issue directly with the IRS or petition the United States Tax Court, which results in an increase in taxpayer burden.<sup>23</sup>

In the discussions leading up to the enactment of RRA 98, several Senators indicated concerns about taxpayer access to the IRS and, in particular, accountability for employees who made decisions on cases.<sup>24</sup> Despite these concerns, the IRS implementation of § 3705(a)(1) fails to provide taxpayers greater access to employees both knowledgeable about and accountable for actions taken on cases.

While it may be unnecessary or impractical to include contact information for a specific employee on all notices, particularly before a case is assigned, failing to do so after a taxpayer has communicated with the IRS may violate the law and contradict the IRS's own Internal Revenue Manual. The codification of RRA 98 § 3705 with a specific definition of manually generated notices and specific requirements about when the contact information must be included will ensure the IRS's accountability and provide real meaning to the taxpayer *rights to quality service, to be informed, and to a fair and just tax system.*

## EXPLANATION OF RECOMMENDATION

Left to define "manually generated" on its own, the IRS does not report either seeking an official Chief Counsel opinion on the meaning of the term nor performing a comprehensive, principled review of notices to determine which should include contact information to address Congress' concerns about employee access and accountability.<sup>25</sup> While its own IRM may suggest that notices resulting from an employee working on a case would include specific employee contact information, many of these notices do not, as the IRS does not follow its IRM.<sup>26</sup>

The National Taxpayer Advocate and other stakeholders have continued to raise concerns regarding the lack of access to knowledgeable and accountable employees despite Congress's enactment of RRA 98,

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- 21 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013). ("Using the ACE, Correspondence Examination can process specified cases with minimal to no tax examiner involvement until a taxpayer reply is received. Because the ACE system will automatically process the case through creation, statutory notice and closing, tax examiner 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.")
- 22 IRM 4.19.20.1, *Automated Correspondence Examination Overview (ACE)* (May 21, 2013).
- 23 See, e.g., Letter 531, *General Statutory Notice of Deficiency*. For a discussion of the National Taxpayer Advocate's concerns about SNOD compliance with RRA 98, see Most Serious Problem: *STATUTORY NOTICES OF DEFICIENCY: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice*, *supra*.
- 24 See, e.g., 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici), and *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) at 97, 213-14; *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997) (questions of Chairman Roth) at 214.
- 25 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998* (May 28, 2014). The record of IRS actions taken to implement RRA 98 shows no comprehensive review of notices or Counsel opinion sought regarding § 3705(a)(1).
- 26 IRM 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

suggesting that meaningful change did not result from the IRS's implementation of §3705(a)(1).<sup>27</sup> Congress should address this failure by codifying RRA 98 §3705(a)(1) and adopting the IRM's definition of "manually generated correspondence" as that issued as a result of an IRS employee exercising his or her judgment in working or resolving a specific taxpayer case or correspondence, or where the employee is asking the taxpayer to provide additional case-related information. Congress should also require the IRS to provide specific manager contact information in automatically generated notices where the legal rights of taxpayers are impacted, such as the Statutory Notice of Deficiency.<sup>28</sup>

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- 27 See, e.g., National Taxpayer Advocate, *Are IRS Correspondence Audits Really Less Burdensome for Taxpayers?*, available at <http://www.taxpayeradvocate.irs.gov/Blog/are-irs-correspondence-audits-really-less-burdensome-for-taxpayers> (last visited Nov. 26, 2014), National Taxpayer Advocate 2011 Annual Report to Congress Vol. 2 63-90 (Research Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*), IRS Oversight Board Public Forum: Panel 1: *How Can Correspondence Audits Be More Effective for the IRS and Less Burdensome for Taxpayers?* (Feb. 28, 2012).
- 28 A taxpayer has only 90 days from the date on the Statutory Notice of Deficiency (150 days if the Statutory Notice of Deficiency is mailed to the taxpayer outside the United States) to file a petition with the U.S. Tax Court. Because a taxpayer has a limited amount of time to file a petition, if the taxpayer has questions about the Statutory Notice of Deficiency, contact information for a manager would be helpful.

**LR  
#11**

## ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices It Sends to Taxpayers

### PROBLEM

Section 3506 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to send annual statements to taxpayers who have an installment agreement (IA) in effect under Internal Revenue Code (IRC) § 6159.<sup>1</sup> This statement must provide a taxpayer's initial balance at the beginning of the year, payments made during the year, and the remaining balance as of the end of the year.<sup>2</sup> However, the IRS is not currently required to and does not provide a detailed breakdown of accrued interest and penalties (and the type of penalty), or how payments (including refund offsets) are applied to tax, penalties, and interest.

Section 1204 of the Taxpayer Bill of Rights (TBOR) 2 added § 7524 to the IRC.<sup>3</sup> This section requires the IRS to send to taxpayers with delinquent accounts an annual reminder notice that sets forth the amount of the tax delinquency as of the date of the notice.<sup>4</sup> Again, however, the IRS is not required to and does not provide a detailed breakdown on the notice showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), and how payments (including refund offsets) are applied to tax, penalties, and interest.

The lack of detailed information on both of these notices undermines taxpayers' *right to be informed*, which entitles taxpayers to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence.<sup>5</sup> Specifically, the IRS's failure to provide detailed information prevents taxpayers from having a complete and accurate picture of their tax accounts and making informed economic decisions about their tax debt.

The lack of detailed information on these notices also undermines taxpayers' *right to pay no more than the correct amount of tax*, which is the right to pay only the amount legally due, including interest and penalties, and to have the IRS apply all tax payments properly.<sup>6</sup> If the IRS fails to provide a breakdown of how payments are applied, then taxpayers cannot determine that their payments have been applied properly and that they are paying no more than the amount of tax legally due.

1 Pub. L. No. 105-206, § 3506, 112 Stat. 685, 771 (1998). Under IRC § 6159, the IRS may enter into installment agreements with taxpayers if it believes that the agreement will facilitate full or partial collection of the tax liability.

2 This requirement was never codified in the IRC. In 2009, the IRS and the Department of Treasury amended the regulations under § 6159 to formalize this requirement. See Treas. Reg. § 301.6159-1(h); T.D. 9473, 2009-52 I.R.B. 945. The IRS sends this statement using Notice CP 89, *Annual Installment Agreement Statement*. See Internal Revenue Manual (IRM) 21.3.1.4.52, *CP 89 Annual Installment Agreement Statement* (Oct. 1, 2004).

3 Pub. L. No. 104-168, § 1204, 110 Stat. 1452, 1471 (1996).

4 The IRS sends this notice using CP 71, *Reminder Notice*. See IRM 21.3.1.4.44, *CP 71 Reminder Notice* (Oct. 19, 2010). There are a few variations of this notice, depending on the status of a taxpayer's account. See IRM 21.3.1.4.45, *CP 71A Reminder Notice* (Oct. 1, 2012); IRM 21.3.1.4.46, *CP 71C and CP 171 Annual Reminder Notices* (Oct. 1, 2012); IRM 21.3.1.4.47, *CP 71D Reminder Notice - Balance Due* (July 9, 2013).

5 See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>; IRS Publication 1, *Your Rights as a Taxpayer* (June 2014).

6 *Id.*

## EXAMPLE

Because she cannot pay her \$5,000 tax liability in full, a taxpayer completes a Form 433-D, *Installment Agreement*, enters into an IA with the IRS, and makes monthly payments throughout the year. The IRS sends her a required annual statement about her IA. While this provides certain information about payments made, it does not break down the accrued interest and penalties (and the type of penalty) and how payments (including refund offsets) are applied to tax, penalties, and interest.<sup>7</sup> Because there is no detailed breakdown on this notice, the taxpayer does not have a complete picture of her account and may not be able to make an informed decision about her debt, including whether an IA is the most economically sound option for her and whether the IRS has properly applied her payments.

The taxpayer also has overdue tax liabilities for several other tax years, including some in which the statute of limitations on collection is close to expiring.<sup>8</sup> The taxpayer has been making periodic voluntary payments on these liabilities, designating them for the more recent liabilities.<sup>9</sup> The IRS sends her statutorily required reminder notices of her tax delinquency for these years. While these notices provide certain basic information about the liabilities,<sup>10</sup> they do not show the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), and how payments (including refund offsets) are applied to tax, penalties, and interest.

Once again, because there is no detailed breakdown, the taxpayer does not have a complete picture of her tax account and may not be able to make informed decisions about her debt, including whether she is repaying it in an economically efficient manner and whether the IRS has properly applied her designated payments.<sup>11</sup> Were the taxpayer able to see the cumulative effect of penalty and interest and track the application of her payments, she might decide to resolve her tax liability through an offer in compromise or by obtaining a less costly loan from another source.

## RECOMMENDATION

To address the lack of detailed information in certain notices sent to taxpayers, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6159 to require the IRS to provide on annual installment agreement statements sent to taxpayers, within one year of the enactment date, a detailed breakdown of information

<sup>7</sup> The annual statement, Notice CP 89, contains two main sections: 1) “Payment Detail” – provides the monthly payment date, applied amount, the tax form to which payment was applied, and the tax period; and 2) “Installment Agreement Activity” – provides a yearly summary of the tax period of the liability, form number, beginning balance of the tax period (includes unpaid tax, penalty, and interest), payments received during the annual period, total penalty, interest, and other charges added, and an ending balance. In addition, in the “Payment Detail” section, the notice provides that payments are applied first to tax, then penalty, then interest, and other charges. However, the notice does not provide a numerical breakdown of these categories.

<sup>8</sup> Under IRC § 6502(a)(1), the IRS generally has ten years from the date of assessment to collect the tax due.

<sup>9</sup> Taxpayers have the right to request designation of voluntary payments made to the IRS. See Rev. Proc. 2002-26, 2002-1 C.B. 746; IRM 5.1.2.8, *Designated Payments* (June 20, 2013); *United States v. Energy Res. Co.*, 495 U.S. 545, 548 (1990). If taxpayers do not provide specific written instructions when they provide a payment, the IRS will apply the payment in a manner that best serves its interests, to older tax periods first, and to tax, penalties, and interest (in that order). See Rev. Proc. 2002-26, 2002-1 C.B. 746; IRM 20.1.2.2.8.2, *Application of Payments* (Apr. 19, 2011).

<sup>10</sup> The Notice CP 71 provides a “Billing Summary” section that lists an “amount you owed” and “Interest charges.” The last page of Notice CP 71, in the “Interest charges” section, lists the interest rates used to calculate the interest on the amount due.

<sup>11</sup> If the IRS does not properly apply her designated tax payments to the appropriate years, the taxpayer may wind up paying tax liabilities that would otherwise not be legally due because the statute of limitations has run. In addition, a taxpayer may be able to obtain a bankruptcy discharge of older tax liabilities. See Legislative Recommendation: *LATE-FILED RETURNS: Clarify the Bankruptcy Law Relating to Obtaining a Discharge, infra*.

showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalties, and interest.

- Amend IRC § 7524 to require the IRS to provide on annual reminder notices sent to taxpayers with delinquent accounts, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest.

## PRESENT LAW

Section 3506 of RRA 98 requires the IRS to send annual statements to taxpayers who have an installment agreement in effect IRC § 6159.<sup>12</sup> This statement must provide a taxpayer's initial balance at the beginning of the year, payments made during the year, and the remaining balance as of the end of the year.<sup>13</sup> The legislative history indicates Congress believed that "taxpayers who enter into an installment agreement should be kept informed of [the] amounts applied towards the outstanding tax liability and [the] amounts remaining due."<sup>14</sup>

Section 1204 of the Taxpayer Bill of Rights (TBOR) 2 added § 7524 to the IRC.<sup>15</sup> This section requires the IRS to send to taxpayers with delinquent accounts an annual reminder notice that sets forth the amount of the tax delinquency as of the date of the notice.<sup>16</sup> The legislative history explains the reason for the new requirement:

[T]he IRS generally pursues larger tax deficiencies first, and then it pursues small deficiencies. Because of the limited amount of IRS resources to work collection cases, cases with smaller deficiencies may not be addressed for years. In the meantime, the taxpayer may come to believe that the apparent lack of IRS collection activity means that it has abandoned its claim against the taxpayer. The taxpayer may be surprised when the IRS resumes collection action years later, when the 10-year statute of limitations on collection is close to expiring.<sup>17</sup>

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<sup>12</sup> Pub. L. No. 105-206, § 3506, 112 Stat. 685, 771 (1998). This provision required the IRS to begin sending such statements no later than July 1, 2000. Under IRC § 6159, the IRS may enter into installment agreements with taxpayers if it believes that the agreement will facilitate full or partial collection of the tax liability.

<sup>13</sup> This requirement was never codified in the IRC. In 2009, the IRS and the Department of Treasury amended the regulations under § 6159 to formalize this requirement. See Treas. Reg. § 301.6159-1(h); T.D. 9473, 2009-52 I.R.B. 945. The IRS sends this statement using Notice CP-89, *Annual Installment Agreement Statement*. See IRM 21.3.1.4.52, CP 89 *Annual Installment Agreement Statement* (Oct. 1, 2004).

<sup>14</sup> S. REP. No. 105-174, at 98 (1998).

<sup>15</sup> Pub. L. No. 104-168, § 1204, 110 Stat. 1452, 1471 (1996).

<sup>16</sup> The IRS sends this notice using CP 71, *Reminder Notice*. See IRM 21.3.1.4.44, CP 71 *Reminder Notice* (Oct. 19, 2010). There are a few variations of this notice, depending on the status of a taxpayer's account. See IRM 21.3.1.4.45, CP 71A *Reminder Notice* (Oct. 1, 2012); IRM 21.3.1.4.46, CP 71C and CP 171 *Annual Reminder Notices* (Oct. 1, 2012); IRM 21.3.1.4.47, CP 71D *Reminder Notice - Balance Due* (July 9, 2013).

<sup>17</sup> H.R. REP. No. 104-506, at 46-47 (1996).

## REASONS FOR CHANGE

Congress has already recognized the need for taxpayers to be informed about their IAs and delinquent accounts. However, if the IRS were required to provide more detailed information, it would keep taxpayers *better informed* about their tax liabilities, which is consistent with congressional intent behind the enactment of these two provisions. A more informed taxpayer accomplishes two goals of a fair and just tax administration: first, the taxpayer is better equipped to make economic decisions about how best to pay his or her tax liability (through IA, offer in compromise, or borrowing from an external source); and second, the taxpayer possesses the information with which to determine the accuracy of the IRS's accounting for payments.

In the context of annual installment agreements, a statement that provides a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalties, and interest, would allow taxpayers to get a better picture of their accounts and how much they are actually paying. It may also encourage speedier repayment of IAs because taxpayers will be made aware of how much they are paying in interest and penalties and will have an incentive to repay their tax obligations more promptly to reduce these amounts.<sup>18</sup> A more detailed statement would also help taxpayers keep track of the proper crediting and application of their payments, ensuring that they *pay no more than the correct amount of tax*.

Similarly, in the context of annual delinquency notices, a notice that provides a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest, would allow taxpayers to be *better informed* about their outstanding tax liabilities. In addition, it would help taxpayers keep track of the proper crediting and application of their payments, ensuring that they *pay no more than the correct amount of tax*.

Congress has already determined that providing detailed information is important in other contexts. For example, Congress passed legislation requiring periodic statements for residential mortgage loans.<sup>19</sup> Regulations issued by the Consumer Protection Financial Bureau require that this periodic statement contain, among other things, a breakdown of how mortgage loan payments are applied to principal, interest, escrow, fees, and charges.<sup>20</sup> Congress should similarly require the IRS to provide a more detailed breakdown of information on certain annual notices it sends to taxpayers. In short, Congress should provide taxpayers with at least the same level of information and consumer knowledge with regard to their federal tax liabilities as is afforded borrowers with respect to residential mortgage loans.

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<sup>18</sup> Taxpayers who are provided a complete picture of their tax liabilities may see a benefit in refinancing their tax debt through other means to reduce the amount of interest and penalties they pay.

<sup>19</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1420, 124 Stat. 1376, 2155 (2010). This legislation amended § 128 of the Truth in Lending Act (15 U.S.C. § 1638) to add a new subsection, 15 U.S.C. § 1638(f), which requires a creditor, assignee, or servicer of any residential mortgage loan to transmit to the consumer, for each billing cycle, a periodic statement that sets forth certain specified information in a conspicuous and prominent manner.

<sup>20</sup> See 12 C.F.R. § 1026.41(d) (2013). Congress has also taken action to require credit card companies to provide more detailed disclosures to consumers on credit card statements. See also Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act of 2009), Pub. L. No. 111-24, § 201, 123 Stat. 1734, 1743 (2009). This statute requires, among other things, several detailed payoff timing disclosures, such as the total cost to the consumer (including interest and principal) if he makes only the minimum required payments.

## EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that Congress require the IRS to provide on certain annual notices, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest.<sup>21</sup> This change will allow taxpayers to *be better informed* about their tax liabilities and ensure that they *pay no more than the correct amount of tax.*

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21 While Notice CP 89, *Annual Installment Agreement Statement*, already contains some suggested changes (such as the taxpayer's initial balance at the beginning of the year) in this legislative recommendation, the IRS should continue to provide all of the information required by § 3506 of RRA 98. In addition, requiring the two notices to have similar content and structure would provide taxpayers with the benefit of uniformity.

**LR  
#12**

## **EO JUDICIAL AND ADMINISTRATIVE REVIEW: Allow IRC § 501(C)(4), (C)(5), or (C)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status**

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### **PROBLEM**

Taxpayers seeking exemption as Internal Revenue Code (IRC) § 501(c)(3) organizations may request a declaratory judgment on their exempt status if they meet the requirements of IRC § 7428.<sup>1</sup> Generally, if their applications have been denied or if the IRS fails to make a determination after 270 days, or the IRS has revoked their exempt status, they may request that a court determine whether they are exempt.<sup>2</sup> In contrast, civic leagues and social welfare organizations seeking exemption as IRC § 501(c)(4) organizations; labor, agricultural and horticultural organizations seeking exemption as IRC § 501(c)(5) organizations; and business leagues, chambers of commerce, real estate boards, or boards of trade seeking exemption as IRC § 501(c)(6) organizations are not entitled to such a declaratory judgment.<sup>3</sup> Consequently, there is comparatively little judicial guidance about the requirements for exempt status under IRC § 501(c)(4), (c)(5), and (c)(6), less IRS accountability for delays in processing applications for exempt status under those subsections, and no venue where organizations that disagree with the IRS can directly challenge the IRS's determination.

Organizations whose exempt status is automatically revoked for failing to file required returns or notices for three consecutive years also cannot obtain a declaratory judgment.<sup>4</sup> Because the IRS has not adopted a meaningful process for administrative review of automatic revocations, these organizations may have no venue, either administrative or judicial, in which to demonstrate the IRS erred in treating them as no longer exempt.

According to the Taxpayer Bill of Rights the IRS adopted on June 10, 2014, taxpayers have the *right to be informed*.<sup>5</sup> For organizations seeking tax exempt status, the right to be informed means receiving sufficient explanation and guidance about the IRS's—and the courts'—positions as applied to similar facts and circumstances. This in turn allows organizations to determine how to proceed and operate. Taxpayers also have the *right to appeal an IRS decision in an independent forum*, including the IRS Office of Appeals, and they generally have the right to take their cases to court.<sup>6</sup> By extending declaratory judgment rights to IRC § 501(c)(4), (c)(5), and 501(c)(6) organizations and requiring that the IRS adopt

1 A declaratory judgment is “[a] binding adjudication that establishes the rights and other legal relations of the parties without providing for or ordering enforcement.” *Black’s Law Dictionary* (10th ed. 2014).

2 See IRC § 7428, providing for judicial review upon exhaustion of administrative remedies. An organization will be deemed to have exhausted its administrative remedies at the expiration of 270 days “if the organization has taken in a timely manner, all reasonable steps to secure such determination.” IRC 7428(b)(2). An important exception, discussed below, is that organizations whose exempt status was automatically revoked pursuant to IRC § 6033(j)(1) are prohibited from bringing an action under the provisions of IRC § 7428. IRC § 7428(b)(4).

3 IRC § 7428. As discussed below, although these organizations are not specifically excluded from the provisions of IRC § 7428, they are not included, and there is no other statutory provision allowing them to obtain declaratory judgment relief.

4 IRC § 7428(b)(4).

5 Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>, describing taxpayers' right to be informed.

6 *Id.*, describing taxpayers' right to appeal an IRS decision in an independent forum.

an administrative review process for automatically revoked organizations, Congress can provide these organizations with a readily accessible remedy to enforce these rights where today there is none.

### EXAMPLE 1

XYZ, Inc. applies for recognition of exempt status as an IRC § 501(c)(4) social welfare organization. The IRS denies the application on the grounds that XYZ has not demonstrated it is “primarily engaged in promoting in some way the common good and general welfare of the people of the community” as required by the applicable Treasury regulation.<sup>7</sup> No statutory, regulatory, or judicial authority establishes:

- How to measure the extent of an entity’s social welfare activity;
- Whether exempt status requires a minimum percentage of such activity;
- Whether to consider multiple factors; and if so
- Whether such factors should receive equal weight.

XYZ may administratively appeal the IRS’s determination, but it cannot seek a declaratory judgment from a court that it is exempt. Without exempt status, XYZ will be treated as a taxable entity and will be required to file federal tax returns, and may have to report contributions as income. It may not qualify for state tax exemptions and mailing privileges that would otherwise be available. The absence of public recognition as an exempt organization may deter potential donors from contributing to XYZ in favor of other social welfare organizations whose exempt status has been acknowledged. The cumulative effect of these consequences may be devastating for XYZ.

### EXAMPLE 2

ABC, Inc. applied for and was granted exempt status as an IRC § 501(c)(3) organization, but four years later was notified that its exempt status had been automatically revoked for failing to file annual information returns or notices for three consecutive years.<sup>8</sup> ABC believes the revocation is erroneous. Like XYZ, ABC cannot seek a declaratory judgment from a court regarding its exempt status. Unlike XYZ, ABC does not even have access to an administrative review procedure in which to demonstrate its exempt status was not automatically revoked. As a taxable entity, ABC may also need to report contributions as income on federal tax returns and may no longer qualify for the state tax exemptions and mailing privileges. Donors will no longer be able to claim the charitable contribution deduction for their contributions to ABC, which will severely limit its ability to attract funding compared to when it was exempt. Even those willing to make nondeductible contributions might select another organization acknowledged by the IRS as exempt. The consequences may devastate ABC, even if it later obtains reinstatement of its exempt status.

<sup>7</sup> Treas. Reg. § 1.501(c)(4)-1(a)(2)(i).

<sup>8</sup> See IRC § 6033(j), providing for automatic revocation of tax-exempt status of organizations that fail to file required returns or notices for three consecutive years.

## RECOMMENDATIONS

To address the lack of judicial review that would provide guidance about the requirements for exempt status as an IRC § 501(c)(4), (c)(5), or (c)(6) organization, and to remedy the lack of administrative appeal procedures in the context of automatic revocations, the National Taxpayer Advocate recommends that Congress:

- A. Amend IRC § 7428 to allow taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as currently allowed for taxpayers seeking exempt status as IRC § 501(c)(3) organizations.
- B. Amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations treated as having had their exempt status automatically revoked.

## PRESENT LAW

### Judicial Review of Applications for Exempt Status

Organizations exempt from tax and described under IRC § 501(c)(3) are generally not required to pay tax on income related to their exempt purpose, and may receive tax-deductible contributions.<sup>9</sup> They must generally apply to the IRS for recognition of exempt status, and if their applications are denied or if the IRS fails to make a determination on their applications after 270 days, or if their exempt status is revoked, they may, under IRC § 7428, seek a declaratory judgment on their status.<sup>10</sup> IRC § 501(c)(4), (c)(5), and (c)(6) organizations are also generally exempt from federal income tax, but contributions to these organizations are generally not tax-deductible.<sup>11</sup> These organizations are not required to apply for recognition of exempt status, although many do so by filing Form 1024, *Application for Recognition of Exemption Under Section 501(a)*.<sup>12</sup> They may seek review of a denial of exempt status from the IRS Office of Appeals, but do not have the same right to seek a declaratory judgment as organizations seeking status as an organization described in IRC § 501(c)(3).<sup>13</sup>

A fundamental difference between taxpayers seeking exemption as IRC § 501(c)(3) organizations on the one hand and those seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations on the other hand concerns the amount of permissible lobbying, participation in political campaign activity, or

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<sup>9</sup> See IRC §§ 501 and 170(c)(2). Unrelated business income may be subject to tax. See IRC § 511 et seq.

<sup>10</sup> See IRC §§ 508 and 7428.

<sup>11</sup> See IRC § 501. Unrelated business income may be subject to tax. See IRC § 511 et seq.

<sup>12</sup> The IRS instructions for Form 1024 note that an organization may want to file for recognition in order to obtain certain benefits such as public recognition of tax-exempt status; exemption from certain state taxes; advance assurance to donors of deductibility of contributions (in certain cases); and nonprofit mailing privileges. Some organizations may file because they do not realize they are not required to apply for recognition of exempt status.

<sup>13</sup> If the IRS Office of Appeals agrees that the organization is not tax exempt, the organization may challenge its non-exempt status by petitioning the U.S. Tax Court for relief following the issuance of a notice of deficiency, if any, or paying any tax owed and seeking a refund in a U.S. district court or the U.S. Court of Federal Claims. IRC §§ 6212, 6213, 7422; 28 U.S.C. § 1346. But by that point, the loss of tax-exempt status may be a fatal blow to the operations of the organization.

engagement in political action.<sup>14</sup> Section 501(c)(3) organizations are permitted to engage generally in only “insubstantial” lobbying activity, and are prohibited from *any* participation or intervention in political campaigns on behalf of (or in opposition to) candidates for public office.<sup>15</sup> IRC § 501(c)(4), (c)(5), or (c)(6) organizations do not face the same statutory or regulatory limitation or prohibition. Generally, they may engage in lobbying without losing their exempt status so long as they primarily engage in activities that further their exempt purpose.<sup>16</sup> They may also participate or intervene in political campaigns so long as they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community” (for organizations exempt under IRC § 501(c)(4)). Organizations will not qualify for exempt status under IRC § 501(c)(4), (c)(5), or (c)(6) if their “*primary purpose or activity*” is to engage in political action.<sup>17</sup> There is no statutory or regulatory quantification of the term “*primarily*” or “*primary*” for these purposes.<sup>18</sup>

Section 7428 allows section 501(c)(3) organizations to seek a declaratory judgment as to their exempt status if the IRS denies an organization’s application for exemption, fails to act on it, or revokes an organization’s exempt status. The provision was prompted in large part by the Supreme Court’s decisions in two exempt organization cases, *Bob Jones University v. Simon* and *Alexander v. ‘Americans United’ Inc.*<sup>19</sup> The Senate and House reports both quote the Supreme Court’s decision in *Bob Jones University v. Simon* as follows:

Congress has imposed an especially harsh regime on Sec. 501(c)(3) organizations threatened with loss of tax-exempt status and with withdrawal of advance assurance of deductibility of contributions. \* \* \* The degree of bureaucratic control that, practically speaking, has

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- 14 Because the regulations that apply to organizations exempt under other provisions of IRC § 501(c) do not cross reference the regulations under IRC § 501(c)(4) or use the terms “primary” or “primarily” in the same manner (except for the regulations applicable to certain war veterans organizations exempt under IRC § 501(c)(19) which have additional membership requirements) and thus may not be as affected by the attendant lack of judicial interpretation of those terms, we limit this legislative recommendation to IRC § 501(c)(4), (5), and (6) organizations. Moreover, that the IRS has issued guidance on whether public advocacy activities of IRC § 501(c)(4), (5), and (6) organizations constitute exempt function expenditures under IRC § 527(e)(2) and would therefore not be subject to tax under IRC § 527(f)(1) suggests that these organizations are more apt to engage in political activity and would consequently benefit most from the availability of judicial review. See Rev. Rul. 2004-6, 2004-1 C.B. 328.
- 15 See Treas. Reg. § 1.501(c)(3)-1(b)(3)(i), providing that an organization “is not organized exclusively for one or more exempt purposes if its articles expressly empower it: (i) To devote more than an insubstantial part of its activities to attempting to influence legislation by propaganda or otherwise”; IRC § 501(c)(3), providing that a charity may “not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”
- 16 See Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 Elec. Law J. 363, 376 (2011), noting “Thus, under various administrative authorities of various official weights, section 501(c)(4), (5), and (6) organizations can all lobby without limit, so long as they can show that such lobbying is related to their exempt purposes.”
- 17 See IRC § 501(c)(4)(A), allowing an exemption for organizations “operated exclusively for the promotion of social welfare”; Treas. Reg. § 1.501(c)(4)-1(a)(2)(i), providing that “an organization is operated exclusively for the promotion of social welfare if it is *primarily* engaged in promoting in some way the common good and general welfare of the people of the community.” (emphasis added); Treas. Reg. § 501(c)(4)-1(a)(2)(ii), providing that promoting social welfare does not include participation or intervention in political campaigns; General Counsel Memorandum 34,233 (Dec. 3, 1969), noting that an organization would not qualify for exempt status under section 501(c)(5) or (c)(6) “if the *primary* purpose or activity of an organization is to engage in political action.” (emphasis added).
- 18 See Legislative Recommendation: SECTION 501(c)4 POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity, *supra*.
- 19 S. Rep. No. 94-938, at 586 (1976); H.R. Rep. No. 94-658, at 283 (1975), referencing *Bob Jones University v. Simon*, 416 U.S. 725 (1974) and *Alexander v. ‘Americans United’ Inc.*, 416 U.S. 752 (1974). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess. 401 (Dec. 29, 1976) (same). The reports all also note that Congress had recently given the Tax Court jurisdiction to hear declaratory judgment suits as to the status of certain employee retirement plan status in the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 1041, 88 Stat. 829, 949 (1974), adding IRC § 7476.

been placed in the Service over those in petitioner's position (*i.e.*, the position of Bob Jones University) is susceptible to abuse, regardless of how conscientiously the Service may attempt to carry out its responsibilities. Specific treatment of not-for-profit organizations to allow them to seek pre-enforcement review may well merit consideration.<sup>20</sup>

Both reports also contain the following note:

The Court's opinion [in *Bob Jones University v. Simon*] noted that former Internal Revenue Commissioner Thrower had criticized the present system for resolving such disputes between the Service and the organization.

This is an extremely unfortunate situation for several reasons. First, it offends my sense of justice for undue delay to be imposed on one who needs a prompt decision. Second, in practical effect it gives a greater finality to IRS decisions than we would want or Congress intended. Third, it inhibits the growth of a body of case law interpretative of the exempt organization provisions that could guide the IRS in its further deliberations. (*Thrower, IRS Is Considering Far Reaching Changes in Ruling on Exempt Organizations*, 34 Journal of Taxation 168 (1971).)<sup>21</sup>

In other words, the House and Senate reports suggest that Congress believed the absence of judicial review of IRC § 501(c)(3) determinations left organizations subject to undue delay, conferred too much power on the IRS, and impeded interpretive case law. And Commissioner Thrower's remarks show that the IRS, at least in 1971, agreed.

In 1976, Congress enacted IRC § 7428, giving organizations seeking exempt status as an IRC § 501(c)(3) organization the right to obtain a declaratory judgment from the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia.<sup>22</sup> The question had been raised whether to extend the availability of declaratory judgment suits to other types of exempt organizations ("such as... a social welfare organization under 501(c)(4), a fraternal organization under 501(c)(8), or a cemetery company under 501(c)(13)"), but the statute as enacted did not provide for such access.<sup>23</sup>

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<sup>20</sup> S. REP. No. 94-938, at 586 (1976); H.R. REP. No. 94-658, at 284 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 401-402 (Dec. 29, 1976) (same).

<sup>21</sup> S. REP. No. 94-938, at 586 n. 649 (1976); H.R. REP. No. 94-658, at 284 n. 216 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 401-402 n. 4 (Dec. 29, 1976) (same).

<sup>22</sup> Tax Reform Act of 1976, Pub. L. No. 94-455, §1306(a), 90 Stat. 1520, 1717 (1976). Though not articulated in the statute, the legislative history makes clear that the Tax Court would have flexibility in assigning petitions for declaratory judgments to special trial judges. See S. REP. No. 94-938, at 591 (1976); H.R. REP. No. 94-658, at 288 (1975). See also Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1976*, 94th Cong., 2d Sess., 406 (Dec. 29, 1976) (same).

<sup>23</sup> See Joint Comm. on Int. Rev. Tax'n, 94th Cong. 2d Sess., *Tax Revision Issues – 1976* (H.R. 10612), No. 6, *Administrative Matters* 5-6, (Comm. Print 1976) available at <https://www.jct.gov/publications.html?func=startdown&id=3848>.

No explanation for the omission appears in the legislative reports.<sup>24</sup> However, the legislative history makes clear that Congress intended to monitor this aspect of exempt organization law.<sup>25</sup>

Perhaps for the same reasons Congress established judicial review of IRC § 501(c)(3) applications, some members have concluded judicial review should be extended, at least to IRC § 501(c)(4) applicants. Early in 2014, the Chairman of the House Ways and Means Committee released draft legislation that contained such a provision.<sup>26</sup>

### Administrative Review of Automatic Revocations

In 2006, Congress enacted section 1223 of the Pension Protection Act of 2006 (PPA), imposing reporting requirements on certain organizations not previously required to file returns, and providing for automatic revocation of exempt status for failing to file required returns or notices for three consecutive years.<sup>27</sup> The PPA amended IRC § 7428 to specifically preclude organizations whose tax-exempt status was automatically revoked from bringing declaratory judgment actions.<sup>28</sup> The PPA does not prohibit administrative review of an IRS conclusion that an organization's exempt status was automatically revoked. However,

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- 24 Some insight about the reason for the omission may be found in the explanation the Tax Section of the American Bar Association (Tax Section) provided for its 1974 recommendation that IRC § 7428 be amended to allow IRC § 501(c)(3) organizations to obtain declaratory judgments. The Tax Section noted that it had considered expanding the remedy to all exempt organizations, but concluded that because IRC § 501(c)(3) organizations may receive deductible contributions and are therefore more directly harmed by doubts regarding their status than other exempt organizations to which contributions are not tax deductible, "such an expansion is not required at this time." As for other types of IRC § 501(c) organizations that may receive deductible contributions (e.g., veterans' organizations, fraternal lodges, or cemetery societies), they would not be as affected by doubt about their status as 501(c)(3) organizations because "[c]ontributions to this type of organization are typically made by a membership group which is likely to continue to support the organization even if a question is raised as to its status." American Bar Association Tax Section Recommendation No. 1974-17, reported in 28 TAX. LAW. No. 3, 431, 434 (Spring 1975).
- 25 The House and Senate reports both noted: "In connection with this, and as an aid to proper oversight and to future decision-making in this area, the committee intends that the Internal Revenue Service report annually to the tax-writing committee of the Congress on the Service's activities with regard to organizations exempt under section 501(a), including the following: (1) the number of organizations that applied for recognition of exempt status, (2) the number of organizations whose applications were accepted and the number of organizations whose applications were denied, (3) the number of organizations whose prior favorable ruling letters were revoked, (4) the number of organizations that were audited during the year, and (5) the number of organizations that the Service regards as being exempt. To the extent possible, these statistics should be broken out by type of organization (e.g., public charity, private foundation, social welfare organization, fraternal beneficial association, and veterans' organization)." S. REP. No. 94-938, at 586 (1976), H.R. REP. No. 94-658, at 285 (1975). The IRS reported some of this data in 1976 and each year thereafter in its annual Statistics of Income Data Book. See IRS Statistics of Income Data Book available at <http://www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book>. The reports include the number of applications processed (rather than the number received) and do not include the number of revocations.
- 26 See U.S. Congress, House Committee on Ways and Means, The Tax Reform Act of 2014, § 6002, 113 Cong., 2 sess., Feb. 2014, available at [http://waysandmeans.house.gov/uploadedfiles/statutory\\_text\\_tax\\_reform\\_act\\_of\\_2014\\_discussion\\_draft\\_\\_022614.pdf](http://waysandmeans.house.gov/uploadedfiles/statutory_text_tax_reform_act_of_2014_discussion_draft__022614.pdf).
- 27 Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006), adding to IRC § 6033 subsections (i) and (j).
- 28 Pension Protection Act of 2006, Pub. L. No. 109-280, § 1223(c), 120 Stat. 780, 1090 (2006), adding to IRC § 7428 subsection (b)(4), providing that "[n]o action may be brought under this section with respect to any revocation of status described in section 6033(j)(1)."

despite the National Taxpayer Advocate's repeated recommendations to the IRS to do so, the IRS does not provide such review.<sup>29</sup>

On June 10, 2014, the IRS adopted the Taxpayer Bill of Rights. These rights include taxpayers' *right to be informed*, i.e., "the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes."<sup>30</sup> Taxpayers also have the *right to appeal an IRS decision in an independent forum*, i.e., they 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."<sup>31</sup>

## REASONS FOR CHANGE

### Judicial Review of Applications for Exempt Status

Congress enacted IRC § 7428 in the light of Supreme Court cases that involved IRC § 501(c)(3) organizations. Lack of access to a declaratory judgment would indeed be a "harsh regime" for section 501(c)(3) organizations, contributions to which may be deductible, but this lack of access may also cause hardship on other section 501(c) organizations. A potential contributor to a section 501(c)(4), (c)(5), or (c)(6) organization would not generally expect his or her contribution to be deductible. Thus, in choosing among organizations to receive a nondeductible contribution, public recognition of exempt status may be the *only* basis for selecting one organization over another. The donor is assured that the contribution will not be a taxable receipt, and public recognition that results from IRS vetting may increase his or her confidence in the organization's legitimacy. Thus, IRS recognition may be just as vital to the continued existence of section 501(c)(4), (c)(5), or (c)(6) organizations as it is for section 501(c)(3) organizations, and doubt about exempt status just as harmful.

In any event, as noted above, Congress intended to monitor the volume and type of exempt organization applications "as an aid to proper oversight and to future decision-making in this area."<sup>32</sup> A significant increase in volume would presumably indicate that additional or different oversight would be appropriate. As the Treasury Inspector General for Tax Administration (TIGTA) reported, over the four-year period

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29 See National Taxpayer Advocate 2013 Annual Report to Congress 165, 172 (Most Serious Problem: EXEMPT ORGANIZATIONS: *The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*); 2012 Annual Report to Congress 192, 200 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442, 444 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2011 Annual Report to Congress 562 (Legislative Recommendation: *Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*). See, e.g., Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions (rev. Sept. 23, 2014), available at <http://www.irs.gov/Charities-&Non-Profits/Automatic-Exemption-Revocation-for-Non-Filing-Revocation-Cannot-Be-Appealed>, answering the question "May my organization appeal its automatic revocation?" with "No, the law provides no appeals process for automatic revocations. To have its tax-exempt status reinstated, the organization must file an application for exemption. An organization may also request retroactive reinstatement as part of its application." Organizations that believe the IRS erroneously listed them as having had their exempt status automatically revoked are advised to simply contact the IRS. There is no mechanism for review of disputed cases.

30 Taxpayer Bill of Rights, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>, describing taxpayers' right to be informed.

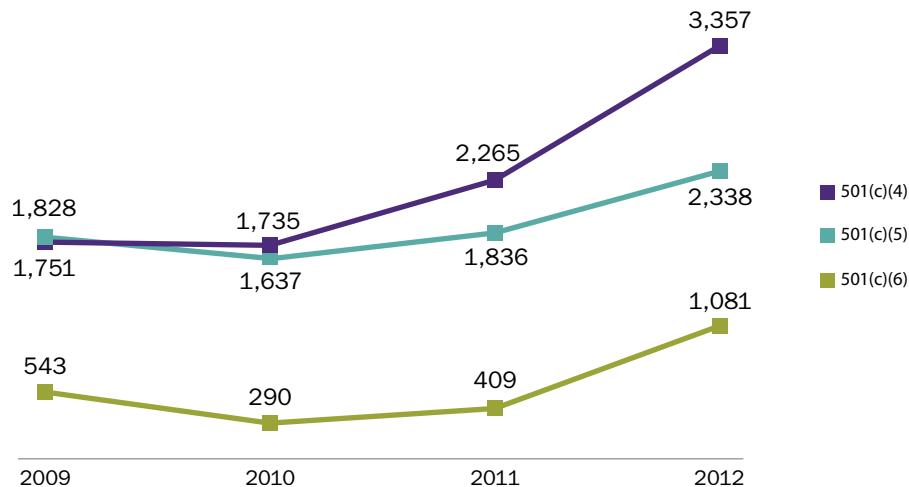
31 *Id.*, describing taxpayers' right to appeal an IRS decision in an independent forum.

32 See S. REP. No. 94-938, at 586 (1976), H.R. REP. No. 94-658, at 285 (1975).

from 2009 to 2012, the number of taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), and (c)(6) organizations increased 92 percent, 99 percent, and 28 percent, respectively, as shown in Figure 2.12.1.<sup>33</sup>

**FIGURE 2.12.1**

**Applications for exempt status under  
IRC sections 501(c)(4), (c)(5), and (c)(6), 2009–2012**



More importantly, as TIGTA also reported, lack of guidance may have contributed to the IRS's adoption of inappropriate procedures for evaluating IRC § 501(c)(4) applications and a 13-month processing stoppage, conditions that increases in application volume only exacerbated.<sup>34</sup> The availability of declaratory judgments would have allowed judicial guidance to emerge where administrative guidance was lacking or inappropriate, preventing the violation of taxpayers' *right to be informed*.<sup>35</sup>

33 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review 3* (Figure 2) (May 14, 2013), reporting the number of applications for exempt status under IRC § 501(c)(4) was 1,751 in fiscal year (FY) 2009; 1,735 in FY 2010; 2,265 in FY 2011, and 3,357 in FY 2012. Applications for exempt status under IRC § 501(c)(5) were 543, 290, 409, and 1,081; and under IRC § 501(c)(6) were 1,828, 1,637, 1,836, and 2,338 in the same respective periods. The number of applications for exempt status under IRC § 501(c)(3) increased only two percent from FY 2009 to FY 2012, with 65,179 applications in FY 2009; 59,486 in FY 2010; 58,712 in FY 2011; and 66,543 applications in FY 2012.

34 *Id.* at 12-13. See also United States Senate, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, *IRS And TIGTA Management Failures Related To 501(c)(4) Applicants Engaged In Campaign Activity* at 17 (Sept. 5, 2014), available at <http://www.hsgac.senate.gov/subcommittees/investigations/reports>, noting that “[m]ost of the court decisions have interpreted the law with respect to 501(c)(3) charities as opposed to social welfare organizations, or examined the term ‘exclusively’ in other contexts.” (Fn. ref. omitted).

35 It is for this reason that the National Taxpayer Advocate, in her FY 2014 Objectives Report to Congress, included a Special Report, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (Special Report), in which she further analyzed the causes of the problems TIGTA identified and suggested that Congress “[c]onsider legislation to provide applicants for exemption under IRC § 501(c)(4) with the ability to seek a declaratory judgment if denied or unanswered after nine months so that more judicial guidance can develop.” Special Report at 15-16.

## Administrative Review of Automatic Revocations

Organizations whose exempt status (under any subparagraph of 501(c)) was automatically revoked not only cannot seek a declaratory judgment under IRC § 7428, but also cannot access an administrative review procedure. The IRS has erroneously treated thousands of organizations as having had their exempt status automatically revoked and has adopted computer programming that will lead to additional erroneous revocations.<sup>36</sup> Despite the urging of the National Taxpayer Advocate and the IRS's adoption of the Taxpayer Bill of Rights (TBOR), which includes "administrative appeal of most IRS decisions ...," the IRS refuses to develop procedures that would allow organizations to demonstrate they remain exempt before the IRS erroneously lists them on public databases as non-exempt. The consequences of being listed as no longer exempt, such as declining contributions and a loss of credibility, and the time and expense of seeking reinstatement, may devastate an organization.

## EXPLANATION OF RECOMMENDATIONS

The first proposal, consistent with taxpayers' *rights to be informed and to appeal an IRS decision in an independent forum*, would amend IRC § 7428 to allow taxpayers seeking exemption as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as those seeking exempt status as IRC § 501(c)(3) organizations. This would ensure that these non-501(c)(3) organizations could obtain relief if their applications remain unaddressed for nine months, increase IRS accountability for delays, and allow judicial guidance to develop. The recommendation is limited to IRC § 501(c)(4), (5), and (6) organizations, who are most affected by the lack of judicial guidance in this area.

The second proposal, consistent with taxpayers' *right to appeal an IRS decision in an independent forum*, would amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations whose tax-exempt status is treated as automatically revoked. This would provide organizations with a venue in which to raise their concerns and help the IRS avert errors that could prove fatal to the organizations. Instituting such a procedure would be good tax administration, especially in the absence of access to a judicial forum under IRC § 7428 in which an organization can show an automatic revocation was erroneous.

<sup>36</sup> National Taxpayer Advocate 2013 Annual Report to Congress 165 n. 5, 169-171, Most Serious Problem: EXEMPT ORGANIZATIONS: *The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status* (noting that TE/GE estimates it erroneously treated about 9,000 organizations as having had their exempt status automatically revoked and will continue to measure the three year nonfiling period from the time an organization obtains its employer identification number, whether or not the organization had a filing requirement).

**LR  
#13**

## **STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date is Properly Calculated by the IRS**

### **PROBLEM**

Collection Due Process (CDP) hearings were created by the IRS Restructuring and Reform Act of 1998 (RRA 98).<sup>1</sup> CDP hearings provide taxpayers with an independent review by the IRS Office of Appeals of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. At the hearing, the Appeals officer is required to "obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met."<sup>2</sup> One element of the analysis is verifying that the calculation of the collection statute expiration date (CSED) is accurate.

The taxpayer may appeal an unfavorable CDP hearing determination to the U.S. Tax Court.<sup>3</sup> How the court reviews the determination depends on whether the taxpayer contests the underlying liability. The Tax Court applies the abuse of discretion standard to determinations made by Appeals that deal with issues other than the underlying liability.<sup>4</sup> Under this standard, the court must give deference to an IRS Office of Appeals determination unless it is "arbitrary, capricious, clearly unlawful, or without sound basis in fact or law."<sup>5</sup> When the taxpayer is raising arguments related to the underlying liability, the Tax Court applies the *de novo* standard of review.<sup>6</sup>

Legislative history does not address whether CSED issues under Internal Revenue Code (IRC) § 6330(c)(1) relate to the taxpayer's underlying liability. In a series of decisions, the Tax Court has held that issues related to IRC § 6330(c)(1) can be both related and not related to the underlying liability.<sup>7</sup> This inconsistency creates a situation where similarly situated taxpayers are treated differently. Recently, the IRS Office of Chief Counsel issued guidance stating that verification of CSED calculation should receive abuse of discretion review, which is limited in its scope, based on the premise that CSED does not affect the underlying liability.<sup>8</sup>

1 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 IRC § 6330(c)(1).

3 *Id.*

4 *Jones v. Comm'r*, 338 F.3d 463, 466 (5th Cir. 2003); *Craig v. Commiss'r*, 119 T.C. 252, 260 (2002); *Sego v. Comm'r*, 114 T.C. 604, 610 (2000); H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998) ("Where the liability is not properly at issue, the appeals officer's determinations should be reviewed for an abuse of discretion.")

5 See *Duarte v. Comm'r*, T.C. Memo 2014-176 at \*10. See, e.g., *Bartley v. United States*, 343 F. Supp. 2d 649, 652 (N.D. Ohio 2004); *Robinette v. Comm'r*, 123 T.C. 85, 93 (2004), rev'd, 439 F.3d 455 (8th Cir. 2006); *Woodral v. Comm'r*, 112 T.C. 19, 23 (1999); *Blondheim v. Comm'r*, T.C. Memo. 2006-216.

6 H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998) ("Where the validity of the tax liability was properly at issue in the hearing, and where the determination with regard to the tax liability is a part of the appeal ... [t]he amount of the liability will in such cases be reviewed by the appropriate court on a *de novo* basis.").

7 See, e.g., *Rosenbloom v. Comm'r*, T.C. Memo. 2011-140, at \*22-23 (holding that since the taxpayer was not challenging the underlying liabilities, the court would review with the abuse of discretion standard); *Roberts v. Comm'r*, T.C. Memo. 2004-100, at \*11-12 (holding that a petitioner's challenge to the expiration of the CSED does not challenge the underlying liability and will receive abuse of discretion review); *Jordan v. Comm'r*, 134 T.C. 1, 15-16 (2010) (holding that since a challenge to the CSED is a challenge to the underlying liability and the petitioners did not have a previous opportunity to raise the issue, the court would review the validity of a signature on Form 900, Tax Collection Waiver, with the *de novo* standard); *Boyd v. Comm'r*, 117 T.C. 127 (2001) (where the taxpayer raises an argument that the IRS is time barred from collecting a tax liability, the court will review the matter *de novo*).

8 Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 4 (May 5, 2014).

The Tax Court's review under the abuse of discretion standard is generally limited to what is in the taxpayer's administrative file, which will include issues raised at the CDP hearing. However, taxpayers do not have easy access to records related to the calculation of their CSED, as this information is held by the IRS. Although Appeals is required to verify the accuracy of the CSED, taxpayers may not know how to bring particular concerns about the CSED to the Appeals officer's attention. Additionally, the IRS's CSED calculation is not always accurate.<sup>9</sup> Moreover, a review of the CDP program by the Treasury Inspector General for Tax Administration (TIGTA) in 2013 found that approximately 21 percent of CSED calculations were not accurate because Appeals did not accurately input the CSED suspension code related to the CDP hearing.<sup>10</sup> The incorrect calculation of the CSED has the potential to result in unlawful collection activity against taxpayers.

The limited review of CSED issues based on the abuse of discretion standard and the inconsistency of Tax Court treatment of CSED issues as both related and not related to the underlying liability impairs the *right to a fair and just tax system*, which among other things, recognizes the right "to expect the tax system to consider facts and circumstances that might affect [a taxpayer's] underlying liabilities."<sup>11</sup> The deferential abuse of discretion standard of review may be detrimental to the full exercise of *the right to challenge the IRS's position and be heard*, which in part includes "the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions."<sup>12</sup> If the taxpayer does not have easy access to the records, then he or she cannot make an effective objection. *The right to pay no more than the correct amount of tax* may be violated when the CSED has expired but the CDP hearing upholds a proposed levy or lien. In this situation the taxpayer is paying more than is legally due. It also violates the *right to finality* because the CSED imposes a set period of time within which the IRS can collect the tax. Lastly, the *right to appeal an IRS decision in an independent forum* is negatively affected because the taxpayer cannot adequately develop a case. By itself, this provision affects half of the rights afforded to taxpayers in the Taxpayer Bill of Rights and as such, this recommendation will go a long way in acknowledging taxpayer rights.

## EXAMPLE

Taxpayer A reported a \$1,000 liability on his 2002 return and entered into an installment agreement but could not keep up with the payments. He then submitted an offer in compromise (OIC), the processing of which extended the CSED. While the IRS was considering his offer, Taxpayer A deployed to a combat zone for a brief period, which suspended his CSED. Following his return, the IRS rejected his offer and eventually proposed a levy on his wages.

Taxpayer A requested a CDP hearing. Unbeknownst to Taxpayer A, an error occurred in the IRS's calculation of his CSED, but because of the miscalculation, the IRS continued to collect the debt. In fact, the CSED had expired and Taxpayer A no longer owed this debt. Taxpayer A, who is unrepresented, did not know that he should question the collectability of the unpaid tax. When Appeals reviewed his transcript, it did not detect anything amiss with the accuracy of the CSED. Taxpayer A filed a petition in Tax Court

<sup>9</sup> See *Reinhart v. Comm'r*, T.C. Memo 2014-218 (applying *de novo* standard of judicial review the court held that the IRS was time barred from collecting a trust fund recovery penalty and filing a Notice of Federal Tax Lien because of CSED expiration; CSED was not suspended because the taxpayer did not live outside of the United States).

<sup>10</sup> This number is projected based on a statistically valid sample of CDP and equivalent hearing cases closed between October 1, 2011 and September 30, 2012. Based on the review, TIGTA determined that 10,151 of the 47,855 CDP cases closed in FY 2012 may have had an incorrect CSED. TIGTA, Ref. No. 2013-10-103, *The Office of Appeals Continues to Experience Difficulties in the Handling of Collection Due Process Cases* 4 (Sept. 17, 2013).

<sup>11</sup> IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

<sup>12</sup> *Id.*

and retained *pro bono* representation through a Low Income Taxpayer Clinic,<sup>13</sup> but because the CSED is reviewed with the abuse of discretion standard, the court will limit its review to the administrative record, which does not contain an argument or any evidence from Taxpayer A with respect to that issue.

## RECOMMENDATION

To address the inequity faced by taxpayers whose CSEDs have expired but who may face an enforced collection action based on miscalculated statutes of limitations and to enhance taxpayer protections contemplated by the Taxpayer Bill of Rights, the National Taxpayer Advocate recommends that Congress:

Amend IRC § 6330(d) to provide for a *de novo* standard of review by the Tax Court of whether the CSED is properly calculated by the IRS pursuant to IRC § 6330(c)(1).

## PRESENT LAW

Once a tax liability is assessed, the IRS generally has ten years to collect the tax, which is known as the collection statute expiration date (CSED).<sup>14</sup> Calculating the correct CSED is not always an easy task. Many events can extend the CSED, including:

- Litigation;<sup>15</sup>
- Pending installment agreement or offer in compromise;<sup>16</sup>
- CDP appeal;<sup>17</sup> and
- Military-related service conducted in a combat zone<sup>18</sup>

In every CDP hearing, the Appeals officer is required to “obtain verification from the IRS office collecting the tax that the requirements of any applicable law or administrative procedure with respect to the proposed levy have been met.”<sup>19</sup> Ensuring that the CSED has not expired is a legal requirement that

<sup>13</sup> Low Income Taxpayer Clinics (LITCs) represent low income individuals in disputes with the Internal Revenue Service, including audits, appeals, collection matters, and federal tax litigation. LITCs can also help taxpayers respond to IRS notices and correct account problems. These services are offered for no more than a nominal fee. See IRC § 7526.

<sup>14</sup> IRC § 6502.

<sup>15</sup> See, e.g., IRC §§ 6502(a)(2); 6503(h).

<sup>16</sup> IRC § 6331(k)(3).

<sup>17</sup> The statute of limitation is extended from the date a timely hearing is requested until the date the IRS receives the taxpayer's written withdrawal of the request for a CDP hearing by Appeals or the determination resulting from the CDP hearing becomes final by expiration of the time for seeking judicial review or the exhaustion of the right of judicial review, including review by a federal court of appeals. Treas. Reg. 301.6330-1(g)(3).

<sup>18</sup> IRC § 7508(a)(1)(I).

<sup>19</sup> See Treas. Reg. § 301.6330-1(e)(1). See also Treas. Reg. § 301.6320-1(e)(1). The Collection function is responsible for sending the case file to Appeals. IRM 8.22.4.2.1(3) (Nov. 5, 2013). It is the job of the Appeals officer to review part 5 of the IRM (Collecting Process) “to verify whether administrative procedures were followed in issuing a Notice of Intent to Levy and/or filing a Notice of Federal Tax Lien (NFTL).” IRM 8.22.4.2.1(5) (Nov. 5, 2013). Appeals officers also receive guidance on CSED issues. For example, see IRM 8.21.5.1.2 (Apr. 20, 2012).

the Appeals officer must consider under IRC § 6330(c)(1).<sup>20</sup> This is in addition to any issues that the taxpayer may raise.<sup>21</sup>

Verifying the CSED under § 6330(c)(1) does not require the IRS to rely on a particular document.<sup>22</sup> In fact, Appeals may use transcripts of the account to satisfy the verification requirement under IRC § 6330(c)(1) unless the taxpayer can identify an irregularity in the assessment process or other irregularity.<sup>23</sup>

### **Standards of Review Used by the Tax Court**

Generally, the court will only review issues that the taxpayer raises in the CDP hearing; however, Appeals' verification under IRC § 6330(c)(1) that all legal and administrative requirements have been satisfied are reviewed by the court in all cases even if the taxpayer does not raise a verification issue during the hearing.<sup>24</sup> How a court will review a particular CDP determination depends on the applicable standard of review. When the existence or amount of underlying tax liability is properly at issue under section 6330(c)(2)(B), the court will review the issue *de novo*,<sup>25</sup> which means the court will conduct a trial "as if there had been no trial in the first instance."<sup>26</sup> However, in order for a court to consider an issue related to the underlying liability or a relevant issue under section 6330(a)(2)(A), it must also be raised during the CDP hearing.<sup>27</sup> A taxpayer is also limited to raising issues related to the underlying liability only if the taxpayer "did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability."<sup>28</sup>

When the validity of the underlying liability is not at issue, the court reviews the determination for abuse of discretion.<sup>29</sup> Unlike *de novo* review, reviewing for abuse of discretion means the extent of the court's review is limited to determining whether the Appeals officer's decision was "arbitrary, capricious, or without sound basis in fact or law."<sup>30</sup>

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20 See *Beeler v. Comm'r*, T.C. Memo. 2009-266, at \*6, vacated and remanded on other grounds, 434 Fed. Appx. 41 (2d Cir. 2011).

21 IRC § 6330(c)(2)(A). The taxpayer may raise "any relevant issue relating to the unpaid tax or the proposed levy," including appropriate spousal defenses, challenges to the appropriateness of collection actions, and offers of collection alternatives. IRC § 6330(c)(2)(A). Additionally, if the taxpayer has not already received a notice of deficiency or otherwise have an opportunity to dispute the liability, he or she may raise issues at the hearing that challenge the existence or amount of the underlying liability. IRC § 6330(c)(2)(B).

22 *Roberts v. Comm'r*, 118 T.C. 365, 371 (2002).

23 See, e.g., *McLaine v. Comm'r*, 138 T.C. 10 (2012); *Clayton v. Comm'r*, T.C. Memo. 2009-114.

24 *Hoyle v. Comm'r*, 131 T.C. 197, 201-202 (2008); *Crites v. Comm'r*, T.C. Memo 2012-267.

25 *Sego v. Comm'r*, 114 T.C. 604, 610 (2000).

26 A trial *de novo* will consider both questions of fact and issues of law. *Black's Law Dictionary* (9th ed. 2009).

27 Treas. Reg. 301.6330-1(f), Q&A-F3. See also, *Giamelli v. Comm'r*, 129 T.C. 107 (2007).

28 IRC § 6330(c)(2)(B).

29 Non-liability issues are reviewed for an abuse of discretion. *Jones v. Comm'r*, 338 F.3d 463, 466 (5th Cir. 2003); *Craig v. Comm'r*, 119 T.C. 252, 260 (2002); *Sego v. Comm'r*, 114 T.C. 604, 610 (2000); H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. Part 2, at 266 (1998).

30 *Murphy v. Comm'r*, 125 T.C. 301, 320 (2005).

Some Tax Court decisions have held that an Appeal officer's IRC § 6330(c)(1) verification regarding CSED does not relate to the underlying liability.<sup>31</sup> Other decisions have held that CSED issues do relate to the underlying liability.<sup>32</sup>

Recently, IRS Counsel issued a notice indicating that the proper standard of review for CDP determinations related to statutes of limitations is abuse of discretion. Counsel concluded that “[t]he existence or amount of an underlying tax liability, an issue the taxpayer may raise in appropriate circumstances in a CDP hearing, does not encompass procedural requirements, such as assessment, necessary for administrative collection.”<sup>33</sup> As a result, the Counsel notice advises attorneys to argue that CSED verification and other procedural requirements under IRC § 6330(c)(1) should be reviewable for abuse of discretion.<sup>34</sup> To treat a CSED issue as affecting the taxpayer's underlying liability, the CSED issue would receive *de novo* review by the court, but this review would only be available to taxpayers who did not previously receive a statutory notice of deficiency or otherwise have an opportunity to dispute the liability.<sup>35</sup> Taxpayers would also have to raise the issue themselves or otherwise the CSED would not be part of the administrative record review.

## REASONS FOR CHANGE

Procedural issues such as CSED go to the heart of the case. In particular, IRC § 6330(c)(1) requires that “The appeals officer *shall* at the hearing obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met” (emphasis added).<sup>36</sup> This makes sense because if a CSED has expired, there is no longer a liability to collect. Given the importance of this verification to the case, it should be reviewed by the court and it should receive *de novo* review.

Despite the CSED being critical to a case, the calculation of the CSED is not always exact. In fact, employees are informed that the “CSED reflected on ICS and IDRS may not always be correct because, at times, actions that suspend or extend the CSED occur simultaneously, increasing the complexity of computing the CSED and requiring manual recalculation.”<sup>37</sup>

Under the new guidance, Counsel attorneys will not argue that a taxpayer who received a notice of deficiency or had a previous opportunity to raise a CSED argument should be barred from raising a CSED challenge during litigation, because the guidance does not treat the CSED as an issue pertaining to the underlying liability.<sup>38</sup> However, Counsel attorneys may object to taxpayer attempts to introduce evidence

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<sup>31</sup> *Beeler v. Comm'r*, T.C. Memo. 2009-266, at \*6, vacated and remanded on other grounds, 434 Fed. Appx. 41 (2d Cir. 2011). See also, *Rosenbloom v. Com'r*, T.C. Memo. 2011-140, at \*5-6; *Roberts v. Comm'r*, T.C. Memo. 2004-100, at \*11-12.

<sup>32</sup> *Jordan v. Comm'r*, 134 T.C. 1, 15-16 (2010) (holding that since a challenge to the CSED is a challenge to the underlying liability and the petitioners did not have a previous opportunity to raise the issue, the court would review the validity of a signature on Form 900, *Tax Collection Waiver*, with the *de novo* standard). See also, *Boyd v. Comm'r*, 117 T.C. 127 (2001) (where the taxpayer raises an argument that the IRS is time barred from collecting a tax liability, the court will review the matter *de novo*).

<sup>33</sup> Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 3 (May 5, 2014).

<sup>34</sup> *Id.* at 4.

<sup>35</sup> See IRC § 6330(c)(2)(B).

<sup>36</sup> Also, the court in *Crites* commented “[W]e held that issues that an Appeals officer has to consider under section 6330(c)(1) are the issues raised at the hearing, even if it's the Code and not the taxpayer that raises them.” *Crites v. Comm'r*, T.C. Memo. 2012-267 at 8 (Sept. 17, 2012) (*citing Hoyle v. Comm'r*, 131 T.C. 197, 201-202 (2008)).

<sup>37</sup> IRM 5.1.19.1.1(3) (Nov. 22, 2013). IDRS is the IRS's Integrated Data Retrieval System, ICS is the Integrated Collection System.

<sup>38</sup> Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 4 (May 5, 2014).

outside of the administrative record.<sup>39</sup> Moreover, the court's review will focus on whether the Appeals officer's determination was arbitrary, capricious, or without sound basis in fact or law, and not whether calculation of the CSED was correct.

The abuse of discretion standard is deferential to the government and requires the court to limit its review of CSED issues to the administrative record, regardless of its accuracy. However, as noted above, a miscalculated CSED is not unheard of.<sup>40</sup>

In addition, the CSED records are in the custody of the IRS. It is not information that is readily available to taxpayers for review. If the court is limited to the abuse of discretion standard of review, this error may never be uncovered, much less corrected.

It is also important to address inconsistent treatment by the Tax Court. In some cases, the Tax Court views the CSED as affecting the underlying liability and in other cases it does not.<sup>41</sup> This may leave similarly situated taxpayers receiving different levels of review by the court. If all CSED issues obtained *de novo* review, there would be a uniform standard for review enhancing existing taxpayer protections and the *right to fair and just tax system* from the Taxpayer Bill of Rights recently adopted by the IRS.

The current system may impose a burden on taxpayers who have an incorrect CSED calculation and may lead to unfair determinations for those who do not know to raise this argument. This result also would impact the taxpayer's *right to challenge the IRS's position and be heard*, which requires, among other things, that taxpayers have the right "to raise objections and provide additional documentation in response to formal IRS actions or proposed actions."<sup>42</sup> When taxpayers cannot fully develop their cases, the *right to appeal an IRS decision in an independent forum* is eroded. *The right to pay no more than the correct amount of tax* is violated when the CSED has expired but the CDP hearing upholds a proposed levy or lien. In this situation the taxpayer is paying more than is legally allowed. It also violates the *right to finality* because the CSED imposes a set period of time within which the IRS can collect the tax.

## EXPLANATION OF RECOMMENDATION

As described in *Reinhart v. Comm'r* and the TIGTA report, it is possible that the calculation of a CSED is not always accurate.<sup>43</sup> Requiring that verification of the CSED calculation receive *de novo* review will protect taxpayers from IRS errors. Without this review, errors in the administrative file may never be realized and the IRS may be permitted to take unlawful actions to collect unenforceable tax liabilities. When

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39 Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 4 (May 5, 2014). If the administrative file does not contain sufficient evidence or inadequate information regarding a CSED issue, Counsel is advised to consider a motion to remand. Office of Chief Counsel, Notice CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* 4 (May 5, 2014).

40 IRC § 7433(a) allows taxpayers to bring civil actions for damages when "any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence, disregards any provision of this title, or any regulation promulgated under this title." Taxpayers could consider this option when the IRS collects on a liability with an expired CSED. However, relying on this option is a burden to taxpayers and the IRS because it creates a second round of expensive (and unnecessary) litigation. Other options include requesting return of levy proceeds under IRC §6343(d)(2)(D) or filing a refund claim with Form 843-A, *Claim for Refund and Request for Abatement*. The recommendation here provides an efficient resolution, since the parties are already before the court.

41 See footnote 7, *supra*.

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

43 See *Reinhart v. Comm'r*, T.C. Memo 2014-218. See also TIGTA, Ref. No. 2013-10-103, *The Office of Appeals Continues to Experience Difficulties in the Handling of Collection Due Process Cases* 4 (Sept. 17, 2013).

the court uses the abuse of discretion standard of review, it is less likely to discover such errors. Without discovery, there is no reliable remedy in the CDP proceeding.

This legislative change will allow the Tax Court to review the IRS CSED calculations based on the *de novo* standard and will allow taxpayers to raise objections or provide additional evidence regarding the proper calculation of CSED in CDP cases. The *de novo* standard will enhance and make meaningful core taxpayer rights such as the *right to challenge the IRS's position and to be heard*, the *right to appeal an IRS decision in an independent forum*, and the *right to a fair and just tax system*.

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## **APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides**

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### **PROBLEM**

*Byers v. Commissioner* recently considered the issue of proper appellate venue in Collection Due Process (CDP) cases that do not involve a redetermination of liability.<sup>1</sup> The court concluded the proper venue for appealing United States Tax Court decisions in non-liability CDP cases lies with the Court of Appeals for the District of Columbia Circuit (D.C. Circuit) unless the case type falls under one of the rules specified in Internal Revenue Code (IRC) § 7482(b)(1) or (b)(3) or the parties both stipulate in writing.<sup>2</sup> Prior to this decision, taxpayers, tax practitioners, and the government adhered to a general practice of appealing all Tax Court decisions involving IRC §§ 6320 and 6330 to the court of appeals for the circuit in which the taxpayer lived (regional court).<sup>3</sup>

The *Byers*<sup>4</sup> decision may create confusion among taxpayers and practitioners regarding the proper venue for appeals of non-liability CDP determinations from the Tax Court. In addition, it may create uncertainty for the Tax Court, which follows its own precedent unless the court of appeals to which the case would be appealable has ruled to the contrary under the *Golsen* rule.<sup>5</sup> Additionally, *Byers* did not provide any guidance as to what will happen when there is a non-liability CDP appeal filed in a regional court without stipulation to venue.

Finally, the *Byers* decision may result in some forum shopping by litigants who are aware of its implications.<sup>6</sup> This could mean that taxpayers with similar procedural issues residing in the same place could get vastly different results, if one taxpayer challenging the underlying liability obtains review by the regional circuit, and the other taxpayer not challenging liability obtains review by the D.C. Circuit. The difference in results could lead to an increased perception of the unfairness of the tax system. This could also lead to an increase in unwarranted challenges to a taxpayer's underlying liability and unnecessary litigation because the taxpayer wants to create a clear path to the regional circuit court. Having all cases go to the regional court could avoid these problems.

Absent congressional clarification,<sup>7</sup> the confusion about proper venue may impact taxpayers' *right to be informed*, which provides that taxpayers "have the right to know what they need to do to comply with the

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1 740 F.3d 668 (D.C. 2014), aff'd T.C. Memo. 2012-27. For a detailed discussion of the case, see Most Litigated Issue: *Appeals from Collection Due Process Hearings Under IRC §§ 6320 and 6330, infra*.

2 IRC § 7482(b)(2).

3 See James Bamberg, *A Different Point of Venue: The Plainer Meaning of Section 7482(b)(1)*, 61 TAX LAW. 445 (Winter 2008).

4 *Byers v. Comm'r*, 740 F.3d 668 (D.C. 2014), aff'd T.C. Memo. 2012-27.

5 *Golsen v. Comm'r*, 54 T.C. 742 (1970), aff'd, 445 F.2d 985 (10th Cir. 1971).

6 Having a choice of the D.C. Circuit or the regional circuits by stipulation may lead one party to have an advantage during litigation. Either the IRS or the taxpayer can now file motions to transfer venue or block requests to stipulate a change in venue, depending on what benefits the case.

7 The taxpayer filed a petition for certiorari, which the Supreme Court denied. See *Byers v. Comm'r*, 740 F. 3d 668 (D.C. 2014), cert. denied, 83 U.S.L.W. 3189 (U.S. Oct. 6, 2014) (No. 14-74).

tax laws.”<sup>8</sup> Additionally, the *Byers* interpretation of IRC § 7482(b)(1) may foster a system where represented taxpayers are better equipped to navigate the appeal process, negatively affecting the *right to a fair and just tax system* for unrepresented taxpayers.<sup>9</sup>

## EXAMPLE

Taxpayer A files a petition in Tax Court to appeal a CDP determination, with the appeal involving an IRS decision to reject an offer in compromise. The taxpayer does not contest the tax liability. The Tax Court upholds the IRS’s determination. However, the unrepresented taxpayer is unaware that the D.C. Circuit has held that it provides proper venue for her case. She files her appeal in the circuit court of appeals for the state in which she resides. The government does not contest venue. In light of the *Byers* decision, it is unclear what the regional court should do with her case.

## RECOMMENDATION

To address the proper venue for appealing Tax Court determinations under IRC §§ 6320 and 6330 that do not involve liability issues, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 7482(b)(1)(A) to provide that proper appellate venue for all CDP cases lies with the circuit court of appeals based on the taxpayer’s legal residency.

## PRESENT LAW

A court must have jurisdiction and venue to hear a case.<sup>10</sup> If the court does not have jurisdiction, it must dismiss the case.<sup>11</sup> However, if venue is incorrect, the court may dismiss the case *or* transfer the case to the correct venue.<sup>12</sup> Generally, the correct venue for appeals from the Tax Court is the D.C. Circuit unless one of the rules specified in IRC § 7482(b)(1) or exceptions specified in IRC § 7482(b)(2) or (b)(3) applies. For instance, IRC § 7482(b)(1)(A) provides that in cases where a petitioner, other than a corporation, seeks redetermination of a tax liability, venue for review by the United States Court of Appeals lies with the Court of Appeals for the circuit based upon the taxpayer’s legal residence.<sup>13</sup> Pursuant to IRC § 7482(b)(2), the taxpayer and the IRS may stipulate the venue for an appeal in writing.

8 IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

9 Between June 1, 2013 and May 31, 2014, *pro se* taxpayers constituted 63 percent of litigated CDP cases. See Most Litigated Issue: *Appeals from Collection Due Process Hearings Under IRC §§ 6320 and 6330, infra*.

10 Jurisdiction is defined generally as “A court’s power to decide a case or issue a decree.” *Black’s Law Dictionary* (9th ed. 2009), available at Westlaw BLACKS. Venue is defined as the “proper or a possible place for a lawsuit to proceed.” *Black’s Law Dictionary* (9th ed. 2009), available at Westlaw BLACKS.

11 See *Ex parte McCardle*, 74 U.S. 506, 514 (1869) (“Without jurisdiction the court cannot proceed at all in any cause. Jurisdiction is power to declare the law, and when it ceases to exist, the only function remaining to the court is that of announcing the fact and dismissing the cause.”).

12 See *Georgia-Pacific Corp. v. Federal Power Com.*, 512 F.2d 782, 783-784 (5th Cir. 1975) (*citing Koehring Co. v. Hyde Constr. Co.*, 382 U.S. 362 (1966)).

13 IRC § 7482(b)(1) also provides that the proper venue lies with the court of appeals for the circuit in which it is located: B) in the case of a corporation seeking redetermination of tax liability, the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in any judicial circuit, then the office to which was made the return of the tax in respect of which the liability arises, C) in the case of a person seeking a declaratory decision under IRC § 7476, the principal place of business, or principal office or agency of the employer, D) in the case of an organization seeking a declaratory decision under IRC § 7428, the principal office or agency of the organization, E) in the case of a petition under IRC §§ 6226, 6228(a), 6247, or 6252, the principal place of business of the partnership, and F) in the case of a petition under section IRC § 6234(c), (i) the legal residence of the petitioner if the petitioner is not a corporation, and (ii) the place or office applicable under subparagraph (B) if the petitioner is a corporation. IRC § 7482(b)(1).

Deciding the issue of proper venue in *Byers v. Commissioner*, the D.C. Circuit held it would not transfer cases to regional courts unless the parties stipulate. In *Byers*, the taxpayer timely requested a CDP hearing in response to a levy notice. The proposed levy action was sustained by the Appeals Officer (AO). The taxpayer appealed to the Tax Court, which granted summary judgment to the IRS, whereupon the taxpayer appealed the grant of summary judgment to the D.C. Circuit.

The IRS argued that since CDP hearings often include challenges to the underlying liabilities, venue is properly placed in the circuit where the taxpayer resides under IRC § 7482(b)(1)(A).<sup>14</sup> The IRS made a motion to transfer the case to the Eighth Circuit. However, the court determined that IRC §7482(b)(1)(A) was not applicable since the taxpayer was not challenging the underlying liability. Thus, the proper venue was in the D.C. Circuit.<sup>15</sup>

## REASONS FOR CHANGE

The *Byers* decision will have several ramifications. For instance, the court does not answer the question of whether another court of appeals could hear an appeal of a non-liability CDP decision without stipulation of the venue.<sup>16</sup> Without congressional action, this issue will likely be addressed by other circuit courts separately and may result in a split in circuits.<sup>17</sup> In the meantime, taxpayers will be left with uncertainty, which impacts *the right to be informed*.

*Byers* will also create complications for how the Tax Court hears its cases. Under the *Golsen* rule, the court follows its own precedent unless the court of appeals to which the case would be appealable has ruled to the contrary.<sup>18</sup> How will the Tax Court know which circuit's law to apply if the taxpayer has a choice in venue? As noted above, this could mean that taxpayers with similar procedural issues residing in the same place could get vastly different results, if one taxpayer challenged the underlying liability and the other taxpayer did not. The difference in results could lead to an increased perception of the unfairness of the tax system. This could also lead to an increase in unwarranted challenges to a taxpayer's underlying liability and unnecessary litigation because the taxpayer wants to create a clear path to the regional circuit court.

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<sup>14</sup> At a CDP hearing, the taxpayer may raise challenges to the existence or amount of the underlying tax liability for any tax period, if the taxpayer did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability. IRC § 6330(c)(2)(B). Such challenges would fall under the exception in IRC § 7482(b)(1)(A). However, taxpayers may also raise any relevant issue relating to the unpaid tax or the proposed levy, including (i) appropriate spousal defenses; (ii) challenges to the appropriateness of collection actions; and (iii) offers of collection alternatives, which may include the posting of a bond, the substitution of other assets, an installment agreement, or an offer-in-compromise. IRC § 6330(c)(2)(A). Certain issues, such as the rejection of a collection alternative, do not challenge the underlying liability and therefore, the taxpayer is not seeking a redetermination of the liability when they raise such issues.

<sup>15</sup> The Court held “[v]enue cannot be proper in the Eighth Circuit unless the parties so stipulate in writing.” *Byers v. Comm'r*, 740 F.3d 668 at 675.

<sup>16</sup> The court notes “we have no occasion to decide in this case whether a taxpayer who is seeking review of a CDP decision on a collection method may file in a court of appeals other than the D.C. Circuit if the parties have not stipulated to venue in another circuit.” *Byers*, 740 F.3d at 677. This language leaves it open for interpretation whether venue would be proper in another circuit court when neither party addresses it, such as the appellate cases decided prior to *Byers*.

<sup>17</sup> Legislation has also been proposed to address this issue. J. Comm. on Tax'n, *Technical Explanation Of The Senate Committee On Finance Chairman's Staff Discussion Draft Of Provisions To Reform Tax Administration*, JCX-16-13,39-40 (November 20, 2013). The legislation provides that cases under IRC §§ 6015, 6320, and 6330 will be appealable to the circuit in which is located the petitioner's legal residence (in the case of an individual). While this provision has appeared in several bills, it has gained little traction.

<sup>18</sup> *Golsen v. Comm'r*, 54 T.C. 742 (1970), aff'd, 445 F.2d 985 (10th Cir. 1971).

In a Tax Court case subsequent to *Byers*, also involving a non-liability CDP hearing, the Tax Court applied the rules of the appellate court based on the residence of the taxpayer (in this instance the Ninth Circuit), stating:

In light of *Byers*, we are mindful of the uncertainty of appellate venue and the controlling law in this case. We further note, however, that we have not found a case wherein the Court of Appeals for the District of Columbia Circuit has either adopted or rejected the administrative record rule in a collection case under sec. 6320 or sec. 6330.<sup>19</sup>

The changes in practice brought by *Byers* mean that taxpayers and practitioners appealing a non-liability CDP case must now understand the type of case they have and whether it involves liability redetermination, so that they obtain the appropriate venue. The court in *Byers* was not concerned with taxpayer confusion over types of CDP cases, explaining instead:

[j]ust as we see in this case, it normally will be obvious from the taxpayer's statement of the issues whether an appeal involves a challenge to a redetermination decision, a CDP decision on a collection method, or both. Therefore, it will not be difficult for this court to distinguish between the two types of cases to determine whether venue is proper in the D.C. Circuit.<sup>20</sup>

In practice, making the distinction between liability and non-liability CDP hearings could prove difficult for taxpayers, especially *pro se* taxpayers. Taxpayers should also be prepared for litigation over the meaning of "redetermination."<sup>21</sup>

If the regional circuit courts of appeal agree with *Byers*, and hold that the D.C. Circuit is proper venue for CDP cases in which taxpayers are not seeking a redetermination of liability, such holding would require all of these cases to be appealed to the D.C. Circuit. This holding would disproportionately burden low-income taxpayers who do not have the means to travel to the District of Columbia or the means to pay someone to travel to the District of Columbia if the case is scheduled for oral argument.

If the regional circuit courts of appeals find that venue is proper in their courts when the taxpayer only disputes a non-liability issue, taxpayers (and the IRS) may now be able to "forum shop." Taxpayers may consider how their regional circuit would handle their non-liability CDP case in comparison to the D.C. Circuit. For instance, in *Robinette v. Comm'r*, the Tax Court held that it could consider evidence that was not part of the administrative record when it reviews an AO's determination for abuse of discretion.<sup>22</sup> This decision was overturned by the Eighth Circuit, which held that evidence is limited to what is in the administrative record.<sup>23</sup>

It is possible that the D.C. Circuit could rule in a way opposite to the Eighth Circuit in regards to evidence at trial. If that happens, taxpayers wishing to submit new evidence during a trial may benefit from

<sup>19</sup> *Boulware v. Commr*, T.C. Memo 2014-80 at 19, n. 4, appeal docketed, No. 14-1147 (D.C. Cir. Aug. 4, 2014). For a discussion on how this can affect the outcome of a case, see *Robinette v. Comm'r*, *infra*.

<sup>20</sup> *Byers*, 740 F.3d at 676.

<sup>21</sup> It is not always clear whether the taxpayer is seeking a redetermination of the tax liability. For instance, some court cases have held that issues related to the collection statute expiration date (CSED) relate to the underlying debt and others have held that CSED issues do not relate to the underlying debt. See Legislative Recommendation: STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date Is Properly Calculated by the IRS, *supra*.

<sup>22</sup> *Robinette v. Comm'r*, 123 T.C. 85 (2004).

<sup>23</sup> *Robinette v. Comm'r*, 439 F.3d 455 (8th Cir. 2006).

having their non-liability CDP appeal heard by the D.C. Circuit. Both the IRS and the taxpayer would be free to either file a motion to transfer venue or block a stipulation, depending on what forum they wanted. In the event the D.C. Circuit Court of Appeals approves the Tax Court's position articulated in *Robinette*, taxpayers challenging a non-liability issue may ask the D.C. Circuit to remand the case and order the Tax Court to permit the parties to submit evidence outside the administrative record. If the taxpayer does not reside in the District of Columbia and chooses not to stipulate to the court of appeals based on his or her residence, the taxpayer will have to incur the travel costs associated with trying the case in the D.C. Circuit. This creates an obstacle for low income taxpayers who cannot use the potentially more advantageous forum.

## EXPLANATION OF RECOMMENDATION

While the *Byers* decision now realigns practice with the law, it has created many unanswered questions that could negatively impact taxpayers. In particular, it places a burden on unrepresented taxpayers who must now understand what type of appeal they have so that they can file their appeal with the court with the proper venue. They must have an understanding of how their choice in venue will affect the outcome of their case. Although the court in *Byers* finds this impact to be minimal on taxpayers, the National Taxpayer Advocate respectfully disagrees, particularly with respect to *pro se* taxpayers, who constituted 63 percent of litigated CDP cases between June 1, 2013 and May 31, 2014.<sup>24</sup> The Tax Court is also affected because in some cases it may have a difficult time ascertaining which law to apply to their analysis. In the absence of congressional action, these issues may continue to linger.

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24 See Most Litigated Issue: Appeals from Collection Due Process Hearings Under IRC §§ 6320 and 6330 at 19, *infra*.

**LR  
#15**

## **OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable”**

### **PROBLEM**

Many small businesses outsource payroll and related tax duties to third-party payroll service providers (PSPs). If a PSP fraudulently fails to pay the IRS, the business owner remains responsible for unpaid tax, interest, and penalties. PSP fraud often results in significant hardship for the business, which (from its perspective) must pay the tax twice—once to the PSP that dissipated the funds, and again to the IRS.<sup>1</sup>

The IRS has the discretionary authority to accept taxpayers’ offers to compromise their tax debts for less than the full amount owed if certain conditions are met.<sup>2</sup> Under its guidelines for evaluating offers in compromise (OICs) based on effective tax administration (ETA) submitted by victims of PSPs, the IRS is to inquire whether the offer will:

1. Result in a financial gain for the taxpayer; and
2. Be “generally perceived within the community as a fair and equitable solution.”<sup>3</sup>

The National Taxpayer Advocate believes the first part of the inquiry is unnecessary because, by definition, a victim of preparer fraud will never be financially advantaged by the fraud. In the second part of this inquiry, the National Taxpayer Advocate, as the “voice of the taxpayer” inside the IRS, is the appropriate official to assess whether an offer would be perceived as fair and equitable.<sup>4</sup>

### **EXAMPLE**

In January 2013, small business MomPop LLC enlists the help of Fasten Tax Group, a PSP, to assist in filing its federal and state payroll taxes. Each pay period, MomPop transfers funds to Fasten to meet its payroll tax obligations. In July 2014, the IRS notifies MomPop that no payroll taxes have been filed since December 2013. For the past six months, Fasten Tax Group has received funds from MomPop and nearly 500 other businesses, but has not made any payments to the IRS on behalf of its clients. MomPop has not been able to reach anyone at Fasten Tax Group. Meanwhile, MomPop has cash reserves of \$20,000 and other assets that exceed its tax liability of approximately \$80,000 to the IRS in payroll taxes, interest, and penalties.

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- 1 For an in-depth discussion of the challenges faced by victims of PSPs, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *supra*.
  - 2 See Treas. Reg. 301.7122-1(b)(1). Treasury Regulations provide three grounds for an offer to be accepted: doubt as to liability; doubt as to collectability; and effective tax administration (ETA). For an in-depth discussion of the IRS’s offer in compromise (OIC) authority, see Most Serious Problem: *OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise*, *supra*.
  - 3 Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014). This guidance supplements the procedures found in Internal Revenue Manual (IRM) 5.8.11.2.2.1, *Public Policy or Equity Compelling Factors*, IRM 5.8.11.4.2, *Financial Statement Analysis*, and IRM 5.8.11.5, *Documentation and Verification*, and will be incorporated into the next revision of these IRM sections.
  - 4 In 1997, The National Commission on Restructuring the Internal Revenue Service called the Taxpayer Advocate the “voice of the taxpayer.” See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 48 (1997).

The majority shareholder of MomPop has been in contact with her congressional office about the harm her company has suffered because of Fasten Tax Group's fraudulent actions. A congressional staffer assures her that Congress has given the IRS the ability to work with victims of PSPs in a fair and equitable manner. At the urging of the staffer, MomPop submits an offer in compromise of \$10,000. Despite the congressional directive to give special consideration to offers from victims of PSP fraud, the IRS rejects MomPop's offer, stating that its acceptance would not be perceived within the community as a fair and equitable solution.

## RECOMMENDATION

To address the inherent conflict with the IRS determining whether acceptance of an offer in compromise by a victim who was defrauded by a payroll service provider is fair and equitable, Congress should specify that such determination be made by National Taxpayer Advocate.

## PRESENT LAW

An OIC is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed.<sup>5</sup> That is, the IRS has the discretionary authority to accept offers for less than the full amount if certain conditions are met.

In 1998, Congress introduced the concept of accepting OICs based on effective tax administration and provided specific guidance to the IRS on accepting such offers.<sup>6</sup> OICs based on ETA provide the IRS the flexibility to consider all of the circumstances that led to a delinquency. The IRS may accept ETA offers even if it could achieve full collection when such collection would create an economic hardship for the taxpayer or the taxpayer identifies "compelling public policy or equity considerations."

Unsatisfied with the IRS's lack of interest in using its ETA OIC authority for victims of PSPs, Congress specifically mandated in section 106 of the Consolidated Appropriations Act of 2014 that the IRS "shall give special consideration to an offer-in-compromise from a taxpayer who has been the victim of fraud by a third party payroll tax preparer."<sup>7</sup> In 2014, the IRS developed an interim guidance memorandum that supplements its Internal Revenue Manual (IRM) section on OICs.<sup>8</sup> This guidance "allows the offer specialist to investigate and process offers submitted by taxpayers impacted by the fraudulent acts of a PSP in the most expeditious manner possible."<sup>9</sup>

Among the considerations outlined in the guidance is whether payment of less than the remaining tax balance would:

- Result in financial gain for the taxpayer?
- Be generally perceived within the community as a fair and equitable solution?

<sup>5</sup> Internal Revenue Code (IRC) § 7122.

<sup>6</sup> The IRS Restructuring and Reform Act of 1998, Pub. L. 105-106, 112 Stat. 685 (1998); H.R. REP. No. 105-599, at 289 (1998) (Conf. Rep.).

<sup>7</sup> Consolidated Appropriations Act, 2014, Division E, Title I, § 106 (Pub. L. No. 113-76).

<sup>8</sup> Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014).

<sup>9</sup> *Id.*

In two other provisions of the Internal Revenue Code, Congress has explicitly designated the National Taxpayer Advocate as the one to determine whether an action is in the best interest of the taxpayer. First, in the context of lien withdrawals, it is the IRS that determines whether withdrawing the lien is in the best interest of the United States.<sup>10</sup> However, it is the National Taxpayer Advocate who decides whether it is in the *taxpayer's* best interest to withdraw the lien.<sup>11</sup> This is because, as the voice of the taxpayer, the National Taxpayer Advocate is charged with advocating on behalf of specific groups of taxpayers and all taxpayers.<sup>12</sup> She is thus the appropriate IRS official to make the determination as to what is in the taxpayer's best interest.

A similar provision exists for releasing a levy. In certain circumstances, the National Taxpayer Advocate makes the determination of whether the return of property is in the taxpayer's best interest.<sup>13</sup> Notwithstanding these provisions, under current IRS guidance, the IRS designates itself to decide whether an OIC submitted under ETA authority would be "generally perceived within the community as a fair and equitable solution."

## REASONS FOR CHANGE

Congress has provided the IRS with the tools to promote the use of OICs as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances. In practice, the IRS has not embraced its ETA OIC authority; instead, it has consistently underutilized this tool to provide relief to victims. For example, in fiscal years 2013 and 2014, the IRS accepted only 54 non-economic hardship ETA offers submitted by victims of PSPs.<sup>14</sup> The IRS does not track the number of these victims. However, even if considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, accepting 54 non-economic hardship ETA offers over the past two years is hardly the "flexible" use that Congress intended.

As discussed above, the IRS's interim guidance on evaluating OICs submitted by victims of PSP fraud provides that the IRS shall inquire whether the offer would be generally perceived within the community as a fair and equitable solution.<sup>15</sup> Just as Congress vested the National Taxpayer Advocate with the authority to make the determination of the taxpayer's best interest with respect to liens and levies, the IRS Commissioner has recognized the National Taxpayer Advocate as the voice of the taxpayer by delegating to her, and to her alone, the authority to issue a Taxpayer Advocate Directive where IRS procedures harm a group of taxpayers or even all taxpayers.<sup>16</sup> Thus, the National Taxpayer Advocate, as the voice of the taxpayer inside the IRS, should be the one to make the determination of whether an offer based on ETA is fair and equitable.

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<sup>10</sup> See IRC § 6323(j)(1)(D).

<sup>11</sup> See *id.*

<sup>12</sup> See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 48-9 (1997). See also IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001); IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

<sup>13</sup> See IRC § 6343(d)(2)(D).

<sup>14</sup> See IRS follow-up response to fact check (Dec. 8, 2014). While the IRS does not systemically track the number of OICs submitted by victims of PSPs, it stated that it knew of 33 such offers received in fiscal year (FY) 2013 and 57 in FY 2014. See IRS response to fact check (Nov. 26, 2014).

<sup>15</sup> Memorandum from Rocco A. Steco, Acting Director, Collection Policy, to Directors, Campus Compliance Operations, and Directors, Field Collection Operations Area, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014).

<sup>16</sup> See IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

## EXPLANATION OF RECOMMENDATION

We concur with the current IRS guidance that requires an inquiry as to whether other taxpayers would perceive the proposed offer to be fair and equitable. However, rather than leaving this determination up to the IRS, we recommend that Congress amend section 106 to provide that when evaluating these offers consideration should be given as to whether other taxpayers would perceive the proposed offer to be fair and equitable and to designate the National Taxpayer Advocate to make such an assessment. The National Taxpayer Advocate, as the voice of the taxpayer within the IRS, is uniquely qualified to make this assessment.

In addition, the recommendation proposes that section 106 of the Consolidated Appropriations Act of 2014 also be amended to provide that in evaluating the offer the IRS should not consider whether the taxpayer received financial gain as a result of compromise of tax liabilities attributable to PSP fraud. This inquiry is irrelevant for two reasons:

1. Every compromise of tax in every instance will result in some financial benefit to the taxpayer proposing the compromise; and
2. Victims of PSP fraud have already paid out the tax liability once (albeit to the PSP), and already are economically in the same situation as a taxpayer who paid the payroll taxes directly to the IRS. The victim will, by definition, be economically disadvantaged vis-à-vis other taxpayers by being required to pay one cent more.<sup>17</sup>

Therefore, the inquiry into financial gain or benefit is meaningless. The relevant inquiry is whether the taxpayer timely paid the payroll taxes and withholding to the PSP, and whether the taxpayer received any sort of reimbursement (*e.g.*, from insurance) that mitigated its loss. This is a simple factual analysis that requires no value-laden subjective judgment.

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<sup>17</sup> This assumes the taxpayer has not recovered some or all of the tax payments via insurance, court ordered restitution, payment on a civil judgment, or distributions from a PSP's bankruptcy.

**LR  
#16**

## MANAGERIAL APPROVAL FOR LIENS: Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations

### PROBLEM

One of the IRS's most significant powers is its authority to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes. The NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders.<sup>1</sup> Unlike most other creditors, the IRS does not need a judgment from a court to file an NFTL.<sup>2</sup> When properly applied, the IRS's lien authority can be an effective tool in tax collection. However, when the IRS uses its authority improperly, NFTLs can needlessly harm taxpayers and undermine long-term tax collection.<sup>3</sup>

Concerned about the serious impact liens can have on a taxpayer's life and the hardship they can cause,<sup>4</sup> Congress enacted § 3421 of the IRS Restructuring and Reform Act of 1998 (RRA 98) to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."<sup>5</sup> The law requires the IRS to adopt procedures in which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor and to set out disciplinary actions when such approval is not obtained.<sup>6</sup>

The IRS has deemed that it is rarely "appropriate" to require such approval, because it has made virtually no adjustments to its procedures along the lines of what Congress directed in enacting § 3421 of RRA 98. Instead, the IRS has adopted a collection strategy that often relies on the *broad* use of its lien authority.<sup>7</sup> Notably, the IRS has eased previous restrictions on NFTL filings by allowing lower-graded employees to file NFTLs without managerial approval.<sup>8</sup> The IRS also flipped Congress' intent on its head by requiring employees to obtain managerial approval if they determine *not* to file an NFTL or defer filing in many circumstances.<sup>9</sup> Further, the IRS never established appropriate disciplinary actions for employees who fail to secure managerial approval to file an NFTL when such approval is required (*i.e.*, Revenue Officers below GS-9).<sup>10</sup>

1 Internal Revenue Code (IRC) §§ 6321, 6322, and 6323(a).

2 *Id.* IRS collection actions are either taken by the Automated Collection System (ACS) or Revenue Officers (ROs). ROs work in field offices and can send letters, issue liens and levies, and answer calls. ACS is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies.

3 See Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*, *supra*.

4 IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance, 105th Cong., 2d Sess. (1998) (see, e.g., statements of Nina E. Olson, Executive Director of the Community Tax Law Project in Richmond, Virginia).

5 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 685, 758 (1998). See also S. Rep. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

6 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

7 Internal Revenue Manual (IRM) 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013).

8 IRM 1.2.44.5 *Delegation Order 5-4* (Rev. 3), (May. 9, 2013); IRM 5.19.4.5.3.4 *When Filing an NFTL Requires Approval* (Jan. 1, 2015).

9 IRM 5.12.2.5.3, *NFTL "Do-Not-File" and Filing Deferral Determination Approvals* (Jan. 1, 2015); IRM 5.19.4.5.2.1, *Do Not File Approvals* (Aug. 4, 2014).

10 See IRS response to TAS research request (Jul. 31, 2014); IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

The IRS's decision to ignore Congress's directive and rely on a broad NFTL filing policy has had significant consequences for both the IRS and taxpayers and compromises a taxpayer's rights to *privacy* and *to a fair and just tax system*.<sup>11</sup> As illustrated by the findings in several significant Taxpayer Advocate Service (TAS) research studies, these expanded NFTL filing policies have not only been ineffective in collecting revenue, but impair current and future payment compliance and the taxpayer's earnings. These policies have particularly damaging effects on taxpayers whose accounts the IRS has classified as "currently not collectible" (CNC) because of economic hardship.<sup>12</sup>

## EXAMPLE

A taxpayer was assessed a tax liability of \$15,000 and placed in CNC (hardship) status because he has no assets and collection action would render him unable to pay his basic living expenses. However, since the liability is over \$10,000, the IRS Automated Collection System (ACS) automatically files an NFTL, which is never reviewed by an ACS supervisor.<sup>13</sup> This NFTL filing damages the taxpayer's credit report, making it difficult for him to find an apartment to rent (many landlords check a potential tenant's credit and have policies against renting to an individual with a poor credit rating or unpaid debt).

## RECOMMENDATIONS

To ensure that NFTLs are given due consideration before being filed, the National Taxpayer Advocate recommends that Congress:

- Codify § 3421 of RRA 98 to require IRS employees to obtain managerial approval prior to filing an NFTL where it is likely that the NFTL will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax, including the following three categories:
  1. The taxpayer's income falls below 250 percent of the federal poverty level;
  2. The taxpayer's account has been placed in currently not collectible status due to economic hardship; or
  3. The taxpayer has entered into an installment agreement (IA) with the IRS.
- Require the IRS supervisor, as part of the managerial approval process, to consider the following:
  1. Whether the NFTL would attach to property;
  2. Whether the benefit of filing an NFTL for the government would outweigh the harm to the taxpayer; and
  3. Whether the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.

<sup>11</sup> See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> and Publication 1, Your Rights as a Taxpayer (June 2014).

<sup>12</sup> See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 105-29 (*Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (*The IRS's Use of Notices of Federal Tax Lien*). See also IRM 1.2.14.1.14 Policy Statement 5-71 (Nov. 19, 1980). Taxpayer accounts are reported as currently not collectible when the taxpayer has no assets or income, which by law, are subject to a levy.

<sup>13</sup> IRM 5.19.4.5.3.2 (3), *Currently Not Collectible* (Jan. 1, 2015). In general, an NFTL is filed when BOTH of the following conditions exist: The aggregate assessed balance is at or above \$10,000 and the account is being closed using unable to locate, unable to contact, or hardship provisions.

- Require the IRS take disciplinary action against employees who fail to secure managerial approval prior to filing an NFTL in the situations required by law.

## PRESENT LAW

During the RRA 98 legislative process, it became evident that Congress and leaders in the tax community were concerned about how the IRS was using its lien authority and its impact on taxpayers. Specifically, the Joint Committee on Taxation observed “the imposition of liens, levies, and seizures may impose significant hardships on taxpayers” and “that extra protection in the form of an administrative approval process is appropriate.”<sup>14</sup> Leaders in the tax community, such as the National Association of Enrolled Agents, recommended that Congress restrict IRS employees’ ability to file NFTLs without proper managerial reviews, thereby ensuring these actions were appropriate and suitable.<sup>15</sup>

To address these concerns, Congress enacted § 3421 in RRA 98.<sup>16</sup> Under this provision, where deemed appropriate, a determination by an employee to file a lien would be approved by an IRS supervisor who would:

- Review the taxpayer’s information;
- Verify that a balance is due; and
- Affirm that the action proposed is appropriate in light of the taxpayer’s circumstances, considering the amount due and the value of the property or right to property.<sup>17</sup>

Failure to follow these procedures should result in appropriate disciplinary action against the responsible supervisor or employee.<sup>18</sup> This section became effective upon passage of the Act with one exception; it did not apply to actions taken under the IRS ACS until January 1, 2001.<sup>19</sup>

## REASONS FOR CHANGE

As mentioned above, the NFTL filing negatively impacts a taxpayer’s credit history,<sup>20</sup> having the potential of reducing a taxpayer’s credit score by 100 points,<sup>21</sup> and has a long-lasting effect on the taxpayer’s financial viability. For example, the existence of the NFTL filing, and the information contained in the

<sup>14</sup> Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 (Nov. 24, 1998). See also RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 695, 758 (1998). See also S. REP. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 CONG. REC. S12230-02, at S12231.

<sup>15</sup> *Exploring the Development of Taxpayer Bill of Rights Legislation, Hearing Before the House Comm. On Ways and Means*, 104th Cong. (1995) (statement of Joseph F. Lane, Enrolled Agent). See also IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance, 105th Cong., 2d Sess. 375 (1998) (statement of Bruce Strauss, Enrolled Agent) (suggesting among other things that tax liens filings “must all be reviewed by an independent IRS quality review function prior to implementation of the decision.”).

<sup>16</sup> RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

<sup>17</sup> RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

<sup>18</sup> RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

<sup>19</sup> RRA 98, Title III, § 3421(c), Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

<sup>20</sup> It is difficult to speculate as to the degree to which an NFTL will affect a taxpayer’s credit score, because every individual’s situation is different, and there are many different credit-scoring systems. Therefore, the impact on one system could be very different from another because the numeric scales are different. See Experian, *A World of Insight*, available at <http://www.experian.com/ask-experian/20080903-tax-liens-and-credit-scores.html> (last visited Dec. 12, 2014). However, a recent IRS study conducted by Experian found that NFTLs have a minimal impact on a consumer’s credit score in certain situations. See IRS and Experian Decision Analytics, *Federal Tax Lien Impact Study* (Mar. 31, 2014).

<sup>21</sup> Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

notice, are included in the consumer (credit) reports<sup>22</sup> and therefore can impair a taxpayer's ability to obtain financing,<sup>23</sup> find or keep a job,<sup>24</sup> and secure affordable housing or insurance.<sup>25</sup> It can also hamper the taxpayer's ability to stay compliant and obtain credit needed to pay preexisting tax debts.<sup>26</sup>

The taxpayer may experience effects of the NFTL filing in the long term, because an NFTL filing will remain on a taxpayer's credit report for years, or even indefinitely. Specifically, "paid tax liens" appear on credit reports for seven years from the date of payment,<sup>27</sup> and unpaid liens may remain on the report indefinitely, even when the underlying lien becomes legally unenforceable (*e.g.*, because the statutory limitations period for collection has expired and the lien self-released or the lien is legally satisfied as a result of an accepted offer in compromise (OIC) or the IRS accepts a bond).<sup>28</sup> When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further damage his or her financial viability and generate significant downstream costs for the government.<sup>29</sup>

Aware of the serious impact and hardship NFTLs can cause in a taxpayer's life,<sup>30</sup> Congress enacted § 3421 of RRA 98 to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."<sup>31</sup> However, relying

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<sup>22</sup> The term "consumer report" is defined in the Fair Credit Reporting Act (FCRA), § 603(d), 15 USC § 1681a(d). Hereinafter, we will use the more commonly used term "credit report."

<sup>23</sup> Some lenders decline to extend credit to a taxpayer if the IRS has filed an NFTL against the taxpayer's property. Others will charge substantially higher rates, even if the lien is subordinated. See, *e.g.*, GMAC Factoring Agreement, available at <http://contracts.onecle.com/arbinet/gmac.factor.2003.02.01.shtml> (last visited Dec. 13, 2014).

<sup>24</sup> Some licensing boards require members to maintain a clean credit history and some employers require employees to do so as a condition of employment. See, *e.g.*, Form U4, *Uniform Application for Broker-Dealer Registration*, Q14M (May 2009), available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf> (last visited Dec. 13, 2014).

<sup>25</sup> See also IRS Publication 594, *What You Should Know About the IRS Collection Process* 4 (Apr. 2012) (recognizing the taxpayer may not be able to obtain a loan to buy a house or a car, get a new credit card, or sign a lease as result of the NFTL filing).

<sup>26</sup> See, *e.g.*, IRC § 6323(d) (providing that security protection only extended to the lender for disbursements made within 45 days after the filing of the NFTL, or until the lender is provided actual notice of the NFTL); IRC § 3505(b) (holding a lender providing funds for the ongoing operation of a business potentially liable for unpaid withholding taxes if certain criteria are met).

<sup>27</sup> FCRA, § 605(a)(3), 15 USC § 1681c(a)(3). See also Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the FCRA, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be noted on the credit report but does not necessarily impact the credit score in a significant way.

<sup>28</sup> As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years while Equifax and Transunion credit reports reflect them indefinitely. See <http://www.transunion.com/personal-credit/credit-issues-bad-credit/what-affects-your-credit-score.page>; <http://www.experian.com/blogs/ask-experian/2007/05/16/how-long-public-records-stay-on-your-credit-report/>; <http://blog.equifax.com/credit/faq-how-long-does-information-stay-on-my-credit-report/> (last visited on Dec. 13, 2014). For example, most NFTLs are self-releasing, *i.e.*, the notice indicates that unless the IRS re-files it by the listed date, the notice operates as a certificate of release under IRC § 6325(a). IRC § 6325(a) also provides for a release of liens because the underlying liability became legally unenforceable or the IRS accepted a bond.

<sup>29</sup> See T. Keith Fogg, *Systemic Problems with Low-Dollar Lien Filing*, 2011 TNT 194-9 (Oct. 6, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-28. A further consequence of a lien's damage to a taxpayer's financial viability may be a need for unemployment benefits, food stamps and the like, thus increasing societal cost.

<sup>30</sup> *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong., 2d Sess. (1998) (see, *e.g.*, statement of Nina E. Olson, Executive Director of the Community Tax Law Project in Richmond, Virginia).

<sup>31</sup> RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 685, 758 (1998). See also S. Rep. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02, at S12231 (statement of Senator Roth).

on the word “appropriate” in § 3421, the IRS has made virtually no adjustments to its procedures along the lines of what Congress directed. Specifically, since Congress enacted § 3421, the IRS has:

1. Restated its policy that only ROs below the GS-9<sup>32</sup> level must receive managerial approval prior to filing an NFLT.<sup>33</sup> The IRS said the costs and administrative burden of expanding the § 3421 protection to other situations outweighed the taxpayer’s interest.<sup>34</sup> This approval requirement for ROs below the GS-9 level applies to only less than one percent of ROs.<sup>35</sup>
2. Eased managerial approval requirements for lien filings. Specifically, despite the fact that Congress gave the IRS more than two years to determine how to implement § 3421 of RRA 98 for ACS,<sup>36</sup> the only change the IRS made was to grant ACS employees in grades as low as GS-6 the authority to file NFLTs without managerial review.<sup>37</sup> This change was contrary to Congress’s directive and more lax than prior ACS guidance, which required GS-7 employees and below to obtain approval from either a senior RO or a manager to file an NFLT.<sup>38</sup> Presently, ACS files about one third of NFLTs and very few require managerial approval<sup>39</sup> (*i.e.*, less than 6.2 percent of ACS employees are below GS-6).<sup>40</sup>
3. Required all ACS employees and ROs, regardless of grade level, to obtain managerial approval if they determine not to file a lien in cases that meet specified criteria.<sup>41</sup>
4. Never established disciplinary action for employees who fail to secure managerial approval where required.<sup>42</sup>

Essentially, the IRS ignored a congressional directive and elected to adopt an even broader NFLT filing policy, rather than one that emphasizes review of taxpayers’ particular facts and circumstances to ensure the NFLT will attach to assets and not cause hardship. The IRS files many NFLTs systemically, pursuant to “business rules” that require automatic NFLT filing or lack substantive human review.<sup>43</sup> This systemic filing has contributed to a significant increase in the number of NFLTs over the last 15 years. For

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<sup>32</sup> The General Schedule (GS) classification and pay system covers the majority of civilian white-collar federal employees (about 1.5 million worldwide) in professional, technical, administrative, and clerical positions. U.S. Office of Personnel Management, <http://www.opm.gov/policy-data-oversight/pay-leave/pay-systems/general-schedule/> (last visited on Dec. 4, 2014). Within the Collection function, a “GS-9” employee is relatively junior.

<sup>33</sup> IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

<sup>34</sup> Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding section 3421 does not require supervisory review of all collection actions but allows the IRS discretion to determine where such review would be appropriate); Memorandum to Counsel to the National Taxpayer Advocate from Chief, Branch 1, General Litigation Division, Ref. No. GL-122444-98 (Dec. 23, 1998) (same).

<sup>35</sup> IRS Human Resources Reporting Center on Revenue Officers (Aug. 13, 2013). As of July 26, 2014, less than one percent of ROs were below the GS-9 level. GS-8 and lower revenue officers totaled two out of 3,742 ROs. Also, the NFLTs issued by ROs below the GS-9 level may still not be reviewed by a manager. The IRM permits a manager to assign the lien review responsibility to another RO at an “appropriate” grade level. (*emphasis added*). See IRM 5.12.2.7, *Approval of Lien Notice Filing* (Oct. 14, 2013).

<sup>36</sup> RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

<sup>37</sup> IRM 1.2.44.5, *Delegation Order 5-4* (Rev. 3) (May. 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFLT Requires Approval* (Jan. 1, 2015).

<sup>38</sup> Email from former IRS Chief Compliance Officer to the National Taxpayer Advocate (Nov. 2, 2009) (on file with TAS).

<sup>39</sup> IRS No 5000-25, Lien Report, FY 2013 and 2014. ACS filed 204,279 and 198,682 liens out of 602,005 and 535,580 total lien filings for FY2013 and FY2014, respectively.

<sup>40</sup> IRS Human Resources Reporting Center, Position Report Query, ACS employees (no exec), All GSs and GS-5 and less, run date 11/14/2014. As of Nov. 1, 2014, 159 employees out of 2,571 ACS employees were below the GS-6 level.

<sup>41</sup> IRM 5.19.4.5.2, *Do Not File Decisions* (Jan. 1, 2015).

<sup>42</sup> IRS response to TAS information request (Jul. 31, 2014).

<sup>43</sup> IRM 5.19.4.5.3.2, *Filing Criteria* (Jan 1, 2015).

example, NFLT filings rose by about 219 percent from fiscal year (FY) 1999 to 2014,<sup>44</sup> yet the Collection function is collecting slightly more in real 2014 dollars than in 1999.<sup>45</sup>

The ACS function's systemic reliance on its collection action as a means to collect revenue has been particularly ineffective. In FY 2014, ACS collected only about 5.9 percent of the dollars placed in its inventory, took in about 5.5 percent of those inventory dollars through refund offsets,<sup>46</sup> and ultimately transfers much of its inventory to the Queue.<sup>47</sup>

As TAS research studies have shown, the IRS's reliance on its NFLT filing authority was unproductive and negatively impacts future compliance.<sup>48</sup> More importantly, the automatic filing of an NFLT imposes further harm on taxpayers who are already experiencing hardship. When a taxpayer has little or no ability to pay and has no assets from which to collect, an NFLT may further impede his or her financial viability and ultimately can undermine tax revenue and future compliance. In addition, the government has a secondary interest at stake. If the NFLT badly damages the taxpayer and the taxpayer's family by driving up the taxpayer's costs or renders him or her unemployed or underemployed, the government may be forced to provide a social safety net in the form of unemployment benefits, food stamps, and the like, thus increasing societal cost and raising everyone's share of taxes.

However, these considerations have not deterred the IRS from filing NFLTs against taxpayers in CNC status. Taxpayer accounts placed in CNC status because the IRS was either unable to contact or locate the taxpayer, or determined the taxpayer was in economic hardship, will be subject to NFLTs as long as certain requirements are met (*i.e.*, the tax liability is \$10,000 or greater).<sup>49</sup> Such NFLT filing on CNC taxpayers is especially concerning in light of a TAS research study that showed NFLTs were responsible for only \$2 of every \$10 in payments collected from taxpayers in CNC status. Nearly \$6 of every \$10 collected from these taxpayers came from refund offsets, which do not require an NFLT filing.<sup>50</sup> Nonetheless, the same study showed the IRS filed NFLTs against more than 72 percent of CNC taxpayers suffering economic hardship.<sup>51</sup> The study also found CNC hardship taxpayers, on average, ended up owing about 50 percent more to the IRS in 2010 than at the time of lien (or proxy lien) filing.<sup>52</sup>

Thus, Congress should codify § 3421 of RRA 98 in the Internal Revenue Code, because the IRS has largely ignored the directive it set out in RRA 98, and contrary to Congress' directive, has adopted a broad NFLT filing strategy that avoids any managerial oversight in most instances. This strategy has achieved

<sup>44</sup> IRS Data Book, Table 16 (Nov. 19, 2014). NFLT filings were 168,000 and 535,580 for FYs 1999 and 2014, respectively.

<sup>45</sup> *Id.* When adjusted for inflation (converted to 2014 dollars) the IRS collected about \$32.1 billion in FY 1999 and about \$34.2 billion in FY 2014.

<sup>46</sup> In FY 2014, ACS collected \$3,107,887,286, and another \$2,850,701,610 were refund offsets, out of \$52,254,945,879 placed in ACS in FY2014. IRS NO 5000-2, Part 1 - TDAs, ACS/CS TDAs.

<sup>47</sup> The Queue is a holding inventory where collection cases sit, based on business rules and available resources, usually after being in ACS, and before being assigned to the Collection Field function or reassignment to ACS.

<sup>48</sup> National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, 93-112 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*). For instance, for the full period analyzed by TAS research (2002–2010), NFLT taxpayers were less likely to file required returns, with the increased likelihood of non-filing ranging between about one and three percent.

<sup>49</sup> IRM 5.19.4.5.3.2(3), *Currently Not Collectible* (Jan. 1, 2015). Generally an NFLT is filed when BOTH of the following conditions exist: Aggregate assessed balance is at or above \$10,000 and account is being closed using unable to locate (cc03), unable to contact (cc12) or hardship (cc24 through 32) provisions.

<sup>50</sup> National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18.

<sup>51</sup> *Id.*

<sup>52</sup> National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 108-30 (*Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

poor collection results, harms taxpayers experiencing economic hardship, and negatively impacts future compliance.

## EXPLANATION OF RECOMMENDATIONS

The IRS was already instructed by Congress in § 3421 of RRA 98 to identify where it would be appropriate to require managerial approval prior to filing an NFTL. The IRS could fulfill Congress' directive administratively, and earlier in this report, the National Taxpayer Advocate provided such administrative recommendations.<sup>53</sup> However, because the IRS has neglected to address Congress' directive over the past 15 years, the National Taxpayer Advocate recommends that Congress codify § 3421 in the IRC and further clarify when managerial approval is required before filing an NFTL.

Congressional clarification requiring managerial approval in specific circumstances will better ensure that a legitimate basis for the NFTL exists, for example, that the NFTL will attach to property or rights to property and will ultimately facilitate collection. Additionally, it also would protect taxpayers' *right to a fair and just tax system* and *right to privacy*, by creating an NFTL policy that considers each taxpayer's individual facts and circumstances, and that IRS actions will be no more intrusive than necessary.<sup>54</sup>

The National Taxpayer Advocate understands requiring managerial approval prior to filing all liens is not feasible, but believes requiring the IRS to mandate managerial approval prior to filing a lien in specific situations would prevent unnecessary and harmful NFTLs. As TAS has illustrated in its research studies on NFTL filings discussed above, NFTLs are particularly damaging to low income taxpayers, and are often less effective than IAs. In light of these findings, it would make sense for managerial approval to be required before filing an NFTL in the following situations:

- **Taxpayer's income falls at or below 250 percent of the federal poverty level:** Prior to filing an NFTL, an employee could review information and determine whether the taxpayer's income falls at or below 250 percent of the federal poverty level.<sup>55</sup> By identifying these taxpayers, the IRS can presume economic hardship (*i.e.*, inability to pay basic living expenses) and consider whether the NFTL will only cause further hardship.<sup>56</sup> The IRS already makes this presumption when identifying low income taxpayers to filter out of the Federal Payment Levy Program (FPLP).<sup>57</sup>

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53 See Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*, *supra*.

54 IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014). The IRS has emphasized the need for such judgment in the context of making a levy determination by instructing ROs to exercise good judgment when making the determination to levy, which means they are to consider the taxpayer's financial condition.

55 To determine a taxpayer's income, employees could review the taxpayer's most recent tax return, or available third-party information, whichever is more recent. See Department of Health and Human Services (DHHS), The 2014 HHS Poverty Guidelines, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>. For calendar year 2014, an individual who makes \$11,670 or less is in poverty. This number is then multiplied by 250 percent to determine the 250 percent federal poverty threshold.

56 IRC § 6343(a)(1)(D) requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Treas. Reg. § 301.6343-1(b)(4) specifies that an economic hardship exists if a taxpayer cannot pay his or her basic living expenses.

57 The FPLP is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. In 2011, the IRS finalized and implemented a low income filter. This filter's design was largely based on a TAS study, which tested a filter model that identified and removed from FPLP low income taxpayers the model showed would experience economic hardship. Largely accepting the findings from the TAS study, the IRS designed a filter that excluded taxpayers from the FPLP whose incomes fall below 250 percent of the federal poverty level. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program).

- **Taxpayers in CNC-hardship status:** As shown above, taxpayers in CNC-hardship status are often crippled by tax debt, and filing NFTLs against them does little to protect the government's interest, and often makes the taxpayer's situation even worse.<sup>58</sup> The manager can consider whether the NFTL will actually assist in collecting the tax (*i.e.*, there are assets to which the lien will attach) or it will only further harm the taxpayer.
- **Taxpayers in a non-streamlined installment agreement:**<sup>59</sup> Taxpayers in an IA make significant strides toward paying off their tax debts.<sup>60</sup> Filing a lien against these taxpayers may jeopardize their ability to pay, because the NFTL can hinder their earning potential by damaging their credit rating and ability to secure financing or maintain professional licenses.

By making these recommendations, the National Taxpayer Advocate is not prohibiting the IRS from filing a lien against these taxpayers. Instead, having IRS managers involved will ensure an NFTL does not impose an undue hardship on taxpayers, *i.e.*, that liens will be filed in the appropriate instances. Managers would be responsible for considering whether an NFTL will attach to property, whether the benefit to the government outweighs the harm to the taxpayer, and whether the filing will jeopardize the taxpayer's ability to comply with the tax laws in the future. Managerial involvement will further protect the government's interest in the taxpayer's property or rights to property and can prevent impediments to the taxpayer's ability to pay the tax in the long run.

By requiring the IRS to take disciplinary action against employees who fail to secure appropriate managerial approval prior to filing an NFTL, the IRS will be prompted to provide better employee training on the law and will communicate to employees the gravity of the NFTL filing process. It will also confirm the IRS's commitment to protecting taxpayers' rights.<sup>61</sup>

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58 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

59 See IRM 5.14.5.1, *Installment Agreements Overview* (May 23, 2014). 1) Guaranteed agreements: under IRC § 6159(c) taxpayers who meet certain conditions and who have a delinquency \$10,000 or less are entitled to an installment agreement. 2) Streamlined agreement: streamlined agreement criteria may be secured where the aggregate unpaid balance of assessments does not exceed \$25,000 and may be paid off within a 72-month period. Taxpayers who meet this criterion do not need to provide a financial information statement to the IRS. 3) Non-streamlined agreement: agreements that fall outside the parameters of the guaranteed and streamlined IAs.

60 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

61 For a detailed discussion of appropriate disciplinary actions see Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98, supra*.

**LR  
#17**

## **MANAGERIAL APPROVAL: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy-Related Penalty Attributable to Negligence under IRC § 6662(b)(1)**

### **PROBLEM**

The IRS can assess penalties against a taxpayer either after an independent review by an IRS employee or automatically with the use of a computer program. An employee who makes an independent determination regarding a penalty assessment must receive written managerial approval before the penalty can be assessed, subject to several exceptions.<sup>1</sup> Penalties that are “automatically calculated through electronic means” do not require managerial approval.<sup>2</sup> This exception makes sense in the context of the failure to pay and failure to file penalties, which require a relatively straightforward mathematical calculation and involve no exercise of judgment and discretion.<sup>3</sup>

However, the exception poses a problem, particularly for accuracy-related penalties imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations pursuant to IRC § 6662(b)(1) (hereinafter “negligence penalty”).<sup>4</sup> “Negligence” includes “any failure to make a reasonable attempt to comply with the provisions of this title, and the term “disregard” includes any careless, reckless, or intentional disregard.”<sup>5</sup> The IRS can consider various factors in deciding if the taxpayer’s actions were negligent, including actions taken by the taxpayer to ensure the tax was correct.<sup>6</sup> However, the negligence penalty does not apply to any portion of an underpayment if it is shown that there was reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.<sup>7</sup> A reasonable

1 See IRC § 6751(b)(1). IRC § 6751(b)(2)(A) provides that managerial approval is not required for additions to tax pursuant to IRC §§ 6651, 6654, and 6655.

2 See IRC § 6751(b)(2)(B).

3 IRC § 6651(a)(1) imposes a penalty for failure to file a required return by the date prescribed (including extensions). The penalty is generally five percent of the amount of tax if the failure to file is not more than one month. There is an additional five percent penalty for each additional month or fraction of a month. The penalty generally cannot exceed 25 percent in the aggregate. The penalty increases to 15 percent per month or fraction of a month for a maximum of 75 percent if the failure to file the return is fraudulent. IRC § 6651(f). See also IRM 20.1.2.2.7, *Failure to File a Tax Return – IRC 6651*, (Apr. 19, 2011). IRC § 6651(a)(2) imposes a penalty for failure to pay the tax shown on the return referenced in IRC § 6651(a)(1) on or before the due date. The penalty is 0.5 percent of the amount of tax if the failure to pay is not more than one month. There is an additional penalty of 0.5 percent for each additional month or fraction of a month. The penalty cannot exceed 25 percent in the aggregate. See also IRM 20.1.2.2.8.4, *Failure to Pay Tax Shown on Return – IRC 6651(a)(2)*, (Apr. 19, 2011). When both penalties are assessed on the same return, the failure to file penalty is reduced by the amount of the failure to pay penalty. See IRC § 6651(c)(1).

4 “Underpayment” is defined as “the amount by which any tax imposed by this title exceeds the excess of (1) the sum of (A) the amount shown as the tax by the taxpayer on his return, plus (B) amounts not so shown previously assessed (or collected without assessment), over (2) the amount of rebates made.” IRC § 6664(a).

5 IRC § 6662(c). See also IRM 4.19.3.16.6, *Accuracy-Related Penalty Due to Negligence or Disregard of Rules or Regulations (Negligence Disregard Penalty)*, (Sept. 30, 2014) (IMF AUR); IRM 20.1.5.7.1(5)(a), *Negligence*, (Jan. 24, 2012) (indicating that exam may assert negligence based on a mismatch of interest income in a single year if the taxpayer does not appear for an examination).

6 IRM 4.10.6.2.1, *Negligence*, (May 14, 1999). Other factors include the taxpayer’s history of noncompliance; the taxpayer’s failure to maintain adequate books and records; and whether the taxpayer had a reasonable explanation for unreported or understated income.

7 IRC § 6664(c)(1).

cause determination takes into account all of the pertinent facts and circumstances, and requires the IRS employee to exercise judgment and discretion.<sup>8</sup>

Assessing penalties electronically involves an automated process that does not consider the facts and circumstances of a case until the taxpayer contacts the IRS in response to the proposed penalty, thus burdening the taxpayer to prove the penalty does not apply. For the negligence penalty in particular, automatic assessments do not allow for a consideration of the taxpayer's specific facts and circumstances. Under the automatic assessment regime, a taxpayer who did make a reasonable attempt to comply and acted in good faith must take extra, burdensome steps to rid him or herself of an arbitrary penalty assessment. Not only does this approach undermine voluntary compliance, but it affects a taxpayer's *right to quality service, right to pay no more than the correct amount of tax, and the right to a fair and just tax system.*<sup>9</sup>

## EXAMPLE

The IRS audited Taxpayer A's return because of an inaccuracy in the income reported. This is the second year that the discrepancy has occurred. The IRS proposed an assessment based on the difference in wages between what she and her employer reported. The notice mentioned that penalties could apply, but no penalty is calculated on the notice.<sup>10</sup> The taxpayer agrees to this assessment and does not respond. As a result, the IRS also automatically imposes a negligence penalty based on IRC § 6662(b)(1) and issues a statutory notice of deficiency (SNOD). The taxpayer does not closely review the SNOD because the taxpayer agrees with the assessment and is unaware that the IRS automatically assesses the penalty when there is no response from the taxpayer.

## RECOMMENDATION

To address the lack of managerial review of IRC § 6662(b)(1) penalties automatically calculated through electronic means, the National Taxpayer Advocate recommends that Congress:

- Amend IRC § 6751(b)(2)(B) to require written managerial approval prior to assessment of the accuracy-related penalty imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations under IRC § 6662(b)(1), and specify which penalties and facts or circumstances result in penalties "automatically calculated through electronic means."

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<sup>8</sup> Treas. Reg. § 1.6664-4(b)(1).

<sup>9</sup> See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. For information on how accuracy-related penalties may impact future compliance among Schedule C taxpayers (i.e., sole proprietors), see National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 1-12 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

<sup>10</sup> Notice CP 2501 is sent to the taxpayer to obtain additional information prior to issuing a CP 2000. The CP 2000 is sent to the taxpayer to propose a change to his or her tax liability because of income not identified or not fully reported on the taxpayer's tax return. Accordingly, the CP 2501 will not contain a penalty computation. It will state that "An accuracy-related penalty is charged if there is any underpayment of tax on your return due to negligence. This penalty is 20 percent of the net tax increase on the portion due to negligence." IRM Exhibit 4.19.3-7(86) (Sept. 30, 2014). While the CP 2000 may include a penalty notice, the IRS is not required to include a penalty calculation. See IRM 4.19.3.20.1.4, *Accuracy Related Penalties*, (Sept. 1, 2012) ("The AUR system electronically calculates the Accuracy Related penalties; therefore, a penalty notice may be issued in the initial letter to the taxpayer proposing a deficiency..."). In fact, the CP 2000 template includes this information about penalties: "If this penalty applies, we will bill you for this amount at a later date. The bill may reflect the amount as unpaid interest." This is in contrast to the statutory notice of deficiency, which includes either Form 4549-A, *Income Tax Examination Changes (Unagreed and Excepted Agreed)* or Form 5278, *Statement – Income Tax Changes*, both of which include a section for the calculation of penalties. See IRS, Letter 531 (Aug. 2012).

## PRESENT LAW

Presently, a taxpayer who submits a return that is not accurate (*i.e.*, reflects an “underpayment”) may be subject to an accuracy-related penalty under IRC § 6662.

The IRS Restructuring and Reform Act of 1998 (RRA 98) introduced the specific statutory requirement that the immediate supervisor of the individual making the initial determination of a penalty assessment must personally approve the initial determination, in writing, prior to assessment.<sup>11</sup> In explaining this legislative reform, the Chair of the Senate Finance Committee commented, “In order to prevent IRS employees from arbitrarily using penalties as leverage against taxpayers, this bill requires non-computer determined penalties to be approved by management.”<sup>12</sup>

Congress carved out the exception for penalties “automatically calculated through electronic means” but there is no legislative history to explain why these penalties should be excluded from managerial approval. However, by enacting IRC § 6751(b), the legislators intended to provide protections to taxpayers against the arbitrary use of penalties by the IRS.<sup>13</sup> IRC § 6751(b)(2) also allows an exception to managerial approval for assessments related to:

- Failure to file a tax return or pay tax under IRC § 6651;
- Failure to pay estimated income tax under IRC § 6654; and
- Failure by a corporation to pay estimated tax under IRC § 6655.<sup>14</sup>

The exceptions under IRC § 6751(b)(2)(A) are based on relatively simple mathematical calculations involving “true/false” fact scenarios and do not require an inquiry into the taxpayer’s facts and circumstances. For example, the question of whether a taxpayer failed to file a required tax return can be answered with a simple “yes” or “no.”

The IRS has defined “automatically calculated through electronic means” to include more than “merely an electronic device to perform arithmetic functions to determine the amount of a penalty.”<sup>15</sup> The exception includes situations where the penalty is assessed “**free** of any independent determination by an IRS employee as to whether the penalty should be imposed against a taxpayer.”<sup>16</sup>

The IRS Office of Chief Counsel has opined that the requirement for managerial approval does not apply to negligence penalties assessed under IRC § 6662(b)(1) pursuant to the Automated Underreporter

<sup>11</sup> See Pub. L. No. 105-206, § 3306(a), 112 Stat. 685, 744 (1998) (codified in IRC § 6751(b)). The statutory language reads in relevant part: “(1) IN GENERAL — No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate. (2) EXCEPTIONS — Paragraph (1) shall not apply to — (A) any addition to tax under section 6651, 6654, or 6655; or (B) any other penalty automatically calculated through electronic means.”

<sup>12</sup> See 144 CONG. REC. S7623-89 (statement of Senator Roth) (1998).

<sup>13</sup> *Id.*

<sup>14</sup> IRC § 6751(b)(2)(A).

<sup>15</sup> IRM 20.1.1.2.3(5), *Managerial Approval for Penalty Assessments*, (Aug. 5, 2014). While there is no legislative history, this position is supported by the IRS Office of Chief Counsel. See SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b)* (Jan. 30, 2002).

<sup>16</sup> IRM 20.1.1.2.3(5), *Managerial Approval for Penalty Assessments*, (Aug. 5, 2014).

program.<sup>17</sup> This is not a distinction that Congress addressed in the statutory provision. Unlike “true/false” penalties, the determination to assess a negligence penalty requires knowledge of what actions the taxpayer took to comply with the tax laws, as well as his or her motivations for those actions. As a result, the National Taxpayer Advocate is focusing her recommendation on automatically calculated negligence penalties under IRC § 6662(b)(1).

For the purpose of this penalty, “negligence” is defined to include “any failure to make a reasonable attempt to comply with the provisions of this title” and the term “disregard” includes any “careless, reckless, or intentional disregard.”<sup>18</sup> The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.<sup>19</sup> A reasonable cause determination takes into account all of the pertinent facts and circumstances.<sup>20</sup> Generally, the most important factor is the extent to which the taxpayer made an effort to determine the proper tax liability.<sup>21</sup>

## REASONS FOR CHANGE

The purpose of penalties is to encourage voluntary compliance and deter noncompliance.<sup>22</sup> A recent TAS research study shows that the arbitrary application of penalties may undermine taxpayer compliance. In 2013, TAS conducted a study to estimate the effect of accuracy-related penalties on Schedule C filers whose examinations were closed in 2007.<sup>23</sup> The results identified matched pairs of taxpayers with similar situations that were different in only one respect: one was assessed a 20 percent accuracy-related penalty and the other was not. Among taxpayers who were subject to a default assessment or who appealed examination’s determination, those subject to penalties were no more compliant (than similarly situated taxpayers who were not penalized) immediately following the assessment.<sup>24</sup> In addition, five years later they were less compliant than those who were not penalized.<sup>25</sup>

The automatic application of negligence penalties is a significant component of the IRS’s Automated Underreporter (AUR) program. AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payors reported via Form W-2, Form 1099, and other information returns.<sup>26</sup> In general, penalties assessed under the AUR program are automatically computed pursuant to a computer program when a discrepancy is detected in the document matching

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<sup>17</sup> See SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 3* (Jan. 30, 2002) (“The circumstances in which the Automated Underreporter program calls for assessment of a negligence penalty, however, does not require an independent determination by a Service employee.”). For general information about the AUR program, see IRM 4.19.3, *Overview of IMF Automated Underreporter*, (Sept. 30, 2014).

<sup>18</sup> IRC § 6662(c).

<sup>19</sup> IRC § 6664(c)(1).

<sup>20</sup> Treas. Reg. § 1.6664-4(b)(1).

<sup>21</sup> *Id.*

<sup>22</sup> See Policy Statement 20-1, IRM 1.2.20.1.1 (June 29, 2004).

<sup>23</sup> See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 1-12 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). TAS used Discriminant Function (or “DIF”) scores—an IRS estimate of the likelihood that an audit of the taxpayer’s return would produce an adjustment—as a proxy for a taxpayer’s subsequent compliance. See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 3.

<sup>24</sup> National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 11.

<sup>25</sup> *Id.* The difference is statistically significant at 95 percent level of confidence.

<sup>26</sup> See IRM 4.19.3.1, *Overview of IMF Automated Underreporter* (Sept. 30, 2014). The AUR program relies on two sources: the Individual Master File (IMF), which contains information reported to the IRS by taxpayers (such as when taxpayers file Form 1040, U.S. Individual Income Tax Return), and the Information Returns Master File (IRMF), which includes information submitted by payers, such as on Form W-2, Wage and Tax Statement. Underreporter cases result when computer analysis detects a discrepancy between the two data sources. IRM 1.4.19.1, *Overview*, (Nov. 1, 2012).

program.<sup>27</sup> If the negligence penalty is assessed in AUR, without an employee independently determining its appropriateness, there is no requirement for managerial approval.<sup>28</sup>

Specifically, when the AUR program detects a discrepancy on a tax return, the IRS sends the taxpayer a letter asking for an explanation and a notice proposing an assessment.<sup>29</sup> If the taxpayer does not respond to those inquiries, AUR will issue a notice of deficiency, which proposes a liability assessment and includes calculation of applicable penalties.<sup>30</sup> If the taxpayer responds to the initial inquiry or the notice of deficiency, the IRS employee must consider the response, and any resulting IRC § 6662(b)(1) penalty assessment must receive prior managerial approval.<sup>31</sup>

The AUR program can also assess the negligence penalty under IRC § 6662(b)(1) automatically.<sup>32</sup> The IRS system has “uniform factual criteria” programming that automatically proposes the negligence penalty when a taxpayer fails to report income reported on third-party information returns for a second year.<sup>33</sup> The programmed determination, in this instance, is that the taxpayer fits into a category of taxpayers who the IRS believes are “negligent” because failing to include third-party information returns for two consecutive years does not constitute the use of ordinary and reasonable care in the preparation of a tax return.<sup>34</sup>

The IRS clearly uses different levels of effort to communicate with taxpayers and ascertain the reason for an apparent discrepancy before proposing a penalty, depending on the type of examination or matching program. Taxpayers receiving notices from the AUR program appear to receive the least communication prior to penalty assessment.<sup>35</sup> This procedure differs from those in field and office audits, where

- 27 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 2* (Jan. 30, 2002).
- 28 IRM 20.1.1.2.3.2, *Automated Underreporter Program*, (Aug. 5, 2014). See also IRM 20.1.5.1.6, *Managerial Approval of Penalties*, (Jan. 24, 2012).
- 29 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 2* (Jan. 30, 2002). As mentioned above, the initial notices may not include a penalty calculation. See footnote 10, *supra*.
- 30 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 2* (Jan. 30, 2002). For information on the notice of deficiency, see IRC § 6212 and IRM 4.8.9.8.3, *Criteria for Issuance*, (July 9, 2013).
- 31 *Id.* at 4. The IRS has implemented Counsel’s advice. When a taxpayer responds to either the initial contact letter or the notice of deficiency, the IRS must consider the response. See IRM 20.1.1.2.3.2(2), *Automated Underreporter Program*, (Aug. 5, 2014). This consideration requires an independent determination and therefore is not automatically calculated through electronic means and requires managerial approval. See IRM 20.1.1.2.3.2(3), *Automated Underreporter Program*, (Aug. 5, 2014). Managerial approval is not required when an employee uses command code FTDPN when working a case involving the failure to deposit penalty under IRC § 6656. IRM 20.1.1.2.3.3, *IDRS Command Code FTDPN*, (Dec. 11, 2009). Employees use command codes while working in the Integrated Data Retrieval System (IDRS), a database of taxpayer information. For more information on IDRS, see IRM 2.9.1.1, *Overview of Integrated Data Retrieval System*, (Jan. 1, 2000).
- 32 “Negligence” includes any failure to make a reasonable attempt to comply with the provisions of the tax law. IRC § 6662(c). The negligence penalty includes instances where the taxpayer shows a disregard for the tax rules. IRC § 6662(b)(1). “Disregard for the tax rules” includes any careless, reckless, or intentional disregard.” IRC § 6662(c). However, a position that has a reasonable basis is not attributable to negligence. Treas. Reg. § 1.6662-3(b)(1).
- 33 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 3* (Jan. 30, 2002).
- 34 SCA 200211040, Office of Chief Counsel, *Memorandum for Associate Area Counsel, Managerial Approval and Notice Requirements of Penalties – Section 6751(b) 3* (Jan. 30, 2002). Counsel believes that this is a correct interpretation of IRC § 6751(b)(2)(B). *Id.*
- 35 See National Taxpayer Advocate 2013 Annual Report to Congress 185. For a discussion on the shortcomings of customer service and data systems within the AUR program, see National Taxpayer Advocate 2007 Annual Report to Congress 259-74 (Most Serious Problem: *Automated Underreporter*).

the IRS employee is encouraged to solicit explanations regarding adjustments from the taxpayer prior to assessment.<sup>36</sup>

Automatically calculated penalties are a significant problem for taxpayers. In FY 2013, the IRS conducted over 75 percent of all individual audits by Correspondence Examination and issued over 4.12 million Notices CP 2000 (AUR notices) in FY 2013.<sup>37</sup> Moreover, in FY 2014, more than 71,000 of these letters proposed over \$71 million in accuracy-related penalties *before* the IRS ever inquired about the discrepancy or called the taxpayer.<sup>38</sup> This leaves the burden on the taxpayer to prove that the penalty does not apply.

As discussed above, if a taxpayer responds to the automatically-proposed penalty, the employee assigned to the case must review the submission. The assessment is no longer “automatically calculated through electronic means” and will be reviewed by a manager. The taxpayer who does not respond will not get the same review.

There are many reasons why a taxpayer may not respond to a notice. First, the taxpayer may not respond to the first notice because he or she agrees with the adjustment proposed and thus does not review the second separate notice that contains the penalty assessment. Second, low income taxpayers often face particular challenges when dealing with the IRS.<sup>39</sup>

Moreover, in an environment of continuing budget cuts, the inability to contact the IRS is a challenge faced not only by low income taxpayers, but by *all* taxpayers. In fiscal year (FY) 2014, only 64.4 percent of taxpayers calling to speak to an IRS customer service representative could get through and the average time on hold was 19.55 minutes.<sup>40</sup> The National Taxpayer Advocate has highlighted the need to improve customer service to preserve taxpayer rights.<sup>41</sup> The consequences of this problem are exacerbated with automatically-assessed penalties, which are reviewed only when a taxpayer responds. Most importantly, automatic IRC § 6662(b)(1) penalty assessments, while “efficient” from the IRS’s point of view, may actually decrease taxpayer compliance and therefore the collection of revenue.<sup>42</sup>

Several taxpayer rights are impacted when negligence penalties are assessed automatically without managerial approval. For instance, taxpayers who must defend themselves from automatically assessed penalties that go to their intent, have not had *their right to quality service* honored. Likewise, *the right to pay no more than the correct amount of tax*, which includes interest and penalties, is violated when the IRS can assess penalties without first reviewing the appropriateness of the assessment. Finally, *the right to a fair and just tax system*, which ensures that the IRS will “consider facts and circumstances that might affect

36 See IRM 4.10.6.3.5, *Soliciting the Taxpayer’s Explanations*, (May 14, 1999). See also National Taxpayer Advocate 2013 Annual Report to Congress 186.

37 IRS Data Book, Table 14, Information Reporting Program (FY 2013).

38 IRS Compliance Data Warehouse, Individual Master File (Dec. 22, 2014). This figure omits the accuracy-related penalties assessed in FY 2014 as a result of AUR cases opened in earlier periods. It also omits taxpayers who received a CP 2000 only after receiving a letter (CP 2501) inquiring about the reason for the discrepancy.

39 Low income taxpayers are more likely to face limited English proficiency, low literacy rates, physical or mental disabilities, lower education levels, limited access to the internet, and limited access to qualified tax professionals. See National Taxpayer Advocate 2009 Annual Report to Congress 112-113.

40 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2014).

41 See National Taxpayer Advocate 2013 Annual Report to Congress 20-39 (Most Serious Problem: *IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 34-41 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); National Taxpayer Advocate 2011 Annual Report to Congress 3-14 (Most Serious Problem: *The IRS is Not Adequately Funded to Serve Taxpayers and Collect Taxes*).

42 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 1-12 (Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

[the taxpayer's] underlying liabilities," is violated when the IRS automatically imposes negligence penalties, without any managerial approval. It also brings into question the fairness of the system when the IRS reviews penalties against taxpayers who respond to a notice, but automatically assesses penalties against taxpayers who do not reply.

## EXPLANATION OF RECOMMENDATION

This legislative recommendation requires managerial approval prior to assessment of the accuracy-related penalty imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations under IRC § 6662(b)(1). The managerial review of this penalty, which includes the failure to make a "reasonable attempt" to comply with rules or "any careless, reckless, or intentional disregard" of the rules, should involve a thorough review of the taxpayer's facts and circumstances, which is not possible with an automatic assessment.<sup>43</sup>

There may be other instances where the IRS automatically imposes penalties where an analysis of facts and circumstances is required. For instance, the IRS applies IRC § 6751 to the analysis of its two-year EITC ban cases under IRC § 32(k).<sup>44</sup> Under IRS procedures, managerial approval is required in all cases that involve the two-year ban under IRC § 32(k).<sup>45</sup> However, in 2013, TAS reviewed cases involving the two-year ban and found that in 69 percent of the cases, the ban was imposed without the required managerial approval.<sup>46</sup>

In response to this review, the IRS agreed to reinforce among its employees "that all two-year bans must have managerial approval on all manual cases and on systemically imposed two-year ban cases *if correspondence is received.*"<sup>47</sup> (emphasis added). This leaves taxpayers facing a two-year ban under IRC § 32(k) in a similar situation to taxpayer receiving automatic penalty assessments under IRC § 6662(b)(1). Therefore, the National Taxpayer Advocate recommends that Congress specify which penalties and facts and circumstances result in penalties "automatically calculated through electronic means."

43 IRC § 6662(c).

44 See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress, vol. 2 44. IRC § 32(k)(1)(B)(ii) disallows Earned Income Tax Credit (EITC) claims for two taxable years if there has been a final determination that the taxpayer's claim of credit was due to "reckless or intentional disregard of rules and regulations."

45 See IRM 4.19.14.6.1(4), *EITC 2/10 Year Ban - Correspondence Guidelines for Examination Technicians (CET)*, (Jan. 1, 2013).

46 See National Taxpayer Advocate 2013 Annual Report to Congress 104. Based on this review, the National Taxpayer Advocate made a legislative recommendation in 2013 to amend IRC § 32(k) to provide that the IRS has the burden of proof as to whether it is appropriate to impose the two-year ban on claiming EITC. See National Taxpayer Advocate 2013 Annual Report to Congress at 311-15 (Most Serious Problem: *Allocate to the IRS the Burden of Proving it Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit*).

47 See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress, vol. 2 44.

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## **CONTACT INFORMATION ON STATUTORY NOTICES OF DEFICIENCY: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population**

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### **PROBLEM**

Section 1102(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) provides that statutory notices of deficiency (SNODs) “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.”<sup>1</sup> The Conference Report provided further clarification by stating the IRS should publish information on the right to contact Taxpayer Service (TAS) “on” the SNOD, as opposed to “with” the notice.<sup>2</sup>

A TAS review of the current IRS inventory of SNODs found that the majority do not include the contact information for the local TAS office on the face of the notices and, in several instances, the wrong TAS office is listed. Congress enacted this provision of RRA 98 to ensure that taxpayers are aware of their right to contact the local office of the Taxpayer Advocate Service at a crucial point in their tax controversy. Taxpayers need to know they can talk to someone in their own state who has knowledge of the underlying local economic conditions that might affect the case. When the taxpayer receives a SNOD, the IRS has not actually assessed the additional tax, and the taxpayer still has a limited opportunity to address the issue directly with the IRS or petition the Tax Court. It is also an ideal time for the IRS to inform certain taxpayers about the services provided by low income taxpayer clinics (LITCs), as well as their contact information. While TAS employees can explain to the taxpayer the right to file a petition in the Tax Court, LITC practitioners can assist an eligible taxpayer throughout the tax controversy and represent the taxpayer in court.

### **EXAMPLE**

A taxpayer receives a statutory notice of deficiency (SNOD) proposing a \$3,000 adjustment due to the disallowance of the Earned Income Tax Credit (EITC). The SNOD was mailed with a Notice 1214, *Helpful Contacts for Your Notice of Deficiency*, containing TAS contact information, but it became separated from the SNOD after receipt by the taxpayer. The taxpayer does not agree with the adjustment and has tried to call the IRS to ask what he needs to do to resolve the issue, but his calls never go through to a live assist. The notice includes language informing the taxpayer of his right to contact TAS, but the taxpayer does not understand that he can seek assistance from the local office of TAS and a low income taxpayer clinic in his county.

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1 Pub. L. 105-206, 112 Stat. 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.

2 H.R. REP. No. 105-599, at 215 (1998) (Conf. Rep.). Because both RRA 98 and IRC § 6212 address both the right to contact TAS and the contact information together, we believe that the conference report language stating that the information should be on the notice should apply to both.

## RECOMMENDATIONS

To bring the IRS inventory of statutory notices of deficiencies (SNODs) into compliance with § 1102(b) of RRA 98 and to inform taxpayers of their right to seek the assistance at the local office of the Taxpayer Advocate Service (TAS) and Low Income Taxpayer Clinics (LITCs), the National Taxpayer Advocate recommends that Congress revise Internal Revenue Code (IRC) § 6212 to require the IRS to do the following:

1. Include language on the face of the SNOD informing the taxpayer of the right to contact a local office of TAS. Such language should also provide the address and phone number of the TAS office aligned with the taxpayer's last known residence.
2. For SNODs determined by the IRS, in consultation with the National Taxpayer Advocate, to have a significant probability of impacting low income taxpayers, include language on the face of the notice describing LITCs and provide a website link that lists contact information for all the LITCs.
3. For SNODs that are certain to impact low income taxpayers (e.g., those proposing to assess the Earned Income Tax Credit), also include in the envelope used to mail the SNOD Publication 4134, Low Income Taxpayer Clinic List, which provides information on the services provided by LITCs and contact information for each clinic.

## PRESENT LAW

### Section 1102(b) of RRA 98

Section 1102(b) of RRA 98 amended IRC § 6212(a) to provide that SNODs “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.”<sup>3</sup> Furthermore, the Conference Report states “The IRS would be required to publish the taxpayer’s right to contact the local Taxpayer Advocate on the statutory notice of deficiency.”<sup>4</sup>

### Chief Counsel Opinion

In response to a request for legal opinion by TAS, the IRS Office of Chief Counsel has opined that the IRS complies with § 1102(b) of RRA 98 when it provides Notice 1214 as an insert in the SNOD. Counsel further explained that Notice 1214 was developed by the IRS for the purpose of complying with RRA 98. In fact, the description of the notice on the IRS Forms Repository site includes the following language: “This notice is issued to conform with the IRS restructuring and reform act of 1998 section 1102(b). It was included as an insert with all statutory notices of deficiency (90-Day Letters).” Counsel supported its opinion by stating that the SNOD includes language regarding TAS and Notice 1214 is listed as an enclosure on the SNOD.<sup>5</sup>

### Validity of the SNOD

In *John C. Hom & Associates, Inc. v. Commissioner*, the Tax Court addressed the validity of the SNOD when it does not include all the information required by RRA 98. Specifically, the taxpayer argued that the SNOD was invalid for failing to include the address and telephone number of the local office of

<sup>3</sup> Pub. L. 105-206, § 1102(b) 112 Stat. 685, 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.

<sup>4</sup> H.R. REP. No. 105-599, at 215 (1998) (Conf. Rep.).

<sup>5</sup> Email from the Office of the Special Counsel to the National Taxpayer Advocate to a TAS Senior Attorney-Advisor (Nov. 20, 2014).

the National Taxpayer Advocate and that inclusion of a web page link is inadequate compliance with IRC § 6212. The court held that the SNOD was valid and complied with IRC § 6212 despite including only the web link.<sup>6</sup> Note that this opinion only addressed the validity of the SNOD for jurisdictional purposes. The opinion did not address whether the IRS actually complied with RRA 98 by only including the Web page link on the face of the notice.<sup>7</sup>

### **IRC § 7526**

IRC § 7526 created the LITC program and authorizes the IRS to award matching grants of up to \$100,000 per year to qualifying clinics. Such clinics cannot charge more than a nominal fee for services (except for reimbursement of actual costs incurred). They must represent low income taxpayers involved in controversies with the IRS and provide education and outreach on the rights and responsibilities of U.S. taxpayers who speak English as a second language. LITCs are generally legal aid or legal services organizations: clinics at accredited law, business, or accounting schools, and other not-for-profit organizations that provide services to the poor.

## **REASONS FOR CHANGE**

### **Inclusion of TAS Information on the Face of the SNOD**

The taxpayer's receipt of a SNOD is a critical point in the audit or appeals process. The taxpayer needs information about what he or she must do to protect the right to an independent review of the proposed deficiency prior to assessment. The SNOD is a pre-assessment document, which means the taxpayer may still have the opportunity resolve the issue before going to the Tax Court.

TAS reviewed the inventory of SNOD templates and notices and found 11 of 17 current ones failed to comply with the requirements in RRA 98. Of the 11 SNODs that failed, eight included, as an insert or stuffer in the envelope with the SNOD, Notice 1214, *Helpful Contacts for Your Notice of Deficiency*, which has the addresses and phone numbers of the local TAS offices.<sup>8</sup> In addition, two included the information on the face of the notice but only auto-populated one particular TAS office rather than one near the taxpayer.<sup>9</sup> Finally, one notice included as a stuffer Publication 3953, which includes information about TAS.<sup>10</sup> While the Tax Court has held the SNOD is still valid with the language required by IRC § 6212(a), it is our position that the failure of the IRS to strictly comply with the RRA 98 requirements harms taxpayers.<sup>11</sup>

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6 140 T.C. 210 (2013), *appeal docketed*, No. 13-72684 (9th Cir. July 31, 2013).

7 See also *Comm'r v. Forest Glen Creamery Co.*, 98 F.2d 968, 971 (7th Cir. 1938) (holding that documents with the notice must be considered when determining if the taxpayer was misled by errors for notice validity purposes).

8 The following SNODs include Notice 1214 as a stuffer: CP 3219N, Letter 531A, Letter 531B, Letter 531C, Letter 531J, Letter 902 (DO), Letter 902-T, and Letter 1384 (SC).

9 CP 3219A, *Notice of Deficiency – AUR IMF*, auto-populates the notice with the TAS Austin, Texas office information. Letter 3219C auto-populates the Atlanta, Georgia office information on every notice issued.

10 Letter 3523, *Notice of Determination of Worker Classification* (NDWC), is not technically a statutory notice of deficiency, but we added this letter to the list because it is similar to a SNOD in that it provides the taxpayer the right to petition Tax Court to contest a proposed assessment of tax. It is the statutory notice for employment tax when there is a controversy involving worker classification or § 530. TAS contact information is included in Publication 3953, Q&A's *About Tax Court Proceedings for Determination of Employment Status Under IRC Section 7436*, which is sent along with Letter 3523. See IRS response to TAS information request (July 31, 2014). For more detail on the SNODs reviewed by TAS, see Most Serious Problem: *Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice*, *supra*.

11 *John C. Hom & Associates, Inc. v. Comm'r*, 140 T.C. 2010 (2013), *appeal docketed*, No. 13-72684 (9th Cir. July 31, 2014).

Congress was very clear that it did not want the IRS to merely give out a national contact number for the Taxpayer Advocate Service. Instead, by requiring the National Taxpayer Advocate to ensure that the phone numbers of the local offices are published, Congress specifically wanted taxpayers to know how to seek assistance from the nearest Local Taxpayer Advocate (LTA) office.<sup>12</sup> The Conference Report gave further clarification by stating that the IRS should publish the right to contact the local office of TAS “on” as opposed to “with” the SNOD.<sup>13</sup>

The IRS Office of Chief Counsel has informally opined that by inserting Notice 1214 into the SNOD envelope, the IRS has complied with the requirements of RRA 98 regarding local contact information. We vigorously disagree with Counsel’s legal reasoning in its opinion. Because of the fundamental disagreement as to what is necessary to satisfy the requirements of RRA 98, Congress should make clear what the IRS is required to do to adequately inform certain taxpayers of their right to seek assistance from the local office of TAS or an LITC.<sup>14</sup>

This recommendation does not address the validity of the SNOD for Tax Court jurisdictional purposes. As the Tax Court noted in *Hom*, inclusion of a mere link to a website providing TAS information is enough to give the SNOD validity for purposes of the current language of IRC § 6212. However, we are proposing that Congress revise the language of the statute to make it consistent with the intent of §1102(b) of RRA 98. Just because a SNOD is valid for Tax Court jurisdictional purposes does not mean that the IRS is in compliance with RRA 98 when it issues a SNOD without adequate language to inform the taxpayer of the right to seek assistance from a local office of TAS.

Finally, the provision of local TAS contact information in this proposed manner furthers the taxpayers’ *right to a fair and just tax system*. The Taxpayer Bill of Rights specifically defines this right by providing that taxpayers have the right to seek assistance from TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels. Therefore, by not clearly providing local address and telephone contact information for TAS on the SNOD as required by RRA 98, the IRS is infringing on the taxpayers’ rights.

### Inclusion of LITC Information on the Face of and as an Insert to the SNOD

Certain taxpayers could benefit from seeking assistance from an LITC at the point in the tax controversy when they receive the SNOD. LITCs represent low income individuals and their services are free or low cost for eligible taxpayers. LITCs assist taxpayers in disputes with the IRS, including audits, appeals, collection matters, and federal tax litigation. They can also help taxpayers respond to IRS notices and correct account problems. LITCs also provide education for low income taxpayers and taxpayers who speak English as a second language (ESL) about their taxpayer rights and responsibilities.<sup>15</sup> There are currently 131 LITCs.<sup>16</sup> In 2013, LITCs represented almost 21,000 taxpayers in over 18,000 cases and provided

12 Pub. L. 105-206, § 1102(a), 112 Stat. 701 (1998) (adding IRC § 7803(c)(2)(C)(iii), which requires the National Taxpayer Advocate to ensure that the local telephone number for each local TAS office is published and available to taxpayers in that local area).

13 H.R. REP. No. 105-599, at 215 (1998) (Conf. Rep.).

14 Email from Office of the Special Counsel to the National Taxpayer Advocate to a TAS Senior Attorney Advisor (Nov. 20, 2014).

15 IRC § 7526. LITCs, their employees, and their volunteers are independent from the IRS but receive some of their funding from the IRS through the LITC grant program. Each clinic determines whether prospective clients meet income guidelines and other criteria before agreeing to represent them. See <http://www.taxpayeradvocate.irs.gov/Tax-Professionals/Low-Income-Taxpayer-Clinics>.

16 See IRS Publication 4134, *Low Income Taxpayer Clinic List* (Jan. 2014) (listing 133 clinics, but two subsequently withdrew from the program).

consultation and advice to over 25,000 additional taxpayers.<sup>17</sup> A clinic practitioner could ensure that the taxpayer is aware of the available options at the time the IRS issues the SNOD. Most importantly, the taxpayer can receive assistance in filing a timely petition with the Tax Court, if necessary.<sup>18</sup>

The provision of a description of LITCs and a website link to a list of all LITCs on the face of those SNODs likely to impact low income taxpayers will ensure that these taxpayers have sufficient information if they choose to seek the assistance of an LITC.<sup>19</sup> For those SNODs that by definition impact this taxpayer population—for example, those proposing to assess the EITC, it is important to also include the contact information as an insert. The provision of the LITC information in the proposed manner also furthers the taxpayers' *right to retain representation*. The Taxpayer Bill of Rights specifically defines this right by including the following language: "Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation."<sup>20</sup>

## EXPLANATION OF RECOMMENDATION

To ensure that the IRS adequately informs taxpayers of their right to contact the local office of the Taxpayer Advocate Service, the National Taxpayer Advocate recommends that Congress include language in IRC § 6212 explicitly directing the IRS to place the address and phone number of the TAS office closest to the taxpayer's address in a prominent manner on the face of the SNOD. The revision of the provision would first provide that the IRS must place on the face of the SNOD language informing the taxpayer about the right to contact the local office of TAS. The revision would also direct the IRS to place on the face of the SNOD the address and phone number for the TAS office aligned with the zip code of the taxpayer's last known address.

In addition, Congress should revise IRC § 6212 to require the IRS to include on the face of those SNODs determined to have a chance of impacting low income taxpayers language describing LITCs and provide a website link for the contact information.<sup>21</sup> The IRS would select the SNODs most likely to impact low income taxpayers in consultation with the National Taxpayer Advocate. For example, SNODs for tax deficiencies related to the EITC, Premium Tax Credit (PTC), Automated Underreporter (AUR), and Automated Substitute for Return (ASFR) are likely to impact low income taxpayers.

For those SNODs that include deficiencies that, by definition, will impact low income taxpayers, the IRS should also include in the SNOD envelope an insert with information describing the services provided by LITCs as well as the addresses and phone numbers of such clinics. The IRS shall determine those SNODs certain to impact low income taxpayers in consultation with the National Taxpayer Advocate. For example, SNODs with deficiencies for EITC and PTC should include such inserts because the income and subject matter of these deficiencies indicate that the taxpayers may be eligible for LITC assistance.

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<sup>17</sup> In 2013, the LITCs represented 20,972 taxpayers in 18,144 cases and provided consultation and advice to 25,179 additional taxpayers. TAS LITC Program Office (Dec. 5, 2014); for more data which illustrates how LITCs help low income taxpayers, see IRS Publication 5066, *Low Income Taxpayer Clinics Program Report* 3, 9, 12 (Dec. 2014).

<sup>18</sup> IRC § 7526.

<sup>19</sup> We are not suggesting that the IRS include a specific LITC located in the taxpayer's geographic area on the face of the SNOD because the IRS is precluded from doing so. See National Taxpayer Advocate 2007 Annual Report to Congress 551-53 (Additional Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

<sup>20</sup> For more information on the Taxpayer Bill of Rights, see <http://www.taxpayeradvocate.irs.gov/about-tas/taxpayer-rights#rights>.

<sup>21</sup> For example, the IRS could provide a link to the LITC page on <http://www.irs.gov/advocate> or a link to IRS Publication 4134, *Low Income Taxpayer Clinic List*.

IRS Pub. 4134, *Low Income Taxpayer Clinic List*, is a four-page document providing:

- A brief description of the services provided by LITCs and taxpayer eligibility to receive such services;
- Clinic locations by geographic area;
- Phone numbers;
- The type of clinic; and
- The languages served at each clinic.

The list of clinics is updated annually. IRS could use the periodically updated version of Publication 4134 as an insert to the SNOD. Because Publication 4134 is a specific purpose publication, it is less likely to be thrown out than a general use document, especially if targeted to the appropriate population.<sup>22</sup> Note that Publication 4134 is not included in the envelope with all SNODs. We are mindful of the IRS interest in minimizing postage costs.<sup>23</sup> However, informing the targeted population of their rights is money appropriately spent.

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22 Treasury's Go Direct campaign, which began in 2005, found that inserts can be effective if they include a clear message and strong visual graphic tailored specifically to each target audience. Information Provided by Weber Shandwick to TAS (Oct. 10, 2014).

23 The IRS Printing and Postage Budget Reduction Implementation Team proposed the elimination of all non-mandatory inserts in all correspondences. IRS Media & Publications, *PPBR Proposals Approved for Implementation* (Sept. 2010).

**LR  
#19****LATE-FILED RETURNS: Clarify the Bankruptcy Law Relating to  
Obtaining a Discharge****PROBLEM**

Taxpayers who face financial hardship and seek a bankruptcy discharge of their tax liabilities face uncertainty as to whether they will be able to obtain a discharge of these liabilities if they do not file their tax returns timely. This lack of clarity is due to conflicting judicial interpretations of a provision of § 523(a) of the Bankruptcy Code, which sets forth exceptions to the bankruptcy discharge in certain cases.<sup>1</sup> Section 523(a)(1)(B)(i) creates an exception for a tax debt for which the debtor had not filed returns, and § 523(a)(1)(B)(ii) creates an exception for a tax debt for which the debtor had filed the return after the due date and within two years of the bankruptcy case. At least before 2005, a tax would be dischargeable when the debtor filed the return late more than two years before the bankruptcy case was filed. As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),<sup>2</sup> Congress amended § 523(a) and added a paragraph at the end of this section, sometimes referred to as the “Hanging Paragraph.” This addition provides “the term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements).”<sup>3</sup>

Some courts, including two circuit courts of appeals, have taken the approach that the language defining a return as one that satisfies “applicable filing requirements” means that unless a return is filed by the appropriate due date, the tax liability is not eligible for discharge.<sup>4</sup> This means an individual taxpayer who files a tax return late—even one day late—could never discharge the tax in bankruptcy. This rule can apply even where the IRS has determined the late filing was due to reasonable cause or a natural disaster, or because the taxpayer was in combat status. Other courts do not interpret the “applicable filing requirements” language as requiring a timely filed return.

Although the IRS currently takes the position that an untimely filed return does not bar a bankruptcy discharge, this stance can change at any time.<sup>5</sup> Also, despite the IRS’s current position, given the split in legal interpretation, it is possible that some courts could ignore the IRS position. In addition, the uncertainty in the bankruptcy law may have an adverse impact on taxpayers with state tax liabilities. As a result, otherwise compliant taxpayers who file late returns may not be able to obtain the fresh start intended by the Bankruptcy Code, or achieve finality in resolving their tax liabilities at the time of the discharge. This may undermine the taxpayers’ *right to a fair and just tax system* and *right to finality*.

<sup>1</sup> The Bankruptcy Code is contained in Title 11 of the United States Code. 11 U.S.C. § 523(a)(1)(B) and (C) sets forth exceptions to a bankruptcy discharge for certain tax debts when the debtor is an individual. See 11 U.S.C. §§ 727(b), 1141(d)(2), and 1328(a)(2). Unless otherwise noted, all code references are to provisions in the Bankruptcy Code contained in Title 11 of the United States Code.

<sup>2</sup> Pub. L. No. 109-8, § 714, 119 Stat. 23, 128 (2005).

<sup>3</sup> The Hanging Paragraph also provides that the term return includes a return prepared pursuant to Internal Revenue Code (IRC) § 6020(a) or similar state or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to IRC § 6020(b) or a similar state or local law. These two IRC provisions will be discussed below.

<sup>4</sup> See, e.g., *In re McCoy*, 666 F.3d 924 (5th Cir. 2012), cert. denied, 133 S. Ct. 192 (2012); *In re Mallo*, 2014 WL 7360130 (10th Cir. Dec. 29, 2014), aff’g 498 B.R. 268 (D. Colo. 2013); *In re Creekmore*, 401 B.R. 748 (Bankr. N.D. Miss. 2008). See also *In re Payne*, 431 F.3d 1055, 1060 (7th Cir. 2005) (Judge Easterbrook dissenting) (after the BAPCPA, tax liability on a late-filed return is nondischargeable).

<sup>5</sup> Chief Counsel Notice 2010-16, 2010 WL 3617597 and Chief Counsel Advisory 201044008 (Nov. 5, 2010), 2010 WL 4384171.

## EXAMPLE

Due to a severe medical condition, a taxpayer with an excellent compliance history files her federal and state tax returns one day after their deadlines. Because of her financial circumstances, she cannot meet her tax obligations timely. Over the next several years, her condition worsens and due to financial hardship, she files a bankruptcy petition seeking a discharge of her tax and other liabilities. Because she filed returns one day late, the taxpayer cannot be certain if her tax liabilities will be discharged, thereby undermining her fresh start.

## RECOMMENDATION

To address conflicting judicial interpretations as to whether the “applicable filing requirements” language in § 523(a) of the Bankruptcy Code imposes a timely filing requirement, the National Taxpayer Advocate recommends that Congress clarify this language to provide that a late-filed tax return may be considered a return for purposes of obtaining a bankruptcy discharge.<sup>6</sup>

## PRESENT LAW

Section 523(a) of the Bankruptcy Code contains many exceptions to the discharge of an individual’s liabilities in bankruptcy.<sup>7</sup> Section 523(a)(1) lists three exceptions to the discharge of tax liabilities:

- An exception to discharge based on the type of tax, date of tax assessment, and the age of the tax debt;<sup>8</sup>
- An exception to discharge in cases where a taxpayer did not file a return<sup>9</sup> or filed a late return within two years of filing a bankruptcy petition;<sup>10</sup> and
- An exception to discharge in the case where a bankruptcy debtor made a fraudulent or willful attempt to evade or defeat taxes for which a discharge is being sought.<sup>11</sup>

In 2005, Congress enacted the BAPCPA, adding an unnumbered “Hanging Paragraph”<sup>12</sup> to the end of § 523. It reads:

For purposes of this subsection, the term ‘return’ means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law, or a written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal, but does not include a return made pursuant to section 6020(b) of the Internal Revenue Code of 1986, or a similar State or local law.

The Hanging Paragraph, which defines what constitutes a return for purposes of a bankruptcy discharge, has caused confusion for the courts. Several courts of appeal dealt with the issue before Congress

<sup>6</sup> The American Bar Association Section of Taxation proposed to Congress a substantially similar amendment to § 523(a) in a submission dated July 29, 2014.

<sup>7</sup> Section 523(a) references the discharge provisions contained in 11 U.S.C. §§ 727, 1141, 1228(a), 1228(b), and 1328(b). 11 U.S.C. § 1328(a)(2) also references section 523(a)(1)(B).

<sup>8</sup> See 11 U.S.C. § 523(a)(1)(A) (referencing 11 U.S.C. §§ 507(a)(3) and 507(a)(8)).

<sup>9</sup> See 11 U.S.C. § 523(a)(1)(B)(i).

<sup>10</sup> See 11 U.S.C. § 523(a)(1)(B)(ii).

<sup>11</sup> See 11 U.S.C. § 523(a)(1)(C).

<sup>12</sup> The term comes from the fact this paragraph is unnumbered and stands alone at the end of § 523(a). See *In re McCoy*, 666 F.3d 924, 926 n.3 (5th Cir. 2012), cert. denied, 133 S. Ct. 192 (2012).

added the paragraph.<sup>13</sup> However, with the change in law in 2005, courts had to interpret the Hanging Paragraph's definition of the term "return" for bankruptcy law purposes—namely that, to be considered a return, the tax filing must satisfy the requirements of applicable nonbankruptcy law—including applicable filing requirements. If a taxpayer files a document that does not qualify as a return under the Hanging Paragraph, it will be considered a non-filed return under § 523(a)(1)(B)(i), and any tax reported will be excepted from discharge.

Some courts have interpreted the phrase "applicable filing requirements" in the Hanging Paragraph to impose a rule requiring the taxpayer to have met the filing due date. This would apply even where the IRS had found reasonable cause for the failure to file a return and thus did not impose a late filing penalty on the taxpayer.<sup>14</sup> Therefore, under a strict reading of this provision, a taxpayer who files even one day late will be denied a discharge for taxes due on the return. This rule can be referred to as the "One-Day-Late Rule."

For example, in *In re Creekmore*,<sup>15</sup> a bankruptcy court held that any late-filed return can never qualify as a return for the purpose of obtaining a bankruptcy discharge,<sup>16</sup> unless it was prepared pursuant to IRC § 6020(a). Under IRC § 6020(a), if a taxpayer fails to file a return, the IRS may prepare a return with information disclosed by the taxpayer and signed by the taxpayer. This is a cooperative process between the taxpayer and the IRS.<sup>17</sup> The *Creekmore* court noted that this reading of the Hanging Paragraph led to a harsh outcome for the taxpayer, but stated that taxpayers could avoid this problem by taking advantage of the "safe-harbor" found in IRC § 6020(a).

The only court of appeals opinion that deals with the Hanging Paragraph after the 2005 change in law is the Fifth Circuit Court of Appeals in *In re McCoy*.<sup>18</sup> *McCoy* dealt with the issue of dischargeability of state tax liabilities. The *McCoy* court held that the first sentence of the Hanging Paragraph provided a "clear definition of 'return' for both state and federal taxes."<sup>19</sup> Therefore, in the view of the Fifth Circuit, the "applicable filing requirements" language in the Hanging Paragraph requires a return be timely filed and a tax liability on a late-filed return, even one day late, cannot be discharged in bankruptcy. Similar to the court in *Creekmore*, the *McCoy* court concluded the only way a taxpayer could avoid this harsh result

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13 The most significant (non-bankruptcy) case dealing with what constitutes a return is *Beard v. Comm'r*, 82 T.C. 766 (1984), aff'd *per curiam*, 793 F.2d 139 (6th Cir. 1986). This case set forth a four-part test to determine whether an income tax filing document qualifies as a return. A document is a return under the test if: 1) it contains sufficient data to calculate the tax liability; 2) it purports to be a return; 3) it represents an honest and reasonable attempt to satisfy the requirements of the tax law; and 4) it is executed under penalties of perjury. Five circuit courts of appeal applied the *Beard* test in the bankruptcy context to determine whether the debtor filed a return for discharge purposes. Four of these cases were decided in favor of the IRS. See *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999), cert. denied, 528 U.S. 810 (1999); *In re Hatton*, 220 F.3d 1057 (9th Cir. 2000); *In re Moroney*, 352 F.3d 902 (4th Cir. 2003); *In re Payne*, 431 F.3d 1055 (7th Cir. 2005). A fifth case, *In re Colsen*, 446 F.3d 836 (8th Cir. 2006), resulted in a victory for the taxpayer.

14 See Treas. Reg. § 301.6651-1(c); IRM 20.1.1.3.2 (Nov. 25, 2011).

15 401 B.R. 748 (Bankr. N.D. Miss. 2008).

16 The *Creekmore* court agreed with Judge Easterbrook's dissent in *In re Payne*, 431 F.3d 1055 (7th Cir. 2005). In *Payne*, a case prior to the change in law, Judge Easterbrook noted that after the change in law, a tax due on a late-filed return is not dischargeable.

17 This is in contrast to IRC § 6020(b), which allows the IRS to prepare a return for a taxpayer who does not file one. This is sometimes referred to as a substitute for return (SFR) and does not involve taxpayer cooperation with the IRS. Under the Hanging Paragraph, a return prepared by the IRS pursuant to IRC § 6020(a) is considered a return for purposes of obtaining a bankruptcy discharge while one prepared pursuant to § 6020(b) is not.

18 666 F.3d 924 (5th Cir. 2012), cert. denied, 133 S. Ct. 192 (2012). In a significant recent development, the Tenth Circuit Court of Appeals agreed with the Fifth Circuit's *McCoy* decision and held that tax debts on late-filed federal returns are not dischargeable in bankruptcy. See *In re Mallo*, 2014 WL 7360130 (10th Cir. Dec. 29, 2014), aff'd 498 B.R. 268 (D. Colo. 2013).

19 *In re McCoy*, 666 F.3d at 930.

was to take advantage of a provision similar to that contained in IRC § 6020(a).<sup>20</sup> Thus, under both *Creekmore* and *McCoy*, the One-Day-Late Rule precludes a bankruptcy discharge for tax liabilities on late-filed returns.

Other courts have taken a different approach to interpreting the “applicable filing requirements” language. In determining the definition of a “return” for bankruptcy purposes, these courts look to the substance of what is filed rather than when it is filed.<sup>21</sup> Therefore, a late-filed return could qualify as a return for purposes of obtaining a bankruptcy discharge.

A significant amount of case law emerged subsequent to the 2005 enactment of the new bankruptcy law that added the Hanging Paragraph. However, the legislative history accompanying the law does not explain or shed light on the congressional intent behind the “applicable filing requirements” language and whether it requires timely filing for a taxpayer to obtain a bankruptcy discharge of tax liabilities.

In 2010, the IRS Office of Chief Counsel issued a Notice regarding its litigating position on the bankruptcy dischargeability of tax liabilities reported on late-filed returns.<sup>22</sup> The Notice first discusses the case law before and after the addition of the Hanging Paragraph, then covers the court’s rationale in the *Creekmore* holding<sup>23</sup> and takes issue with reading a timely filing requirement into the “applicable filing requirements” language in the first sentence of the paragraph. Such a reading would make redundant the second sentence, providing that an IRC § 6020(b) return is not considered a return because this type of return (often referred to by the IRS as a substitute for return) is always prepared after the due date.

In addition, the Notice is critical of the *Creekmore* holding that timely filing of a return is required for a bankruptcy discharge because such a reading would essentially narrow the application of § 523(a)(1)(B)(ii), which excepts from discharge late-filed returns filed within two years of the bankruptcy petition filing (*i.e.*, allowing returns filed outside a two-year timeframe to be dischargeable), to the small number of returns prepared by the IRS under IRC § 6020(a).<sup>24</sup> Finally, the Notice points out that the *Creekmore* court’s “safe harbor” option under IRC § 6020(a) is “illusory,” as taxpayers do not have a right to demand that the IRS prepare a return for them under this provision and the IRS only does so in a “minute number of cases.”<sup>25</sup> The Notice therefore concludes that “section 523(a) in its totality does not create the rule that every late filed return is not a return for dischargeability purposes.”

20 Because *McCoy* dealt with the dischargeability of state tax liabilities, there was no possibility of a safe harbor under IRC § 6020(a). In the court’s view, the taxpayer needed a state law safe harbor provision similar to IRC § 6020 to be able to take advantage of a safe harbor.

21 See, e.g., *In re Gonzalez*, 506 B.R. 317 (1st Cir. B.A.P. 2014); *In re Martin*, 500 B.R. 1 (D. Colo. 2013); *In re Rhodes*, 498 B.R. 357 (Bankr. N.D. Ga. 2013).

22 Chief Counsel Notice 2010-16.

23 The Notice was issued prior to the *McCoy* decision and therefore does not discuss it. However, the Notice is discussed in the *McCoy* opinion.

24 See *In re Martin*, 482 B.R. 635, 639 (Bankr. D. Colo. 2012), *rev’d*, 500 B.R. 1 (D. Colo. 2013).

25 State-law provisions similar to IRC § 6020(a) are probably rare as well. This would call into question the “safe harbor” option recommended by the *McCoy* court.

## REASONS FOR CHANGE

Courts have reached conflicting conclusions as to whether the “applicable filing requirements” language in the Hanging Paragraph imposes a timely tax return filing requirement in order for individual taxpayers to obtain a bankruptcy discharge. Some courts interpret this language to impose a strict One-Day-Late Rule, preventing taxpayers who file a return even a day past the deadline, or who have reasonable cause for late filing, from obtaining a bankruptcy discharge for liabilities reported on the return.<sup>26</sup> Courts, such as *Creekmore* and *McCoy*, have insisted that the only way liabilities on a late-filed return can be discharged is if the return is prepared under IRC § 6020(a) or a similar provision under state or local law. However, as noted in the IRS Chief Counsel Notice, this “safe harbor” does not really exist as taxpayers have no right to demand that the IRS prepare a return for them under this provision and the IRS only rarely does so.<sup>27</sup> This narrow and strict interpretation of 11 U.S.C. § 523(a) may result in harsh outcomes that undermine the “fresh start” rationale behind bankruptcy discharge.<sup>28</sup> However, other courts (and the IRS Office of Chief Counsel) have taken the opposite approach—the “applicable filing requirements” language in the Hanging Paragraph does not require timely filing of a tax return to obtain a discharge.<sup>29</sup>

Forever barring the discharge of tax debts merely because the debtor files a return one date late seems unfair when considering how taxpayers who file late are treated under federal tax law. As noted earlier, while late filers can be subject to penalties, the penalties can be abated. In jurisdictions where tax debts cannot be discharged merely because the return was filed late, the consequences can be more financially severe. In other words, late-filing taxpayers may be punished more severely under bankruptcy law than under tax law.

Similarly, the One-Day-Late rule can have serious repercussions for previously compliant taxpayers who experience financial distress. In the example above, a taxpayer who otherwise meets the bankruptcy law requirements for discharge may not discharge a tax debt because she filed a return one day late.<sup>30</sup> This will hinder her from emerging from her financial predicament and undermine her fresh start.<sup>31</sup> In addition, under certain circumstances, individuals (such as those in disaster areas or military combat zones) may be

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<sup>26</sup> See, e.g., *In re McCoy*, 666 F.3d 924 (5th Cir. 2012), cert. denied, 133 S. Ct. 192 (2012); *In re Creekmore*, 401 B.R. 748 (Bankr. N.D. Miss. 2008). See also *In re Payne* 431 F.3d 1055, 1060 (7th Cir. 2005) (Judge Easterbrook dissenting) (after the BAPCPA, tax liability on a late-filed return is nondischargeable).

<sup>27</sup> While there are regulations under IRC § 6020, they focus on IRC § 6020(b) (including several examples) and only make brief mention of IRC § 6020(a). See Treas. Reg. § 301.6020-1. Similarly, the IRM only makes passing mention of IRC § 6020(a). See, e.g., IRM 4.12.1.8.2 (Oct. 05, 2010). However, there are more frequent and detailed IRM references and descriptions as to the preparation of returns under IRC § 6020(b). See, e.g., IRM 5.1.11.6.7.2 (Apr. 23, 2014).

<sup>28</sup> See *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (noting that the bankruptcy law “gives to the honest but unfortunate debtor...a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.”).

<sup>29</sup> See, e.g., *In re Gonzalez*, 506 B.R. 317 (1st Cir. B.A.P. 2014) (noting that the definition of return in the Hanging Paragraph appears to be focus on what is filed rather than when it is filed); *In re Martin*, 482 B.R. 635 (Bankr. D. Colo. 2012), rev'd, 500 B.R. 1 (D. Colo. 2013) (both the bankruptcy court and the district court rejected the timeliness requirement; they disagreed as to whether the taxpayer had made an honest and reasonable attempt to comply with the tax law).

<sup>30</sup> Because the IRS does not agree with the One-Day-Late Rule, this issue is limited at present to jurisdictions that follow the Fifth Circuit's holding in *McCoy*. However, it is possible that the IRS will change its litigation position in the future. In a significant recent development, the Tenth Circuit Court of Appeals agreed with the Fifth Circuit's *McCoy* decision and held that tax debts on late-filed federal returns are not dischargeable in bankruptcy. See *In re Mallo*, 2014 WL 7360130 (10th Cir. Dec. 29, 2014), aff'g 498 B.R. 268 (D. Colo. 2013).

<sup>31</sup> As a result, the taxpayer may have to request a currently-not-collectible (CNC) status from the IRS and deal with IRS collection function for an extended period of time, resulting in taxpayer frustration and the use of limited IRS resources to provide relief to a financially distressed taxpayer. See IRM 5.16.1 (Aug. 25, 2014).

permitted to file their returns late with no penalty.<sup>32</sup> However, these returns are still officially late and the taxpayers may not be able to obtain a bankruptcy discharge of tax liabilities in the future.

## EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that Congress clarify the meaning of the Hanging Paragraph language in § 523(a) of the Bankruptcy Code to provide that a late-filed tax return may be considered a return for bankruptcy discharge purposes. This would clear up judicial confusion over the 2005 law and indicate whether the “applicable filing requirements” language in the first sentence of the Hanging Paragraph imposes a timely filing requirement. It would also eliminate disparate treatment of taxpayers under the Bankruptcy Code.

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<sup>32</sup> See IRC §§ 7508, 7508A; Rev. Rul. 2007-59, 2007-2 C.B. 582 (providing that special late filing rules for those in military combat zones or disaster areas do not change the filing due date and only waive penalties).

## MOST LITIGATED ISSUES: Introduction

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(X) requires the National Taxpayer Advocate to identify in her Annual Report to Congress (ARC) the ten tax issues most litigated in federal courts (Most Litigated Issues).<sup>1</sup> The National Taxpayer Advocate may analyze these issues to develop recommendations to mitigate the disputes resulting in litigation.

The Taxpayer Advocate Service (TAS) identified the Most Litigated Issues from June 1, 2013, through May 31, 2014, by using commercial legal research databases. For purposes of this section of the Annual Report, the term “litigated” means cases in which the court issued an opinion.<sup>2</sup> This year’s Most Litigated Issues are:

- Accuracy-related penalty (IRC § 6662(b)(1) (2), and (3));<sup>3</sup>
- Trade or business expenses (IRC § 162(a) and related Code sections);
- Summons enforcement (IRC §§ 7602(a), 7604(a), and 7609(a));
- Gross income (IRC § 61 and related Code sections);
- Collection due process (CDP) hearings (IRC §§ 6320 and 6330);
- Failure to file penalty (IRC § 6651(a)(1)), failure to pay penalty (IRC § 6651(a)(2)), and failure to pay estimated tax penalty (IRC § 6654);
- Civil actions to enforce federal tax liens or to subject property to payment of tax (IRC § 7403);
- Frivolous issues penalty (IRC § 6673 and related appellate-level sanctions);
- Charitable deductions (IRC §170); and
- Passive activity losses and credits (IRC § 469).<sup>4</sup>

All of these issues were identified as Most Litigated Issues last year, with the exception of passive activity losses and credits.<sup>5</sup> Accuracy-related penalties remained the top issue this year, although we identified 25 fewer cases.<sup>6</sup> The number of CDP cases decreased significantly this year with 105 cases in 2013, and only

<sup>1</sup> Federal tax cases are tried in the United States Tax Court, United States District Courts, the United States Court of Federal Claims, United States Bankruptcy Courts, United States Courts of Appeals, and the United States Supreme Court.

<sup>2</sup> Many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers’ cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Additionally, courts can issue less formal “bench opinions,” which are not published or precedential.

<sup>3</sup> IRC § 6662 also includes (b)(4), (5), (6), and (7), but because those types of accuracy-related penalties were not heavily litigated, we have only analyzed (b)(1), (2), and (3).

<sup>4</sup> This year we identified cases under IRC §§ 7402, 7407, and 7408 which involve injunctions against tax return preparers. While there was a high number of cases, most of the cases were conceded or not decided on the merits. Therefore, we have not included this issue in the top ten this year. However, the frequency of this issue underscores the need for regulation of tax return preparers, which the National Taxpayer Advocate has continuously recommended. See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 61 (Most Serious Problem: *Regulation of Return Preparers*); National Taxpayer Advocate 2008 Annual Report to Congress 423 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270 (Legislative Recommendation: *Federal Tax Return Preparers Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

<sup>5</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 322.

<sup>6</sup> See *id.* at 339.

76 in 2014.<sup>7</sup> Cases involving failure to pay and failure to file penalties saw the largest decrease of about 35 percent with 86 cases in 2013, and only 56 in 2014.<sup>8</sup>

Once TAS identified the Most Litigated Issues, it analyzed each one in four sections: summary of findings, description of present law, analysis of the litigated cases, and conclusion. Each case is listed in Appendix III, which categorizes the cases by type of taxpayer (*i.e.*, individual or business).<sup>9</sup> Appendix III also provides the citation for each case, indicates whether the taxpayer was represented at trial or argued the case *pro se* (*i.e.*, without representation), and lists the court's decision.<sup>10</sup>

We have also included a "Significant Cases" section summarizing decisions that are not among the top ten issues but are relevant to tax administration.<sup>11</sup> This year, the Significant Cases discussion includes three decisions issued by the Supreme Court that impact tax administration issues.<sup>12</sup>

## AN OVERVIEW OF HOW TAX ISSUES ARE LITIGATED

Initially, taxpayers can generally litigate a tax matter in four different types of courts:

- The United States Tax Court;
- United States District Courts;
- The United States Court of Federal Claims; and
- United States Bankruptcy Courts.

With limited exceptions, taxpayers have an automatic right of appeal from decisions of any of these courts.<sup>13</sup>

The Tax Court is a "prepayment" forum. In other words, taxpayers can access the Tax Court without having to pay the disputed tax in advance. The Tax Court has jurisdiction over a variety of issues, including

7 National Taxpayer Advocate 2013 Annual Report to Congress 371.

8 See *id.* at 384.

9 Individuals filing Schedules C, E, or F are deemed business taxpayers for purposes of this discussion even if items reported on such schedules were not the subject of litigation.

10 "Pro se" means "for oneself; on one's own behalf; without a lawyer." *Black's Law Dictionary* (10th ed. 2014), available at Westlaw BLACKS. For purposes of this analysis, we considered the court's decision with respect to the issue analyzed only. A "split" decision is defined as a partial allowance on the specific issue analyzed. The citations also indicate whether decisions were on appeal at the time this report went to print.

11 Two of the cases discussed in the "Significant Cases" section of this report were decided outside the June 1, 2013, through May 31, 2014, period used to identify the ten most litigated issues, but we nonetheless have included these cases because of their impact on tax administration.

12 *United States v. Clarke*, 134 S. Ct. 2361 (2014), vacating and remanding 517 F. App'x 689 (11th Cir. 2013), vacating and remanding 2012-2 U.S.T.C. (CCH) ¶ 50,732 (S.D. Fla. 2012), on remand, 573 F. App'x. 826 (2014); *United States v. Quality Stores, Inc.*, 134 S. Ct. 1395 (2014), rev'g 693 F.3d 605 (6th Cir. 2012), aff'g 424 B.R. 237 (W.D. Mich. 2010), aff'g 383 B.R. 67 (Bankr. W.D. Mich. 2008); *United States v. Woods*, 134 S. Ct. 557 (2013), rev'g 471 F. App'x 320 (5th Cir. 2012), aff'g 794 F. Supp. 2d 714 (W.D. Tex. 2011).

13 See IRC § 7482, which provides that the United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) have jurisdiction to review the decisions of the Tax Court. There are exceptions to this general rule. For example, IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals \$50,000 or less) for which appellate review is not available. See also 28 U.S.C. § 1294 (appeals from a United States District Court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court). See also *Byers v. Comm'r*, 740 F. 3d 668 (D.C. 2014), cert. denied, 83 U.S.L.W. 3189 (U.S. Oct. 6, 2014) (No. 14-74) (the D.C. Circuit will not transfer cases to another circuit in non-liability CDP cases unless both parties stipulate to transfer the case).

deficiencies, certain declaratory judgment actions, appeals from collection due process hearings, relief from joint and several liability, and determination of employment status.<sup>14</sup>

The United States District Courts and the United States Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full,<sup>15</sup> and (2) the taxpayer has filed an administrative claim for refund.<sup>16</sup> The United States District Courts, along with the bankruptcy courts in very limited circumstances, provide the only fora in which a taxpayer can receive a jury trial.<sup>17</sup> Bankruptcy courts can adjudicate tax matters that were not adjudicated prior to the initiation of a bankruptcy case.<sup>18</sup>

## ANALYSIS OF *PRO SE* LITIGATION

As in previous years, many taxpayers appeared before the courts *pro se*. Figure 3.0.1 lists the Most Litigated Issues for the review period of June 1, 2013, through May 31, 2014, and identifies the number of cases, broken down by issue, in which taxpayers appeared without representation. As the table illustrates, the issues with the highest rates of *pro se* appearance are failure to file, failure to pay, and estimated tax penalties and the frivolous issues penalty.

**FIGURE 3.0.1. *Pro se* cases by issue**

Most Litigated Issue	Litigated Cases Reviewed	Pro Se Litigation	% of Cases Involving Pro Se Taxpayers
Accuracy-Related Penalty	153	81	53%
Trade or Business Expenses	115	74	64%
Summons Enforcement	102	70	69%
Gross Income	89	55	62%
Collection Due Process	76	48	63%
Failure to File, Failure to Pay, and Estimated Tax Penalties	56	41	73%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	52	26	50%
Frivolous Issues Penalty (and analogous appellate-level sanctions)	30	28	93%
Charitable Deductions	30	13	43%
Passive Activity Losses and Credits	28	17	61%
<b>Total</b>	<b>731</b>	<b>453</b>	<b>62%</b>

14 IRC §§ 6214; 7476-7479; 6330(d); 6015(e); 7436.

15 28 U.S.C. § 1346(a)(1). See *Flora v. United States*, 362 U.S. 145 (1960), *reh'g denied*, 362 U.S. 972 (1960).

16 IRC § 7422(a).

17 The bankruptcy court may only conduct a jury trial if the right to a trial by jury applies, all parties expressly consent, and the district court specifically designates the bankruptcy judge to exercise such jurisdiction. 28 U.S.C. § 157(e).

18 See 11 U.S.C. § 505(a)(1) and (a)(2)(A).

Figure 3.0.2 affirms our contention that overall, taxpayers are more likely to prevail if they are represented.

**FIGURE 3.0.2. Outcomes for *pro se* and represented taxpayers**

Most Litigated Issue	Pro Se Taxpayers			Represented Taxpayers		
	Total Cases	Taxpayer prevailed in whole or in part	Percent	Total Cases	Taxpayer prevailed in whole or in part	Percent
Accuracy-Related Penalty	81	11	14%	72	23	32%
Trade or Business Expenses	74	17	23%	41	11	27%
Summons Enforcement	70	0	0%	32	5	16%
Gross Income	55	4	7%	34	12	35%
Collection Due Process	48	2	4%	28	6	21%
Failure to File, Failure to Pay, and Estimated Tax Penalties	41	4	10%	15	3	20%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	26	2	8%	26	3	12%
Frivolous Issues Penalty (and analogous appellate-level sanctions)	28	4	14%	2	1	50%
Charitable Contributions	13	2	15%	17	3	18%
Passive Activity Losses and Credits	17	1	6%	11	4	36%
<b>Total</b>	<b>453</b>	<b>47</b>	<b>10%</b>	<b>278</b>	<b>71</b>	<b>26%</b>

## Significant Cases

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.<sup>1</sup> These decisions are summarized below.

**In *United States v. Clarke*, the Supreme Court held that to obtain a hearing concerning whether an IRS summons was issued for an improper purpose, a taxpayer must produce circumstantial evidence that plausibly raises an inference of bad faith.<sup>2</sup>**

In 2010, the IRS examined returns filed by Dynamo Holdings Limited Partnership (Dynamo) for tax years 2005-2007. In August 2010, the revenue agent signed, but did not mail, a notice of Final Partnership Administrative Adjustment (FPAA).<sup>3</sup> In September and October 2010, immediately following Dynamo's refusal to extend the statute of limitations on assessment, the agent issued summonses to various parties, including Mr. Clarke, the chief financial officer for both Dynamo and Beekman Vista, Inc. (Beekman).<sup>4</sup> In December 2010, the IRS mailed the FPAA to Dynamo.

In February 2011, Dynamo filed suit in the Tax Court to challenge the adjustments reflected in the FPAA. In April 2011, the government sought to enforce the summons in the District Court for the Southern District of Florida so that it could use the information in the case pending before the Tax Court.<sup>5</sup>

By way of background, a district court will enforce a summons under Internal Revenue Code (IRC) § 7604 if the IRS demonstrates it issued the summons for a legitimate purpose, seeks information relevant to that purpose, which the IRS does not possess, and that it followed the administrative steps required by the Code.<sup>6</sup> In a typical case, the IRS satisfies these requirements by producing a sworn affidavit from the investigating agent, which then shifts the burden to the person resisting the summons to raise a "substantial question" as to whether the summons is an abuse of process.<sup>7</sup> If he meets this burden, then an "adversary hearing" is granted at which he may "challenge the summons on any appropriate ground."<sup>8</sup>

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- 1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2013, and ending on May 31, 2014. For purposes of this section, we generally used the same period, except that we discuss one Supreme Court case decided shortly thereafter and another case that was reversed on appeal after this discussion had been drafted.
  - 2 *United States v. Clarke*, 134 S. Ct. 2361 (2014) [hereinafter *Clarke III*], vacating and remanding 517 F. App'x 689 (11th Cir. 2013) [hereinafter *Clarke II*], vacating and remanding 2012-2 U.S.T.C. (CCH) ¶ 50,732 (S.D. Fla. 2012) [hereinafter *Clarke I*], on remand, 573 F. App'x. 826 (2014) [hereinafter *Clarke IV*].
  - 3 Brief for Respondents at 3, *Clarke III* (No. 13-301). While summons is one of the ten most litigated issues covered elsewhere in this report, we are including a discussion of *Clarke* in this section because it is a decision of the Supreme Court that was decided outside of the reporting period. For a discussion of other notable summons cases, see Most Litigated Issue: *Summons Enforcement, infra*.
  - 4 In issuing the summons after signing the FPAA, Mr. Clarke suggests that the agent did not follow the reasoning of Internal Revenue Manual (IRM) 25.5.4.4.8, which states that once a taxpayer's liability has been finally determined, "the examination has been concluded," and "[t]he Service should no longer be in the process of gathering the data to support a determination." Brief for Respondents at 4, *Clarke III* (No. 13-301). However, the IRM only instructs agents not to issue a summons "after a Statutory Notice of Deficiency (SND) is mailed to the taxpayer." IRM 25.5.4.4.8(3) (Oct. 4, 2006) (emphasis added).
  - 5 Transcript of Oral Argument at 52, *Clarke III* (No. 13-301).
  - 6 *United States v. Powell*, 379 U.S. 48, 57-58 (1964).
  - 7 See, e.g., *United States v. Lawn Builders of New England, Inc.*, 856 F.2d 388, 392 (1st Cir. 1988). The IRS presented such an affidavit in this case. *Clarke I* at \*5. Although Mr. Clarke alleged the agent's declaration was unsworn, the district court characterized this allegation as "baseless." *Id.*
  - 8 *Powell*, 379 U.S. at 58.

However, challenging a summons generally extends the statute of limitations in IRC § 6501 (assessment and collection) and IRC § 6531 (criminal prosecutions).<sup>9</sup>

In this case, Mr. Clarke sought a pre-enforcement hearing and discovery to challenge the summonses, alleging among other things that the IRS issued the summons (1) in retaliation for Dynamo's refusal to extend the period of limitations, (2) to examine another taxpayer (Beekman), and (3) to circumvent the Tax Court's discovery process.<sup>10</sup>

The district court denied Mr. Clarke's request for a hearing and ordered the summons enforced. It observed that events occurring after issuance of the summons (*e.g.*, a Tax Court proceeding) are irrelevant to its validity. It explained that the possibility the summons might enable the IRS to obtain information about Beekman would not render it unenforceable. It also concluded that a hearing was not required based on Mr. Clarke's "mere allegation" of improper purpose to retaliate.<sup>11</sup>

On appeal, the U.S. Court of Appeals for the Eleventh Circuit vacated and remanded the case, holding that the district court abused its discretion in denying a hearing at which Mr. Clarke could question the IRS examining agent about his motives for issuing the summons (though the court declined to authorize discovery). The court reasoned that Mr. Clarke's allegations of retaliation, if true, would make enforcement of the summons improper. It stated that "requiring the taxpayer to provide factual support for an allegation of improper purpose, without giving the taxpayer a meaningful opportunity to obtain such facts, saddles the taxpayer with an unreasonable circular burden, creating an impermissible 'Catch 22.'"<sup>12</sup>

The Supreme Court vacated the judgment of the Court of Appeals and remanded the case, concluding that the taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons only when the taxpayer can point to specific facts or circumstances that plausibly raise an inference of bad faith. Naked allegations of improper purpose are not enough, but circumstantial evidence can suffice to meet that burden. The Court stated that the U.S. Court of Appeals for the Eleventh Circuit had concluded a naked allegation of bad faith was sufficient. It had not evaluated whether the affidavits presented in the case were sufficient to raise a plausible inference of bad faith. However, the Supreme Court expressly avoided deciding whether using a summons to retaliate for a taxpayer's refusal to extend the statute of limitations or to circumvent the Tax Court's rules of discovery were improper purposes.

This case is significant because it clarifies that a taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons if the taxpayer presents circumstantial evidence that plausibly raises an inference of bad faith. However, it is still not clear how this standard will be applied.<sup>13</sup> Mr. Clarke could be deemed to have satisfied the standard on remand. If the IRS is concerned that such

<sup>9</sup> In general, these limitations periods are tolled if the taxpayer with respect to whose liability the summons is issued, or an agent, nominee, or other person acting under the direction or control of the taxpayer, takes any action to intervene or quash the summons or if the summons remains unresolved for six months. See generally IRC § 7609(e); Treas. Reg. § 301.7609-5.

<sup>10</sup> For example, a summons can compel a taxpayer to submit to a deposition that he or she might not be required to provide in litigation before the Tax Court. See TAX CT. R. 70(a) ("Discovery is not available under these Rules through depositions except to the limited extent provided in Rule 74.") and TAX CT. R. 74(c)(1)(B) (treating non-consensual depositions as "an extraordinary method of discovery").

<sup>11</sup> *Clarke I* at \*10.

<sup>12</sup> *Clarke II* at 691.

<sup>13</sup> On remand, the U.S. Court of Appeals for the Eleventh Circuit remanded the case to the district court without providing more specific direction. See *Clarke IV*.

hearings could delay cases, it could take steps to avoid the appearance that summonses have been issued for an improper purpose, and thus reduce requests for hearings.<sup>14</sup>

**In *United States v. Woods*, the Supreme Court held the 40 percent gross valuation misstatement penalty applied to partners who claimed outside basis in a partnership deemed a sham.<sup>15</sup>**

Mr. Woods formed several partnerships to implement a tax shelter. After the IRS audited the partnerships' tax returns, it disregarded the partnerships as "shams" because they lacked "economic substance." Therefore, the IRS disallowed losses attributable to outside basis in the partnerships that Mr. Woods had claimed.

The 40 percent gross valuation misstatement penalty applies to the portion of any underpayment on a return that is "attributable to... the value of any property (or the adjusted basis of any property) claimed" that exceeds a threshold amount.<sup>16</sup> When an asset's true value or adjusted basis is zero, "[t]he value or adjusted basis claimed ... is considered to" exceed the gross valuation misstatement threshold.<sup>17</sup> Accordingly, the IRS determined that Mr. Woods was subject to the gross valuation misstatement penalty for claiming outside basis in the partnerships.<sup>18</sup>

The U.S. District Court for the Western District of Texas held that the partnerships were properly disregarded as shams but that the valuation misstatement penalty did not apply to the partners.<sup>19</sup> The court explained that when the IRS totally disallows a deduction, it may not penalize the taxpayer for a valuation overstatement included in that deduction. The underpayment is attributable to the improper deduction, rather than a valuation overstatement.<sup>20</sup> Accordingly, the court applied the 20 percent penalty for negligence instead of the 40 percent gross valuation misstatement penalty. The U.S. Court of Appeals for the Fifth Circuit affirmed,<sup>21</sup> but the Supreme Court reversed.

First, the Supreme Court addressed jurisdictional issues. Under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA),<sup>22</sup> a court in a partnership-level proceeding has jurisdiction to determine

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14 For example, the IRS could audit returns more promptly so that summonses are less likely to coincide with a taxpayer's refusal to extend the statute of limitations on assessment. Moreover, Congress has expressed a policy preference for prompt adjustments by enacting IRC § 6404(g), which suspends interest and penalties against individuals if the IRS does not timely provide the taxpayer with a notice specifically stating the amount of any increased liability and the basis for that liability, as further discussed below. See *Corbalis v. Comm'r*, *infra*. Improving the timeliness of any assessments may also reduce the need for the IRS to enforce summonses when a case is docketed in the Tax Court. In addition, the IRS could rely on the discovery process, rather than enforcement of previously issued administrative summonses, when cases are docketed in the Tax Court. As noted above, it is unclear if these alleged purposes would be improper. In any event, the IRS should avoid any appearance of impropriety.

15 *United States v. Woods*, 134 S. Ct. 557 (2013), rev'd 471 F. App'x 320 (5th Cir. 2012), aff'd 794 F. Supp. 2d 714 (W.D. Tex. 2011).

16 IRC §§ 6662(b), 6662(e)(1)(A), and 6662(h)(1).

17 Treas. Reg. § 1.6662-5(g).

18 IRC § 6662(h); Treas. Reg. § 1.6662-5(g). For transactions entered into after March 30, 2010, a 40 percent penalty also applies to transactions that lack economic substance, potentially reducing the importance of determining whether an amount was disallowed on the basis of a gross valuation misstatement or a lack of economic substance. See Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409, 124 Stat. 1029, 1067-1070 (2010) (codified at IRC §§ 7701(o), 6662(b)(6), 6662(i), and 6676(c) and applicable to transactions entered into after March 30, 2010, the date of enactment).

19 *Woods*, 794 F. Supp. 2d at 717.

20 *Id.* at 717-19.

21 *Woods*, 471 F. App'x at 320.

22 Pub. L. No. 97-248, Title IV, 96 Stat. 648 (1982) (codified at IRC §§ 6221-6232).

partnership items and “the applicability of any penalty … which relates to an adjustment to a partnership item.”<sup>23</sup> The court reasoned that the partner-level gross valuation misstatement penalty “relates to” the determination that the partnerships are shams because the trigger for the partners’ valuation overstatement calculation is the conclusion that a sham partnership has zero basis. Thus, it held that the district court had jurisdiction to determine if the penalty could apply to the partners.

The Supreme Court rejected Mr. Woods’s argument that a penalty cannot “relate to” a partnership-item adjustment if it requires a partner-level determination, such as a determination of the partner’s outside basis. The Court observed that several statutory provisions assume a penalty can relate to a partnership-item adjustment even if the IRS must make partner-level determinations before it may impose the penalty.<sup>24</sup> Thus, it concluded that TEFRA authorizes courts in partnership-level proceedings to determine that a penalty could result from an adjustment to a partnership item, even if actually imposing the penalty may also require other partner-level determinations.<sup>25</sup>

Finally, the Supreme Court held that the gross valuation misstatement penalty provisionally applied to the partners. It rejected the Fifth Circuit’s premise that the total disallowance of a deduction is inconsistent with the gross valuation misstatement penalty. It also rejected the taxpayer’s argument that the valuation misstatement penalty applies only to factual misrepresentations about an asset’s worth or cost, not to misrepresentations that rest on legal errors (like the use of a sham partnership).<sup>26</sup> According to the Supreme Court, the statute references both “value” and “adjusted basis,” and “adjusted basis” is a legal term. Thus, both factual and legal errors may trigger the penalty.<sup>27</sup>

This case is significant because it abrogates precedent that made it difficult for the IRS to impose the 40 percent gross valuation misstatement penalty in TEFRA cases involving sham partnerships.<sup>28</sup> Following this decision, if a court in a partnership proceeding makes a “provisional” determination that a penalty applies to the partners, the IRS could then assess the penalty without issuing a deficiency notice. If it did,

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23 IRC § 6226(f).

24 See IRC § 6664(c)(1) (requiring omissions from income to be “substantial” enough in comparison to a person’s overall income to trigger certain penalties); IRC § 6230(a)(2)(A)(i) (requiring the IRS to use deficiency proceedings for computational adjustments that rest on “affected items which require partner level determinations (other than penalties … that relate to adjustments to partnership items.”); IRC § 6230(c)(4) (stating that while a partnership-level determination “concerning the applicability of any penalty … which relates to an adjustment to a partnership item” is “conclusive” in a subsequent refund action, that does not prevent the partner from “assert[ing] any partner level defenses that may apply.”).

25 For example, the IRS would have to adjust each partner’s outside basis before it could impose the gross valuation misstatement penalty based on an outside basis overstatement. Moreover, each partner would remain free to raise, in subsequent, partner-level proceedings, reasons why the penalty should not be imposed on him or her specifically.

26 Woods, 134 S. Ct. at 566.

27 Because the Court based its decision on statutory language, it did not analyze legislative history. Moreover, it commented that the Joint Committee on Taxation’s General Explanation (i.e., the Blue Book) has the same weight as a law review article—relevant only to the extent persuasive. Woods, 134 S. Ct. at 568.

28 For prior coverage of these issues, see, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 574–76, which discussed *Belmont and Tigers Eye Trading, LLC v. Comm'r*, 138 T.C. 67 (2012). In *Belmont*, the U.S. Court of Appeals for the Fifth Circuit held that the 40 percent gross valuation misstatement penalty did not apply because the IRS totally disallowed the loss. *Belmont Invs., LLC v. United States*, 679 F.3d 339, 347–48 (5th Cir. 2012). In *Tigers Eye*, the U.S. Tax Court held that it had jurisdiction to determine the partners’ outside bases and accuracy-related penalties in a partnership-level proceeding, notwithstanding a seemingly contrary holding by the court to which an appeal would lie (a holding by the Court of Appeals for the D.C. Circuit in *Petaluma FX Partners, LLC v. Comm'r*, 591 F.3d 649 (D.C. Cir. 2010)). *Tigers Eye*, 138 T.C. at 132. As noted in the 2012 report, *Petaluma* was in accord with *Jade Trading, LLC v. United States*, 598 F.3d 1372 (Fed. Cir. 2010). *Belmont*, *Petaluma*, and *Jade* are all abrogated by *Woods*.

then the partners could not contest the penalty in court—or the IRS’s determination (if any) concerning partner-level defenses—without first paying it.<sup>29</sup>

**In *United States v. Quality Stores, Inc.*, the Supreme Court held that supplemental unemployment benefit (SUB) payments to involuntarily terminated employees were subject to Federal Insurance Contributions Act (FICA) taxes.<sup>30</sup>**

In connection with its bankruptcy, Quality Stores made severance payments to employees who were involuntarily terminated, as required by its supplemental unemployment benefit (SUB) plans. It treated the payments as wages on Forms W-2, and withheld and paid employment taxes on them. Quality Stores and some of its employees sought a refund of the FICA tax, arguing that the payments were not “wages” within the meaning of IRC § 3121(a), but rather SUB payments that were not taxable under FICA.

By way of background, for SUB plans to supplement (rather than supplant) state unemployment benefits, it may be necessary to avoid having the SUB payments defined as “wages.” Some states only provide unemployment benefits if terminated employees are not earning wages from their employers. If the payments are not wages for purposes of federal income tax (FIT) withholding, however, terminated employees could face significant tax liability at the end of the year because SUB payments are still taxable as income. In the IRS’s view, only certain SUB payments that are coordinated with state unemployment benefits—not those at issue—are excluded from wages under FICA, as described in a series of revenue rulings.<sup>31</sup>

In this case, Quality Stores petitioned the bankruptcy court to obtain a refund. The bankruptcy court agreed with Quality Stores, as did the district court, and the United States Court of Appeals for the Sixth Circuit, concluding that the severance payments were not wages for purposes of either FICA or FIT.<sup>32</sup>

According to the Court of Appeals for the Sixth Circuit, IRC § 3402(o) states that a severance payment is “treated as if it were a payment of wages,” and by implication, not actually wages.<sup>33</sup> It reasoned that Congress allowed SUB payments (*i.e.*, a type of severance) to be treated as wages under IRC § 3402(o) to facilitate FIT withholding for taxpayers. Thus, the court held that SUB payments were not wages.

The Supreme Court disagreed, concluding that the severance payments at issue were wages under a plain reading of the statute.<sup>34</sup> It reasoned that severance payments, like traditional wages, varied based on factors such as length of service, function, and seniority. Moreover, it observed that during a brief period Congress had specifically exempted certain severance payments from the definition of wages.<sup>35</sup> If severance payments were not wages, then repeal of that exemption would have been superfluous.

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29 IRC § 6230(a).

30 *United States v. Quality Stores, Inc.*, 134 S. Ct. 1395 (2014), rev’d 693 F.3d 605 (6th Cir. 2012), aff’g 424 B.R. 237 (W.D. Mich. 2010), aff’g 383 B.R. 67 (Bankr. W.D. Mich. 2008).

31 *Quality Stores*, 693 F.3d at 619. See, e.g., Rev. Rul. 56-249, 1956-1 C.B. 488 and Rev. Rul. 90-72, 1990-2 C.B. 211 (providing an exception for a stream of payments coordinated with the receipt of unemployment compensation, but not for a lump-sum payment).

32 According to the Court of Appeals for the Sixth Circuit, Congress adopted a definition of “wages” for FIT purposes that is nearly identical to the definition of “wages” included in FICA. *Quality Stores*, 693 F.3d at 613 (citing *Rowan Cos. v. United States*, 452 U.S. 247, 255-57 (1981)).

33 As noted above, if the SUB payments were actually wages, then some employees might lose the very state unemployment benefits that the SUB payments were intended to supplement. *Id.* at 617.

34 *Quality Stores*, 134 S. Ct. at 1399-1400.

35 *Id.* at 1401 (citing Social Security Act Amendments of 1939, 53 Stat. 1384, which Congress repealed in 1950).

Next, the Court rejected the argument that if severance payments were wages, then IRC § 3402(o)'s<sup>36</sup> directive to treat them "as if" wages would be superfluous. It reasoned that when Congress enacted IRC § 3402(o), it was aware that only some severance payments were treated as wages pursuant to IRS rulings, but sought to treat all severance payments as wages to prevent workers from facing large tax liabilities at the end of the year. In other words, to the extent IRC § 3402(o) suggests that some severance payments might be excluded from wages (*i.e.*, certain SUB payments coordinated with state unemployment benefits) it does not suggest that all severance payments are excluded.<sup>37</sup>

Finally, the Court reaffirmed "that the meaning of 'wages' should be in general the same for income-tax withholding and for FICA calculations."<sup>38</sup> However, it expressly declined to address the validity of current IRS rulings that exempt from the FICA wage base SUB payments that are coordinated with state unemployment benefits because such payments were not at issue.<sup>39</sup>

This case is significant because it clarifies that severance payments (including SUB payments) that are not coordinated with state unemployment benefits are wages for both FIT and FICA purposes. It is also significant because it leaves unanswered questions about the validity of the IRS's conclusion, set forth in Revenue Rulings 56-249 and 90-72, that SUB payments that are coordinated with state unemployment benefits are not subject to FICA. Moreover, it is unclear if states will seek to use the Supreme Court's holding—that SUB payments are wages—to reduce unemployment benefits to workers eligible for SUB payments.

**In *Loving v. Internal Revenue Service*, the United States Court of Appeals for the District of Columbia Circuit held that the Treasury Department lacked authority to regulate the conduct of registered tax return preparers.<sup>40</sup>**

In June 2011, the Treasury Department issued regulations governing "registered tax return preparers," a previously unregulated group of 600,000 to 700,000 paid preparers.<sup>41</sup> It issued them pursuant to 31 U.S.C. § 330(a)(1), which grants the Secretary of the Treasury authority to "regulate the practice of representatives of persons before the Department of the Treasury." Sabina Loving and two other preparers challenged the regulations as unauthorized. The District Court for the District of Columbia agreed, and the U.S. Court of Appeals for the District of Columbia Circuit affirmed.<sup>42</sup>

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36 In relevant portion, the statute states that "any supplemental unemployment compensation benefit paid to an individual ... shall be treated as if it were a payment of wages." IRC § 3402(o).

37 By analogy, "[T]he statement that 'all men shall be treated as if they were six feet tall does not imply that no men are six feet tall." *Quality Stores*, 134 S. Ct. at 1402 (quoting *CSX Corp. v. United States*, 518 F.3d 1328, 1342 (Fed. Cir. 2008)).

38 *Quality Stores*, 134 S. Ct. at 1405.

39 *Id.*

40 *Loving v. Comm'r*, 742 F.3d 1013 (D.C. Cir. 2014), aff'd 920 F. Supp. 2d 108 (D.D.C. 2013).

41 See T.D. 9527, 76 Fed. Reg. 32,286, 32,299 (June 3, 2011). They are sometimes called "unenrolled" preparers. See 26 C.F.R. § 601.502(b)(5)(ii); Rev. Proc. 81-38, 1981-2 C.B. 592, modified and superseded by Rev. Proc. 2014-42, 2014-29 I.R.B. 192 for tax returns and claims for refund prepared and signed (or prepared if there is no signature space on the form) after December 31, 2015. Attorneys, certified public accountants, enrolled agents and enrolled actuaries are already subject to IRS regulation under Circular 230. The National Taxpayer Advocate has long championed the regulation of return preparers. See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 423 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*); National Taxpayer Advocate 2004 Annual Report to Congress 67 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270 (Legislative Recommendation: *Federal Tax Return Preparers Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

42 For a discussion of the district court decision, see National Taxpayer Advocate 2013 Annual Report to Congress 334-336 (Significant Cases); National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers*). See also Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 139 Tax Notes 767 (2013).

Agency regulations are generally given *Chevron* deference and upheld unless they (1) contradict the unambiguously stated intent of Congress or (2) adopt an unreasonable construction of an ambiguous statute.<sup>43</sup> The IRS argued that the terms “practice” and “representative” were ambiguous and that it reasonably interpreted them as covering tax return preparers. Thus, the court should give the agency *Chevron* deference.

The court disagreed, concluding that the statute unambiguously fails to authorize the government to regulate tax return preparers making the regulations inconsistent with congressional intent – failing the first prong of *Chevron*. It went on to conclude that even if the statute was ambiguous, the regulations were unreasonable in light of the statute’s text, history, structure, and context – failing the second prong.

First, the court reasoned that the term “representative” is commonly defined as an agent authorized to act for someone else. However, a preparer is not necessarily authorized to act for the taxpayer unless he or she obtains a power of attorney. Thus, a preparer is not necessarily a “representative.”

Second, the court observed that the statute references “practice … before the Department.” It reasoned that unlike practicing in the abstract, practice “before” an agency generally refers to an adversarial proceeding. Although commentators had argued that filing a return constitutes presenting a case before the agency, the IRS did not make that argument.<sup>44</sup> Rather, the IRS argued that the statutory language in 31 U.S.C. § 330(a)(2), which authorizes it to consider a person’s competency to “assist persons in presenting cases,” was irrelevant in determining the meaning of “practice” because Congress meant to use the disjunctive “or” rather than the conjunctive “and” in connecting the list of attributes a person must have before being admitted as a “representative to practice.”<sup>45</sup>

The court found the IRS’s argument unpersuasive and inconsistent with the original statutory language enacted in 1884 and re-codified in 1982 “without substantive change.”<sup>46</sup> It covered “agents, attorneys, or other persons representing claimants before … [the Treasury]” and authorized the Treasury to require them to be competent to “assist such claimants in the presentation of their cases,” presumably cases presented in an adversarial proceeding.<sup>47</sup> The court also noted that subsequent Congresses had enacted many specific penalties targeting specific misconduct by tax return preparers with specific sanctions – sanctions that would have been unnecessary if the IRS was already authorized to penalize preparers for the same conduct.<sup>48</sup> Thus, the court concluded that preparers do not necessarily “practice … before the Department,” within the meaning of the statute.

As further support, the court cited the *Brown & Williamson* principle “that courts should not lightly presume congressional intent to implicitly delegate decisions of major economic or political significance.”<sup>49</sup> Finally, it cited the IRS’s past approach to the statute—the IRS never suggested that it possessed this

<sup>43</sup> *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

<sup>44</sup> See, e.g., Nina E. Olson, *More Than a ‘Mere’ Preparer: Loving and Return Preparation*, 139 TAX NOTES 767 (2013); Lawrence B. Gibbs, *Loving v. IRS: Treasury’s Authority to Regulate Tax Return Preparers*, 141 TAX NOTES 331 (2013).

<sup>45</sup> *Loving*, 742 F.3d at 1018-19.

<sup>46</sup> Act of Sept. 13, 1982, Pub. L. No. 97-258, 96 Stat. 877 (1982).

<sup>47</sup> Act of July 7, 1884, ch. 334, sec. 3, 23 Stat. 258 (1884).

<sup>48</sup> *Loving*, 742 F.3d at 1020. The court did not comment on the fact that the IRS did not have authority to impose a monetary penalty until 2004. See American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 822(a)(1), (b), 118 Stat. 1418, 1586-87 (2004).

<sup>49</sup> *Loving*, 742 F.3d at 1021 (citing *F.D.A. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 160 (2000)).

authority before.<sup>50</sup> Accordingly, the court held that the Treasury Department lacked statutory authority to issue and enforce the regulations governing registered tax return preparers.

This case is significant because it affects hundreds of thousands of return preparers and the taxpayers they serve.<sup>51</sup> As a result of this litigation, the Treasury Department and the IRS have established an Annual Filing Season Program designed to encourage tax return preparers who are not attorneys, certified public accountants, or enrolled agents to improve their knowledge of tax law and to protect taxpayers from preparer errors.<sup>52</sup> On July 15, 2014, the American Institute of Certified Public Accountants (AICPA) filed suit in the U.S. District Court for the District of Columbia, challenging this new voluntary program.<sup>53</sup> The proliferation of litigation regarding the IRS's authority to regulate tax return preparers is an indication that Congress should take action.<sup>54</sup>

**In *Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund*, the United States Court of Appeals for the First Circuit held that a private equity firm was engaged in a “trade or business” for purposes of the Employee Retirement Income Security Act of 1974 (ERISA).<sup>55</sup>**

Marc Leder and Roger Krouse founded private equity companies, including Sun Fund III and Sun Fund IV (the Sun Funds), to acquire poorly managed companies, install competent management, and sell them within two to five years. Mr. Leder and Mr. Krouse owned affiliated companies, including Sun Capital Advisors, Inc. (collectively, SCAI Companies), and retained control of the Sun Funds' general partners (GPs).

Although the Sun Funds had no employees, SCAI Companies provided employees and consulting services to portfolio companies for a fee. The GPs would reduce the fees they charged the Sun Funds for managing portfolio companies by the amount the portfolio companies paid the SCAI Companies.

The Sun Funds acquired Scott Brass Inc. (SBI). SBI ultimately stopped contributing to its employees' multiemployer pension plan, the Trucking Industry Pension Fund (TPF), and SBI was forced into bankruptcy by its creditors. TPF asserted that the Sun Funds were liable for SBI's unpaid pension contributions under the Employee Retirement Income Security Act of 1974 (ERISA).<sup>56</sup> The Sun Funds filed suit seeking a declaratory judgment that they were not liable, in relevant part, because they were not in a “trade or business,” as explained below. The district court agreed, citing tax cases for the proposition that mere investment activity is not a trade or business. However, the United States Court of Appeals for the First Circuit reversed and remanded on this point.

By way of background, entities under common control may be jointly and severally liable as a “single employer” under ERISA if they are engaged in a “trade or business.”<sup>57</sup> The Pension Benefits Guarantee

50 The court cited an IRS publication and testimony before Congress by the head of the IRS Criminal Investigation Division and the National Taxpayer Advocate as evidence that the IRS had not previously claimed it had authority to regulate preparers.

51 *Loving v. Comm'r*, 742 F.3d at 1021.

52 Rev. Proc. 2014-42, 2014-29 I.R.B. 192.

53 The U.S. District Court for the District of Columbia dismissed the case after determining the AICPA lacked standing. *AICPA v. IRS*, No. 14-1190 (D.D.C. Oct. 27, 2014).

54 See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71.

55 *Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund*, 724 F.3d 129 (1st Cir. 2013), *rev'd and remanding* 903 F. Supp. 2d 107 (D. Mass 2012), *cert. denied*, 134 S. Ct. 1492 (Mar. 3, 2014) [hereinafter *Sun Capital*].

56 Pub. L. No. 93-406, 88 Stat. 829 (codified at 29 U.S.C. § 1001 et seq.), as amended by Multiemployer Pension Plan Amendments Act of 1980, Pub. L. No. 96-364, 94 Stat. 1208 (codified at 29 U.S.C. § 1381 et seq.).

57 29 U.S.C. § 1301(b)(1).

Corporation (PBCG) is authorized to issue regulations defining trade or business “consistent and coextensive with regulations prescribed for similar purposes by the Secretary of the Treasury under section 414(c) of Title 26,” but it has not issued any such regulations.<sup>58</sup>

Instead, the PBCG issued an unpublished ruling. The ruling concluded that while a fund conducting mere investment activity is not a trade or business, a fund that acquires companies to turn them around and sell them is a trade or business because it is for the “primary purpose of income or profit” and conducted with “continuity and regularity.”<sup>59</sup> PBCG’s “investment plus” test was purportedly derived from *Groetzinger*, a tax case decided by the Supreme Court.<sup>60</sup> Although PBCG argued in an amicus brief that its ruling should be given deference, neither the district court nor the First Circuit gave any special deference to the PBCG.<sup>61</sup> Nonetheless, all three courts analyzed tax cases to determine the statutory meaning of a “trade or business” under ERISA.<sup>62</sup>

The First Circuit ultimately adopted an “investment plus” test in concluding that Sun Fund IV was a trade or business, and thus liable for SBIs unpaid pension contributions. It acknowledged that the absence of trade or business income on the Sun Funds’ tax returns cut against treating them as a trade or business. However, it reasoned that Sun Fund IV would receive a direct economic benefit from its active involvement in the management of SBI that a passive investor would not ordinarily derive—an offset to the management fee payable to its general partner.<sup>63</sup>

This case may be significant in two respects. First, it confirms that an agency’s unpublished determinations are not necessarily entitled to any special deference in subsequent litigation. Second, it suggests that when a passive investor receives a direct economic benefit as a result of services its agents or affiliates provide to one or more portfolio companies, the investor may be treated as engaged in a trade or business for purposes of ERISA, and potentially, the IRC.<sup>64</sup> If otherwise passive investors in private equity funds are treated as engaged in a trade or business for tax purposes, some could be subject to additional taxes (e.g., foreign investors, tax-exempt investors, and managers holding “profits” interests). This case has prompted significant debate in the tax community.<sup>65</sup>

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58 29 U.S.C. § 1301(b)(1).

59 *Sun Capital*, 724 F.3d at 139.

60 *Id.* (citing *Comm'r v. Groetzinger*, 480 U.S. 23 (1987)).

61 Although the PBCG argued in an amicus brief that its letter should be entitled to *Auer* deference under *Auer v. Robbins*, 519 U.S. 452 (1997)—deference to an agency’s interpretation of its own regulations—the First Circuit concluded that it was entitled to *Skidmore* deference—deference only to the extent its underlying reasoning has the power to persuade—under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). The court reasoned that *Auer* deference is inappropriate where significant monetary liability would be imposed for conduct that took place at a time when that party lacked fair notice of the interpretation at issue. *Sun Capital*, 724 F.3d at 140. It also noted that the PBCG had not actually defined trade or business in its regulations and that *Auer* deference is inapplicable where regulations simply parrot the statute under the “anti-parroting” principle. *Id.* at 141.

62 However, the First Circuit expressly rejected “the proposition that, apart from the provisions covered by 26 U.S.C. § 414(c), interpretations of other provisions of the Internal Revenue Code are determinative.” *Sun Capital*, 724 F.3d at 144.

63 The court remanded the case for further factual development because it could not determine if Sun Fund II received a similar economic benefit from the offset. *Sun Capital*, 724 F.3d at 143 n.20.

64 See, e.g., Tax Analysts, *ABA Meeting: Sun Capital May Provide Opportunity to Reassess ‘Trade or Business,’ Treasury Says*, 2013 TNT 184-5 (Sept. 23, 2013) (quoting Craig Gerson, Attorney-Adviser, Treasury Office of Tax Legislative Counsel, as saying the decision “may give us [the Treasury Department] an opportunity to reassess what trade or business means” for tax purposes). As for the importance of the decision under ERISA, Sun Funds’ appeal asserts that, “by significantly deterring investment funds from providing … financing to distressed companies with multiemployer pension plan obligations, the First Circuit’s opinion will deprive such companies of their primary avenue for avoiding bankruptcy.” Petition for a Writ of Certiorari at 33–34, *Sun Capital Partners III, LP v. TPF*, 134 S. Ct. 1492 (2014) (No. 13-648).

65 See, e.g., Tax Analysts, *Transcript Available of Tax Analysts’ Forum on Implications of Sun Capital*, 2013 TNT 190-29 (Oct. 1, 2013) (roundtable discussion of “the tax implications of the First Circuit’s trade or business determination in *Sun Capital*”).

**In *Morehouse v. Commissioner*, the United States Court of Appeals for the Eighth Circuit held that Conservation Reserve Program (CRP) payments received by an investor were not subject to Self-Employment Contributions Act (“SECA”) taxes.<sup>66</sup>**

Mr. Morehouse, a Minnesota investor who owned farmland in South Dakota, received annual rents under the Conservation Reserve Program (CRP) from the U.S. Department of Agriculture (USDA) in exchange for implementing a conservation plan.<sup>67</sup> He hired a farmer to carry out most of the plan, but performed minor activities such as purchasing seed and regularly inspecting the property. He reported the CRP payments as rental income from real estate. The IRS issued a notice of deficiency, determining that the CRP payments were subject to Self-Employment Contributions Act (SECA) tax under IRC § 1401.

Generally, SECA tax is imposed on a taxpayer’s net earnings from self-employment, which usually include the gross income derived from any trade or business carried on by the taxpayer either personally or through agents or employees, minus qualifying deductions.<sup>68</sup> However, Congress excluded certain “rentals from real estate” from SECA tax.<sup>69</sup>

According to Revenue Ruling 60-32, payments under the Soil Bank Act (a predecessor of the CRP) received by a person who does not materially participate in the production of commodities (*i.e.*, farming), or management of such production, qualify as “rentals from real estate.”<sup>70</sup> Subsequently, in *Wuebker*, the United States Court of Appeals for the Sixth Circuit held that a farmer was subject to SECA tax on CRP payments because the farmer’s obligations under the CRP contract were so similar to his normal farming activities that they did not rise to the level of “occupancy or use” by the government needed to qualify for the rentals from real estate exception.<sup>71</sup>

Following *Wuebker*, the IRS issued Notice 2006-108, asking for comments on a proposal to obsolete Revenue Ruling 60-32 on the basis that CRP payments could not qualify for the “rentals from real estate” exclusion because they could not be considered rents (even if paid to non-farmers).<sup>72</sup> However, Revenue Ruling 60-32, was never officially obsoleted and therefore still represents the IRS’s official position.

Mr. Morehouse argued that the CRP payments were not includable in his self-employment income because they were not derived from (*i.e.*, had no nexus to) his trade or business. Alternatively, he argued that the CRP payments were excluded from SECA tax as rentals from real estate.

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66 *Morehouse v. Comm'r*, 769 F.3d 616 (8th Cir. 2014), rev'd 140 T.C. 350 (2013).

67 According to a 2013 USDA news release,

[P]roducers will receive payments on almost 700,000 CRP contracts on 390,000 farms covering 26.8 million acres. In exchange for a yearly rental payment provided by USDA on contracts ranging from 10 to 15 years, farmers and ranchers enrolled in CRP agree to remove environmentally sensitive land from agricultural production and plant grasses or trees that will improve water quality and improve waterfowl and wildlife habitat.

USDA Farm Service Agency, *USDA Issues Conservation Reserve Program Rental Payments, Direct Payments and ACRE Payments*, USDA News Release 0181.13 (Oct. 21, 2013).

68 IRC §§ 1402(a) (defining “net earnings from self-employment”), 1402(b) (defining “self-employment income”), and 1402(c) (defining “trade or business” by reference to IRC § 162); Treas. Reg. § 1.1402(a)-2(b) (providing that the “[t]he trade or business must be carried on by the individual, either personally or through agents or employees.”).

69 IRC § 1402(a)(1).

70 Rev. Rul. 60-32, 1960-1 C.B. 23. See also Rev. Rul. 65-149, 1965-1 C.B. 434 (1965) (“if this income is received by a farm operator, or a landlord who materially participates, it should be treated as self-employment income. If it is received by a landlord who does not materially participate, it should be treated as rental income and excluded from net earnings from self-employment.”).

71 *Wuebker v. Comm'r*, 205 F.3d 897 (6th Cir. 2000).

72 Notice 2006-108, 2006-2 C.B. 1118.

Following the logic of Notice 2006-108, the Tax Court agreed with the IRS. It reasoned that because Mr. Morehouse's receipt of CRP payments depended on his continued maintenance of his land in accordance with the CRP contracts, his participation in the CRP was a trade or business (and not a passive investment) with the requisite nexus to the CRP payments. It also concluded the CRP payments were not rents from real estate.<sup>73</sup>

The United States Court of Appeals for the Eighth Circuit reversed. It distinguished this case from *Wuebker* on the basis that Mr. Morehouse was not a farmer, characterizing the IRS's extension of *Wuebker*'s rationale to non-farmers in Notice 2006-108 as "problematic."<sup>74</sup> It went on to observe that Notice 2006-108 contained "little analysis" and deferred to the IRS's "reasonable" and "longstanding" judgment expressed in Revenue Ruling 60-32, concluding that CRP payments made to non-farmers, such as Mr. Morehouse, constitute rentals from real estate, which are excluded from SECA tax.<sup>75</sup>

This case is significant because it clarifies that CRP payments received by non-farmer investors can qualify for the "rentals from real estate" exclusion from SECA tax. Also notable is that the IRS made, and both the Tax Court and the Eighth Circuit Court of Appeals allowed, arguments inconsistent with the IRS's official published position, as reflected in Revenue Ruling 60-32.<sup>76</sup>

**In *BASR Partnership v. United States*, the Court of Federal Claims held that a preparer's fraud could not extend the normal three-year statute of limitations for the IRS to assess a tax.<sup>77</sup>**

The BASR partnership entered into a tax shelter that it and its partners reported on returns filed in 2000. In 2010, the IRS issued a Notice of Final Partnership Administrative Adjustment (FPAA) to BASR and assessed additional tax against the partners. The promoter of the tax shelter had the intent to evade tax, but BASR and its partners did not. BASR argued that the FPAA was time-barred because the promoter's "intent to evade" did not extend the assessment statute of limitations for the partners.

Under IRC § 6501, the IRS generally must assess any additional tax within three years after a return is filed,<sup>78</sup> except "in the case of a false or fraudulent return with the intent to evade tax."<sup>79</sup> Some

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73 The Tax Court also reasoned that Congress had expressed its intent not to exclude all CRP payments when it enacted legislation in 2008 that specifically excluded CRP payments from the calculation of net earnings from self-employment in certain limited circumstances. Legislation enacted in 2008 specifically excluded CRP payments from the calculation of net earnings from self-employment where the taxpayer is receiving Social Security retirement or disability payments, seemingly based on the assumption that they might otherwise be subject to SECA tax. Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246, § 15301(a), 122 Stat. 1651, 2263 (codified at IRC § 1402(a)(1)).

74 *Morehouse v. Comm'r*, 769 F.3d at 621.

75 *Id.*

76 The IRS is generally bound by its published positions. See *Rauenhorst v. Comm'r*, 119 T.C. 157, 172-83 (2002) ("Respondent's counsel may not choose to litigate against the officially published rulings of the Commissioner without first withdrawing or modifying those rulings. The result of contrary action is capricious application of the law ... we treat the Commissioner's position in ...[the revenue ruling at issue], as a concession.... [internal citations omitted]"); CCDM 35.7.2.1.8(8) (Aug. 11, 2004) ("Respondent may not argue against his published position"). However, the public was on notice that the IRS was reconsidering its position because of Notice 2006-108.

77 113 Fed. Cl. 181 (2013), *appeal docketed*, No. 14-5037 (Fed. Cir. Jan. 7, 2014).

78 IRC § 6501(a).

79 IRC § 6501(c)(1). A similar exception applies to "a willful attempt in any manner to defeat or evade tax." IRC § 6501(c)(2).

authority suggests that even a preparer's "intent to evade" may trigger this exception for fraud.<sup>80</sup> Under IRC § 6229(a), however, the IRS generally must assess any additional tax attributable to any partnership item (or affected item) within three years after the partnership return is filed.<sup>81</sup> The period is extended if "any partner has, with the intent to evade tax, signed or participated directly or indirectly in the preparation of a partnership return which includes a false or fraudulent item."<sup>82</sup>

First, BASR argued that IRC § 6229(c), which specifically applies to partnership items, displaces IRC § 6501(c) with respect to them, and any other interpretation would render IRC § 6229(c) superfluous. Under this theory, the FPAA was time-barred because the partners did not have the requisite intent to extend the assessment period. The government countered that IRC § 6229 could extend, but not shorten, the limitations period provided by IRC § 6501. The court agreed with the government on this point.

Next, the government argued that the assessment was authorized under IRC § 6501(c). It reasoned that the promoter's intent to evade tax (or status as an agent of the taxpayer) was sufficient to extend the limitations period. It cited the maxim that statutes of limitations are strictly construed in favor of the government.<sup>83</sup> The government also advanced public policy arguments that the taxpayer's willful ignorance in failing to verify the accuracy of the returns should not be rewarded, and that fraud, whether perpetrated by the taxpayer or a preparer, is particularly difficult for the IRS to detect within the normal limitations period.

The court disagreed with the government. It reasoned that because the language of IRC § 6501(a) is expressly limited to a return filed by "the taxpayer," the fraudulent intent referenced in IRC § 6501(c) is "by implication limited to fraud by the taxpayer."<sup>84</sup> The court cited the legislative history of IRC § 6501(c)(1) and similar statutory language contained in a predecessor statute (*i.e.*, language used to both extend the limitations period and trigger a fraud penalty) as supporting this interpretation. Thus, it held the FPAA was time-barred under IRC § 6501(a).

This case is significant because it suggests that innocent victims of preparer fraud may not lose the benefit of the three-year assessment statute of limitations.

**In *Kaplan v. United States*, the Court of Federal Claims held it had jurisdiction to prevent "manifest injustice," even though the plaintiff could not establish he had paid enough to trigger jurisdiction under 28 U.S.C. § 1491(a)(1).<sup>85</sup>**

Merchants Restaurant failed to pay its employment taxes for three quarters. Under IRC § 6672, "[a]ny person required to collect, truthfully account for, and pay over" employment taxes (*i.e.*, a "responsible person") who willfully fails to do so is personally liable for a trust fund recovery penalty. The IRS assessed \$86,902.76 in trust fund recovery penalties against Mr. Kaplan. He claimed that he was merely an

<sup>80</sup> See, e.g., *Allen v. Comm'r*, 128 T.C. 37 (2007) (holding that even where a taxpayer had no intent to evade tax, his preparer's intent to evade tax kept the assessment period open). Some have argued that a preparer's intent does not trigger the fraud exception. See, e.g., Bryan Camp, *Tax Return Preparer Fraud and the Assessment Limitations Period*, 116 TAX NOTES 687 (2007); Bryan Camp, *Presumptions and Tax Return Preparer Fraud*, 120 TAX NOTES 167 (2008). See also Jeremiah Coder, *The IRS's Misguided Fraud Whodunit*, 2012 TNT 190-1 (2012).

<sup>81</sup> If filed early, however, the period begins on the last day for filing the partnership return for that year (without regard to extensions). IRC § 6229(a).

<sup>82</sup> IRC § 6229(c). The extended period is unlimited for signing or "participating" partners and six years for others. *Id.*

<sup>83</sup> BASR, 113 Fed. Cl. at 191 (quoting *Badaracco v. Comm'r*, 464 U.S. 386 (1984)).

<sup>84</sup> *Id.*

<sup>85</sup> *Kaplan v. United States*, 115 Fed. Cl. 491 (2014), vacating 113 Fed. Cl. 84 (2013).

investor, not a responsible person. Mr. Kaplan made three \$100 payments toward the penalties associated with each of the quarters and filed a claim for refund in order to establish jurisdiction to contest the assessment in court. When the IRS denied his claim, Mr. Kaplan petitioned the Court of Federal Claims, seeking a determination that he was not liable for the penalties.

In general, under the *Flora* rule, neither federal district courts nor the Court of Federal Claims have authority (under 28 U.S.C. § 1346(a)(1) or 28 U.S.C. § 1491(a)(1), respectively) to decide the merits of a tax refund suit, unless the taxpayer-plaintiff has paid the tax in full.<sup>86</sup> Because a trust fund recovery penalty is “divisible” (*i.e.*, relating to separate transactions or events), the *Flora* rule only requires the plaintiff to pay the penalty as to the wages of a single employee for one quarter.<sup>87</sup>

In this case, the government filed a motion to dismiss Mr. Kaplan’s complaint because he could not show that his payments satisfied the entire assessment for at least one employee per quarter.<sup>88</sup> Mr. Kaplan argued his payments were sufficient based on estimates from one week’s worth of payroll records. The court initially disagreed and dismissed the case.<sup>89</sup>

On reconsideration, the court determined that Mr. Kaplan was caught in a “catch-22” because in order to prove that he was not a responsible person he would first have to produce evidence (*i.e.*, the records required to ascertain the amount needed to satisfy the jurisdictional requirement), which he could only obtain if he were a responsible person. The inequity of his situation was magnified by the government’s inability to state what minimum payment would be sufficient. Therefore, to prevent a “manifest injustice,” the court accepted his payments as sufficient to establish jurisdiction.

This case is significant to the extent it signals that other courts may relax the *Flora* rule with respect to others caught in a similar catch-22. However, the case may be somewhat unique due to Mr. Kaplan’s diligent, but unsuccessful attempts to obtain the payroll information needed to establish that his payments were sufficient and also the IRS’s own inability to estimate what payments would have been sufficient.

#### **In Florida Bankers Assoc. v. United States Department of Treasury, the District Court for the District of Columbia upheld regulations requiring banks to report interest paid to certain non-resident aliens.<sup>90</sup>**

In 2012, the Treasury Department issued final regulations requiring banks to report interest they paid on deposits maintained at U.S. offices to residents of any of the 70 countries that had entered into information exchange agreements with the United States.<sup>91</sup> The preamble to the regulations stated that the IRS needed this information so that it could provide reciprocal information to foreign countries pursuant to information exchange agreements.

The IRS had received comments on the proposed regulations raising concerns that the reporting requirement would negatively affect U.S. banks because customers would close accounts due to confidentiality

<sup>86</sup> See *Flora v. United States*, 362 U.S. 145 (1960); *Shore v. United States*, 9 F.3d 1524 (Fed. Cir. 1993).

<sup>87</sup> See, e.g., *Psaty v. United States*, 442 F.2d 1154 (3d Cir. 1971); *Steele v. United States*, 280 F.2d 89 (8th Cir. 1960).

<sup>88</sup> The IRS could have accepted a “representative amount,” but the IRS may have concluded that Mr. Kaplan’s payment was not sufficiently representative. See IRM 8.25.1.7.4.2 (Oct. 14, 2014) (“[I]f the amount required cannot be accurately determined, the Service may accept a representative amount.”).

<sup>89</sup> *Kaplan*, 113 Fed. Cl. at 84.

<sup>90</sup> *Florida Bankers Assoc. v. United States Department of Treasury*, 113 A.F.T.R.2d (RIA) 498 (D.D.C. 2014), appeal docketed, No. 14-5036 (D.C. Cir. Feb. 11, 2014).

<sup>91</sup> T.D. 9584, 77 Fed. Reg. 23,391 (Apr. 19, 2012) (codified, in relevant part, at Treas. Reg. § 1.6049-4(b)(5)(i)).

concerns.<sup>92</sup> In the preamble to the final regulations, the IRS discussed existing legal and procedural safeguards, such as provisions in its exchange agreements requiring foreign governments to treat the information as secret. The IRS concluded that because of these safeguards, the regulations “should not significantly impact the investment and savings decisions of the vast majority of nonresidents who are aware of and understand these safeguards and existing law and practice.”<sup>93</sup>

The Florida and Texas Bankers Associations challenged the regulations as violating the Administrative Procedure Act (APA) and the Regulatory Flexibility Act (RFA).<sup>94</sup> First, the government argued that the plaintiffs had no standing, and if they did, the Anti-Injunction Act (AIA) or the Declaratory Judgment Act (DJA) barred the court from hearing the case.<sup>95</sup> The court concluded, however, that the association-plaintiffs had standing.<sup>96</sup> Next, the court found that the AIA and the DJA were inapplicable because they only bar suits that would restrain the assessment or collection of any tax. The court acknowledged that a violation of the regulations could trigger a penalty that would be treated as a tax, but it reasoned that this suit was to bar implementation of reporting requirements before any tax (or penalty) had been incurred.<sup>97</sup>

However, the court upheld the regulations. Under the APA, a court will set aside agency actions that are arbitrary and capricious.<sup>98</sup> According to the court, “[t]he agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made” in order to satisfy the APA’s arbitrary and capricious standard.<sup>99</sup> Under the RFA, the agency must either analyze the proposed rule’s impact on small businesses or certify that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities.<sup>100</sup> The banking associations argued that the regulations would cause more harm to banks (including small banks) than the IRS anticipated, and that the final regulations did not articulate a satisfactory explanation for not taking additional steps to address the risk of capital flight.

92 77 Fed. Reg. 23,391, 23,392 (Apr. 19, 2012).

93 77 Fed. Reg. 23,391, 23,393 (Apr. 19, 2012). One commentator countered that: (a) the preamble does not conclude that the vast majority of nonresident aliens would not withdraw their funds from U.S. banks, but rather that funds would not be withdrawn by “the vast majority of nonresidents who are aware of and understand these safeguards and existing law and practice,” (b) most people would probably not take the time to learn about the safeguards, and (c) residents of some treaty partners such as China, Egypt, Indonesia, Mexico, Pakistan, Panama, the Russian Federation, and Venezuela, might reasonably fear their governments would not respect the confidentiality provisions of a treaty. See Patrick J. Smith, *District Court Misapplies APA in Florida Bankers Association*, 142 TAX NOTES 745 (2014).

94 Administrative Procedure Act (APA), 5 U.S.C. ch. 5 and ch. 7; and Regulatory Flexibility Act (RFA), 5 U.S.C. ch. 6.

95 IRC § 7421(a) (AIA); 28 U.S.C. § 2201 (DJA). As the DJA is generally interpreted as barring the same suits as the AIA, the court did not analyze them separately.

96 The government argued the associations lacked standing because they did not submit an affidavit identifying a specific member who was injured by the regulation. *Florida Bankers Assoc.*, 113 A.F.T.R.2d (RIA) 498 at \*5. The court reasoned that an affidavit is only required when the association’s interest is not self-evident. *Id.* at \*6. It found the association’s interest self-evident, explaining,

[P]laintiffs’ member banks are directly regulated by the regulations being challenged. They are currently suffering from additional, allegedly unlawful reporting requirements, causing them injury. That injury would undoubtedly be redressed by abrogation of the regulations. Because such a lawsuit ‘is germane to the organization[s’] purpose,’ which involves policy advocacy on behalf of financial institutions, the Bankers Associations have standing ... *Id.*

97 According to the court, “[T]he D.C. Circuit has confirmed that reporting requirements related to Chapter 61A of the Internal Revenue Code—as opposed to the associated penalties found in Chapter 68B—are not subject to the AIA or DJA.” *Florida Bankers Assoc.*, 2014 U.S. Dist. LEXIS 3521 at \*21 (citing *Foodservice and Lodging Inst., Inc. v. Regan*, 809 F.2d 842 (D.C. Cir. 1987)).

98 5 U.S.C. § 706(2)(A). The association-plaintiffs also argued the regulations failed under 5 U.S.C. § 706(2)(E) for lack of “substantial evidence” to support their conclusions, but the court concluded the “substantial evidence” standard inapplicable and that the challenge would have failed under that standard as well. *Florida Bankers Assoc.*, 2014 U.S. Dist. LEXIS 3521 at \*24.

99 *Florida Bankers Assoc.*, 2014 U.S. Dist. LEXIS 3521 at \*14 (quoting *Motor Vehicle Mfrs. Ass’n of United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983)).

100 5 U.S.C. §§ 603-605.

The court upheld the regulations under the APA because the IRS reasonably concluded that they would improve U.S. tax compliance, impose a minimal reporting burden on banks, and not cause any rational actor—other than a tax evader—to withdraw his funds from U.S. accounts. The regulations also withstood challenge under the RFA because the IRS reasonably concluded that they would not have a “significant” economic impact on a significant number of small entities. The court discounted the economic impact of capital flight as a speculative indirect economic effect that the government did not need to consider under the RFA.<sup>101</sup>

This case is significant to the extent it suggests that agencies do not need to consider secondary effects, such as capital flight, when promulgating rules under the RFA. In addition, this case confirms the viability of the APA and RFA as vehicles for challenging Treasury regulations and illustrates that the AIA and DIA do not shield regulations that do not directly impose a tax.

**In *Corbalis v. Commissioner*, the U.S. Tax Court held that it had jurisdiction to review the IRS's denial of interest suspension under IRC § 6404(g), notwithstanding an IRS Revenue Procedure to the contrary.<sup>102</sup>**

After the IRS made an audit adjustment to Mr. Corbalis' returns, he requested interest suspension under IRC § 6404(g). IRC § 6404(g) generally provides that if a taxpayer files a timely return and the IRS does not give the taxpayer timely notice of an additional liability and the basis for the additional liability, then the IRS “shall suspend” interest, provided certain other requirements are satisfied.

In certain circumstances, IRC § 6404(h) authorizes the Tax Court to review the IRS’s “failure to abate interest under this section... if such action is brought within 180 days after... [the IRS’s] final determination not to abate such interest.” On October 11, 2012, the IRS issued Mr. Corbalis Letter 3477, *IRC 6404(g) Interest Suspension*, denying his request for interest suspension.<sup>103</sup> The letter stated that “[t]he judicial review provisions of IRC section 6404(h) do not apply to IRC section 6404(g). Therefore, you do not have appeal rights, nor may you petition the Tax Court for judicial review regarding this letter.”<sup>104</sup> On November 9, 2012, Mr. Corbalis filed a protest, asserting the letter constituted a final determination which the Tax Court could review pursuant to its authority to review denials of requests for abatement under IRC § 6404(h).

The IRS filed a motion to dismiss, arguing that the Tax Court had no jurisdiction because IRC § 6404(h) only authorizes it to review a denial of interest “abatement” under IRC § 6404(e), not interest “suspension,” under IRC § 6404(g). It cited Revenue Procedure 2005-38, which provides that no judicial review is available under IRC § 6404(h) where the IRS has failed to suspend interest under IRC § 6404(g), with one limited exception.<sup>105</sup> The exception may apply if the IRS’s failure to suspend interest was the result of an unreasonable IRS error or delay in performing a ministerial or managerial act, the taxpayer filed a claim for abatement of the interest, and the claim was denied.<sup>106</sup> The exception did not apply in this case.

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<sup>101</sup> Florida Bankers Assoc., 2014 U.S. Dist. LEXIS 3521 at \*35-36 (“RFA calls for agencies to scrutinize only the regulations’ direct impact, such as ‘reporting, recordkeeping and other compliance requirements’—not indirect impacts caused by the actions of third parties like capital flight.”).

<sup>102</sup> *Corbalis v. Comm'r*, 142 T.C. No. 2 (2014).

<sup>103</sup> Although the IRS also denied Mr. Corbalis’ request for interest abatement, the parties agreed that the denial was not a final determination.

<sup>104</sup> *Corbalis*, 142 T.C. No. 2, \*3.

<sup>105</sup> Rev. Proc. 2005-38 § 2.05, 2005-28 I.R.B. 81.

<sup>106</sup> *Id.*

In addition, the IRS argued, in the alternative, that Letter 3477 was not a “final determination,” which could trigger jurisdiction under IRC § 6404(h).

The Tax Court held it had jurisdiction to review the IRS’s denial of interest suspension. It concluded that interest suspension is a category of abatement. It reasoned there is a strong presumption that administrative actions are subject to judicial review,<sup>107</sup> and the requirement in IRC § 6404(g) that the IRS “shall” suspend interest in appropriate circumstances weighed in favor of judicial review. The Tax Court gave Revenue Procedure 2005-38 no deference because it contained “no reasoning” to support its conclusion that with one limited exception, no judicial review of the failure to suspend interest is available to taxpayers. The court also found that Letter 3477 was a final determination for jurisdictional purposes under IRC § 6404(h). It reasoned that if the taxpayer had delayed filing a petition in the Tax Court, the IRS might have argued that the 180-day period for doing so had lapsed.

This case is significant because it confirms the Tax Court has jurisdiction to review denials of interest suspension under IRC § 6404(g). It is also significant because it suggests that revenue procedures and statements in IRS letters are not entitled to deference, particularly when they do not include any reasoning.

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<sup>107</sup> *Corbalis*, 142 T.C. No. 2, \*8 (“...respondent’s position ignores a strong presumption that the actions of an administrative agency are subject to judicial review.” [Internal citations omitted.]).

**MLI  
#1****Accuracy-Related Penalty Under IRC §§ 6662(b)(1), (2), and (3)****SUMMARY**

Internal Revenue Code (IRC) §§ 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations caused an underpayment of tax, or if an underpayment exceeded a computational threshold called a substantial understatement, respectively. This year, we also analyzed accuracy-related penalties under IRC § 6662(b)(3) (substantial valuation misstatement) and the increased penalty amount under IRC § 6662(h) for a gross valuation misstatement because during our review period of June 1, 2013, through May 31, 2014, taxpayers litigated these penalties more frequently than in past years.<sup>1</sup> Specifically, we reviewed 12 cases involving IRC § 6662(b)(3), and 14 cases involving IRC § 6662(h). IRC § 6662(b) also authorizes the IRS to impose four other accuracy-related penalties.<sup>2</sup>

**PRESENT LAW**

The amount of an accuracy-related penalty equals 20 percent of the portion of the underpayment attributable to the taxpayer's negligence or disregard of rules or regulations, or to a substantial understatement.<sup>3</sup> Underpayment is the amount by which any tax imposed by the Internal Revenue Code exceeds the excess of

1. The sum of (A), the amount shown as the tax by the taxpayer on his return, plus (B) amounts not shown on the return but previously assessed (or collected without assessment), over
2. The amount of rebates made.<sup>4</sup>

Refundable credits cannot reduce the amount shown as tax, by the taxpayer on a return, below zero.<sup>5</sup>

The IRS may assess penalties under IRC § 6662(b)(1), IRC § 6662(b)(2), and IRC § 6662(b)(3), but the total penalty rate generally cannot exceed 20 percent (*i.e.*, the penalties are not "stackable").<sup>6</sup> Generally, taxpayers are not subject to the accuracy-related penalty if they establish that they had reasonable cause for the underpayment and acted in good faith.<sup>7</sup> In addition, a taxpayer will be subject to the negligence component of the penalty only on the portion of the underpayment attributable to negligence. If a

<sup>1</sup> The United States Supreme Court has recently interpreted IRC § 6662(h) in the context of a partner claiming outside basis in a sham partnership. See *United States v. Woods*, 134 S. Ct. 557 (2013), rev'g 471 F. App'x 320 (5th Cir. 2012), aff'g per curiam 794 F. Supp. 2d 714 (W.D. Tex. 2011). For a more detailed discussion of *Woods*, see Significant Cases, *infra*.

<sup>2</sup> IRC § 6662(b)(4) authorizes a penalty for any substantial overstatement of pension liabilities; IRC § 6662(b)(5) authorizes a penalty for any substantial valuation understatement of estate or gift taxes; IRC § 6662(b)(6) authorizes a penalty when the IRS disallows the tax benefits claimed by the taxpayer when the transaction lacks economic substance; and IRC § 6662(b)(7) authorizes a penalty for any undisclosed foreign financial asset understatement.

<sup>3</sup> IRC § 6662(b)(1) (negligence/disregard of rules or regulations) and IRC § 6662(b)(2) (substantial understatement).

<sup>4</sup> I.R.C. § 6664(a).

<sup>5</sup> *Rand v. Comm'r*, 141 T.C. 376 (2013). Following *Rand*, there has been a proposal to calculate negative tax in computing the amount of underpayment for accuracy-related penalty purposes. See Joint Committee on Taxation, *Technical Explanation of the Tax Reform Act of 2014, A Discussion Draft of the Chairman of the House Committee on Ways and Means to Reform the Internal Revenue Code: Title VI- Tax Administration and Compliance* (JCX-17-14), (Feb. 26, 2014), at 42-43.

<sup>6</sup> Treas. Reg. § 1.6662-2(c). The penalty rises to 40 percent if any portion of the underpayment is due to a "gross valuation misstatement." See IRC § 6662(h)(1).

<sup>7</sup> IRC § 6664(c)(1).

taxpayer wrongly reports multiple items of income, for example, some errors may be justifiable mistakes while others might be the result of negligence; the penalty applies only to the latter.

### Negligence

The IRS may impose the IRC § 6662(b)(1) negligence penalty if it concludes that a taxpayer's negligence or disregard of the rules or regulations caused the underpayment. Negligence is defined to include "any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard."<sup>8</sup> Negligence includes a failure to keep adequate books and records or to substantiate items that gave rise to the underpayment.<sup>9</sup> Strong indicators of negligence include instances where a taxpayer failed to report income on a tax return that a payor reported on an information return as defined in IRC § 6724(d)(1),<sup>10</sup> or failed to make a reasonable attempt to ascertain the correctness of a deduction, credit, or exclusion.<sup>11</sup> The IRS can also consider various other factors in determining whether the taxpayer's actions were negligent.<sup>12</sup>

### Substantial Understatement

Generally, an "understatement" is the difference between (1) the correct amount of tax and (2) the tax reported on the return, reduced by any rebate.<sup>13</sup> Understatements are reduced by the portion attributable to (1) an item for which the taxpayer had substantial authority, or (2) any item for which the taxpayer, in the return or an attached statement, adequately disclosed the relevant facts affecting the item's tax treatment and the taxpayer had a reasonable basis for the tax treatment.<sup>14</sup> For individuals, the understatement of tax is substantial if it exceeds the greater of \$5,000 or ten percent of the tax that must be shown on the return.<sup>15</sup> For corporations (other than S corporations or personal holding companies), an understatement is substantial if it exceeds the lesser of ten percent of the tax required to be shown on the return (or, if greater, \$10,000), or \$10,000,000.<sup>16</sup>

For example, if the correct amount of tax is \$10,000 and an individual taxpayer reported \$6,000, the substantial underpayment penalty under IRC § 6662(b)(2) would not apply because although the \$4,000 shortfall is more than ten percent of the correct tax, it is less than the fixed \$5,000 threshold. Conversely, if the same individual reported a tax of \$4,000, the substantial understatement penalty would apply because the \$6,000 shortfall is more than \$5,000, which is the greater of the two thresholds.

8 IRC § 6662(c).

9 Treas. Reg. § 1.6662-3(b)(1).

10 IRC § 6724(d)(1) defines an information return by cross-referencing various other sections of the Code that require information returns (e.g., IRC § 6724(d)(1)(A)(ii) cross-references IRC § 6042(a)(1) for reporting of dividend payments).

11 Treas. Reg. § 1.6662-3(b)(1)(i)-(ii).

12 These factors include the taxpayer's history of noncompliance; the taxpayer's failure to maintain adequate books and records; actions taken by the taxpayer to ensure the tax was correct; and whether the taxpayer had an adequate explanation for under-reported income. Internal Revenue Manual (IRM) 4.10.6.2.1, *Negligence* (May 14, 1999).

13 IRC § 6662(d)(2)(A)(i)-(ii).

14 IRC § 6662(d)(2)(B)(i)-(ii). No reduction is permitted, however, for any item attributable to a tax shelter. See IRC § 6662(d)(2)(C)(i). If a return position is reasonably based on one or more of the authorities set forth in Treas. Reg. § 1.6662-4(d)(3)(iii), the return position will generally satisfy the reasonable basis standard. This may be true even if the return position does not satisfy the substantial authority standard found in Treas. Reg. § 1.6662-4(d)(2). See Treas. Reg. § 1.6662-3(b)(3). Types of authority found in Treas. Reg. § 6662-4(d)(3)(iii) include (among others): applicable provisions of the Internal Revenue Code, proposed, temporary and final regulations construing such statutes, revenue rulings and revenue procedures, and tax treaties and regulations thereunder. A taxpayer may qualify for relief under the reasonable cause and good faith exception even if a return does not satisfy the reasonable basis standard. See Treas. Reg. § 1.6662-3(b)(3).

15 IRC § 6662(d)(1)(A)(i)-(ii).

16 IRC § 6662(d)(1)(B)(i)-(ii).

## Substantial Valuation Misstatement/Gross Valuation Misstatement

IRC § 6662(b)(3) imposes a 20 percent penalty on any portion of an underpayment shown to be due to a substantial valuation misstatement. This occurs when the value of any property (or adjusted basis of any property) claimed on an income tax return is 150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis.<sup>17</sup> The penalty does not apply, however, unless the portion of the underpayment attributable to substantial valuation misstatements exceeds \$5,000 (\$10,000 in the case of a corporation other than an S corporation or a personal holding company).<sup>18</sup>

If any part of the underpayment is attributable to a gross valuation misstatement, the penalty increases from 20 percent to 40 percent.<sup>19</sup> A gross valuation misstatement occurs if the value or adjusted basis of the property claimed on any return is 200 percent or more of the correct amount of such valuation or adjusted basis.<sup>20</sup>

## Reasonable Cause

The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.<sup>21</sup> A reasonable cause determination takes into account all of the pertinent facts and circumstances.<sup>22</sup> Generally, the most important factor is the extent to which the taxpayer made an effort to determine the proper tax liability.<sup>23</sup> In the context of a substantial (or gross) valuation misstatement of charitable deduction property,<sup>24</sup> there can be no reasonable cause unless: (i) the claimed value of property was based on a qualified appraisal by a qualified appraiser, and (ii) the taxpayer made a good faith investigation of the value of the contributed property.<sup>25</sup>

## Penalty Assessment and the Litigation Process

In general, the IRS proposes the accuracy-related penalty as part of its examination process<sup>26</sup> and through its Automated Underreporter (AUR) computer system.<sup>27</sup> Before a taxpayer receives a notice of deficiency,

<sup>17</sup> IRC § 6662(e)(1)(A).

<sup>18</sup> IRC § 6662(e)(2).

<sup>19</sup> IRC § 6662(h)(1).

<sup>20</sup> IRC § 6662(h)(2)(A)(i).

<sup>21</sup> IRC § 6664(c)(1).

<sup>22</sup> Treas. Reg. § 1.6664-4(b)(1).

<sup>23</sup> *Id.*

<sup>24</sup> See Treas. Reg. §1.6664-4(h)(2) for the definition of charitable deduction property.

<sup>25</sup> Treas. Reg. § 1.6664-4(h)(1)(i)-(ii).

<sup>26</sup> IRM 4.10.6.2(1), *Recognizing Noncompliance* (May 14, 1999) (“assessment of penalties should be considered throughout the audit”). See also IRM 20.1.5.3(1)-(2), *Examination Penalty Assertion* (Jan. 24, 2012).

<sup>27</sup> The AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payors reported via Form W-2, Form 1099, and other information returns. See IRM 4.19.2, *Liability Determination, IMF Automated Underreporter (AUR) Control* (Aug. 16, 2013). IRC § 6751(b)(1) provides the general rule that IRS employees must have written supervisory approval before assessing any penalty. However, IRC § 6751(b)(2)(B) allows an exception for situations where the IRS can calculate a penalty automatically “through electronic means.” The IRS interprets this exception as allowing it to use its AUR system to propose the substantial understatement and negligence components of the accuracy-related penalty without human review. If a taxpayer responds to an AUR-proposed assessment, the IRS first involves its employees at that point to determine whether the penalty is appropriate. If the taxpayer does not respond timely to the notice, the computers automatically convert the proposed penalty to an assessment. See National Taxpayer Advocate 2007 Annual Report to Congress 259 (“Although automation has allowed the IRS to more efficiently identify and determine when such underreporting occurs, the IRS’s over-reliance on automated systems rather than personal contact has led to insufficient levels of customer service for taxpayers subject to AUR. It has also resulted in audit reconsideration and tax abatement rates that are significantly higher than those of all other IRS examination programs.”).

he or she generally has an opportunity to engage the IRS on the merits of the penalty.<sup>28</sup> Once the IRS concludes an accuracy-related penalty is warranted, it must follow deficiency procedures (*i.e.*, IRC § 6211-6213).<sup>29</sup> Thus, the IRS must send a notice of deficiency with the proposed adjustments and inform the taxpayer that he or she has 90 days to petition the United States Tax Court to challenge the assessment.<sup>30</sup> Alternatively, taxpayers may seek judicial review through refund litigation.<sup>31</sup> Under certain circumstances, a taxpayer can request an administrative review of IRS collection procedures (and the underlying liability) through a Collection Due Process (CDP) hearing.<sup>32</sup>

#### Burden of Proof

In court proceedings, the IRS bears the initial burden of production regarding the accuracy-related penalty.<sup>33</sup> The IRS must first present sufficient evidence to establish that the penalty is warranted. The burden of proof then shifts to the taxpayer to establish any exception to the penalty, such as reasonable cause.<sup>34</sup>

### ANALYSIS OF LITIGATED CASES

We identified 153 opinions issued between June 1, 2013 and May 31, 2014 where taxpayers litigated the negligence/disregard of rules or regulations, substantial understatement, or substantial (or gross) valuation misstatement components of the accuracy-related penalty. The IRS prevailed in full in 119 cases (78 percent), the taxpayers prevailed in full in 24 cases (16 percent) and 10 cases (seven percent) resulted in split decisions. Table 1 in Appendix III provides a detailed list of these cases.

Taxpayers appeared *pro se* (without representation) in 81 of the 153 cases (53 percent) and convinced the court to dismiss or reduce the penalty in 11 (14 percent) of those cases. Represented taxpayers fared significantly better, achieving full or partial relief from the penalty in 23 of their 72 cases (32 percent).

In some cases, the court found taxpayers liable for the accuracy-related penalty but failed to clarify whether it was for negligence under IRC § 6662(b)(1), a substantial understatement of tax under § 6662(b)(2),

28 For example, when the IRS proposes to adjust a taxpayer's liability, including additions to tax such as the accuracy-related penalty, it typically sends a notice ("30-day letter") of proposed adjustments to the taxpayer. A taxpayer has 30 days to contest the proposed adjustments to the IRS Office of Appeals, during which time he or she may raise issues related to the deficiency, including any reasonable cause defense to a proposed penalty. If the issue is not resolved after the 30-day letter, the IRS sends a statutory notice of deficiency ("90-day letter") to the taxpayer. See IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree* (Jan. 1999); IRS Pub. 3498, *The Examination Process* (Nov. 2004).

29 IRC § 6665(a)(1).

30 IRC § 6213(a). A taxpayer has 150 days instead of 90 to petition the Tax Court if the notice of deficiency is addressed to the taxpayer outside the United States.

31 Taxpayers may litigate an accuracy-related penalty by paying the tax liability (including the penalty) in full, filing a timely claim for refund, and then timely instituting a refund suit in the appropriate United States District Court or the Court of Federal Claims. 28 U.S.C. § 1346(a)(1); IRC §§ 7422(a), 6532(a)(1); *Flora v. United States*, 362 U.S. 145 (1960) (requiring full payment of tax liabilities as a prerequisite for jurisdiction over refund litigation).

32 IRC §§ 6320 and 6330 provide for due process hearings in which a taxpayer may raise a variety of issues including the underlying liability, provided the taxpayer did not receive a statutory notice of deficiency or did not otherwise have an opportunity to dispute such liability. IRC §§ 6320(c), 6330(c)(2).

33 IRC § 7491(c) provides that "the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title."

34 IRC § 7491(a). See also Tax Ct. R. 142(a).

or both.<sup>35</sup> Regardless of the subsection at issue, the analysis of reasonable cause is generally the same.<sup>36</sup> As such, we have combined our analyses of reasonable cause for the negligence, substantial understatement, and substantial (or gross) misstatement cases.

### Adequacy of Records and Substantiation of Deductions to Show Reasonable Cause and as Proof of Taxpayer's Good Faith

Taxpayers are required to maintain records sufficient to establish the amount of gross income, deductions, and credits claimed on a return.<sup>37</sup> Taxpayers were most successful in establishing a defense for an asserted underpayment when they produced adequate records or proved they made a reasonable attempt to comply with the requirements of law.

For example, in *Rodriguez v. Commissioner*,<sup>38</sup> the taxpayers sought to deduct losses from their horse breeding activities. Although a deduction is allowed for ordinary and necessary expenses paid or incurred by a taxpayer in carrying on a trade or business,<sup>39</sup> the IRS disallowed the reported losses in this case for failure to substantiate that the activity was conducted in "a businesslike manner."<sup>40</sup> In *Rodriguez*, the taxpayers kept electronic records of their farm's finances; however, the court did not find these records credible or adequate to substantiate the losses taken on Schedule F.<sup>41</sup> The court did not uphold the accuracy-related penalty asserted against the taxpayers because their records demonstrated that they made a good faith effort to maintain a record of their horse breeding activities even though their attempt at recordkeeping fell short for substantiation purposes.<sup>42</sup>

While the Tax Court has been sympathetic to honest misunderstandings of a complex tax code,<sup>43</sup> it will still impose an accuracy-related penalty on taxpayers not demonstrating a good faith effort to comply with the law. For example, in *Adeyemo v. Commissioner*,<sup>44</sup> the taxpayers (a husband and wife) maintained a logbook of time spent on rental activities. Although the court acknowledged the husband put in a certain amount of effort, it found that taxpayers' actions did not amount to good faith because they did not maintain records for all of their business expenses and did not rely on the logbook when filing their returns.<sup>45</sup>

In contrast, in *Goralski v. Commissioner*,<sup>46</sup> the taxpayers (a husband and wife) sought to obtain the First-Time Homebuyer Credit (FTHBC) pursuant to IRC § 36. The husband's mother had passed away

<sup>35</sup> See, e.g., *Douglas v. Comm'r*, T.C. Memo. 2014-104 (IRS assessed accuracy-related penalties against the taxpayer for both §§ 6662(b)(1) and (b)(2), but the Tax Court ultimately held him liable for "the accuracy-related penalty under section 6662(a)," without identifying which subsection applied). Compare with *Sampson v. Comm'r*, T.C. Memo. 2013-212 (IRS proposed accuracy-related penalties under both § 6662(b)(1) and (b)(2); however, once the IRS established that the taxpayer had substantially understated his income under § 6662(b)(2), the court declined to consider the negligence claim).

<sup>36</sup> As discussed earlier, the reasonable cause exception is narrower in the context of a substantial (or gross) valuation misstatement of charitable deduction property.

<sup>37</sup> IRC § 6001; Treas. Reg. § 1.6001-1(a).

<sup>38</sup> T.C. Memo. 2013-221.

<sup>39</sup> IRC § 162(a).

<sup>40</sup> See also Treas. Reg. § 1.183-2(b)(1).

<sup>41</sup> *Rodriguez*, T.C. Memo. 2013-221.

<sup>42</sup> *Id.*

<sup>43</sup> See, e.g., *Faylor v. Comm'r*, T.C. Memo. 2013-143 (relieving from the accuracy-related penalty a taxpayer who improperly deducted a payment to his ex-spouse as alimony because of his inexperience and honest misunderstanding).

<sup>44</sup> T.C. Memo. 2014-1.

<sup>45</sup> *Id.* The court also did not find that the taxpayers had established reasonable cause.

<sup>46</sup> T.C. Memo. 2014-87.

during the taxable year in question, and his sister was experiencing difficulty with their mother's loss.<sup>47</sup> During this time, the husband shared his late mother's house, which he had inherited, with his sister. The husband and wife subsequently bought their own house and the IRS disallowed their FTHBC claim for failure to substantiate that the house the husband inherited from his mother was *not* his principal residence. The IRS assessed an accuracy-related penalty. However, the court found that the taxpayers had reasonable cause for believing that they were entitled to the FTHBC as a result of "honest misunderstanding of law that was reasonable in the light of all the facts and circumstances, including [the husband's] experience, knowledge, and education." The court sympathized with the family's circumstances and, among other factors, relied on the fact that the taxpayers acted in good faith by researching the relevant law before claiming the credit.

While expectations for compliance with the tax code are high, taxpayers avoided an accuracy-related penalty attributable to negligence or disregard of rules and regulations by showing that their tax position had a reasonable basis.<sup>48</sup> In *TIFD III-E, Inc. v. United States*,<sup>49</sup> the taxpayer treated banks that held its preferred shares as equity partners. The Second Circuit denied the taxpayer's equity characterization, upheld the IRS's assessment of a 20 percent penalty for substantial understatement, and reversed the district court's holding without remand.<sup>50</sup> However, the government later realized that the substantial understatement penalty could not be assessed because the ten percent substantial understatement threshold had not been satisfied. The parties jointly moved to alter the judgment, and then the district court evaluated whether to impose the penalty. The district court concluded that the uncertain state of the law and the uncertain outcome of litigation were factors to support a finding of reasonable basis to the taxpayer's tax position, and therefore the court found that the negligence penalty was not applicable.<sup>51</sup>

In *Chandler v. Commissioner*,<sup>52</sup> the taxpayers were found liable for gross valuation misstatement when they deducted the value of easements as a charitable deduction, which was improperly substantiated. The IRS imposed accuracy-related penalties on the understatement that arose from the unsubstantiated basis increase. However, the correct method of valuing conservation easements was unsettled at the time the taxpayers filed their returns. The court focused the penalty application in this case on whether the deduction had been properly substantiated through appraisals as a sign of a good faith effort to comply with the tax code.<sup>53</sup> The court found that even though Mr. Chandler had a law degree and was an experienced businessman, he reasonably relied on a professional appraiser and his accountant. Further, the court found that the valuation of easements is not an issue that most taxpayers encounter.

### Definition of Underpayment

We also reviewed several cases in which taxpayers contested an accuracy-related penalty assessed by the IRS after it challenged their claim to refundable tax credits. In computing their penalties, the IRS reduced the amount of tax shown by taxpayers on their return by the amount of refundable tax credits they claimed. Until recently, the Tax Court has not addressed, in a precedential opinion, whether the amount

47 T.C. Memo. 2014-87.

48 IRC § 6662(a), (b)(1), and (c). A return position that has a reasonable basis is not attributable to negligence. Treas. Reg. §§ 1.6662-3(b)(1).

49 113 A.F.T.R.2d (R.I.A.) 1557 (D. Conn. 2014), *appeal docketed*, No. 14-1952 (2d Cir. June 9, 2014 ).

50 *TIFD III-E, Inc. v. United States*, 459 F.3d 220 (2d Cir. 2006).

51 *TIFD III-E, Inc.* 113 A.F.T.R.2d (R.I.A.) 1557 (D.Conn. 2014).

52 142 T.C. No. 16 (2014).

53 *Id.*

of tax shown by a taxpayer on his or her return could be reduced below zero by refundable credits, including the Earned Income Tax Credit.<sup>54</sup>

In *Rand v. Commissioner*,<sup>55</sup> the taxpayers were able to reduce their liability for accuracy-related penalties from about \$1,494 to about \$29. The taxpayers had claimed the earned income tax credit, the child tax credit, and the recovery rebate credit. However, the IRS determined that the taxpayers were not entitled to any of these credits and assessed an accuracy-related penalty against them. On their return, the taxpayers had shown a tax liability of \$144 and claimed credits worth \$7,471. In computing the penalty amount, the IRS reduced the amount of tax shown by the taxpayers on their return below zero, to -\$7,327, by subtracting the amount of credits they had claimed.

The taxpayers challenged the IRS's method of computing underpayment. The case centered on the meaning of "the amount shown as tax," a component to determining underpayment. First, the taxpayers argued that the amount shown on their tax return is limited to the amount actually reported on the return (without reducing that amount for refundable credits). Second, they asserted that refundable credits cannot reduce the amount shown on the return below zero. The Tax Court agreed with the taxpayers' second argument. Relying on the definition of "deficiency,"<sup>56</sup> and on the legislative history of links between the definitions of "deficiency" and "underpayment," the court's majority held that rebates—such as refundable credits—*can* reduce the amount of tax shown on the return, but *not* below zero. Consequently, the amount of tax shown on the taxpayers' return was not -\$7,327 but \$0, the amount of underpayment was \$144, and the penalty amount \$29. The Tax Court had reached similar conclusions on the computation of amount of tax shown on the return in earlier cases, but *Rand* is the first precedential opinion of the court to reach this conclusion.<sup>57</sup>

The Office of Chief Counsel recently issued litigating guidelines for handling Tax Court cases involving the accuracy-related penalty determined with respect to disallowed refundable credits in light of the *Rand* decision.<sup>58</sup> Chief Counsel has ceded to the Tax Court's position. Attorneys are instructed to not treat claims for refund or credit based on erroneous refundable credits as a negative amount of tax shown on the return when determining the amount of an underpayment subject to a penalty under IRC § 6662. It should be noted that this guidance is provided "pending any future guidance" and is effective until further notice, perhaps suggesting that the issue is not settled.<sup>59</sup>

### **Reliance on Advice of a Tax Professional as Reasonable Cause**

Another commonly litigated question was whether reliance on a tax professional established reasonable cause. The taxpayer's education, sophistication, and business experience are relevant in determining whether his or her reliance on tax advice was reasonable.<sup>60</sup> To prevail, a taxpayer must establish that:

1. The adviser was a competent professional who had sufficient expertise to justify reliance;
2. The taxpayer provided necessary and accurate information to the adviser; and

54 See IRC § 32.

55 141 T.C. 376 (2013).

56 See I.R.C. § 6211(b)(4).

57 See, e.g., *Solomon v. Comm'r*, T.C. Summ.Op. 2008-95.

58 See Chief Counsel Notice CC-2014-007 (July 31, 2014).

59 *Id.*

60 See Treas. Reg. § 1.6664-4(c)(1). See also IRM 20.1.5.6.1(6), *Reasonable Cause* (Jan. 24, 2012).

3. The taxpayer actually relied in good faith on the adviser's judgment.<sup>61</sup>

Taxpayers argued their good faith reliance on a competent tax professional in several cases this year,<sup>62</sup> including *Moore v. Commissioner*.<sup>63</sup> In *Moore*, the IRS imposed an accuracy-related penalty for a substantial understatement of income tax resulting from transactions in which the taxpayers' cost basis in stock was overstated. The taxpayers hired a professional tax advisory firm to help them prepare their returns and provided the advisors with all facts concerning the transactions in good faith to properly report their basis in stock. The Tax Court declined to uphold the accuracy-related penalty because the taxpayers established good faith reliance on a competent tax professional.

In *Palmer Ranch Holdings Ltd. v. Commissioner*,<sup>64</sup> the IRS imposed a 40 percent accuracy-related penalty on the taxpayer (a partnership) for a gross valuation misstatement.<sup>65</sup> Alternatively, the IRS argued that the taxpayer was liable for a 20 percent accuracy-related penalty for negligence or disregard of rules or regulations, a substantial understatement of income tax, or a substantial valuation misstatement.<sup>66</sup> The taxpayer had donated a conservation easement and claimed its appraised value as a charitable deduction. The Tax Court found that the actual value of the easement was less than what the taxpayer had claimed, and therefore disallowed a portion of its deduction.<sup>67</sup> However, because the amount of overstatement was about 20 percent, it was not a gross valuation misstatement and the 40 percent penalty was inapplicable. The taxpayer presented credible evidence of good faith reliance on competent professionals, including a tax attorney, a licensed appraiser, and a land planning and engineering firm. The partnership was unsophisticated in the field of tax and relied on a tax attorney to "advise it on how to donate the easement in compliance with the Internal Revenue Code."<sup>68</sup> The partnership was able to establish the three criteria above, and the court held it was not liable for any accuracy-related penalties.

In several cases, the taxpayer could not establish all three of the above-mentioned criteria had been satisfied. For example, in *Ames-Mechelke v. Commissioner*,<sup>69</sup> the taxpayer hired a tax return preparer to determine the tax consequences of her income and expenses. The taxpayer participated in an abusive trust arrangement, the promoter of which had introduced the taxpayer to her return preparer. As her participation in the abusive transaction escalated, the taxpayer became aware of the tax avoidance aspect of the trust arrangement. Eventually, she engaged in a more aggressive trust arrangement organized by the same promoter. The Tax Court concluded that the taxpayer could not have relied on her return preparer in good faith once she gained knowledge of the tax avoidance aspect of the trust arrangement. As the taxpayer was not able to establish actual reliance in good faith, she failed to meet the third prong of the *Neonatology* test described above and was liable for an accuracy-related penalty.<sup>70</sup>

61 *Neonatology Associates, P.A. v. Comm'r*, 115 T.C. 43, 99 (2000) (citations omitted), aff'd, 299 F.3d 221 (3d Cir. 2002).

62 See, e.g., *Azimzadeh v. Comm'r*, T.C. Memo. 2013-169 (finding the taxpayer reasonably relied on his CPA's judgment in claiming a real-estate loss and home mortgage interest deductions to which he was not entitled; but finding that the taxpayer failed to show that he had provided adequate documentation to his CPA for unreported wages and was, therefore, liable for an accuracy-related penalty for that portion of the underpayment of tax).

63 T.C. Memo. 2013-249.

64 T.C. Memo. 2014-79.

65 See IRC § 6662(h)(2).

66 See IRC §§ 6662(a) and (b)(1), (2), and (3).

67 Generally, the charitable contribution amount is the contributed property's fair market value at the time it is contributed. See Treas. Reg. §§ 1.170A-1(a), (c)(1).

68 *Palmer Ranch Holdings Ltd.*, T.C. Memo. 2014-79.

69 T.C. Memo. 2013-176.

70 *Neonatology*, 115 T.C. at 99.

There are many more examples of taxpayers' failure to establish the competence of their tax return preparers.<sup>71</sup> While some taxpayers choose to use tax software to prepare their tax returns, the Tax Court may not find reliance on tax return preparation software justifiable to avoid an accuracy-related penalty. In this regard, the Tax Court has observed "[a] mistake in entering the amount into the tax preparation software, albeit accidental, is not a defense to the imposition of the section 6662(a) penalty."<sup>72</sup> In particular, relying on tax preparation software without doing any independent research or consulting a tax expert may not provide a defense of reasonable cause.<sup>73</sup> Prior year cases indicate that the Tax Court may be open to allowing a reasonable cause defense if there is a tax preparation software programming error.<sup>74</sup>

### No Affirmative Defense Offered by the Taxpayer

Many taxpayers offered no affirmative defense for the understatement in tax, failing completely to claim the reasonable cause and good faith defense under IRC § 6664(c). In *Schlievert v. Commissioner*,<sup>75</sup> the taxpayers substantially understated income tax by deducting losses associated with investments in record label activities. The court found that the taxpayers were not allowed to deduct expenses in excess of gross income because they were not engaged in the record label for profit, as defined in IRC § 183.

The taxpayers did not address the penalty issue in their brief, and they presented no evidence on reasonable cause for their underpayment. Consequently, the court held that the taxpayers were liable for the accuracy-related penalty. The taxpayers appeared *pro se* in this case. It may be that some *pro se* taxpayers are unaware that they bear the burden of proving reasonable cause.

## CONCLUSION

In approximately one fifth of the cases, the courts abated the accuracy-related penalties, partially or in full, where the taxpayer showed a reasonable and good faith attempt to ascertain the correct amount of tax due. The courts most commonly found reasonable cause on the bases of maintenance of adequate records to substantiate deductions and reasonable reliance on a competent tax professional.

Our review of cases this year shows that taxpayers with representation fared significantly better than their unrepresented counterparts. Represented taxpayers were successful in dismissing or reducing their penalties in 32 percent of the cases with representation versus 14 percent of unrepresented taxpayers.<sup>76</sup>

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<sup>71</sup> See, e.g., *Curtis v. Comm'r*, T.C. Memo. 2014-19 (finding taxpayer liable for an accuracy-related penalty because he failed to show any credible evidence that he had hired a competent tax return preparer). Taxpayers may have a difficult time demonstrating the competency of many tax return preparers if the government is barred from regulating unenrolled return preparers. See *Loving v. Internal Revenue Service*, 742 F.3d 1013 (D.C. Cir. 2014), aff'g 917 F.Supp.2d 67 (D.D.C. 2013); Written Statement of Nina E. Olson, National Taxpayer Advocate, Hearing on Protecting Taxpayers From Incompetent and Unethical Return Preparers Before the Committee on Finance, U.S. Senate, at 9 (Apr. 8, 2014) (citing Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31 (May 13, 2013)).

<sup>72</sup> See *Brooks v. Comm'r*, T.C. Memo. 2013-141, 2013 Tax Ct. Memo. LEXIS 142 at \*50-\*51 (citation omitted).

<sup>73</sup> See *Bigdeli v. Comm'r*, T.C. Memo 2013-148 (June 11, 2013); *Estate of Limberea v. Comm'r*, T.C. Summ. Op. 2013-50 (June 24, 2013).

<sup>74</sup> See *Langley v. Comm'r*, T.C. Memo 2013-22, 10 (Jan. 17, 2013) ("Although they have not shown exactly the manner in which they relied on TurboTax or its instructions, we find it unlikely that TurboTax was responsible for the items giving rise to the Petitioners' deficiency."); *Morales v. Comm'r*, T.C. Memo 2012-341, 6 (Dec. 6, 2012) ("Moreover, Petitioners failed to introduce other evidence that demonstrates their improperly claiming the first-time homebuyer credit was the result of a TurboTax programming flaw or instructional error.")

<sup>75</sup> T.C. Memo. 2013-239.

<sup>76</sup> See Analysis of Litigated Cases discussion, *supra*.

Represented taxpayers fared better than they did over the same period last year, while unrepresented taxpayers fared worse over the same period.<sup>77</sup>

Taxpayers should be aware that they must raise an affirmative defense to the penalty in order to have a chance at avoiding liability for the penalty, because taxpayers are deemed to have conceded those issues that they do not raise.<sup>78</sup>

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<sup>77</sup> Compare National Taxpayer Advocate 2013 Annual Report to Congress 342 (Most Litigated Issue: *Accuracy-Related Penalty Under IRC §§ 6662(b)(1) and (2)*) (the court dismissed or reduced penalties in 20 percent of the cases for *pro se* taxpayers and 24 percent of the cases for represented taxpayers).

<sup>78</sup> See Tax Ct. R. 34(b)(4).

**MLI  
#2****Trade or Business Expenses Under IRC § 162 and Related Sections****SUMMARY**

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998.<sup>1</sup> We identified 115 cases involving a trade or business expense issue that were litigated between June 1, 2013, and May 31, 2014. The courts affirmed the IRS position in 87 of these cases (76 percent), while taxpayers fully prevailed in only three cases (three percent). The remaining 25 cases (22 percent) resulted in split decisions.

**PRESENT LAW**

Internal Revenue Code § 162 allows deductions for ordinary and necessary trade or business expenses paid or incurred during the course of a taxable year.<sup>2</sup> Rules regarding the practical application of IRC § 162 have evolved largely from case law and administrative guidance. The IRS, the Department of the Treasury, Congress, and the courts continue to provide guidance about whether a taxpayer is entitled to claim certain deductions. The cases analyzed for this report illustrate that this process is ongoing and involve the analysis of facts and circumstances particular to each case. When a taxpayer seeks judicial review of the IRS's determination of a tax liability relating to the deductibility of a particular expense, the courts must often address a series of questions, including those discussed below.

**What is a trade or business expense under IRC § 162?**

Although "trade or business" is one of the most widely used terms in the IRC, neither the Code nor Treasury Regulations provide a definition.<sup>3</sup> The definition of a "trade or business" comes from common law, where the concepts have been developed and refined by the courts.<sup>4</sup> The Supreme Court has interpreted "trade or business" for purposes of IRC § 162 to mean an activity conducted with "continuity and regularity" and with the primary purpose of earning income or making profit.<sup>5</sup>

**What is an ordinary and necessary expense?**

IRC § 162(a) requires a trade or business expense to be both "ordinary" and "necessary" in relation to the taxpayer's trade or business in order to be deductible. In *Welch v. Helvering*, the Supreme Court stated that the words "ordinary" and "necessary" have different meanings, both of which must be satisfied for the taxpayer to benefit from the deduction.<sup>6</sup> The Supreme Court describes an "ordinary" expense

<sup>1</sup> See National Taxpayer Advocate 1998-2013 Annual Reports to Congress.

<sup>2</sup> Hereafter, the Internal Revenue Code will be referred to as the "IRC" or the "Code."

<sup>3</sup> In 1986, the term "trade or business" appeared in at least 492 subsections of the Code and in over 664 Treasury Regulations. See F. Ladson Boyle, *What is a Trade or Business?*, 39 Tax Law. 737 (Summer 1986).

<sup>4</sup> Carol Duane Olson, *Toward a Neutral Definition of "Trade or Business" in the Internal Revenue Code*, 54 U. Cin. L. Rev. 1199 (1986).

<sup>5</sup> *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

<sup>6</sup> 290 U.S. 111, 113 (1933) (suggesting an examination of "life in all its fullness" will provide an answer to the issue of whether an expense is ordinary and necessary).

as customary or usual and of common or frequent occurrence in the taxpayer's trade or business.<sup>7</sup> The Court describes a "necessary" expense as one that is appropriate and helpful for development of the business.<sup>8</sup>

Common law also requires that in addition to being ordinary and necessary, the amount of the expense must be reasonable for the expense to be deductible. In *Commissioner v. Lincoln Electric Co.*, the Court of Appeals for the Sixth Circuit held "the element of reasonableness is inherent in the phrase 'ordinary and necessary.' Clearly it was not the intention of Congress to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount."<sup>9</sup>

### Is the expense a currently deductible expense or a capital expenditure?

A currently deductible expense is an ordinary and necessary expense paid or incurred during the taxable year in the course of carrying on a trade or business.<sup>10</sup> No current deductions are allowed for the cost of acquisition, construction, improvement, or restoration of an asset expected to last more than one year.<sup>11</sup> Instead, those types of expenses are generally considered capital expenditures, which may be subject to depreciation, amortization, or depletion over the useful life of the property.<sup>12</sup>

Whether an expenditure is deductible under IRC § 162(a) or is a capital expenditure under IRC § 263 is a question of fact. Courts have adopted a case-by-case approach to applying principles of capitalization and deductibility.<sup>13</sup>

### When is an expense paid or incurred during the taxable year, and what proof is there that the expense was paid?

IRC § 162(a) requires an expense to be "paid or incurred during the taxable year" in order to be deductible. The Code also requires a taxpayer to maintain books and records that substantiate income, deductions, and credits, including adequate records to substantiate deductions claimed as trade or business expenses.<sup>14</sup> If a taxpayer cannot substantiate the exact amounts of deductions by documentary evidence (e.g., invoice, paid bill, or canceled check), but can establish that he or she had some business expenditures, the courts may employ the *Cohan* rule to grant the taxpayer a reasonable amount of deductions.

### The *Cohan* rule

The *Cohan* rule is one of "indulgence" established in 1930 by the Court of Appeals for the Second Circuit in *Cohan v. Commissioner*.<sup>15</sup> The court held that the taxpayer's business expense deductions were not

7 *Deputy v. du Pont*, 308 U.S. 488, 495 (1940) (citation omitted).

8 *Comm'r v. Tellier*, 383 U.S. 687, 689 (1966) (citations omitted).

9 176 F.2d 815, 817 (6th Cir. 1949), cert. denied, 338 U.S. 949 (1950).

10 IRC § 162(a).

11 IRC § 263. See also *INDOPCO, Inc. v. Comm'r*, 503 U.S. 79 (1950).

12 IRC § 167.

13 See *PNC Bancorp, Inc. v. Comm'r*, 212 F.3d 822 (3d Cir. 2000); *Norwest Corp. v. Comm'r*, 108 T.C. 265 (1997).

14 IRC § 6001. See also Treas. Reg. §§ 1.6001-1 and 1.446-1(a)(4).

15 39 F.2d 540 (2d Cir. 1930). George M. Cohan was an actor, playwright, and producer who spent large sums travelling and entertaining actors, employees, and critics. Although Cohan did not keep a record of his spending on travel and entertainment, he estimated that he incurred \$55,000 in expenses over several years. The Board of Tax Appeals, now the Tax Court, disallowed these deductions in full based on Cohan's lack of supporting documentation. Nevertheless, on appeal, the Second Circuit concluded that Cohan's testimony established that legitimate deductible expenses had been incurred. As a result, the Second Circuit remanded the case back to the Board of Tax Appeals with instructions to estimate the amount of deductible expenses.

adequately substantiated, but stated that “the [Tax Court] should make as close an approximation as it can, bearing heavily, if it chooses, upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent.”<sup>16</sup>

The *Cohan* rule cannot be used in situations where IRC § 274(d) applies. Section 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deductions are allowable for:

1. Travel expenses;
2. Entertainment, amusement, or recreation expenses;
3. Gifts; and
4. Certain “listed property.”<sup>17</sup>

A taxpayer must substantiate a claimed IRC § 274(d) expense with adequate records or sufficient evidence to establish the amount, time, place, and business purpose.<sup>18</sup>

### **Who has the burden of proof in a substantiation case?**

Generally, the taxpayer bears the burden of proving that he or she is entitled to the business expense deductions and the IRS’s proposed determination of tax liability is incorrect.<sup>19</sup> IRC § 7491(a) provides that the burden of proof shifts to the IRS when the taxpayer:

- Introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer’s liability;
- Complies with the requirements to substantiate deductions;
- Maintains all records required under the Code; and
- Cooperates with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews.

## **ANALYSIS OF LITIGATED CASES**

The deductibility of trade or business expenses has been one of the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate’s Annual Report to Congress in 1998.<sup>20</sup> This year, we reviewed 115 cases involving trade or business expenses that were litigated in federal courts from June 1, 2013, through May 31, 2014. Table 2 in Appendix III contains a list of the main issues in those cases. Figure 3.2.1 (below) categorizes the main issues raised by taxpayers. Cases involving more than one issue are included in more than one category.

16 39 F.2d 544 (2d Cir. 1930), *aff’g and remanding* 11 B.T.A. 743 (1928).

17 “Listed property” means any passenger automobile; any property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; any computer or peripheral equipment (except when used exclusively at a regular business establishment and owned or leased by the person operating such establishment); and any other property specified by regulations. IRC §§ 280F(d)(4)(A) and (B).

18 Treas. Reg. § 1.274-5T(b).

19 See *Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted) and U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

20 See National Taxpayer Advocate 1998–2013 Annual Reports to Congress.

**FIGURE 3.2.1. Trade or Business Expense Issues in Cases Reviewed**

Issue	Type of Taxpayer	
	Individual	Business (including sole proprietorships)
Substantiation of expenses, including application of the <i>Cohan</i> rule <sup>a</sup>	16	54
Profit objective <sup>b</sup>	0	12
Ordinary and necessary trade or business expenses <sup>c</sup>	2	9
Personal vs. business expenses <sup>d</sup>	9	17
Business expenses vs. capital expenditures <sup>e</sup>	1	2
Did the taxpayer establish the carrying on of a trade or business?	3	9
Gambling expenses <sup>f</sup>	0	4

a IRC § 6001 and Treas. Reg. § 1.6001-1 require a taxpayer to maintain books and records that substantiate income, deductions and credits. Treas. Reg. § 1.162-17 provides guidance regarding maintaining adequate records to substantiate deductions claimed as trade or business expenses in connection with the performance of services as an employee. The *Cohan* rule allows courts to estimate certain expenses not properly substantiated. See *Cohan*, 39 F.2d at 544.

b IRC § 183(a) provides the general rule that no deduction attributable to an activity engaged in by an individual or an S corporation shall be allowed if such activity is not engaged in for profit. reas. Reg. § 1.183-2(b) provides the following nonexhaustive list of nine factors to consider in determining whether an activity is conducted for profit: ( ) manner in which the taxpayer carries on the activity; (2) expertise of the taxpayer or his advisors; (3) time and effort expended by the taxpayer in carrying on the activity; (4) expectation that assets used in the activity may appreciate in value; (5) success of the taxpayer in carrying on similar or dissimilar activities; (6) taxpayer's history of income or losses with respect to the activity; (7) amount of occasional profits if any, which are earned; (8) financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

c IRC § 162(a) allows deductions for ordinary and necessary trade or business expenses paid or incurred during the taxable year.

d IRC § 262(a) provides that personal, living, and family expenses are generally not deductible.

e Under IRC § 263(a), generally no deduction is allowed for capital expenditures, where capital expenditures include any amount paid for permanent improvements made to increase the value of any property. Under IRC § 195(a), start-up expenditures generally cannot be deducted unless a taxpayer makes an expense/amortization election according to IRC § 195(b). Taxpayers who make the election may generally deduct up to \$5,000 of start-up expenditures in the tax year in which an active trade or business begins and amortize any excess over 180 months. The \$5,000 deduction is reduced by a dollar for every dollar that total start-up expenditures exceed \$50,000. See IRC §§ 195(b)(1)(A) and (B). (These amounts are increased to \$10,000 and \$60,000 for taxable years beginning in 2010. See IRC § 195(b)(3).

f IRC § 165(d) provides that “losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.”

Approximately 64 percent of the cases (74 of 115) involved taxpayers representing themselves (*pro se*). The 36 percent (41 of 115) of cases with taxpayers represented by counsel fared slightly better than their *pro se* counterparts. Taxpayers with representation received full or partial relief in approximately 27 percent of cases (11 of 41). By contrast, *pro se* taxpayers received full or partial relief in 23 percent of cases (17 of 74).

### Individual Taxpayers

None of the 23 decisions involving individual taxpayers (where the term “individual” excludes a sole proprietorship) was issued as a regular opinion of the Tax Court.<sup>21</sup> Seventeen of the 23 individual taxpayers

21 Tax Court decisions fall into three categories: regular decisions, memorandum decisions, and small tax case (“S”) decisions. The regular decisions of the Tax Court include cases which have some new or novel point of law, or in which there may not be general agreement, and therefore have the most legal significance. In contrast, memorandum decisions generally involve fact patterns within previously settled legal principles and therefore are not as significant. Finally, “S” case decisions (for disputes involving \$50,000 or less) are not appealable and, thus, have no precedential value. See IRC § 7463(b). See also U.S. Tax Court Rules of Practice and Procedure, Rules 170-175. More than half of the cases reviewed this year involving individual taxpayers (excluding sole proprietorships) were “S” cases.

appeared *pro se*. No individual taxpayers received full relief, while only seven earned split decisions. The court upheld the IRS position in 16 of 23 cases (70 percent).

The most prevalent issue was the substantiation of claimed trade or business expense deductions. For example, in *Humphrey v. Commissioner*, the Tax Court denied several claimed business expense deductions for failure to substantiate.<sup>22</sup> The taxpayer, a Customs and Border Protection agent, was unable to substantiate travel and vehicle expenses for trips related to his work because he only gave the Court a rough estimate of his miles rather than a contemporaneous log. He similarly failed to provide any records for other travel expenses. Further, the Tax Court denied expense deductions for meals and entertainment because the taxpayer did not provide any substantiation. Deductions for gifts and cell phone expenses were also denied as there was no evidence proving a business purpose. Finally, the Court denied a deduction for legal fees for failure to provide adequate substantiation.<sup>23</sup>

### **Business Taxpayers**

We reviewed 92 cases involving business taxpayers. As it turned out, business taxpayers had a slightly lower success rate compared to individual taxpayers. Individual taxpayers did not win a single case in full; however, individuals received partial relief from split decisions in 30 percent of cases (seven of 23). Meanwhile, business taxpayers received full or partial relief in approximately 23 percent of cases (21 of 92).

Business taxpayers were represented by counsel in 38 percent (eight of 21) of favorably decided cases, including all three of the cases in which the taxpayer received full relief. Business taxpayers were represented by counsel in 37 percent (26 of 71) of the cases the IRS won. The success of *pro se* taxpayers in court stemmed mostly from their ability to provide records substantiating deductions in cases where such substantiation was in controversy.

As it was for the individual taxpayers, substantiation of expenses was by far the most prevalent issue, and in most instances, the courts denied the business taxpayers' deductions for failure to substantiate.<sup>24</sup> Courts did, however, allow some of these deductions when the taxpayer produced sufficient evidence.<sup>25</sup> Courts occasionally applied the *Cohan* rule where the taxpayer presented sufficient documentation to prove an expense was incurred, but had limited documentation of the precise amount. As previously mentioned, however, IRC § 274(d) makes the *Cohan* rule unavailable in certain circumstances in which the taxpayer must substantiate the deductions.

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22 T.C. Memo. 2013-198.

23 The taxpayer provided carbon copies of checks without anything more, which is not adequate substantiation. *Id.* (citing *Miller v. Comm'r*, T.C. Memo. 1996-402). Another example is *Golit v. Comm'r*, T.C. Memo. 2013-191, where the Tax Court disallowed deductions for books and stethoscopes, among other items, due to the taxpayer's failure to substantiate claimed business expenses.

24 See *Alexander v. Comm'r*, T.C. Memo. 2013-203 (deduction denied for grain farming expenses for failure to substantiate; court did not reach question of profit motive); *Edem v. Comm'r*, T.C. Memo. 2013-238 (taxpayers introduced no evidence to substantiate business expenses; deductions were denied); *Gorokhovsky v. Comm'r*, 549 F. App'x 527 (7th Cir. 2013), aff'g T.C. Memo. 2012-206 (deduction denied for business expenses for failure to substantiate; self-generated, handwritten notes were not credible evidence of deductions); *Van Velzor v. Comm'r*, T.C. Memo. 2014-71 (deduction for labor expenses for failure to substantiate when only evidence was self-serving testimony and unreliable hearsay).

25 See *Azimzadeh v. Comm'r*, T.C. Memo. 2013-169 (deductions for business expenses allowed to the extent substantiated; deduction denied for travel expenses for failure to meet IRC § 274 substantiation requirements); *Karch v. Comm'r*, T.C. Memo. 2013-237, appeal docketed, No. 14-3179 (3d Cir. July 3, 2014) (deduction for wage, mortgage, and contract service expenses allowed to the extent substantiated; deductions denied for other business expenses for failure to substantiate).

Taxpayers had particular difficulty validating their home office deductions, losing cases where business use of a personal residence was at issue.<sup>26</sup> One example of this issue was *Thunstedt v. Commissioner*, where the taxpayer, an art dealer, sought to deduct over 60 percent of his home as an office.<sup>27</sup> In his testimony, the taxpayer listed business activities he conducted out of his home, asserting, “everything I do is business.”<sup>28</sup> However, he failed to provide evidence that any part of the house was exclusively used for business and also attested that his children frequently stayed in the house. The Tax Court denied the deduction in full because the taxpayer did not give evidence that any specific part of the house was used exclusively for business, which meant the Court could not even make a rough estimate of the proper deduction using *Cohan*.

Another common theme was the difficulty in proving that expenses were ordinary and necessary to the taxpayer’s business.<sup>29</sup> The taxpayer in *Bagley v. Commissioner*, however, scored a victory after he sought to deduct litigation expenses from a *qui tam* lawsuit.<sup>30</sup> Laid off and failing to find other work, the taxpayer initiated a *qui tam* lawsuit against his old employer, a federal contractor, under the False Claims Act. The government eventually intervened in the suit, and at the case’s conclusion, the government paid the taxpayer over \$36 million as the combination of an award, plus statutory attorneys’ fees. The taxpayer in turn paid over \$18 million to the attorneys he had hired to assist with the suit. The IRS disputed the categorization of the \$18 million of legal fees as a business expense.

After determining the litigation activities did indeed constitute a trade or business, the court proceeded to examine whether the litigation expenses were ordinary and necessary. Because the trade or business in question was litigation, the court agreed with the taxpayer that legal fees constituted ordinary and necessary business expenses and allowed the claimed deduction.<sup>31</sup>

Taxpayers were also denied business expense deductions under IRC § 262(a) when the courts found the expenses were related to personal, rather than business activities.<sup>32</sup> In *Dargie v. United States*, Dr. Dargie

26 IRC § 280(A)(c)(1) allows the deduction of “a portion of the dwelling unit which is exclusively used on a regular basis ... as the principal place of business for any trade or business of the taxpayer.” If the taxpayer is an employee, the home office deduction is only allowable if the exclusive use is for the convenience of the employer. *Id.* Examples of cases examined in which the court denied deductions for home office expenses are *Dupre v. Comm'r*, T.C. Memo. 2013-287 (home office deduction denied for failure to show exclusive use or convenience of employer) and *Scully v. Comm'r*, T.C. Memo. 2013-229 (deduction denied for failure to provide any evidence of exclusive use).

27 T.C. Memo. 2013-280.

28 *Id.*

29 See IRC § 162(a) (“There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including ... (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property.”). For examples of cases examined in which the court denied deductions for failure to prove the expense was ordinary and necessary in business, see, e.g., *Chaganti v. Comm'r*, T.C. Memo. 2013-285 (deduction for court-ordered fines denied because they were not ordinary and necessary to the taxpayer’s business); *Elick v. Comm'r*, T.C. Memo. 2013-139, appeal docketed, No. 13-73837 (9th Cir. Oct. 31, 2013) (deduction denied for management fees for failure to prove ordinary and necessary in business).

30 963 F. Supp. 2d 982 (C.D. Cal. 2013). The False Claims Act (FCA) establishes liability for any person who knowingly presents, or causes to be presented, to an officer or employee of the United States Government a false or fraudulent claim for payment or approval. 31 U.S.C. § 3729(a). The FCA authorizes both the Attorney General and private persons to bring civil actions to enforce the Act. 31 U.S.C. § 3730. An action brought by a private person under § 3730(b) of the FCA is termed a *qui tam* suit. *Qui tam* is a writ whereby a private individual who assists a prosecution can receive all or part of any penalty imposed. Its name is an abbreviation of the Latin phrase *qui tam pro domino rege quam pro se ipso in hac parte sequitur*, meaning “[he] who sues in this matter for the king as well as for himself.”

31 963 F. Supp. 2d at 1002.

32 IRC § 262(a) provides that personal, living and family expenses are generally not deductible. See, e.g., *Bigdeli v. Comm'r*, T.C. Memo. 2013-148 (deduction denied for vehicle and travel expenses because expenses were of a personal nature); *Austin Otology Assocs. v. Comm'r*, T.C. Memo. 2013-293 (deduction denied for hunting trips and security expenses because expenses were of a personal nature).

signed a “conditional award agreement” with his medical school saying that he would either spend four years working in an underserved community in exchange for payment of his educational expenses or pay back his award—up to double the amount being awarded.<sup>33</sup> After graduating, he chose not to work in the specified location and instead repaid the amount of his initial award, plus interest.

The taxpayers (husband and wife) then sought to deduct that expense, claiming it was a payment of damages attributable to Dr. Dargie’s breach of the agreement and thus an ordinary and necessary expense of opening his medical practice in the chosen location. The Court of Appeals for the Sixth Circuit rejected that characterization, upholding the lower court’s determination that the payments were personal expenses incurred to enable Dr. Dargie to meet the minimum requirements for his occupation.<sup>34</sup>

Courts likewise generally sustained IRS determinations that business expense deductions were not attributable to an activity engaged in for profit within the meaning of IRC § 183.<sup>35</sup> In *United States v. Hart*, the taxpayer sought to deduct expenses related to a book he had written.<sup>36</sup> The court proceeded to examine the taxpayer’s deductions using the nine-factor test of Treas. Reg. § 1.183-2(b).<sup>37</sup> The taxpayer self-published the book, entitled *Constitutional Income: Do You Have Any?*, but failed to realize any profit from the publication. Hart testified the first and second editions of the book sold out, but he also gave away hundreds of copies.

The court held that he did not engage in his book writing activity for profit, stating that “Mr. Hart’s testimony concerning how he managed his book-writing activity simply does not support a finding that the book writing was engaged in for purposes of generating a profit.”<sup>38</sup> The court noted that Hart had never written a book before, worked as an engineer during the writing process, never put together a business plan for his writing activities, and admitted that he had personal reasons for writing the book.

Similarly, the taxpayers in *Schlievert v. Commissioner* sought to deduct expenses related to their music label activity under IRC § 162(a), but the Tax Court denied the deduction because the activity was not engaged in for profit pursuant to IRC § 183.<sup>39</sup> In *Schlievert*, the taxpayers, a husband and wife, held themselves out as a record label and sought to deduct a variety of expenses related to band activities.

The taxpayers started their label at the behest of their daughter, who was trying to break into the music industry as a band manager. They financed a band their daughter had recruited by reimbursing her for expenses and claimed those reimbursements as deductions. Examining those expenses with the nine factors of Treas. Reg. § 1.183-2(b), the Tax Court denied the deductions because the activity was not engaged in for profit. It cited the lack of previous experience in the music industry, the lack of profits, the absence of a business plan, and a personal desire to help their daughter succeed as weighing against

<sup>33</sup> 742 F.3d 243 (6th Cir. 2014), aff’g 113 A.F.T.R.2d (RIA) 817 (W.D. Tenn. 2013).

<sup>34</sup> *Id.*

<sup>35</sup> See, e.g., *Hoelscher v. Comm'r*, T.C. Memo. 2013-236 (deduction denied for ranching activities because not engaged in for profit under IRC § 183).

<sup>36</sup> 111 A.F.T.R.2d (RIA) 2235 (D. Idaho 2013).

<sup>37</sup> Those factors are (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on similar or dissimilar activities; (6) the taxpayer’s history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

<sup>38</sup> 111 A.F.T.R.2d 2235 (D. Idaho 2013).

<sup>39</sup> T.C. Memo. 2013-239.

a profit motive. The Tax Court declared the record label expenses were investments in the career of the taxpayers' daughter, which, "though laudable," were not deductible.<sup>40</sup>

Another issue addressed by the courts this year deals with the question of whether a transaction has economic substance, which is a prerequisite for deductibility.<sup>41</sup> For example, in *John Hancock Life Insurance Company v. Commissioner*, the Tax Court denied rent, depreciation, interest, and transaction expense deductions because they were derived from transactions that lacked economic substance.<sup>42</sup> The transactions in question were a series of lease-in-lease-out (LILO) and sales-in-lease-out (SILO) transactions whereby John Hancock would lease (LILO) or buy (SILO) from a tax-exempt entity, then lease the property back to the original entity, garnering favorable tax treatment. The Tax Court found that the transactions lacked economic substance because they were structured so that John Hancock never incurred any real risk and thus were similar in substance to a loan rather than a lease or sale.

## CONCLUSION

The definition of an allowable business expense remains open to interpretation and is highly fact-specific. This circumstance continues to generate substantial controversy between the IRS and taxpayers regarding the scope of properly claimed business deductions. This year, as in prior years, the IRS actively scrutinized and challenged many such deductions, while taxpayers were often willing to resort to litigation where the disallowance could not be resolved administratively within the IRS. From June 1, 2013, through May 31, 2014, courts generally favored the IRS's denial of business expense deductions, but specific facts and circumstances yielded some victories for taxpayers.

Many taxpayers remain confused over the Code's requirements. This confusion is particularly apparent with respect to the IRC § 280(A) limitations on the home office deduction.<sup>43</sup> Taxpayers lost on this issue and routinely argued for deductions while admitting that the space was used for personal activities or that their employer did not ask them to work from home. The fact that taxpayers claim home office deductions, while then effectively conceding their inapplicability through their testimony, indicates a general lack of understanding about the requirements. This confusion regarding the rules surrounding IRC § 280(A) underscores the need for a home office standard deduction or similar safe harbor as previously recommended by the National Taxpayer Advocate.<sup>44</sup>

Given the relative frequency of home office litigation, we recommend that the IRS highlight the available home office guidance on its website and improve the landing page taxpayers see when they access the home office section.<sup>45</sup> While the page provides an accurate overview of the deduction, it may not adequately emphasize or define the requirement of "exclusive use" or define the phrase "for the convenience

40 T.C. Memo. 2013-239.

41 Taxpayers lost all three cases litigated on the economic substance issue. See *John Hancock Life Ins. Co. v. Comm'r*, 141 T.C. 1 (2013); *UnionBanCal & Subsidiaries v. U.S.*, 113 Fed. Cl. 117 (Fed. Cl. 2013) (denying deduction for rent expenses because transactions did not have economic substance); *Humboldt Shelby Holding Corp. v. Comm'r*, T.C. Memo. 2014-47, appeal docketed, No. 14-3428 (2d Cir. Sept. 12, 2014) (denying deduction for legal expenses because the associated transactions did not have economic substance).

42 141 T.C. 1 (2013).

43 This longstanding confusion likely is why the IRS issued guidance to simplify calculation and reporting of this deduction in Revenue Procedure 2013-13. As part of a taxpayer burden reduction effort, the IRS concurrently began a marketing campaign to further educate taxpayers regarding this deduction.

44 National Taxpayer Advocate 2007 Annual Report to Congress 503-511 (Key Legislative Recommendation: *Home Office Business Deduction*).

45 See IRS, Home Office Deduction, available at <http://www.irs.gov/Businesses/Small-Businesses-& Self-Employed/Home-Office-Deduction> (last visited on Sept. 5, 2014).

of your employer.” Taxpayers may access more detailed explanations by following the link to Publication 587, *Business Use of Your Home*, but would be better served if the initial page elaborated on these two vital and frequently misunderstood requirements. Through education, outreach, and collaboration with stakeholders, the IRS can help taxpayers understand the requirements and limitations of the home office and other business expense deductions.

**MLI  
#3****Summons Enforcement Under IRC §§ 7602, 7604, and 7609****SUMMARY**

Pursuant to Internal Revenue Code (IRC) § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability.<sup>1</sup> To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information.<sup>2</sup> If a person summoned under § 7602 neglects or refuses to obey the summons, or to produce books, papers, records, or other data, or to give testimony, as required by the summons, the IRS may seek enforcement of the summons in a United States District Court.<sup>3</sup>

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it.<sup>4</sup> Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because often the government, rather than the taxpayer, initiates the litigation pertaining to summons enforcement. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons.<sup>5</sup> Generally, the burden on the taxpayer to establish the illegality of the summons is heavy.<sup>6</sup> When challenging the summons's validity, the taxpayer generally must provide "some credible evidence" supporting an allegation of bad faith or improper purpose.<sup>7</sup> The taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons only when the taxpayer can point to specific facts or circumstances that plausibly raise an inference of bad faith.<sup>8</sup> Naked allegations of improper purpose are not enough, but because direct evidence of IRS's bad faith "is rarely if ever available," circumstantial evidence can suffice to meet that burden.<sup>9</sup>

We identified 102 federal cases decided between June 1, 2013, and May 31, 2014, that included issues of IRS summons enforcement. In 49 cases, the government filed a petition to enforce the summons. In 51 cases, the taxpayer or a third party initiated the litigation by filing a motion to quash the summons. In two cases, the IRS was allowed to issue "John Doe" summonses.<sup>10</sup>

Of the 102 cases, the parties contesting the summonses prevailed fully in two cases, with three other cases resulting in split decisions. The IRS prevailed in full in the remaining 97 decisions.

1 IRC § 7602(a)(1); Treas. Reg. § 301.7602-1.

2 IRC § 7602(a).

3 IRC § 7604(b).

4 *United States v. Powell*, 379 U.S. 48, 58 (1964).

5 IRC § 7609(b).

6 *United States v. LaSalle Nat'l Bank*, 437 U.S. 298, 316 (1978).

7 *United States v. Clarke*, 189 L. Ed. 2d 330, 337 (2014), vacating 517 F. App'x 689 (11th Cir. 2013), rev'd 2012-2 U.S. Tax Cas. (CCH) ¶ 50,732 (S.D. Fla. 2012). For a more detailed discussion of this important Supreme Court case, see *Significant Cases, supra*.

8 *Id.* (stating that "[t]he taxpayer need only make a showing of facts that give rise to a plausible inference of improper motive.").

9 *Id.*

10 *In re Tax Liabilities of John Does*, 112 A.F.T.R.2d (RIA) 5982 (N.D. Cal. 2013); *In re Does*, 112 A.F.T.R.2d (RIA) 5466 (N.D. Pa. 2013). A John Doe summons identifies a particular group or class of people instead of a specific person. For the requirements for issuing a John Doe summons, see note 13, *infra*.

## PRESENT LAW

The IRS has broad authority under IRC § 7602 to issue a summons to examine a taxpayer's books and records or demand testimony under oath.<sup>11</sup> Further, the IRS may obtain information related to an investigation from a third party if, subject to the exceptions of IRC § 7609(c), it provides notice to the taxpayer or other person identified in the summons.<sup>12</sup> In limited circumstances, the IRS can issue a summons even if the name of the taxpayer under investigation is unknown, i.e., a "John Doe" summons.<sup>13</sup> However, the IRS cannot issue a summons after referring the matter to the Department of Justice (DOJ).<sup>14</sup>

If the recipient fails to comply with a summons, the United States may commence an action under IRC § 7604 in the appropriate U.S. District Court to compel document production or testimony.<sup>15</sup> If the United States files a petition to enforce the summons, the taxpayer may contest the validity of the summons in that proceeding.<sup>16</sup> Also, if the summons is served upon a third party, any person entitled to notice may petition to quash the summons in an appropriate District Court, and may intervene in any proceeding regarding the enforceability of the summons.<sup>17</sup>

Generally, a taxpayer or other person named in a third-party summons is entitled to notice.<sup>18</sup> However, the IRS does not have to provide notice in certain situations. For example, the IRS is not required to give notice if the summons is issued to aid in the collection of "an assessment made or judgment rendered against the person with respect to whose liability the summons is issued."<sup>19</sup> Congress created this exception because it recognized a difference between a summons issued in an attempt to compute the taxpayer's taxable income, and a summons issued after the IRS has assessed tax or obtained a judgment.

For example, the IRS does not have to give notice to the taxpayer or person named in the summons if it is attempting to determine whether the taxpayer has an account in a certain bank with sufficient funds to pay an assessed tax because such notice might seriously impede the IRS's ability to collect the tax.<sup>20</sup> Courts have interpreted this "aid in collection" exception to apply only if the taxpayer owns a legally identifiable interest in the account or other property for which records are summoned.<sup>21</sup> Another situation in

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<sup>11</sup> IRC § 7602(a). See also *LaMura v. United States*, 765 F.2d 974, 979 (11th Cir. 1985) (citing *U.S. v. Bisceglia*, 420 U.S. 141, 145-46 (1975)).

<sup>12</sup> IRC § 7602(c). Those entitled to notice of a third-party summons (other than the person summoned) must be given notice of the summons within three days of the day on which the summons is served to the third party but no later than the 23rd day before the day fixed on the summons on which the records will be reviewed. IRC § 7609(a).

<sup>13</sup> The court must approve a "John Doe" summons prior to issuance. In order for the court to approve the summons, the United States commences an *ex parte* proceeding. The United States must establish during the proceeding that its investigation relates to an ascertainable class of persons; it has a reasonable basis for the belief that these unknown taxpayers may have failed to comply with the tax laws; and it cannot obtain the information from another readily available source. IRC § 7609(f).

<sup>14</sup> IRC § 7602(d). This restriction applies to "any summons, with respect to any person if a [DOJ] referral is in effect with respect to such person." IRC § 7602(d)(1).

<sup>15</sup> IRC § 7604.

<sup>16</sup> *Powell*, 379 U.S. at 58.

<sup>17</sup> IRC § 7609(b). The petition to quash must be filed not later than the 20th day after the date on which the notice was served. IRC § 7609(b)(2)(A).

<sup>18</sup> IRC § 7609(a)(1); Treas. Reg. § 301.7609-1(a)(1). See, e.g., *Cephas v. United States*, 112 A.F.T.R.2d (RIA) 6483 (D. Md. 2013).

<sup>19</sup> IRC § 7609(c)(2)(D)(i). The exception also applies to the collection of a liability of "any transferee or fiduciary of any person referred to in clause (i)." IRC § 7609(c)(2)(D)(ii).

<sup>20</sup> H.R. Rep. No. 94-658 at 310, reprinted in 1976 U.S.C.C.A.N. at 3206. See also S. Rep. No. 94-938, pt. 1, at 371, reprinted in 1976 U.S.C.C.A.N. at 3800-01 (containing essentially the same language).

<sup>21</sup> *Ip v. United States*, 205 F.3d 1168, 1172-76 (9th Cir. 2000).

which notice is not required is when an IRS criminal investigator serves a summons in connection with a criminal investigation on any person who is not the third-party record-keeper.<sup>22</sup>

Whether the taxpayer contests the summons in a motion to quash or in response to the United States' petition to enforce, the legal standard is the same.<sup>23</sup> In *United States v. Powell*, the Supreme Court set forth four threshold requirements (referred to as the *Powell* requirements) that must be satisfied to enforce an IRS summons:

- The investigation must be conducted for a legitimate purpose;
- The information sought must be relevant to that purpose;
- The IRS must not already possess the information; and
- All required administrative steps must have been taken.<sup>24</sup>

The IRS bears the initial burden of establishing that these requirements have been satisfied.<sup>25</sup> The government meets its burden by providing a sworn affidavit of the agent who issued the summons declaring that each of the *Powell* requirements has been satisfied.<sup>26</sup> The burden then shifts to the person contesting the summons to demonstrate that the IRS did not meet the requirements or that enforcement of the summons would be an abuse of process.<sup>27</sup>

The taxpayer can show that enforcement of the summons would be an abuse of process if he can prove that the IRS issued the summons in bad faith.<sup>28</sup> In *United States v. Clarke*, the Supreme Court held that during a summons enforcement proceeding a taxpayer has a right to conduct an examination of the responsible IRS officials about whether a summons was issued for an improper purpose only when the taxpayer "can point to specific facts or circumstances plausibly raising an inference of bad faith."<sup>29</sup> Blanket claims of improper purpose are not sufficient, but circumstantial evidence can be.<sup>30</sup>

A taxpayer may also allege that the information requested is protected by a statutory or common-law privilege, such as the

- Attorney-client privilege;<sup>31</sup>

22 IRC § 7609(c)(2)(E). A third-party record-keeper is broadly defined and includes banks, consumer reporting agencies, persons extending credit by credit cards, brokers, attorneys, accountants, enrolled agents, and owners or developers of computer source code but only when the summons "seeks the production of the source or the program or the data to which the source relates." IRC § 7603(b)(2).

23 *Kamp v. United States*, 112 A.F.T.R.2d (RIA) 6630 (E.D. Cal. 2013).

24 *Powell*, 379 U.S. at 57-58.

25 *Fortney v. United States*, 59 F.3d 117, 119-20 (9th Cir. 1995).

26 *United States v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993).

27 *Id.*

28 *Powell*, 379 U.S. at 58.

29 *United States v. Clarke*, 189 L. Ed. 2d 330, 337 (2014), vacating 517 F. App'x 689 (11th Cir. 2013), rev'd 2012-2 U.S. Tax Cas. (CCH) ¶ 50,732 (S.D. Fla. 2012). For a more detailed discussion of this important Supreme Court case, see *Significant Cases*, *supra*.

30 *Id.*

31 The attorney-client privilege provides protection from discovery of information where:

(1) legal advice of any kind is sought, (2) from a professional legal advisor in his or her capacity as such, (3) the communication is related to this purpose, (4) made in confidence, (5) by the client, (6) and at the client's insistence protected, (7) from disclosure by the client or the legal advisor, (8) except where the privilege is waived. *United States v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing John Henry Wigmore, *Evidence in Trials at Common Law* § 2292 (John T. McNaughten rev. 1961)).

- Tax practitioner privilege;<sup>32</sup> or
- Work product privilege.<sup>33</sup>

However, these privileges are limited. For example, attorney-client privilege protects “tax advice,” but not tax return preparation materials.<sup>34</sup> The “tax shelter” exception limits the tax practitioner privilege and permits discovery of communications between a practitioner and client that promote participation in any tax shelter.<sup>35</sup> Thus, the tax practitioner privilege does not apply to any written communication between a federally authorized tax practitioner and “any person, any director, officer, employee, agent, or representative of the person, or any other person holding a capital or profits interest in the person” which is “in connection with the promotion of the direct or indirect participation of the person in any tax shelter.”<sup>36</sup> A tax shelter is defined as “a partnership or any other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.”<sup>37</sup>

## ANALYSIS OF LITIGATED CASES

Summons enforcement has appeared as a Most Litigated Issue in the National Taxpayer Advocate’s Annual Report to Congress every year since 2005. That year, we identified only 44 cases but predicted the number would rise as the IRS became more aggressive in its enforcement initiatives. The volume of cases rose to 101 during the reporting period ending on May 31, 2006, peaked at 158 for the reporting period ending on May 31, 2009, and stands at 102 during this year’s period as shown in Figure 3.3.1 below. A detailed list of these cases appears in Table 3 of Appendix III.

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<sup>32</sup> IRC § 7525 extends the protection of the common law attorney-client privilege to federally authorized tax practitioners in federal tax matters. Criminal tax matters and communications regarding tax shelters are exceptions to the privilege. IRC § 7525(a) (2), (b). The interpretation of the tax practitioner privilege is based on the common law rules of attorney-client privilege. *United States v. BDO Seidman, LLP*, 337 F.3d 802, 810-12 (7th Cir. 2003).

<sup>33</sup> The work product privilege protects against the discovery of documents and other tangible materials prepared in anticipation of litigation. FED. R. Civ. P. 26(b)(3); see also *Hickman v. Taylor*, 329 U.S. 495 (1947).

<sup>34</sup> *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999).

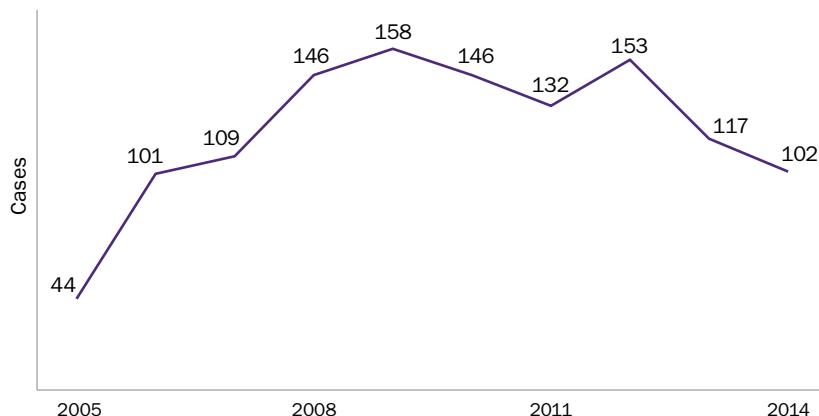
<sup>35</sup> IRC § 7525(b); *Valero Energy Corp. v. United States*. 569 F.3d 626 (7th Cir. 2009).

<sup>36</sup> IRC § 7525(b).

<sup>37</sup> IRC § 6662(d)(2)(C)(ii).

**FIGURE 3.3.1**

**IRS Summons Enforcement**  
by reporting period of June 1-May 31 of each year



In November of 2013, the Large Business and International Division (LB&I) of the IRS issued guidance to examiners on how to handle cases where the taxpayer does not provide a complete response to an Information Document Request (IDR) by the response date. The guidance requires that the examiner issue a delinquency notice and then a pre-summons letter prior to issuing a summons.<sup>38</sup> LB&I created these new procedures, which focus on enhanced pre-summons communications, because it believes the new process will improve the IRS's "ability to gather information timely and reduce the need to enforce IDR's through summonses." If effective, these new procedures could reduce the number of summonses issued, and as a consequence, we may see less litigation in this area in the future.

Of the 102 cases we reviewed this year, the IRS prevailed in full in 97, a success rate of 95 percent. Taxpayers were represented in 32 cases and appeared *pro se* (*i.e.*, on their own behalf) in the remaining 70. Seventy-nine cases involved individual taxpayers, while the remaining 23 involved business taxpayers, including sole proprietorships.<sup>39</sup> The arguments the litigants raised against IRS summonses generally fell into one of seven categories:

**Powell Requirements:** Taxpayers frequently but unsuccessfully argued that the IRS did not meet one or more of the *Powell* requirements. Taxpayers often were unable to meet the substantial burden to rebut the IRS's *prima facie*<sup>40</sup> showing that the summons should be enforced. The U.S. Court of Appeals for the Eighth Circuit described the taxpayer's burden as heavy since the taxpayer must disprove one of the *Powell* requirements or show that enforcement of the summons would otherwise be an abuse of process.<sup>41</sup>

<sup>38</sup> Memorandum for LB&I Employees From Heather C. Maloy, Commissioner, Large Business and International Division, *Large Business and International Directive on Information Document Requests Enforcement Process*, Control No. LB&I-04-1113-009, 2013 TNT 214-19 (Nov. 4, 2013).

<sup>39</sup> There were cases in which the IRS issued summons for investigations into both the individual taxpayer and his or her business. For the purposes of this MLI, we placed these cases into the business taxpayer category.

<sup>40</sup> *Prima facie* means "at first sight, on appearance but subject to further review or evidence." *Black's Law Dictionary* (9th ed. 2009), available at Westlaw BLACKS.

<sup>41</sup> *United States v. Claes*, 747 F.2d 491, 494 (8th Cir. 1984).

When taxpayers challenge the IRS's compliance with the *Powell* requirements, they often allege that the IRS failed to take one of the required administrative steps.<sup>42</sup> One recurring argument was that the person who issued the summons did not have the authority to do so.<sup>43</sup> Taxpayers were unsuccessful in making that argument because the Commissioner of Internal Revenue delegated his power to serve summonses to certain employees.<sup>44</sup>

However, one taxpayer was able to prove that the IRS did not meet one of the *Powell* requirement—namely, failing to complete all of the required administrative steps. In *Jewell v. United States*,<sup>45</sup> the United States Court of Appeals for the Tenth Circuit determined that the IRS could not establish a *prima facie* case for summons enforcement under *Powell* because it failed to comply with the 23-day notice of a third party summons required by statute.<sup>46</sup> The Tenth Circuit felt obliged to quash the summons to comply with Supreme Court precedent that requires *all* administrative requirements of the IRC be met even if its ruling might be viewed as “inequitable” or “form over substance.”<sup>47</sup> In choosing to quash the summons for failure to meet the notice requirement, the Court of Appeals for the Tenth Circuit created a circuit split because the five other circuits to consider this issue all held that the failure to comply with the statutory notice requirement did not prevent enforcement of the summons.<sup>48</sup>

**Criminal Referral:** The IRS can issue summonses for the purpose of investigating a possible criminal offense, unless the matter has already been referred to the DOJ.<sup>49</sup> Some taxpayers argued that because the IRS issued a summons pursuant to a possible criminal investigation, it violated IRC § 7602(d).<sup>50</sup> However, the courts clearly state that a criminal investigation is not sufficient to show a referral to the DOJ.<sup>51</sup>

**Constitutional Arguments:** At least one court reiterated the longstanding rule that taxpayers cannot use the Fourth Amendment as a defense against a third-party summons.<sup>52</sup> Courts also continued to reject blanket assertions of the Fifth Amendment,<sup>53</sup> but noted that taxpayers may have valid Fifth Amendment

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42 See, e.g., *United States v. Soong*, 113 A.F.T.R.2d (RIA) 1589 (N.D. Cal. 2014), *appeal docketed*, No. 14-15987 (9th Cir. May 20, 2014); *Gangi v. United States*, 113 A.F.T.R.2d (RIA) 1175 (D. Mass. 2014).

43 See, e.g., *Mahmood v. United States*, 2013 U.S. Dist. LEXIS 184841, at \*6 (S.D. Cal. Dec. 10, 2013).

44 See Delegation Order No. 25-1, IRM 1.2.52.2 (Apr. 30, 2009).

45 *Jewell v. United States*, 749 F.3d 1295 (10th Cir. 2014), *aff'g* 111 A.F.T.R.2d (RIA) 1129 (E.D. Okla. 2013) and *rev'g* 111 A.F.T.R.2d (RIA) 1005 (W.D. Okla. 2013), *reh'g denied en banc*, No. 13-7038 (10th Cir. June 16, 2014).

46 “[N]otice shall be given to any person so identified [in the summons] within 3 days of the day on which such service is made but no later than the 23rd day before the day fixed in the summons as the day upon which such records are to be examined.” IRC § 7609(a)(1).

47 *Jewell*, 749 F.3d at 1301.

48 Four circuit courts declined to hold that the 23-day notice period was mandatory. See *Sylvestre v. United States*, 978 F.2d 25, 26, 28 (1st Cir. 1992) (per curiam) (acknowledges that *Powell* requires the IRS to comply with all administrative requirements but ignores the 23-day notice requirement found in the Code); see also *Cook v. United States*, 104 F.3d 886, 889- 90 (6th Cir. 1997), *Azis v. United States IRS*, 522 Fed. Appx. 770, 777 (11th Cir. 2013) (per curiam), *Adamowicz v. United States*, 531 F.3d 151, 161 (2d Cir. 2008) (per curiam) (all assume equitable power to excuse notice defect if taxpayer not prejudiced). One other circuit court allowed enforcement of the summons to avoid elevating “form over substance” and rejected the suggestion that every infringement of a statutory requirement absolutely precludes enforcement of an IRS summons. *United States v. Bank of Moulton*, 614 F.2d 1063, 1066 (5th Cir. 1980) (per curiam).

49 IRC § 7602(d);

50 See, e.g., *Bone v. United States*, 2013 U.S. Dist. LEXIS 127631 (D. Idaho Sept. 5, 2013), *adopting* 2013 U.S. Dist. LEXIS 127748 (D. Idaho Aug. 12, 2013); *Hunkler v. United States*, 113 A.F.T.R.2d (RIA) 1788 (S.D. Oh. 2014).

51 *Worsham v. Dep't of the Treasury*, 112 A.F.T.R.2d (RIA) 6315 (D. Md. 2013) (D. Md. Sept. 17, 2013).

52 See, e.g., *Nevius v. Tomlinson*, 113 A.F.T.R.2d (RIA) 1872 (W.D. Mo. 2014).

53 See e.g., *United States v. McClintic*, 113 A.F.T.R.2d (RIA) 330 (D. Or. 2013).

claims regarding specific documents or testimony.<sup>54</sup> However, even if a taxpayer may assert the Fifth Amendment on behalf of himself, he cannot assert it on behalf of a business entity.<sup>55</sup>

Additionally, taxpayers cannot, on the basis of the Fifth Amendment privilege, withhold self-incriminatory evidence of a testimonial or communicative nature if the summoned documents fall within the “foregone conclusion” exception to the Fifth Amendment. The exception applies if the government establishes its independent knowledge of three elements:

- The documents’ existence;
- The documents’ authenticity; and
- The possession or control of the documents by the person to whom the summons was issued.<sup>56</sup>

In *United States v. Lawrence*, the court analyzed the applicability of the foregone conclusion exception, specifically, the government’s ability to meet the authenticity requirement of the exception.<sup>57</sup> The IRS wanted the taxpayer to produce “cheat sheets” that the taxpayer allegedly withheld. The IRS contended that because one of its agents saw the cheat sheets, their existence was a foregone conclusion, precluding the taxpayer from asserting his Fifth Amendment privilege. The court disagreed, finding that “[e]ven if the IRS may have knowledge of the documents’ existence, the Government has made no showing that the documents’ authenticity can be independently verified.”<sup>58</sup> Because compelling the taxpayer to produce the “cheat sheets” would implicitly affirm the authenticity of the documents, producing the documents would be sufficiently testimonial so that the Fifth Amendment privilege should apply.<sup>59</sup>

When the IRS issues a summons for oral testimony, the process for claiming the Fifth Amendment is similar to that involving an IRS request for documents. In *United States v. Tagle*,<sup>60</sup> the IRS wanted the court to enforce a summons for oral testimony,<sup>61</sup> and the taxpayers argued the order to enforce the summons would violate their Fifth Amendment rights. When the IRS is seeking to enforce summons by way of oral testimony, the taxpayer is required to show that he or she has a reasonable fear that answering the IRS’s questions could be incriminating.<sup>62</sup> The court granted the enforcement of summons because it could not assess the hazards of self-incrimination before particular questions had been posed. However, the court noted that the taxpayers may invoke their Fifth Amendment privilege in response to specific questions asked at the interview.

**Abuse of Process:**<sup>63</sup> Taxpayers consistently tried to make the argument that it would be an abuse of the court’s process to enforce the summons.<sup>64</sup> Taxpayers most frequently tried to show that the summons was

54 See, e.g., *United States v. Lawrence*, 113 A.F.T.R.2d (RIA) 1933 (S.D. Fla. 2014).

55 See, e.g., *United States v. Ali*, 113 A.F.T.R.2d (RIA) 1863 (D. Md. 2014) (citing *United States v. Wujkowski*, 929 F.2d 981, 983 (4th Cir. 1991)).

56 *United States v. Bright*, 596 F.3d 683, 692 (9th Cir. 2010).

57 113 A.F.T.R.2d (RIA) 1933 (S.D. Fla. 2014).

58 *Id.*

59 *Id.*

60 113 A.F.T.R.2d (RIA) 1818 (N.D. Cal. 2014).

61 The summons also requested documents but that issue is omitted.

62 *Tagle*, 113 A.F.T.R.2d (RIA) 1818 (N.D. Cal. 2014) (citing *United States v. Neff*, 615 F.2d 1235, 1239 (9th Cir. 1980) (internal quotation and citation omitted)).

63 “[A] court may not permit its process to be abused. Such an abuse would take place if the summons had been issued for an improper purpose ...” *Powell*, 379 U.S. at 58.

64 See, e.g., *Gangi*, 113 A.F.T.R.2d (RIA) 1175; *Ryder v. United States*, 113 A.F.T.R.2d (RIA) 706 (C.D. Cal. 2014).

issued in bad faith. However, taxpayers were generally unsuccessful in proving bad faith or improper motive based on mere allegations, without any facts and circumstances that can plausibly infer bad faith.<sup>65</sup>

**Privilege:** In *Wells Fargo and Co. v. United States*, the court analyzed whether certain taxpayer documents summoned by the IRS were protected by the work product doctrine and attorney-client privilege.<sup>66</sup> As part of the IRS's examination of Wells Fargo's federal tax returns for 2007 and 2008, the IRS issued summonses to KPMG, Wells Fargo's independent auditor, and to Wells Fargo seeking its tax accrual work papers (TAWs) and other information. Wells Fargo moved to quash the summonses claiming, among other things, that some of the TAWs, including those related to Wells Fargo's Uncertain Tax Positions (UTPs),<sup>67</sup> were protected by the work product doctrine.

The IRS was partially successful in enforcing the summons. First, the court found that Wells Fargo's identification of UTPs and factual information related to those UTPs contained in the TAWs was not protected by the work product privilege because it was "created in the ordinary course of business and not in anticipation of litigation."<sup>68</sup> Moreover, Wells Fargo could not have anticipated litigation with the IRS because it would not enter into transactions related to a UTP unless there was at least a 70 percent probability of success in litigation. With such a high probability of success, it was unlikely that the IRS would challenge the taxpayer.

Second, the Court determined that "the recognition and measurement analysis [in TAWs] sought by the summonses is work product because it involves legal analysis prepared in anticipation of litigation."<sup>69</sup> Even though Wells Fargo provided the IRS with documents that referenced these analyses, they did not cease to be work product because if the IRS had access to that information, it would give the government "a window into the legal thinking of Wells Fargo's attorneys."<sup>70</sup>

The IRS tried to overcome the work product doctrine by arguing that Wells Fargo waived privilege by disclosing the information to a potential adversary, its auditor, KPMG. The court found that KPMG's TAWs and testimony were protected to the same extent as Wells Fargo's TAWs and testimony because the likelihood of an adversarial relationship between KPMG and Wells Fargo was insufficient to support a finding of waiver.<sup>71</sup> Alternatively, the IRS argued that even if KPMG was not an adversary, Wells Fargo waived the privilege because KPMG was a conduit to an adversary. The IRS based this argument on the theory that KPMG may be required to disclose the TAWs to the Securities and Exchange Commission or the Public Company Accounting Oversight Board.<sup>72</sup> However, the IRS failed to show that there was "more than a remote possibility of disclosure" and that there was an intention that the documents be

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65 Clarke, 189 L. Ed. 2d 330 (2014). For a more detailed discussion of this important Supreme Court case, see *Significant Cases*, *supra*. See also, e.g., *Worsham*, 112 A.F.T.R.2d (RIA) 6315.

66 *Wells Fargo and Co. v. United States*, 112 A.F.T.R.2d (RIA) 5380 (D. Minn. 2013).

67 UTPs are tax positions taken by the taxpayer in which it has reordered a reserve on its audited financial statements or expects to litigate the position. Wells Fargo would have to disclose its UTPs on Schedule UTP which is filed with its tax return. See IRS Schedule UTP (Form 1120), *Uncertain Tax Position Statement* (2013).

68 *Wells Fargo*, 112 A.F.T.R.2d (RIA) 5380 (D. Minn. 2013) at \*35.

69 *Id.* at \*100. These TAWs were developed by both KPMG and Wells Fargo's attorneys. Several emails discussed potential challenges by the IRS and developments in possible litigation. These emails also contained analysis of cases and assessments of outcomes in potential litigation. *Id.*

70 *Wells Fargo*, 112 A.F.T.R.2d (RIA) 5380 (D. Minn. 2013) at 114.

71 Specifically, the court noted that KPMG and Wells Fargo have had a "cooperative and professional" relationship for 20 years and that litigation between a client and its auditor is rare. *Id.* at 70.

72 *Id.* at 123 (citing *United States v. Johnson*, 378 F. Supp. 2d 1041, 1046 (N.D. Iowa 2005) and *Gundacker v. Unisys Corp.*, 151 F.3d 842, 848 (8th Cir. 1998)).

disclosed to the adversary.<sup>73</sup> The Court concluded that certain TAWs were protected by the work product doctrine and eight of the documents sought by the United States were protected by attorney-client privilege. The court ordered Wells Fargo and KPMG to disclose specific documents not protected by privilege.

The IRS prevailed in 14 cases involving motions to quash summonses based solely on the court lacking subject matter jurisdiction. The courts dismissed these cases for lack of jurisdiction for the following reasons:

**Lack of Jurisdiction Due to Procedural Requirements:** The United States is immune from suit unless Congress has expressly waived its sovereign immunity.<sup>74</sup> Therefore, a court has jurisdiction only when Congress has expressly waived this immunity. When a taxpayer wishes to challenge an IRS summons issued to a third party, federal law sets forth the exclusive method by which the taxpayer can proceed. The taxpayer must initiate the proceeding in U.S. District Court for the district in which the third party resides, but the proceeding must be initiated no later than 20 days from the date the notice of summons was given.<sup>75</sup> Courts have strictly construed the IRC § 7609(b) deadline when determining whether sovereign immunity has been waived. For example, a court dismissed a *pro se* taxpayer's motion to quash for lack of jurisdiction because the taxpayer filed the motion three days after the 20-day limit expired.<sup>76</sup> Another court held that it lacked subject matter jurisdiction over a petition to quash a third-party summons, where the third parties neither resided in nor were found within the jurisdiction of the district court.<sup>77</sup>

**Lack of Jurisdiction Due to Notice Requirements:**<sup>78</sup> Courts denied multiple motions to quash because the parties contesting the summonses were not entitled to notice of the summonses due to one of the IRC § 7609(c) exceptions and therefore lacked standing to contest their validity.<sup>79</sup> In *Beakley v. United States*, the government served third-party summonses requesting information related to the taxpayer's tax liability or the collection of the liability involving the potential settlement of a case in which the taxpayer was a party.<sup>80</sup> The taxpayer moved to quash the summonses, arguing that the IRS failed to give him proper statutory notice. The court rejected this argument because the summonses were issued in aid of collection of tax assessment, which is a statutory exception to the notice requirement.<sup>81</sup> Therefore, the court held that sovereign immunity had not been waived and the court lacked subject matter jurisdiction.

## CONCLUSION

The IRS may issue a summons to obtain information needed to determine whether a tax return is correct or if a return should have been filed, to ascertain a taxpayer's tax liability, or to collect a liability.<sup>82</sup> Accordingly, the IRS may request documents and testimony from taxpayers who have failed to provide

73 *Id.* at 128.

74 *United States v. Dalm*, 494 U.S. 596, 608 (1990).

75 IRC § 7609(b)(2)(A).

76 *Fisher v. United States*, 112 A.F.T.R.2d (RIA) 6971 (E. Wis. 2013).

77 *Abusch v. United States*, 112 A.F.T.R.2d (RIA) 7089 (E.D. La. 2013), *adopting* 112 A.F.T.R.2d (RIA) 7088 (E.D. La. 2013).

78 There is a jurisdictional split as to whether the failure to comply with the statutory notice requirement is an absolute bar to enforcement of the summons. Cf. *Jewell v. United States*, 749 F.3d 1295 (10th Cir. 2014) with *Sylvestre v. United States*, 978 F.2d 25, 26, 28 (1st Cir. 1992) (per curiam); *Cook v. United States*, 104 F.3d 886, 889 (6th Cir. 1997), *Azis v. United States* IRS, 522 Fed. App'x. 770, 777 (11th Cir. 2013) (per curiam); *Adamowicz v. United States*, 531 F.3d 151, 161 (2d Cir. 2008) (per curiam); *United States v. Bank of Moulton*, 614 F.2d 1063, 1066 (5th Cir. 1980) (per curiam).

79 IRC § 7609(c)(2).

80 *Beakley v. United States*, 113 A.F.T.R.2d (RIA) 1848 (N.D. Tex. 2014), *adopting* 113 A.F.T.R.2d (RIA) 1846 (N.D. Tex. 2014).

81 IRC § 7609(c)(2)(D)(i).

82 IRC § 7602(a).

that information voluntarily. Taxpayers and third parties rarely succeed in contesting IRS summonses due to the significant burden of proof and strict procedural requirements.

After a spike in 2012, the number of summons enforcement cases returned to pre-2007 levels. Because the IRS in November 2013 developed new procedures that provide for better pre-summons communications, we expect even less litigation in this area in the future. The Supreme Court's recent decision in *Clarke* may reduce the number of cases as well. The Supreme Court clarified that during a summons enforcement proceeding, a taxpayer is entitled to examine an IRS agent about the purpose of the summons only if the taxpayer presents credible evidence of bad faith or an improper motive.<sup>83</sup> Thus, taxpayers can no longer challenge the summons based on an unsupported claim of improper purpose, which may reduce future litigation in this area.

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<sup>83</sup> *United States v. Clarke*, 189 L. Ed. 2d 330, 337 (2014), vacating 517 F. App'x 689 (11th Cir. 2013), rev'g 2012-2 U.S. Tax Cas. (CCH) ¶ 50,732 (S.D. Fla. 2012).

**MLI  
#4****Gross Income Under IRC § 61 and Related Sections****SUMMARY**

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress.<sup>1</sup> For this report, we reviewed 89 cases decided between June 1, 2013, and May 31, 2014. The majority of cases involved taxpayers failing to report items of income, including some specifically mentioned in Internal Revenue Code (IRC) § 61 such as wages,<sup>2</sup> interest,<sup>3</sup> dividends,<sup>4</sup> and annuities.<sup>5</sup>

**PRESENT LAW**

IRC § 61 broadly defines gross income as "all income from whatever source derived."<sup>6</sup> The U.S. Supreme Court has defined gross income as any accession to wealth.<sup>7</sup> However, over time, Congress has carved out numerous exceptions and exclusions from this broad definition of gross income, and has based other elements of tax law on the definition.<sup>8</sup>

The Commissioner may identify particular items of unreported income or reconstruct a taxpayer's gross income using methods such as the bank deposits method.<sup>9</sup> If the Commissioner determines a tax deficiency, the IRS issues a Statutory Notice of Deficiency.<sup>10</sup> If the taxpayer challenges the deficiency, the Commissioner's notice is entitled to a presumption of correctness; the taxpayer bears the burden of proving that the determination is erroneous or inaccurate.<sup>11</sup>

**ANALYSIS OF LITIGATED CASES**

In the 89 opinions involving gross income issued by the federal courts and reviewed for this report, gross income issues most often fall into two categories: (1) what is included in gross income under IRC § 61, and (2) what can be excluded under other statutory provisions. A detailed list of the cases appears in Table 4 of Appendix III.

1 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 355-61; National Taxpayer Advocate 2012 Annual Report to Congress 637-42.

2 IRC § 61(a)(1). See, e.g., *Aldrich v. Comm'r*, T.C. Memo. 2013-201.

3 IRC § 61(a)(4). See, e.g., *Duggan v. Comm'r*, T.C. Memo. 2014-17.

4 IRC § 61(a)(7). See, e.g., *Edem v. Comm'r*, T.C. Memo. 2013-238.

5 IRC § 61(a)(9). See, e.g., *Craighead v. Comm'r*, T.C. Memo. 2013-246.

6 IRC § 61(a).

7 *Comm'r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955) (interpreting § 22 of the Internal Revenue Code of 1939, the predecessor to IRC § 61).

8 See, e.g., IRC §§ 104 (compensation for injuries or sickness); 105 (amounts received under accident and health plans); 108 (income from discharge of indebtedness); 6501(limits on assessment and collection, determination of "substantial omission" from gross income).

9 IRC § 6001. See, e.g., *DiLeo v. Comm'r*, 96 T.C. 858, 867 (1991).

10 IRC § 6212. See also Internal Revenue Manual (IRM) 4.8.9.2 (July 9, 2013).

11 See IRC § 7491(a) (burden shifts only where the taxpayer produces credible evidence contradicting the Commissioner's determination and satisfies other requirements). See also *Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted).

In 34 cases (about 38 percent), taxpayers were represented, while the rest were *pro se* (without counsel). Eight of the 34 represented taxpayers (about 24 percent) prevailed in full in their cases and four prevailed in part, whereas *pro se* taxpayers prevailed in full in just two cases and in part in two others. Overall, taxpayers prevailed in full or in part in 16 of 89 cases (about 18 percent).

Drawing on the full list in Table 4 of Appendix III, we have chosen to discuss cases involving damage awards and IRA distributions, which were among the most common issues. In addition, we discuss a case of first impression involving the characterization of payments to a parent to care for her disabled adult son as foster care payments.

### **Damage Awards**

Taxation of damage awards continues to generate litigation. This year, taxpayers in at least five cases (about six percent of those reviewed) challenged the inclusion of damage awards in their gross income, but just one taxpayer prevailed, and only in part, on the issue.<sup>12</sup>

IRC § 104(a)(2) specifies that damage awards and settlement proceeds<sup>13</sup> are taxable as gross income unless the award was received “on account of personal physical injuries or physical sickness.”<sup>14</sup> Congress added the “physical injuries or physical sickness” requirement in 1996;<sup>15</sup> until then, the word “physical” did not appear in the statute. The legislative history of the 1996 amendments to IRC § 104(a)(2) provides that “[i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness...[but] emotional distress is not considered a physical injury or physical sickness.”<sup>16</sup> Thus, damage awards for emotional distress are not considered as received on account of physical injury or physical sickness, even if the emotional distress results in “insomnia, headaches, [or] stomach disorders.”<sup>17</sup>

To justify exclusion from income under IRC § 104, the taxpayer must show settlement proceeds are in lieu of damages for physical injury or sickness.<sup>18</sup> In *Molina v. Commissioner*, the taxpayer petitioned the U.S. Tax Court to exclude from his income a settlement award from his former employer for alleged discrimination, alleged creation of a hostile work environment, and alleged retaliation for reporting the alleged discrimination.<sup>19</sup>

The parties entered into mediation and negotiated a settlement after Mr. Molina filed suit in the Superior Court of New Jersey. Mr. Molina’s complaint only alleged serious and significant emotional and physical distress, and made no mention of any physical injuries or sickness suffered as a result of the alleged discrimination and retaliation. He settled with his former employer, and in 2007 received an installment payment under the agreement and a payment for attorneys’ fees. While he reported the installment

12 See, e.g., *Simpson v. Comm'r*, 141 T.C. 331 (2013), appeal docketed, No. 14-72372 (9th Cir. Aug. 4, 2014).

13 See Treas. Reg. § 1.104-1(c) (damages received, for purposes of IRC § 104(a)(2), means amounts received “through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of such prosecution”).

14 IRC § 104(a)(2).

15 Pub. L. No. 104-188, § 1605(a), 110 Stat. 1755, 1838 (1996).

16 H.R. Rep. No. 104-586, at 143-44 (1996).

17 H.R. Conf. Rep. No. 104-737, at 301 (1996). Note, however, that IRC § 104(a)(2) excludes from income damages, up to the cost of medical treatment for which a deduction under IRC § 213 was allowed for any prior taxable year, for mental or emotional distress causing physical injury.

18 See, e.g., *Green v. Comm'r*, 507 F.3d 857 (5th Cir. 2007), aff'g T.C. Memo. 2005-250.

19 T.C. Memo. 2013-226.

payment on his tax return, he argued that it was excludible from gross income and did not include it in his total gross income.<sup>20</sup>

The court looked to the employer's intent in making the payments.<sup>21</sup> The settlement agreement characterized the payments as wages and attorney fees.<sup>22</sup> The Tax Court then looked to the contents of the taxpayer's complaint for insight into what the settlement payment was for, and determined it made no claims of physical injuries or illness, nor was there any evidence that Mr. Molina ever informed his former employer of any injuries or illness. This led the court to conclude that the employer intended the payments to be solely for wages and attorney fees.<sup>23</sup> This case serves as a caution to taxpayers that failure to carefully consider how the settlement agreement specifies the reasons and characterization for the payments can lead to significant tax consequences down the road.

As illustrated by continuing litigation of the characterization of settlement damages, the question of when damage awards can be excluded from gross income continues to confuse taxpayers. Even when taxpayers seek legal advice before filing a complaint for damages or accepting settlement proceeds, they may not understand how to characterize the damages in the complaint to be able to exclude them under IRC § 104(a)(2), or they may be uncertain about the proper tax treatment of the proceeds. For example, in *Simpson v. Commissioner*, the taxpayer's attorney informed the taxpayer and her family that her settlement proceeds would not be taxed.<sup>24</sup> The taxpayer relied on her attorney (who was not her tax advisor) and failed to include the settlement proceeds in her gross income.<sup>25</sup>

As these cases illustrate, the issue of including damages awarded on account of mental illness in gross income continues to plague the courts, and taxpayers continue to disagree with the IRS's and courts' interpretation that mental illness equates to emotional distress, opposed to physical sickness or injury. As discussed in the National Taxpayer Advocate's 2009 Annual Report to Congress, this assessment seems particularly outdated when considering the medical communities' advancements in understanding the physical cause and symptoms of mental illness.<sup>26</sup>

### IRA Distributions

IRC § 61(a) defines gross income as "all income from whatever source derived, including (but not limited to)... (9) Annuities; ... and (11) Pensions."<sup>27</sup> IRC § 408(d)(1) governs the tax treatment of distributions from individual retirement accounts (IRAs), and provides that they are generally included in gross income as amounts received as an annuity under IRC § 72.

20 *Molina v. Comm'r*, T.C. Memo. 2013-226.

21 *Id.*

22 *Id.*

23 *Id.*

24 141 T.C. 331 (2013).

25 *Simpson v. Comm'r*, 141 T.C. 331 (2013).

26 National Taxpayer Advocate 2009 Annual Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*). The National Taxpayer Advocate recommended that Congress amend IRC §104(a)(2) to exclude from gross income payments received as settlement for mental anguish, emotional distress, and pain and suffering. Such change was recommended because mental anguish, emotional distress, and pain and suffering can be caused by a physical condition in the body and can cause physical symptoms. Over the past few years, doctors and researchers have made significant advances in identifying changes that occur in the brain when a person is plagued with mental illness.

27 IRC § 61(a).

Taxpayers in at least ten cases argued that portions of their IRA distributions were excluded from gross income, prevailing in full in two cases and in part in one case.<sup>28</sup> Taxpayers in at least three cases challenged the taxability of the distributions, arguing the “rollover provision” under § 408(d) applied.<sup>29</sup> The “rollover provision” generally excludes from gross income IRA distributions that are transferred into an eligible retirement account within 60 days of receipt.<sup>30</sup> Taxpayers are limited, however, under IRC § 408(d)(3)(B) to one nontaxable rollover per year.<sup>31</sup>

For example, in *Bobrow v. Commissioner* the taxpayers (husband and wife) received distributions from three separate IRAs, and attempted to complete two nontaxable rollovers for the husband in one tax year.<sup>32</sup> The court found that distributions from two of the accounts were includable in gross income, while the distribution from the third account was excludable. In addition, the court found Mr. Bobrow’s second rollover for the tax year was properly characterized as a taxable distribution and includable in gross income.

### Foster Care Payments

One court this year decided a case of first impression regarding the characterization of payments from the state as foster care payments.<sup>33</sup> Qualified foster care payments, received by a foster care provider, are excludable from gross income under IRC § 131(a).

In *Ray v. Commissioner*, Mrs. Ray provided certified care to her severely disabled adult son Tony. Tony’s Individualized Service Plan (ISP), developed by the Franklin County (Ohio) Board of Developmental Disabilities after he turned 18, requires that he receive this care from a certified provider, and further dictates that he reside in the Rays’ home.<sup>34</sup> Additionally, upon Tony turning 18, Mrs. Ray was appointed his legal guardian, as his disabilities are such that he is unable to talk, walk, or provide for any of his own needs.<sup>35</sup> She receives compensation for the care she provides to Tony from the state of Ohio, through a Medicaid program called Individual Options Waiver, which permits a person with disabilities to live at home.<sup>36</sup>

The Rays filed amended returns for tax years 2005–2007 to exclude the payments Mrs. Ray received from the state for her care of Tony as foster care payments.<sup>37</sup> The issue before the court was whether the payments were excludable as qualified foster care payments. The decision turned on the meaning of “foster,” and whether the IRC § 131 exclusion is applicable if the taxpayer providing the care is the biological parent of a recipient older than 18. The word “foster” appears throughout IRC § 131, but Congress did not define the term.

<sup>28</sup> See *Roberts v. Comm'r*, 141 T.C. No. 19 (2013) (taxpayer prevailed in full); *Haury v. Comm'r*, 751 F.3d 867 (8th Cir. 2014) (taxpayer prevailed in full); *Bobrow v. Comm'r*, T.C. Memo. 2014-21 (taxpayers prevailed in part).

<sup>29</sup> See *Alexander v. Comm'r*, T.C. Summ. Op. 2014-18; *Bobrow v. Comm'r*, T.C. Memo. 2014-21; *Haury v. Comm'r*, 751 F.3d 867 (8th Cir. 2014).

<sup>30</sup> IRC § 408(d)(3)(A)(i), (ii); *Schoof v. Comm'r*, 110 T.C. 1, 7 (1998).

<sup>31</sup> IRC § 408(d)(3)(B).

<sup>32</sup> T.C. Memo. 2014-21.

<sup>33</sup> See *Ray v. U.S.*, 113 A.F.T.R.2d (RIA) 382 (S.D. Ohio 2014).

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

Where a word is not defined statutorily, the court must use its “ordinary meaning.”<sup>38</sup> The court determined that a foster care situation exists when one voluntarily provides care for a minor or other qualified foster individual in absence of a legal obligation.<sup>39</sup> Because Mrs. Ray is Tony’s legal guardian, she was under a legal obligation to either obtain or provide care to him. As a result, payments made to her for personally providing that care cannot be construed as foster care payments.<sup>40</sup> Thus, the payments Mrs. Ray received from the state were not excludable.

## CONCLUSION

Taxpayers litigate many of the same gross income issues every year due to the complex nature of what constitutes gross income. As the definition is very broad and the courts broadly interpret accession to wealth as gross income, most cases were decided in favor of the IRS and exclusions from gross income continued to be narrowly interpreted.

While the number of cases involving the tax treatment of settlements and awards continued to decrease, from six in 2013 to five this year, it remains a perennial area of confusion for taxpayers. The National Taxpayer Advocate has previously recommended a legislative change that would clarify the tax treatment of court awards and settlements by permitting taxpayers to exclude any payments received as a settlement or judgment for mental anguish, emotional distress, or pain and suffering.<sup>41</sup> Additionally, the National Taxpayer Advocate plans to provide for inclusion in the IRS 2015-2016 Priority Guidance Plan her recommendations for published guidance regarding facts and circumstances under which damages awarded on account of mental illness should be considered a physical injury, and thereby excluded from gross income under IRC § 104(a)(2).

Cases involving the tax treatment of distributions from IRAs continued to rise this year, with ten cases compared to eight last year. Taxpayers litigated this issue with some success, prevailing in full or in part in three cases.

38 Ray v. U.S., 113 A.F.T.R.2d (RIA) 382 (S.D. Ohio 2014) (quotations omitted).

39 *Id.*

40 *Id.*

41 National Taxpayer Advocate Annual 2009 Report to Congress 351-56 (Legislative Recommendation: *Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income*).

**MLI****#5**

## **Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330**

### **SUMMARY**

Collection Due Process (CDP) hearings were created by the IRS Restructuring and Reform Act of 1998 (RRA 98).<sup>1</sup> CDP hearings provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.<sup>2</sup>

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court.<sup>3</sup> Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.<sup>4</sup>

Since 2001, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 76 opinions on CDP cases during the review period of June 1, 2013, through May 31, 2014.<sup>5</sup> Taxpayers prevailed in full in five of these cases (nearly seven percent) and in part in three others (nearly four percent). Of the eight opinions where taxpayers prevailed in whole or in part, two taxpayers appeared *pro se* and six were represented.

The cases discussed below demonstrate that CDP hearings serve an important function by providing taxpayers with a forum to raise legitimate issues before the IRS deprives them of property. Many of these decisions provide guidance on substantive issues. The Court imposed sanctions for inappropriate use of the CDP process in some of the 76 cases reviewed.

CDP hearings are particularly valuable because they provide taxpayers with an enforceable remedy with respect to several rights articulated in the Taxpayer Bill of Rights recently adopted by the IRS in response to National Taxpayer Advocate recommendations.<sup>6</sup> In particular, by providing an opportunity for a taxpayer to challenge the underlying liability and raise alternatives to the collection action, the CDP hearing enforces the taxpayer's *right to challenge the IRS position and be heard*. If the taxpayer does not agree with the Appeals determination, he may file a petition in Tax Court, which furthers the taxpayer's *right to*

1 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 Internal Revenue Code (IRC) §§ 6320(c) (lien) and 6330(c) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test.

3 Internal Revenue Code (IRC) § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

4 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review upon a showing of "good cause," if the underlying tax liability is not at issue.

5 For a list of all cases reviewed, see Table 5 in Appendix III, *infra*.

6 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (TAXPAYER RIGHTS: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration).

*appeal an IRS decision in an independent forum.* Lastly, since the Appeals Officer must consider whether the IRS's proposed collection action balances the overall need for efficient collection of taxes with the legitimate concern that the IRS's collection actions are no more intrusive than necessary, the CDP hearing protects a taxpayer's *right to privacy*.

## PRESENT LAW

Current law provides taxpayers an opportunity for independent review of an NFTL filed by the IRS or of a proposed levy action.<sup>7</sup> As noted above, the purpose of CDP rights is to give taxpayers adequate notice of IRS collection activity and a meaningful hearing before the IRS deprives them of property.<sup>8</sup> The hearing allows taxpayers to raise issues relating to collection of the liability, including:

- The appropriateness of collection actions;<sup>9</sup>
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;<sup>10</sup>
- Appropriate spousal defenses;<sup>11</sup>
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a statutory notice of deficiency or have another opportunity to dispute the liability;<sup>12</sup> and
- Any other relevant issue relating to the unpaid tax, the NFTL, or the proposed levy.<sup>13</sup>

A taxpayer cannot raise an issue considered at a prior administrative or judicial hearing if the taxpayer participated meaningfully in that hearing or proceeding.<sup>14</sup>

## Procedural Collection Due Process Requirements

The IRS must provide a CDP notice to the taxpayer after filing the first NFTL or generally before its first intended levy for the particular tax and tax period.<sup>15</sup> The IRS must provide the notice not more than five business days after the day of filing the NFTL, or at least 30 days before the day of the proposed levy.<sup>16</sup>

If the IRS files a lien, the CDP lien notice must inform the taxpayer of the right to request a CDP hearing within a 30-day period, which begins on the day after the end of the five-business-day period after the

7 IRC §§ 6320 and 6330. See RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

8 Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. See *U.S. v. National Bank of Commerce*, 472 U.S. 713, 719-722 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

9 IRC § 6330(c)(2)(A)(ii).

10 IRC § 6330(c)(2)(A)(iii).

11 IRC § 6330(c)(2)(A)(i).

12 IRC § 6330(c)(2)(B).

13 IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

14 IRC § 6330(c)(4).

15 IRC § 6330(f) permits the IRS to levy without first giving a taxpayer a CDP notice in the following situations: the collection of tax is in jeopardy, a levy was served on a state to collect a state tax refund, the levy is a disqualified employment tax levy; or the levy was served on a federal contractor. A disqualified employment tax levy is any levy to collect employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h).

16 IRC § 6320(a)(2) or § 6330(a)(2). The CDP notice can be provided to the taxpayer in person, left at the taxpayer's residence or dwelling, or sent by certified or registered mail (return receipt requested) to the taxpayer's last known address.

filing of the NFTL.<sup>17</sup> In the case of a proposed levy, the CDP levy notice must inform the taxpayer of the right to request a hearing within the 30-day period beginning on the day after the date of the CDP notice.<sup>18</sup>

### Requesting a CDP Hearing

Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing within the applicable period.<sup>19</sup> The Code and regulations require taxpayers to provide their reasons for requesting a hearing. Failure to provide the basis may result in denial of a face-to-face hearing.<sup>20</sup> Taxpayers who fail to timely request a CDP hearing will be afforded an “equivalent hearing,” which is similar to a CDP hearing but lacks judicial review.<sup>21</sup> Taxpayers must request an equivalent hearing within the one-year period beginning the day after the five-business-day period following the filing of the NFTL, or in levy cases, within the one-year period beginning the day after the date of the CDP notice.<sup>22</sup>

### Conduct of a CDP hearing

The IRS generally will suspend levy action throughout a CDP hearing involving a notice of intent to levy, unless it determines that:

- The collection of tax is in jeopardy;
- The collection resulted from a levy on a state tax refund;
- The IRS has served a disqualified employment tax levy; or
- The IRS has served a federal contractor levy.<sup>23</sup>

The IRS also suspends collection activity throughout any judicial review of Appeals’ determination, except if an appeal is pending, the underlying tax liability is not at issue, and the IRS can demonstrate good cause to resume collection activity.<sup>24</sup>

CDP hearings are informal. When a taxpayer requests a hearing with respect to both a lien and a proposed levy, Appeals will attempt to conduct one hearing.<sup>25</sup> Courts have determined that a CDP hearing

<sup>17</sup> IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

<sup>18</sup> IRC § 6330(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

<sup>19</sup> IRC §§ 6330(a)(3)(B) and 6320(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2)A-C1(ii) and 301.6330-1(c)(2)A-C1(ii).

<sup>20</sup> IRC §§ 6320(b)(1) and 6330(b)(1); Treas. Reg. §§ 301.6320-1(c)(2)A-C1, 301.6330-1(c)(2)A-C1, 301.6320-1(d)(2)A-D8 and 301.6330-1(d)(2)A-D8. The regulations require the IRS to provide the taxpayer an opportunity to “cure” any defect in a timely filed hearing request, including providing a reason for the hearing. Form 12153 includes space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider, as well as examples of common reasons for requesting a hearing. See IRS Form 12153, *Requests for Collection Due Process or Equivalent Hearing* (Mar. 2011).

<sup>21</sup> Treas. Reg. §§ 301.6320-1(i)(2) Q&A-I16 and 301.6330-1(2) Q&A-I16; *Business Integration Services, Inc. v. Comm'r, T.C. Memo. 2012-342; Moorhouse v. Comm'r*, 116 T.C. 263 (2001). A taxpayer can request an equivalent hearing by checking a box on Form 12153, *Request for Collection Due Process or Equivalent Hearing*, by making a written request, or by confirming that he or she wants the untimely CDP hearing request to be treated as an equivalent hearing when notified by Collection of an untimely CDP hearing request. Internal Revenue Manual 5.19.8.4.3, *equivalent hearing (EH) Requests and timeliness of EH Requests* (Nov.1, 2007).

<sup>22</sup> Treas. Reg. §§ 301.6320-1(i)(2)A-17 and 301.6330-1(i)(2)A-17.

<sup>23</sup> IRC § 6330(e)(1) provides the general rule for suspending collection activity. IRC § 6330(f) provides that if collection of the tax is deemed in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS served a disqualified employment tax levy or a federal contractor levy, IRC § 6330 does not apply, except to provide the opportunity for a CDP hearing within a reasonable time after the levy. See *Clark v. Comm'r*, 125 T.C. 108, 110 (2005) (citing *Dora v. Comm'r*, 119 T.C. 356 (2002)).

<sup>24</sup> IRC §§ 6330(e)(1) and (e)(2).

<sup>25</sup> IRC § 6320(b)(4).

need not be face-to-face but can take place by telephone or correspondence,<sup>26</sup> and Appeals will conduct the hearing by telephone unless the taxpayer requests a face-to-face conference.<sup>27</sup> The CDP regulations state that taxpayers who provide non-frivolous reasons for opposing the IRS collection action will generally be offered but not guaranteed face-to-face conferences.<sup>28</sup> Taxpayers making frivolous arguments are not entitled to face-to-face conferences.<sup>29</sup> A taxpayer will not be granted a face-to-face conference concerning a collection alternative, such as an installment agreement (IA) or offer in compromise (OIC), unless other taxpayers would be eligible for the alternative under similar circumstances.<sup>30</sup> For example, the IRS will not grant a face-to-face conference to a taxpayer who proposes an OIC as the only issue to be addressed but has failed to file all required returns and is therefore ineligible for an offer. However, Appeals may, at its discretion, grant a face-to-face conference to explain the eligibility requirements for a collection alternative.<sup>31</sup>

The CDP hearing is to be held by an impartial officer from Appeals, who is barred from engaging in *ex parte* communication with IRS employees about the substance of the case and who has had “no prior involvement.”<sup>32</sup> In addition to addressing the issues raised by the taxpayer, the Appeals Officer must verify that the IRS has met the requirements of all applicable laws and administrative procedures.<sup>33</sup> Appeals must weigh the issues raised by the taxpayer and decide whether the proposed collection action “balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be no more intrusive than necessary.”<sup>34</sup>

Special rules apply to the IRS’s handling of hearing requests that raise frivolous issues. IRC § 6330(g) provides that the IRS may disregard any portion of a hearing request based on a position the IRS has identified as frivolous, or that reflects a desire to delay or impede the administration of tax laws.<sup>35</sup>

26 *Katz v. Comm'r*, 115 T.C. 329, 337-38 (2000) (finding that telephone conversations between the taxpayer and the Appeals Officer constituted a hearing as provided in IRC § 6320(b)). Treas. Reg. §§ 301.6320-1(d)(2)A-D6, A-D8 and 301.6330-1(d)(2)A-D6, A-D8.

27 See, e.g., Appeals Letter 4141 (rev. Aug. 2012) (acknowledging the taxpayer’s request for a CDP hearing and providing information on the availability of face-to-face conference). The National Taxpayer Advocate has repeatedly raised concerns regarding the inadequacy of Appeals’ communication to taxpayers on how to request a face-to-face hearing and where this information is included in the letter. See National Taxpayer Advocate 2005 Annual Report to Congress 136 (Most Serious Problem: *Appeals Campus Centralization*); National Taxpayer Advocate 2009 Annual Report to Congress 70 (Most Serious Problem: *Appeals’ Efficiency Initiatives Have Not Improved Customer Satisfaction or Confidence in Appeals*); National Taxpayer Advocate 2010 Annual Report to Congress 128 (Most Serious Problem: *The IRS’s Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered*). For information regarding the availability of Virtual Service Delivery (VSD) teleconferencing, which provides virtual face-to-face meeting in remote locations, see National Taxpayer Advocate 2012 Annual Report to Congress 462 (*Status Update: The IRS Has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance*). See also Director, Policy, Quality and Case Support, *Implementation of Virtual Service Delivery (VSD)*, Memorandum AP-08-0714-0007 (July 24, 2014).

28 Treas. Reg. § 301.6320-1(d)(2) A-D8.

29 Treas. Reg. §§ 301.6320-1(d)(2) A-D7 and 301.6330-1(d)(2) A-D8.

30 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8.

31 *Id.*

32 IRC §§ 6320(b)(1), 6320(b)(3), 6330(b)(1) and 6330(b)(3). See also Rev. Proc. 2012-18, 2012-1 C.B. 455. See, e.g., *Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo. 2006-93, *action on dec.*, 2007-2 (Feb. 27, 2007); *Cox v. Comm'r*, 514 F.3d 1119, 1124-28 (10th Cir. 2008), *action on dec.*, 2009-22 (June 1, 2009).

33 IRC § 6330(c)(1); *Hoyle v. Comm'r*, 131 T.C. 197 (2008).

34 IRC § 6330(c)(3)(C).

35 IRC § 6330(g). Section 6330(g) is effective for submissions made and issues raised after the date on which the IRS first prescribed a list of frivolous positions. Notice 2007-30, 2007-1 C.B. 883, which was published on or about April 2, 2007, provided the first published list of frivolous positions. Notice 2010-33, 2010-17 C.B. 609, contains the current list.

Similarly, IRC § 6330(c)(4) provides that a taxpayer cannot raise an issue if it is based on a position identified as frivolous or reflects a desire to delay or impede tax administration.

IRC § 6702(b) allows the IRS to impose a penalty for a specified frivolous submission, including a frivolous CDP hearing request.<sup>36</sup> A request is subject to the penalty if any part of it “(i) is based on a position which the Secretary has identified as frivolous...or (ii) reflects a desire to delay or impede the administration of the Federal tax laws.”<sup>37</sup> In *Thornberry v. Commissioner*, the Tax Court held that if Appeals determines a request for an administrative hearing is based entirely on a frivolous position under IRC § 6702(c), and issues a notice stating that Appeals will disregard the request, the Tax Court does have jurisdiction to review Appeals’ decision if the taxpayer timely petitions for review. The court found Appeals’ letter disregarding the hearing request was a determination conferring jurisdiction under IRC § 6330(d)(1) because it authorized the IRS to proceed with the disputed collection action.<sup>38</sup>

### Judicial Review of CDP Determination

Within 30 days of Appeals’ determination, the taxpayer may petition the Tax Court for judicial review.<sup>39</sup> The court will only consider issues, including challenges to the underlying liability, that were properly raised during the CDP hearing.<sup>40</sup> An issue is not properly raised if the taxpayer fails to request Appeals consideration of the issue or requests consideration but fails to present any evidence regarding that issue after being given a reasonable opportunity.<sup>41</sup> The Tax Court, however, may remand a case back to Appeals for more fact finding when the taxpayer’s factual circumstances have materially changed between the hearing and the trial.<sup>42</sup> When the case is remanded, the court retains jurisdiction.<sup>43</sup> The resulting hearing on remand provides the parties with an opportunity to complete the initial hearing while preserving the taxpayer’s right to receive judicial review of the ultimate administrative determination.<sup>44</sup>

Where the validity of the underlying tax liability is properly at issue in the hearing, the court will review the amount of the tax liability on a *de novo* basis.<sup>45</sup> Where the Tax Court is reviewing the appropriateness of the collection action or subsidiary factual and legal findings, the court will review these determinations under an abuse of discretion standard.<sup>46</sup>

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36 The frivolous submission penalty applies to the following submissions: CDP hearing request, under IRC §§ 6320 and 6330, offers in compromise under IRC § 7122, installment agreements under IRC § 6159, and application for a Taxpayer Assistance Order, under IRC § 7811.

37 IRC § 6702(b)(2)(a). Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous hearing request. The taxpayer then has 30 days to withdraw the submission to avoid the penalty.

38 *Thornberry v. Comm'r*, 136 T.C. 356 (2011). The Office of Chief Counsel disagrees with the *Thornberry* holding and will continue to file motions to dismiss for lack of jurisdiction if the taxpayer petitions for Tax Court review of a denial, under § 6330(g), of a CDP hearing request that was determined to be based on a frivolous position. See Chief Counsel Directives Manual (CCDM) 35.3.23.5.1, *Motion to Dismiss for Lack of Jurisdiction When CDP Hearing Request Denied Under Section 6330(g)* (July 25, 2012).

39 IRC § 6330(d)(1).

40 *Giamelli v. Comm'r*, 129 T.C. 107 (2007).

41 Treas. Reg. §§ 301.6320-1(f)(2) Q&A-F3, 301.6330-1(f)(2) Q&A-F3.

42 *Churchill v. Comm'r*, T.C. Memo. 2011-182; see also CCN-2013-002 (Nov. 30, 2012), which provides Counsel attorneys with instructions on when a remand based on changed circumstances might be appropriate.

43 *Pomeroy v. Comm'r*, T.C. Memo 2013-26.

44 *Wadleigh v. Comm'r*, 134 T.C. 280, 299 (2010).

45 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals’ CDP determinations. H.R. Rep. No. 1059-99, at 266 (Conf. Rep.). The term *de novo* means anew. *Black's Law Dictionary*, 447 (7th Ed. 1999).

46 See, e.g., *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006); *Dalton v. Comm'r*, 682 F.3d 149 (1st Cir. 2012).

## ANALYSIS OF LITIGATED CASES

We identified and reviewed 76 CDP court opinions, a 28 percent decrease from the 105 cases in last year's report. As shown in the chart below, litigation of CDP cases considered by the court has been averaging about 141 cases per year since 2001.

This decline in the number of litigated cases may be associated with a series of significant operational changes in lien-filing policies and collection payment options (including offers in compromise and "streamlined" installment agreements) the IRS implemented in fiscal years (FYs) 2011 and 2012. These changes were in response to concerns from the National Taxpayer Advocate and the Internal Revenue Service Advisory Council (IRSAC), and are collectively known as the "Fresh Start" initiative.<sup>47</sup> The "Fresh Start" initiative has resulted in fewer NFLTs and more accepted offers in compromise in the past few years, and had a positive impact on many taxpayers and revenue collection.<sup>48</sup>

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47 See IRS, IR-2011-20, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes Made to Lien Process* (Feb. 24, 2011); IR-2012-31, *IRS Offers New Penalty Relief and Expanded Installment Agreements to Taxpayers under Expanded Fresh Start Initiative* (Mar. 7, 2012); IR-2012-53, *IRS Announces More Flexible Offer-in-Compromise Terms to Help a Greater Number of Struggling Taxpayers Make a Fresh Start* (May 21, 2012). See also National Taxpayer Advocate 2012 Annual Report to Congress 348-351; National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 32-35.

48 For instance, in FY 2014, the IRS filed about 49 percent fewer NFLTs than in FY 2011, including a corresponding 58 percent reduction in liens filed by the Automated Collection System (ACS). In FY 2011, the IRS filed 1,042,230 liens. See IRS, 5000-23 Collection Workload Indicators (Oct. 11, 2011). In FY 2014, the IRS filed 535,580 liens. See IRS, 5000-25 Collection Activity Report (Sept. 29, 2014). Additionally, the dollars collected increased from about \$17 billion in FY 2011 to about \$18.5 billion in FY 2014. See IRS, 5000-2 (Oct. 3, 2011), IRS 5000-6 (Oct. 3, 2011), IRS 5000-108 (Oct. 5, 2011); IRS, 5000-2 (Sept. 29, 2013), IRS, 5000-6 (Sept. 30, 2014), IRS 5000-108 (Sept. 29, 2014). We also note that the IRS has accepted 38 percent more offers in compromise than during FY 2011, and that the actual number of accepted offers has almost doubled when compared to FY 2010. Considering FY 2014, the offer acceptance rate of 42 percent is the highest we have seen in many years. See IRS, 5000-108 Collection Activity Report (Oct. 5, 2010); IRS, 5000-108 Collection Activity Report (Oct. 5, 2011); IRS, 5000-108 Collection Activity Report (Sept. 29, 2014). During FY 2014, thousands of financially struggling taxpayers have successfully obtained lien withdrawals to help regain their financial viability. See IRS, FY 2014 C-25 Report.

**FIGURE 3.5.1<sup>49</sup>**

The 76 opinions identified this year do not reflect the full number of CDP cases because the court does not issue an opinion in all cases. Some are resolved through settlements, and in other cases taxpayers do not pursue litigation after filing a petition with the court. The Tax Court also disposes of some cases by issuing unpublished orders. Table 5 in Appendix III provides a detailed list of the published CDP opinions, including specific information about the issues, the types of taxpayers involved, and the outcomes of the cases.

### Litigation Success Rate

Taxpayers prevailed in full in five of the 76 cases brought during the year ending May 31, 2014 (nearly seven percent).<sup>50</sup> Taxpayers prevailed in part in three other cases (nearly four percent). Of the cases in which the courts found for the taxpayer in whole or in part, the taxpayers appeared *pro se* in two cases and were represented in six others. The IRS prevailed fully in 89 percent of cases, an increase from the lowest recorded success rate of 84 percent last year.

49 See National Taxpayer Advocate 2013 Annual Report to Congress 371; National Taxpayer Advocate 2012 Annual Report to Congress 595; National Taxpayer Advocate 2011 Annual Report to Congress 619; National Taxpayer Advocate 2010 Annual Report to Congress 436; National Taxpayer Advocate 2009 Annual Report to Congress 418; National Taxpayer Advocate 2008 Annual Report to Congress 476; National Taxpayer Advocate 2007 Annual Report to Congress 569; National Taxpayer Advocate 2006 Annual Report to Congress 556; National Taxpayer Advocate 2005 Annual Report to Congress 477-478; National Taxpayer Advocate 2004 Annual Report to Congress 500; National Taxpayer Advocate 2003 Annual Report to Congress 318; National Taxpayer Advocate 2002 Annual Report to Congress 273; See National Taxpayer Advocate 2001 Annual Report to Congress 263. CDP cases did not appear as a most litigated issue in the National Taxpayer Advocate 2000 Annual Report to Congress.

50 *Bogart v. Comm'r*, T.C. Memo. 2014-46; *Dixon v. Comm'r*, 141 T.C. 173 (2013); *Dixon v. Comm'r*, T.C. Memo. 2013-207; *Moosally v. Comm'r*, 142 T.C. No. 10 (2014); *Szekely v. Comm'r*, T.C. Memo. 2013-227.

**FIGURE 3.5.2. Success Rates in CDP Cases<sup>51</sup>**

Court Decision	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Decided for IRS	95%	95%	89%	90%	92%	90%	92%	89%	92%	86%	84%	89%
Decided for Taxpayer	1%	3%	8%	8%	5%	8%	4%	10%	3%	7%	8%	7%
Split Decision	4%	2%	3%	2%	3%	2%	4%	2%	3%	6%	9%	4%
Neither	n/a	n/a	n/a	n/a	<1%	n/a	n/a	n/a	1%	<1%	n/a	n/a

### Issues Litigated

The cases discussed below are those the National Taxpayer Advocate considers significant or noteworthy. Their outcomes can provide important information to Congress, the IRS, and taxpayers about the rules and operation of CDP hearings. Equally important, all of the cases offer the IRS an opportunity to improve the CDP process, and collection practices in general, in both application and execution.

#### *Isley v. Commissioner*

In *Isley v. Commissioner*,<sup>52</sup> the IRS issued four CDP notices (two involving the filing of an NFLT and two involving a proposed levy) to the taxpayer, Ronald Isley (Isley), a founding member of the Isley Brothers singing group. The CDP notices were for unpaid income taxes covering the years 1997–2004, and 2006. Isley had repeatedly failed to pay income taxes for over 30 years, filed for bankruptcy twice, and was convicted of tax evasion for the years 1997–2002 (conviction years). He was sentenced to 37 months in prison followed by a three-year probationary period. The terms of his probation required that he make full payment of taxes owed for his conviction years during his probationary period. While the court did not include exact dates in its decision, Isley entered prison around December 1, 2006 and was released in late 2009 or early 2010. The court noted that the probationary period would not have ended until December 2010 at the earliest.

Isley received the CDP notices while serving his sentence, and in response, he requested a CDP hearing in 2007 for each of the NFLTs and levy notices. During the CDP hearing, Isley submitted an OIC covering both his conviction years and non-conviction years, proposing to pay \$1,047,216 and providing the required 20 percent down payment.<sup>53</sup> The Appeals Officer (AO) assigned to the case recommended acceptance and the OIC was sent to attorney Ronald Chun (Chun) in the Office of Chief Counsel for review as required under IRC § 7122(b).<sup>54</sup>

51 Numbers have been rounded to nearest percentage and may not add to 100% due to rounding. A “split” decision refers to a case with multiple issues where both the IRS and the taxpayer prevail on one or more substantive issues. A “neither” decision refers to a case where the court’s decision was not in favor of either party.

52 141 T.C. 349 (2013).

53 An OIC is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount the IRS believes is owed. IRC § 7122. There are several grounds for an OIC, doubt as to collectibility, doubt as to liability, and effective tax administration. Doubt as to collectibility exists when the taxpayer’s assets and income are less than the liability. Treas. Reg. § 301.7122-1(b).

54 If an OIC is submitted in a case where the unpaid amount of the tax assessed is \$50,000 or more, the IRS Office of Counsel is required to review the OIC for legal sufficiency so as to ensure that all legal requirements for compromise have been met. See also IRM 5.8.8.12, (Aug. 8, 2014). Following the conclusion of the CDP hearing, Isley owed over \$9 million in tax liability, including penalties.

Chun, who had been involved with Isley's second bankruptcy, recommended that the IRS reject the OIC because he determined that the IRS lacked settlement authority. Isley's case had already been referred to the Department of Justice (DOJ) for criminal prosecution and therefore was subject to IRC § 7122(a) (discussed below). On a related note, Chun found that the OIC was inconsistent with Isley's terms of probation. Lastly, Chun recommended rejecting the offer on the alternative grounds that Isley's collection potential exceeded the offer, that he provided incomplete or inaccurate information, and that he was not in current compliance with his tax obligations. Based on Mr. Chun's recommendation and his own further examination, the AO issued a determination rejecting the OIC and sustaining the proposed levies and NFLT filings. Isley appealed the AO's determination to the Tax Court.

The Commissioner argued that IRC § 7122(a) prohibits the IRS from compromising Isley's liabilities.<sup>55</sup> Since the DOJ prosecuted Isley for criminal tax evasion, the Commissioner reasoned that the IRS had no authority to accept or even process the OIC. Isley countered that IRC § 6330 gave him the right to raise all relevant issues during his CDP hearing. Additionally, he argued that IRC § 7122(a) only applied to pending criminal prosecutions and that his criminal case was complete as of his sentencing in September of 2006.

Neither party's arguments persuaded the court. Instead, the Tax Court ruled that IRC § 7122(a) did not bar the AO from negotiating the OIC, but that the AO could not unilaterally approve the OIC—he would need to seek approval from DOJ. The court came to this determination for several reasons. First, the court found that IRC § 6330(c) does not supersede IRC § 7122(a). Second, the court found that DOJ's approval continued to be necessary until the terms of the settlement in his criminal case had been met. In particular, the court found that an OIC in this instance would have violated Isley's terms of probation. However, the court did note that Isley (either on his own or along with the AO) could have requested that the terms of his probation be modified. No such request had been made. Lastly, since Isley was behind on his current tax obligations, the Tax Court held the AO had not abused his discretion in rejecting the offer.

Isley contended that Chun's involvement in reviewing the OIC effectively made him a "*de facto*" AO and because of Chun's involvement in Isley's bankruptcy case, Chun's involvement in the CDP hearing violated the impartial officer requirement of IRC § 6330(b)(3). However, the court rejected that argument because Chun was involved in the case as an IRS Office of Chief Counsel attorney pursuant to IRC § 7122(b), and thus the impartial officer requirement did not apply to him. Additionally, the Tax Court noted that the bankruptcy proceedings concerned different tax years so Chun's actions in the bankruptcy proceeding could not have constituted prior involvement.

Isley also alleged that Chun's participation violated the prohibition against *ex parte* communication between AOs and other IRS employees.<sup>56</sup> The Tax Court disagreed, finding that the *ex parte* prohibition

<sup>55</sup> IRC § 7122(a) provides: "The Secretary may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense." The regulations provide further guidance by prohibiting the IRS from accepting "for processing any offer to compromise a liability following reference of a case involving such liability to the Department of Justice for prosecution or defense." Treas. Reg. 301.7122-1(d)(2).

<sup>56</sup> Section 1001(a)(4) of RRA 98 directed the Commissioner to "ensure an independent appeals function within the Internal Revenue Service, including the prohibition ... of *ex parte* communications between appeals officers and other Internal Revenue Service employees to the extent that such communications appear to compromise the independence of the appeals officers." In accordance with that directive, the IRS initially issued guidance in Rev. Proc. 2000-43, 2000-2 C.B. 404 which was then superseded by Rev. Proc. 2012-18, 2012-1 C.B. 455.

rules only apply to IRS employees working in the Office of Appeals. Since Chun was an employee of the IRS Office of Chief Counsel, this rule did not apply.

Isley also argued that his tax liabilities were overstated because the IRS did not properly apply certain payments received after his first bankruptcy proceeding to his tax debt. Isley had previously raised this issue in a refund suit. The Tax Court found that Isley was precluded from raising this issue in the CDP case because Isley had been given a prior opportunity to raise it in his second bankruptcy proceeding and also because it was barred by *res judicata* since Isley had raised this issue in his previous refund suit.

Isley submitted a 20 percent down payment with his OIC, which he argued that the IRS should refund as fraudulently induced because he was told that his offer would be evaluated on collectibility and it was rejected on other grounds. The court concluded that the IRS properly retained the payment since there was no evidence of fraud or false representations and there were in fact collectibility issues raised by the AO in rejecting the OIC.

Finally, the court addressed the AO's decision to sustain the proposed levies (Isley did not challenge the NFLT filings). The court noted that Chun's memo suggested gathering more information related to Isley's assets and future income potential. This indicated to the court that Chun believed continuing negotiations could be productive and that Isley could have submitted another OIC or an installment agreement. As a result, the court concluded that Appeals acted prematurely in sustaining the proposed levies and that such action might be more intrusive than necessary. The court also noted that Isley's tax compliance problems for 2009 and 2010 were inadvertent and curable. Based on that information, the court remanded the case to Appeals for further consideration. The court instructed Appeals to reexamine Isley's financial position to see if submission of another OIC or an installment agreement might be a viable alternative. The Tax Court noted that DOJ would need to approve any OIC or installment agreement before such agreement could be processed or accepted.<sup>57</sup>

### *Dixon v. Commissioner*

In *Dixon v. Commissioner*, James and Sharon Dixon, (the Dixons) were the owners of Tryco Corporation, a temporary employment company that failed to pay its withholding and employment taxes from 1992 to 1995.<sup>58</sup> The Dixons also neglected to pay a substantial part of their individual income tax liabilities during that period. After they were charged with criminal failure to file, they hired an accounting firm that uncovered the tax issues at Tryco. The Dixons reached a plea agreement under which they were to pay restitution for their unpaid taxes in the amount of \$61,021.

In order to make those payments and start paying Tryco's withholding liability, the Dixons' tax attorney advised them to give the money to Tryco, which in turn would pay the IRS. In December 1999, Tryco transferred \$61,021 to the IRS. A cover letter from the Dixons' attorney accompanied the payment, designating the payment as "payment of [Form] 941 taxes of the corporation" that was 'to be applied to the withheld income taxes' of [the Dixons] for specified calendar quarters of 1992–95."<sup>59</sup> In early 2000, the Dixons' accountant discovered that the couple actually owed \$30,202 more in individual income tax for 1992-1995. In June 2000, Tryco paid this money to the IRS with a cover letter stipulating that this was

<sup>57</sup> The Court noted that the probationary period would have ended in late 2012 or early 2013. If Isley had fully complied with the terms of his probation or the liabilities had been discharged by a settlement with DOJ, the OIC issues and IRC § 7122(a) would be considered moot. However, the Court noted that it had not been notified by either party that this occurred and therefore, DOJ approval would be necessary.

<sup>58</sup> 141 T.C. 173 (2013).

<sup>59</sup> *Id.* at 1.

a pre-assessment payment of Form 941 taxes of the corporation, which represented the withheld income taxes for the Dixons for the fourth quarter of 1995.

The IRS initially honored those designations. However, it eventually decided to disregard the designations, applying the restitution funds to Tryco's outstanding general unpaid employment tax liabilities instead. The IRS then issued the Dixons a CDP levy notice seeking to collect the Dixons' unpaid individual income taxes for 1992–1995.

The Dixons requested a CDP hearing. The AO sustained the proposed levy on the basis that the payments were not withheld at the source and that the payments could not be designated to specific employees. The Dixons filed a petition with the Tax Court, arguing on two alternative bases that their payments through Tryco satisfied their individual income tax liabilities.

First, the Dixons argued that the Tryco payments designated for their individual liabilities entitled them to a withholding credit under IRC § 31. Section 31(a)(2) states employees are entitled to a credit against their income taxes equivalent to the amount their employer withholds from their income. However, the regulations governing IRC § 31 state that the taxes must be actually withheld by the employer.<sup>60</sup> To be considered “actually withheld,” the withholding must be done contemporaneously in the correct amount or corrected within the prescribed time. The court determined that the restitution payments were not withheld contemporaneously at the source. The payments were also made outside of the window for allowable adjustments under IRC § 31(a). As a result, the court found that the Dixons were not entitled to an IRC § 31 credit.

Alternatively, the Dixons argued that the Commissioner must respect Tryco's designation of the payments to their individual income tax liabilities. IRS policy allows taxpayers to designate where and how voluntary payments should be credited. However, the Commissioner argued that taxpayers are only allowed to designate between a particular tax period or particular type of tax (*i.e.*, trust fund)<sup>61</sup> liabilities versus corporate income tax liabilities), so corporate taxpayers like Tryco could not designate which particular employee within the withholding liabilities would receive credit. The Tax Court rejected this argument, finding that employers are commonly allowed to designate withholding taxes to specific employees for refund suits, which allows employers to do test cases without paying all of the taxes for a class of employees.<sup>62</sup> The court further reasoned that allowing designations was necessary to uphold the policy against double collection of tax. The IRS had already collected the tax from Tryco, and collecting it again from the Dixons would require them to pay the same liability twice.

For these reasons, the Tax Court held that Appeals abused its discretion in failing to honor the Dixons' payment designations. The \$91,223 in payments fully discharged the Dixons' individual income tax liabilities for 1992–1995 and therefore, the IRS could not take further levy action for this debt. However, since the court found the payments were valid at the time they were paid through Tryco in 1999 and 2000, and not as IRC § 31 credits, which would have been counted as paid in April 1996, the Dixons owed penalties and interest dating from the original periods the tax was due up to the time when they

<sup>60</sup> Treas. Reg. § 1.31-1.

<sup>61</sup> Employers are often responsible for collecting and paying employment taxes on behalf of their employees. The employer is to hold the money as a “special fund in trust for the United States.” See IRC § 7501. Failure to collect, truthfully account for, and pay over any such tax can result in a trust fund recovery penalty under IRC § 6672.

<sup>62</sup> Employers are required to withhold and deduct taxes on wages as they are paid to the employee, minus applicable exemptions. See IRC § 3402.

paid the liabilities. The court determined that the IRS could collect the penalties and interest through levy action.

### *Moosally v. Commissioner*

In *Moosally v. Commissioner*, the taxpayer had been assessed trust fund recovery penalties for several quarters in 2000 and individual income tax liabilities for 2008.<sup>63</sup> The taxpayer submitted an OIC seeking to compromise these liabilities. The Centralized Offer in Compromise (COIC) unit rejected the offer because the amount was below the reasonable collection potential (RCP). The taxpayer appealed the decision. Appeals informed the taxpayer that Settlement Officer (SO) Smeck would be assigned to the case. Shortly after requesting her OIC Appeal, the IRS sent the taxpayer a CDP NFLT notice concerning the same tax liabilities covered in the OIC.<sup>64</sup> In response, the taxpayer requested a timely CDP hearing, which SO Kane was initially assigned to conduct.

While the CDP hearing was pending, SO Smeck reviewed the OIC rejection. Prior to SO Smeck's final determination regarding the rejection, SO Kane informed the taxpayer that her CDP hearing had been reassigned to SO Smeck. After conducting the CDP hearing, which included reviewing the taxpayer's information, SO Smeck sustained the NFLT filing and the rejection of the OIC. The taxpayer timely petitioned the Tax Court, arguing that Smeck was not an impartial officer because she reviewed the taxpayer's appeal of the rejected offer before she was assigned to the CDP hearing.

IRC § 6320(b)(3) requires that a CDP hearing must be conducted by an impartial AO, which means that the officer has had no prior involvement with the liability in question. The IRS argued that SO Smeck's review of the rejected OIC was current involvement rather than prior, since she had not issued a determination on her review of the OIC. But the Tax Court read the statute and regulations to mean that prior involvement constituted any involvement with the liabilities at issue outside of the CDP hearing context. Therefore, it found that SO Smeck's review of the OIC before the commencement of the CDP hearing constituted prior involvement and remanded the case to give the taxpayer a new CDP hearing with an impartial officer.

### *Byers v. Commissioner*

In *Byers v. Commissioner*, the IRS sent a CDP levy notice to the taxpayer.<sup>65</sup> The taxpayer timely requested a CDP hearing. The proposed levy action was sustained by the AO at the CDP hearing, and the taxpayer appealed to the Tax Court, which granted summary judgment to the Commissioner. The taxpayer appealed the grant of summary judgment to the Court of Appeals for the District of Columbia Circuit (D.C. Circuit).

The first question on appeal was whether the proper venue for the taxpayer's appeal was in the D.C. Circuit. The IRS argued that venue was only proper in the Eighth Circuit, where the taxpayer resided. IRC § 7482(b)(1) states that appeals from the Tax Court are to be reviewed in the D.C. Circuit unless one

<sup>63</sup> 142 T.C. No. 10 (2014).

<sup>64</sup> The National Taxpayer Advocate has long argued against the practice of filing a lien once an offer has been submitted. Such filings, absent jeopardy or abuse of the system, harm taxpayers at a critical time when they are trying to resolve their tax debts. For instance, a lien could jeopardize a taxpayer's ability to obtain credit or maintain employment. See National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, 1-18. For a discussion of the impact liens have on taxpayer compliance generally, see National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, 91-112; National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 105-125.

<sup>65</sup> 740 F.3d 668 (D.C. 2014), aff'g T.C. Memo. 2012-27. The taxpayer filed a petition for *certiorari*, which the Supreme Court denied. See *Byers v. Comm'r*, 740 F. 3d 668 (D.C. 2014), cert. denied, 83 U.S.L.W. 3189 (U.S. Oct. 6, 2014) (No. 14-74).

of the specified exceptions applies. IRC § 7482(b)(1)(A) sets forth a general exception which provides that in cases where a petitioner, other than a corporation, seeks redetermination of a tax liability, venue for review by the United States Court of Appeals is based upon the taxpayer's legal residence. The IRS argued that since CDP hearings often include challenges to the underlying liabilities, venue is properly placed in the circuit where the taxpayer resides under IRC § 7482(b)(1)(A). However, the court determined this provision was not applicable since the taxpayer was not challenging the underlying liability. Thus, the proper venue was in the D.C. Circuit. This decision is important because it holds that the D.C. Circuit will not transfer cases to another circuit in non-liability CDP cases unless both parties stipulate to transfer the case.

The *Byers* decision will have several ramifications. For instance, the court does not answer the question of whether another court of appeals could hear an appeal of a non-liability CDP decision without stipulation.<sup>66</sup> This issue will likely be addressed by other circuit courts.<sup>67</sup>

*Byers* will also create complications for how the Tax Court hears its cases. Under the *Golsen* rule, the Tax Court follows its own precedent unless the court of appeals to which the case would be appealable has ruled to the contrary.<sup>68</sup> How will the Tax Court know where the case is going to be appealed if the taxpayer has a choice in venue? In a Tax Court case subsequent to *Byers*, also involving a non-liability CDP hearing, the Tax Court applied the rules of the appellate court based on the residence of the taxpayer (in this instance the Ninth circuit), stating:

In light of *Byers*, we are mindful of the uncertainty of appellate venue and the controlling law in this case. We further note, however, that we have not found a case wherein the Court of Appeals for the District of Columbia Circuit has either adopted or rejected the administrative record rule in a collection case under sec. 6320 or sec. 6330.<sup>69</sup>

The changes in practice brought by *Byers* mean that taxpayers and practitioners appealing a non-liability CDP case must now understand the type of case they have and whether it involves redetermination, so that they obtain the appropriate venue. The court in *Byers* was not concerned with taxpayer confusion over types of CDP cases, explaining instead:

[j]ust as we see in this case, it normally will be obvious from the taxpayer's statement of the issues whether an appeal involves a challenge to a redetermination decision, a CDP decision on a collection method, or both. Therefore, it will not be difficult for this court to distinguish between the two types of cases to determine whether venue is proper in the D.C. Circuit.<sup>70</sup>

<sup>66</sup> The court notes "we have no occasion to decide in this case whether a taxpayer who is seeking review of a CDP decision on a collection method may file in a court of appeals other than the D.C. Circuit if the parties have not stipulated to venue in another circuit." *Byers*, 740 F.3d at 677. This language leaves it open for interpretation whether venue would be proper in another circuit court when neither party addresses it, such as the appellate cases decided prior to *Byers*.

<sup>67</sup> Legislation has also been proposed to address this issue. Joint Committee On Taxation, *Technical Explanation Of The Senate Committee On Finance Chairman's Staff Discussion Draft Of Provisions To Reform Tax Administration*, JCX-16-13, 39-40 (November 20, 2013). The legislation provides that cases under IRC §§ 6015, 6320, and 6330 will be appealable to the circuit in which is located the petitioner's legal residence (in the case of an individual). While this provision has appeared in several bills, it has gained little traction. The National Taxpayer Advocate has also made a legislative recommendation to address this issue. See Legislative Recommendation: *APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides*, *supra*.

<sup>68</sup> *Golsen v. Comm'r*, 54 T.C. 742 (1970).

<sup>69</sup> *Boulware v. Commr*, T.C. Memo 2014-80 at 19. On appeal No. 14-1147 (D.C. Cir. Aug. 4, 2014).

<sup>70</sup> *Byers*, 740 F.3d at 676.

In practice, making the distinction between liability and non-liability CDP hearings could prove difficult for taxpayers, especially *pro se* taxpayers. This is an area that could benefit from IRS guidance to taxpayers and practitioners, pending judicial or legislative clarification. Taxpayers should also be prepared for litigation over the meaning of “redetermination.”

Additionally, “stand alone” innocent spouse cases brought under IRC § 6015(e), may be impacted by *Byers* because the IRS may argue in these cases that they do not involve a redetermination of the underlying liability, but rather seek relief from an existing joint liability.<sup>71</sup> As such, under *Byers*, appeals of these cases from the Tax Court could go to the D.C. Circuit if there is no stipulation otherwise.

Despite these unanswered questions, *Byers* could be beneficial for taxpayers in certain situations. With this ruling, taxpayers may now be able to “forum shop.” Taxpayers may consider how their regional circuit would handle their non-liability CDP case in comparison to the D.C. Circuit. For instance, in *Robinette v. Comm'r*, the Tax Court held that it could consider evidence that was not part of the administrative record when it reviews an AO’s determination for abuse of discretion.<sup>72</sup> This decision was overturned by the Eighth Circuit, which held that evidence is limited to what is in the administrative record.<sup>73</sup> It is possible that the D.C. Circuit could rule in a way opposite to the Eighth Circuit in regards to evidence at trial. If that happens, taxpayers wishing to submit new evidence during a trial may benefit from having their non-liability CDP appeal heard by the D.C. Circuit. Of course, if the taxpayer is not local to the District of Columbia and chooses not to stipulate to the Court of Appeals based on their residence, they will have to incur the travel costs associated with having their case tried in the D.C. Circuit.

After dealing with the venue issue, the court moved to the substance of the taxpayer’s appeal. The taxpayer accused the SO of engaging in improper *ex parte* communications with other IRS employees, but the court denied relief on this issue, finding no credible evidence to support this claim. The court noted that the fact the SO had emailed the Office of Chief Counsel to obtain a copy of the Notice of Deficiency that the SO needed to conduct the hearing was not an improper *ex parte* communication. The taxpayer also argued that Senior Judge Swift was not properly appointed under the Appointments Clause. However, this argument was not raised until Judge Swift had already issued his judgment and was thus deemed untimely. Further, the Court determined that Judge Swift was properly recalled under IRC § 7447(c) and that such a recall is constitutional.<sup>74</sup>

Last, the taxpayer challenged the Tax Court’s decision to dismiss as moot the claim relating to the proposed levy on the taxpayer’s 2003 tax liability. Previously the IRS abated the liability and indicated that it was no longer pursuing a levy. The taxpayer argued the 2003 issues were still relevant to the case, but the D.C. Circuit affirmed the Tax Court’s dismissal of those issues based on the abatement of the 2003 liabilities. The taxpayer then argued that the Tax Court erred in upholding the SO’s proposed levy determination after removing the 2003 liability, contending that the SO might not have found that the proposed levy was proper if the 2003 liability had not been at issue when she made her initial determination. The court rejected the argument as untimely since the taxpayer failed to raise the issue in the lower court. The D.C. Circuit therefore upheld the Tax Court’s determination sustaining the levy.

<sup>71</sup> The filing of a Tax Court petition in response to the final notice of determination or after the IRC § 6015 claim is pending for six months is often referred to as a “stand-alone” proceeding, because jurisdiction is predicated on IRC § 6015(e) and not deficiency jurisdiction under IRC § 6213.

<sup>72</sup> *Robinette v. Comm'r*, 123 T.C. 85 (2004).

<sup>73</sup> *Robinette v. Comm'r*, 439 F.3d 459 (8th Cir. 2006).

<sup>74</sup> See *Byers v. Comm'r*, 740 F.3d 679 (citing *Shoemaker v. United States*, 147 U.S. 282, 301 (1893)).

### *Reed v. Commissioner*

In *Reed v. Commissioner*, the taxpayer requested a CDP hearing after receiving a CDP levy notice covering tax years 1987–2001.<sup>75</sup> The taxpayer failed to file timely income tax returns in the years at issue, and after eventually filing late returns, he submitted two OICs to settle the resulting liabilities. In the first offer, the taxpayer offered to pay only a fraction of the liability (less than five percent) based on doubt as to collectibility. The IRS rejected the offer, and Appeals sustained the rejection, finding the taxpayer had generated significant income from a real estate sale and subsequently dissipated those funds. Appeals included the dissipated proceeds in its estimate of collection potential.

The taxpayer submitted a second OIC in 2008, where he again sought to settle his outstanding tax liabilities for a small fraction of the outstanding liability, but the SO returned the offer after discovering that the taxpayer was not in compliance with his income tax obligations.<sup>76</sup> The IRS subsequently issued a final notice of intent to levy to the taxpayer. The taxpayer then filed a CDP hearing request.

During the subsequent CDP hearing, the taxpayer contested the manner in which the IRS handled the 2004 and 2008 offers. In particular, he requested that the SO reopen and evaluate the OIC that the taxpayer had submitted in 2008. The SO declined to reopen the 2008 OIC and ultimately issued a notice of determination sustaining the proposed levy. The taxpayer then filed a petition to the Tax Court.

The IRS challenged the Tax Court's jurisdiction over the case, arguing that there was nothing to review since the taxpayer had not offered a new OIC for consideration during the CDP hearing. The IRS also argued that the taxpayer did not have a right to judicial review of the rejected offer in 2004 or the returned offer in 2008. The court rejected this argument since the SO issued a notice of determination and the taxpayer filed a timely petition, the two prerequisites for Tax Court jurisdiction.

Since the taxpayer did not contest the tax liability, the Tax Court reviewed the proposed levy action for abuse of discretion. First, the taxpayer challenged the SO's refusal to reopen the 2008 OIC during the CDP hearing.<sup>77</sup> The SO determined that she did not have authority to reopen the offer, while the taxpayer argued that the IRS could be required to reopen the offer. The Tax Court applied IRC §§ 7122 and 6330 and rejected the taxpayer's argument. Doing otherwise would mean that the Appeals Office in 2011 would be required to consider an offer submitted in 2008, which contained stale financial information. Taxpayers must submit current financial information with offers based on doubt as to collectibility.<sup>78</sup> Requiring Appeals to consider an old offer during the CDP process would expand administrative and judicial review of offers beyond what Congress intended.<sup>79</sup> Thus, the proposed collection action was sustained.

<sup>75</sup> 141 T.C. 248 (2013), *opinion supplemented on denial of reconsideration by T.C. Memo. 2014-41.*

<sup>76</sup> Under IRC § 7122(e), taxpayers may seek review of rejected offers. There is no such right for returned offers. The National Taxpayer Advocate has pointed out that the IRS can harm taxpayers by expanding the definition of "returned" offers, which do not provide appeal rights. For a discussion on this, see National Taxpayer Advocate 2007 Report to Congress 374-87; National Taxpayer Advocate 2006 Report to Congress 83-109; National Taxpayer Advocate 2004 Annual Report to Congress 311-41; National Taxpayer Advocate 2003 Annual Report to Congress 99-112; National Taxpayer Advocate 2002 Annual Report to Congress 15-24.

<sup>77</sup> Following the return of his 2008 offer, the taxpayer exchanged several letters with the offer unit in an attempt to have the offer unit reconsider its decision to return his offer. The taxpayer continued to make payments during the exchange of letters. The Court notes that the taxpayer wanted the 2008 offer reopened on the belief that these payments would be treated as meeting the payment terms of his offer.

<sup>78</sup> See *Reed v. Comm'r*, 141 T.C. 248 at 13 (citing *Sullivan v. Comm'r*, T.C. Memo 2009-4; *Goodwin v. Comm'r*, T.C. Memo 2003-289).

<sup>79</sup> As noted above, taxpayers may only seek review of rejected offers, and not offers that are returned. IRC § 7122(e).

## Imposition of Sanctions

IRC § 6673(a)(1) authorizes the Tax Court to impose sanctions when it appears the taxpayer instituted or maintained proceedings primarily for delay or when the taxpayer's position is frivolous or groundless.<sup>80</sup> As we found in last year's analysis, the court imposed these penalties in only a few CDP cases. Of the 76 cases reviewed this year, the court imposed sanctions in only two cases, or approximately three percent.<sup>81</sup> Last year, with 105 CDP cases decided, the court imposed sanctions in three cases, or three percent.<sup>82</sup> This low number may be attributable to IRC § 6330(g), which allows the IRS to disregard a frivolous hearing request.

## Pro Se Analysis

*Pro se* taxpayers (those without the benefit of counsel) litigated 48 (or 63 percent) of the 76 cases brought before the Tax Court, a decrease from the previous year. Table 3.5.3 shows the breakdown of *pro se* and represented cases and the decisions rendered by the court indicating that eight taxpayers, represented or unrepresented (or about 11 percent of the 76 cases), received some relief on judicial review.

**FIGURE 3.5.3, Pro Se and Represented Taxpayer Cases and Decisions**

Court Decisions	Pro Se Taxpayers		Represented Taxpayers	
	Volume	% of Total	Volume	% of Total
Decided for IRS	46	96%	22	79%
Decided for Taxpayer	1	2%	4	14%
Split Decisions	1	2%	2	7%
<b>Totals</b>	<b>48</b>	<b>100%</b>	<b>28</b>	<b>100%</b>

## CONCLUSION

CDP hearings provide an invaluable opportunity for taxpayers to meaningfully address the appropriateness of IRS collection actions. Given the important protection that CDP hearings offer, it is unsurprising that CDP remains one of the most frequently litigated issues. In fact, despite a decline in the number of CDP cases being litigated, there are several important cases that may impact CDP litigation in the future.

As described in the *Moosally* case, the IRS's desire to consolidate work may interfere with taxpayer rights.<sup>83</sup> The recently adopted Taxpayer Bill of Rights increases taxpayers' awareness of their rights, including the right to appeal an IRS decision in an independent forum, under which the Appeals employee conducting the CDP hearing must have had no prior involvement with the taxpayer's case.<sup>84</sup> Similarly, as discussed in *Isley*, in cases involving criminal convictions, taxpayers may need to consider requesting modification of probation terms by the sentencing court with the consent of the Attorney General in order to resolve tax liabilities with the IRS.

<sup>80</sup> See Most Litigated Issue: *Frivolous Issues Penalty Under Internal Revenue Code Section 6673 and Related Appellate-Level Sanctions, infra.*

<sup>81</sup> *Best v. Comm'r*, T.C. Memo. 2014-72; *Golub v. Comm'r*, T.C. Memo. 2013-196.

<sup>82</sup> National Taxpayer Advocate 2013 Annual Report to Congress 381.

<sup>83</sup> See IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

<sup>84</sup> See, e.g., IRC § 6330(b)(3).

The opinions reviewed this year suggest the communication process between the taxpayer and the Appeals Officers occasionally breaks down. For example, in many cases the taxpayer did not provide the requested documentation.<sup>85</sup> Taxpayers also frequently challenged the denial of a face-to-face hearing, an issue that most often resulted from a failure to provide documentation.<sup>86</sup> When the facts of the case are not sufficiently developed, the taxpayer may not obtain the collection alternative or liability determination that he or she would be eligible for if all the facts were known. Appeals Officers and Settlement Officers may need to make special efforts to ensure that taxpayers know what documentation to provide, are given an opportunity to provide the documentation, and encourage them to do so.

The Office of Chief Counsel recently reiterated its position that when Appeals makes a determination under IRC § 6330(c)(1) that the IRS has complied with all applicable legal and administrative requirements, this determination should be reviewed using an abuse of discretion standard.<sup>87</sup> The notice also clarified that when assessing whether all legal and administrative requirements have been met, issues related to payments, overpayment credits, validity of the assessment, and the statute of limitations must be addressed as part of that inquiry. These types of issues are not challenges to the underlying liability, which would require the taxpayer to raise them. Because the abuse of discretion standard applies to these verification requirements, if the administrative record supports Appeals' determination, the IRS Office of Chief Counsel will rely on the administrative record and object to the taxpayer submitting additional evidence at trial. If the administrative record is insufficient, Counsel attorneys are instructed that a motion to remand may be appropriate. This notice serves as a reminder to taxpayers to provide complete information and supporting documentation to the AO during the hearing process as it will not only increase the chance of resolution during the CDP hearing but will also provide the court with a more complete record if the taxpayer appeals the AO's determination.

In all cases, the AO must review the case to ensure that all legal and administrative requirements have been met. If the taxpayer believes that this review has been inadequate, the taxpayer should formally challenge the AO's determination that the IRS has complied with all legal and administrative requirements. Taxpayers should make sure that this challenge, as well as any evidence to support it, is properly documented in the administrative record. The taxpayer may be at a disadvantage in this situation because the IRS is the party with the records in its custody. For the above reasons, it is possible that this will be an issue of litigation in the future.

Lastly, the *Byers* decision may impact future litigation of non-liability CDP cases from the perspective of potential forum-shopping. When considering an appeal from a non-liability CDP case, taxpayers may decide to file in either the Circuit Court of Appeals based on their place of residence or in the D.C. Circuit based on what forum's case law is more advantageous. However, *pro se* taxpayers may have difficulty understanding the distinction between issues involving redetermination of liability and non-liability issues raised at a CDP hearing.

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<sup>85</sup> See, e.g., *Adighibe v. Comm'r*, T.C. Memo 2013-296; *Arede v. Comm'r*, T.C. Memo. 2014-29; *Cheli v. Comm'r*, T.C. Memo. 2013-200; *Lyons v. Comm'r*, T.C. Memo. 2014-32; *Mayhugh v. Comm'r*, T.C. Memo. 2014-98.

<sup>86</sup> See, e.g., *LaForge v. Comm'r*, T.C. Memo. 2013-183; *Shirley v. Comm'r*, T.C. Memo. 2014-10 (holding that denial of a face-to-face hearing as part of a supplemental CDP hearing on remand was appropriate when the taxpayer failed to provide amended returns, a completed Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, substantiating documentation, and a reasonable cause explanation).

<sup>87</sup> IRS Office of Chief Counsel, Notice CC-2014-002 (May 5, 2014).

In sum, the CDP hearing is a powerful tool for taxpayers. Communication between the IRS and the taxpayer is crucial for this process to work properly. If taxpayers provide full documentation to prove their cases, the IRS can make determinations on collection cases that better take into account the taxpayer's facts and circumstances.

**MLI  
#6****Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654****SUMMARY**

We reviewed 56 decisions issued by federal courts from June 1, 2013 to May 31, 2014, regarding the additions to tax for:

- Failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1);
- Failure to pay an amount shown as tax on a return under IRC § 6651(a)(2);
- Failure to pay estimated tax under IRC § 6654; or
- Some combination of the three.<sup>1</sup>

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Thirteen cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; four involved both the failure to file and failure to pay penalties; one case involved only the estimated tax penalty; three cases involved only the failure to pay penalty; and 30 cases involved only the failure to file penalty.<sup>2</sup>

The IRS imposes the failure to file and failure to pay penalties unless the taxpayer can demonstrate the failure is due to reasonable cause and not willful neglect.<sup>3</sup> The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions.<sup>4</sup> Taxpayers were unable to avoid a penalty in 49 of the 56 cases.

**PRESENT LAW**

Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before its due date (including extensions) will be subject to a penalty of five percent of the tax due (minus any credit the taxpayer is entitled to receive and payments made by the due date) for each month or partial month the return is late, up to a maximum of 25 percent, unless the failure is due to reasonable cause and not willful neglect.<sup>5</sup> To establish reasonable cause, the taxpayer must show that he or she exercised ordinary business care and prudence but was still unable to file by the due date.<sup>6</sup> The failure to file penalty applies to income, estate, gift, employment and self-employment, and certain excise tax returns.<sup>7</sup>

<sup>1</sup> Internal Revenue Code (IRC) § 6651(a)(3) imposes an addition to tax for failure to pay a tax liability not shown on a return. However, because only a small number of cases involved this penalty, we did not include it in our analysis.

<sup>2</sup> There were two additional categories of combined case issues: four involved the estimated tax penalty with just the failure to file penalty, and one case involved the estimated tax penalty with just the failure to pay penalty.

<sup>3</sup> IRC § 6651(a)(1), (a)(2).

<sup>4</sup> IRC § 6654(e).

<sup>5</sup> IRC § 6651(a)(1), (b)(1). The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

<sup>6</sup> Treas. Reg. § 301.6651-1(c)(1).

<sup>7</sup> IRC § 6651(a)(1).

The failure to pay penalty applies to a taxpayer who fails to pay an amount shown as tax on his or her return. The penalty accrues at a rate of 0.5 percent per month on the unpaid balance for as long as it remains unpaid, up to a maximum of 25 percent of the amount due.<sup>8</sup> When both the failure to file and failure to pay penalties are imposed for the same month, the amount of the failure to pay penalty reduces the amount of the failure to file penalty by 0.5 percent for each month.<sup>9</sup>

The failure to pay penalty applies to income, estate, gift, employment and self-employment, and certain excise tax returns.<sup>10</sup> The taxpayer will not be held liable if he or she can establish reasonable cause, *i.e.*, the taxpayer must show that he or she exercised ordinary business care and prudence but still could not pay by the due date, or that payment on that date would have caused undue hardship.<sup>11</sup> Courts will consider “all the facts and circumstances of the taxpayer’s financial situation” to determine whether the taxpayer exercised ordinary business care and prudence.<sup>12</sup> In addition, “consideration will be given to the nature of the tax which the taxpayer has failed to pay.”<sup>13</sup>

IRC § 6654 imposes a penalty on any underpayment of estimated tax by an individual or by certain estates or trusts.<sup>14</sup> The law requires four installments per taxable year, each generally 25 percent of the required annual payment.<sup>15</sup> The required annual payment is generally the lesser of 90 percent of the tax shown on the return for the current taxable year or 100 percent of the tax for the previous year.<sup>16</sup> The IRS will determine the amount of the penalty by applying the underpayment rate according to IRC § 6621 to the amount of the underpayment for the applicable period.<sup>17</sup>

To avoid the penalty, the taxpayer has the burden of proving that one of the following exceptions applies:

- The tax due (after taking into account any federal income tax withheld) is less than \$1,000;<sup>18</sup>
- The preceding taxable year was a full 12 months, the taxpayer had no liability for the preceding taxable year, and the taxpayer was a U.S. citizen or resident throughout the preceding taxable year;<sup>19</sup>
- The IRS determines that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience;<sup>20</sup> or

<sup>8</sup> IRC § 6651(a)(2). Note that if the taxpayer timely files the return (including extensions) but an installment agreement is in place, the penalty will continue accruing at the lower rate of 0.25 percent rather than 0.5 percent of the tax shown. IRC § 6651(h).

<sup>9</sup> IRC § 6651(c)(1). When both the failure to file and failure to pay penalties are accruing simultaneously, the failure to file will max out at 22.5 percent and the failure to pay will max out at 2.5 percent, thereby abiding by the 25 percent limitation.

<sup>10</sup> IRC § 6651(a)(2).

<sup>11</sup> Treas. Reg. § 301.6651-1(c)(1). Even when a taxpayer shows undue hardship, the regulations require him or her to prove reasonable cause.

<sup>12</sup> *Id.* See, e.g., *East Wind Indus., Inc. v. U.S.*, 196 F.3d 499, 507 (3d Cir. 1999).

<sup>13</sup> Treas. Reg. § 301.6651-1(c)(2).

<sup>14</sup> IRC § 6654(a), (l).

<sup>15</sup> IRC § 6654(c)(1), (d)(1)(A).

<sup>16</sup> IRC § 6654(d)(1)(B).

<sup>17</sup> IRC § 6654(a).

<sup>18</sup> IRC § 6654(e)(1).

<sup>19</sup> IRC § 6654(e)(2).

<sup>20</sup> IRC § 6654(e)(3)(A).

- The taxpayer retired after reaching age 62 or became disabled in the taxable year for which estimated payments were required, or in the taxable year preceding that year, and the underpayment was due to reasonable cause and not willful neglect.<sup>21</sup>

In any court proceeding, the IRS has the burden of producing sufficient evidence that it imposed the failure to file, failure to pay, or estimated tax penalties appropriately.<sup>22</sup>

## ANALYSIS OF LITIGATED CASES

We analyzed 56 opinions issued between June 1, 2013 and May 31, 2014, where the failure to file penalty, failure to pay penalty, or estimated tax penalty was in dispute. All but five of these cases were litigated in the United States Tax Court. A detailed list appears in Table 6 in Appendix III. Thirty-six cases involved individual taxpayers and 20 involved businesses (including individuals engaged in self-employment or partnerships).

Of the 41 cases in which taxpayers appeared *pro se* (without counsel), taxpayers prevailed in full in one case, and three resulted in split decisions. Of the 15 cases in which taxpayers had representation, taxpayers prevailed in full in three cases, and none were split decisions.

### Failure to File Penalty

To be held liable for the failure to file penalty, the taxpayer must have a filing requirement. In *Ungvar v. Commissioner*,<sup>23</sup> a tax-exempt religious corporation petitioned the U.S. Tax Court for redetermination of an employment tax deficiency and additions to tax after the reclassification of an individual as the taxpayer's employee.<sup>24</sup> The IRS issued a notice of determination of worker classification and a notice of deficiency for employment tax deficiencies that arose from this reclassification.<sup>25</sup> The deficiency included a penalty under IRC § 6651(a)(1) for failing to file federal employment tax returns. However, the Tax Court held the taxpayer was not required to file these returns or make any required deposits for the taxable periods at issue, because it was determined the taxpayer did not have any employees at that time. Accordingly, the court held the taxpayer was not liable for the failure to file penalty.<sup>26</sup>

21 IRC § 6654(e)(3)(B).

22 *Higbee v. Comm'r*, 116 T.C. 438, 446 (2001) (quoting IRC § 7491(c)). An exception to this rule relieves the IRS of this burden where the taxpayer's petition fails to state a claim for relief from the penalty (and therefore is deemed to concede the penalty), such as where the taxpayer only makes frivolous arguments. *Funk v. Comm'r*, 123 T.C. 213 (2004).

23 *Ungvar v. Comm'r*, T.C. Memo. 2013-161.

24 IRC § 7436 grants the Tax Court jurisdiction to determine whether the IRS's determination of worker classification is correct and whether the employment taxes, including additions to tax, associated with the worker classification are the proper amount. Originally IRC § 7436 only granted jurisdiction to the Tax Court to review and determine worker classification status and not the proper amount of employment tax associated with the classification. In 2000, Congress amended IRC § 7436 and clarified that the Tax Court does have jurisdiction to determine the proper amount of employment tax under the determination of worker status. See The Community Renewal Tax Relief Act of 2000, Pub. L. No. 106-554, § 314(f) and (g), 114 Stat. 2763A-587, 2763A-643 (Dec. 21, 2000).

25 The IRS assessed amounts due as a result of the taxpayer's failure to withhold and deposit payments from its employee's wages. Specifically, the taxpayer did not remit amounts required under the Federal Insurance Contributions Act (FICA) and amounts required for income tax withholding (ITW) for the last three quarters of 2004 and all quarters of taxable years 2005, 2006, and 2007. Under IRC §§ 3401 through 3405, employers are required to withhold from employees' wages an amount for payment of tax, such as income tax and employment tax, and are required to remit these withholdings to the IRS.

26 T.C. Memo. 2013-161. The court also held that because the taxpayer did not have any employees during the time period at issue, the taxpayer did not fail to make employment tax deposits and was therefore, not liable for the penalties assessed under IRC § 6656.

More commonly, taxpayers raised reasonable cause arguments in defense to the failure to file penalty. However, in most cases reviewed, taxpayers could not successfully establish that the failures to file were due to reasonable cause. Frequent reasonable cause claims included the following issues.

### ***Medical Illness***

Depending on the facts and circumstances, a medical illness may establish reasonable cause for failure to file, if the taxpayer can show incapacitation to such a degree that he or she could not file a return on time.<sup>27</sup> When considering whether the severity of the illness suffices to establish reasonable cause, the court will analyze a taxpayer's management of his or her business affairs during the illness.<sup>28</sup> In *Wolfington v. Commissioner*,<sup>29</sup> the taxpayers (husband and wife) failed to file their 2005 and 2006 federal income tax returns after seeking and receiving filing extensions.<sup>30</sup> In addition to raising other arguments, which the court found unconvincing and misguided, the taxpayers argued that Mrs. Wolfington's illness was "one of the distractions whose cumulative effect prevented [them] from timely filing their return."<sup>31</sup> However, the taxpayers did not provide any evidence, aside from Mr. Wolfington's testimony, that his wife's illness, alone or cumulatively, had a direct impact on their ability to file a return. As the taxpayers' arguments cumulatively did not establish reasonable cause, the Tax Court upheld the penalty as properly assessed. This case highlights the importance of providing additional documentation to establish illness as a reasonable cause.

In *Stevens Tech., Inc. v. Commissioner*,<sup>32</sup> the taxpayer was assessed additions to tax for failure to file quarterly employment tax returns (Forms 941, *Employer's Quarterly Federal Tax Return*) for a number of quarters between 2005 and 2008.<sup>33</sup> After the assessment, the IRS filed a Notice of Federal Tax Lien and sent the taxpayer a *Notice of Federal Tax Lien Filing and Your Right to a Hearing under IRC § 6320*. The taxpayer then requested a Collection Due Process (CDP) hearing requesting abatement of the failure to file penalties on the basis of reasonable cause. After the CDP hearing, and considering the taxpayer's request, the Appeals Officer issued a notice of determination stating that abatement of the failure to file penalties was unwarranted. After receiving this determination, the taxpayer petitioned the U.S. Tax Court under IRC § 6320(a), which grants the Tax Court judicial review of the IRS Appeals Office's CDP determinations.<sup>34</sup> During the trial, the taxpayer argued that its failure to file timely was due to reasonable cause, because one of its officers had significant health and family problems. Despite those difficulties, "the company was able to continue its operations, market its services to clients and potential clients,

27 *Williams v. Comm'r*, 16 T.C. 893, 905-06 (1951) (interpreting § 291 of the 1939 Code, a predecessor to IRC § 6651), acq., 1951-2 C.B. 1. See, e.g., *Harbour v. Comm'r*, T.C. Memo. 1991-532 (finding reasonable cause for failing to timely file because the taxpayer was in a coma the month before the due date of his tax return).

28 *Judge v. Comm'r*, 88 T.C. 1175, 1189–91 (1987).

29 T.C. Memo. 2014-45.

30 The taxpayers filed returns only after the IRS issued a statutory notice of deficiency in 2011.

31 T.C. Memo. 2014-45 at 8. The taxpayers also stated they believed it was unnecessary to timely file the 2005 return because they were not expecting to owe tax, and were unable to timely file the 2006 return because they were still gathering necessary information.

32 T.C. Memo. 2014-13.

33 *Id.* The term "employment taxes," as used in this case, included: (1) employer's share of Federal Insurance Contributions Act (FICA), (2) employee's FICA withholding, and (3) employee's income tax withholding. The term also includes withholding under the Federal Unemployment Tax Act. See generally, IRC §§ 3101, 3102, 3111-3113, and 3121-3128 (Federal Insurance Contributions Act); IRC §§ 3201, 3202, 3211, 3221, 3231-3233 and 3241 (Railroad Retirement Tax Act); IRC §§ 3301-3311 (Federal Unemployment Tax Act); IRC §§ 3401-3407 (collection of income at source on wages).

34 Where the validity of the underlying tax liability is properly at issue, the court will review the amount of the tax liability on a *de novo* basis. The legislative history of RRA '98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. Rep. No. 105-599, at 266 (1998) (Conf. Rep.). The term *de novo* means anew. *Black's Law Dictionary*, 447 (7th Ed. 1999).

increase its workforce, and hire an accounting firm to prepare its Forms 941.”<sup>35</sup> As a result, the Tax Court held the officer’s health and family problems could not be reasonable cause because the failure to file was the result of the company’s deliberate choice to focus on business matters rather than on tax compliance.<sup>36</sup>

### *Reliance on Agent*

The U.S. Supreme Court, in *United States v. Boyle*,<sup>37</sup> held taxpayers have a nondelegable duty to file a return on time and a taxpayer’s reliance on an agent to file the return does not excuse a failure to comply with a known filing requirement. In *Lamb v. Commissioner*,<sup>38</sup> the taxpayers relied on their attorney to prepare and file their 2008 tax return, but the IRS never received it. The court held, even if the taxpayers’ testimony regarding their relationship and interactions with their attorney were credible, their reliance did not excuse their failure to timely file their return.

A taxpayer may establish reasonable cause for a failure to file if he or she can prove reasonable reliance on a professional tax advisor’s advice or that the taxpayer made a good-faith effort to ascertain return filing requirements.<sup>39</sup> In order to reasonably rely on the advice of a tax professional, the taxpayer must present evidence of the professional’s expertise and show he or she provided the professional with all necessary and accurate information.<sup>40</sup>

In *Sean McAlary Ltd., Inc. v. Commissioner*,<sup>41</sup> the taxpayer relied on a preparer to compute and remit employment taxes and file required employment tax returns for tax year 2006 (Form 941, *Employer’s Quarterly Federal Tax Return* and 940, *Employer’s Annual Federal Unemployment ‘FUTA’ Tax Return*).<sup>42</sup> However, the returns were not filed and the IRS imposed a failure to file penalty under IRC § 6651(a)(1). The taxpayer argued he was not liable for the penalty, because reliance on advice from the tax professional established reasonable cause. However, the court held reasonable cause did not exist because the taxpayer

35 *Stevens Tech., Inc. v. Comm'r*, T.C. Memo. 2014-13.

36 *Id.* The court also upheld the imposition of the failure to pay penalty under IRC § 6651(a)(2) and failure to make tax deposits under IRC § 6656.

37 469 U.S. 241, 252 (1985).

38 T.C. Memo. 2013-155.

39 *Estate of La Meres v. Comm'r*, 98 T.C. 294, 315-17 (1992) (citations omitted).

40 *Id.* In her Annual Reports to Congress, the National Taxpayer Advocate has emphasized the need for minimum competency standards for paid unenrolled return preparers. See National Taxpayer Advocate 2013 Annual Report to Congress 61-74; National Taxpayer Advocate 2009 Annual Report to Congress 41-69; National Taxpayer Advocate 2008 Annual Report to Congress 503-512. In June of 2014, the IRS announced that it would be offering a new voluntary program designed to encourage education and filing season readiness for such preparers. The program will allow unenrolled return preparers to obtain a record of completion when they voluntarily complete a required amount of continuing education, including a course in basic tax filing issues and updates, ethics and other federal tax law courses. Tax return preparers who elect to participate in the program and receive a record of completion from the IRS will be included in a database on IRS.gov that will be available by January 2015 to help taxpayers determine return preparer qualifications. See IRS Press Release, *New IRS Filing Season Program Unveiled for Tax Return Preparers*, IR-2014-75 (June 26, 2014). The American Institute of CPAs filed suit, in the District Court for the District of Columbia, alleging that the IRS lacks the authority to implement the voluntary program. The government subsequently filed a motion to dismiss. On October 27, 2014, the District Court for the District of Columbia granted the IRS’s motion to dismiss. *AICPA v. IRS*, 2014 WL 5585334 (D.D.C. 2014).

41 T.C. Summ. Op. 2013-62. This is a summary opinion small tax case and pursuant to IRC § 7463(b) cannot be cited as precedent. Normally we do not discuss Tax Court cases that are designated as a “Small Case” under IRC § 7463(b) but we have elected to discuss this case here because it best illustrates the point that reliance on a tax professional is not an absolute defense, but merely a factor to be considered. See e.g., *Freytag v. Comm'r*, 89 T.C. 849, 888 (1987).

42 IRC § 7436(a) vests the Tax Court with jurisdiction to review certain determinations made by the Commissioner regarding employment status (worker classification) and to determine the proper amount of employment tax arising from such determination. In this case, the parties agreed the IRS classification of employee was correct and the remaining issues were the amounts of employment tax and additions to tax.

never investigated the preparer's background or qualifications, or otherwise confirmed that he was a competent professional who had sufficient knowledge and expertise to warrant reliance on his advice.<sup>43</sup>

### ***“Zero Return” Filers and Other Frivolous Arguments***

Under the longstanding four-part test articulated in *Beard v. Commissioner*,<sup>44</sup> a valid return must:

1. Contain sufficient data to calculate the tax liability;
2. Purport to be a return;
3. Represent an honest and reasonable attempt to satisfy the requirements of the tax laws; and
4. Be signed under penalties of perjury.

Each year, some taxpayers claim they have no obligation to pay taxes by filing returns reporting zero income when they have earned substantial wages accurately reported on a Form W-2.<sup>45</sup> A “zero” return does not constitute a tax return under the *Beard* test because it is devoid of financial data and lacks sufficient information to calculate the tax liability.<sup>46</sup> Thus, when the taxpayer in *Hill v. Commissioner* filed returns containing zeros for taxable income, the court upheld the failure to file penalty.<sup>47</sup>

### ***Failure to Pay an Amount Shown Penalty***

A taxpayer can file a return by the due date and still be liable for a penalty if he or she does not pay the amount shown on the return. In cases where individual taxpayers disputed that they were subject to the failure to pay penalty, many of their justifications were similar to those used for the failure to file penalty under IRC § 6651(a)(1), as the taxpayers often unsuccessfully argued medical illness or reliance on an agent.<sup>48</sup>

However, a taxpayer succeeded in disputing the penalty when the IRS could not meet its burden of production under IRC § 7491(c). Specifically, the IRC § 6651(a)(2) penalty applies only when the return filed by the taxpayer shows the amount due.<sup>49</sup> If the taxpayer did not file a return, the IRS can only assess the penalty if it has prepared a Substitute for Return (SFR) that satisfies the requirements of IRC § 6020(b). If the IRS cannot produce the SFR, it falls short of satisfying its burden of production under IRC § 7491.<sup>50</sup>

For example, in *Close v. Commissioner*,<sup>51</sup> the IRS stated it prepared a valid SFR for the taxpayers for each year in issue. However, no SFRs were introduced into evidence, and the parties did not stipulate that valid SFRs were prepared. Instead, the IRS relied upon certified Forms 4340, *Certificate of Assessments, Payments, and Other Specified Matters*, that purported to show the IRS filed SFRs for the taxpayers. Still,

43 T.C. Summ. Op. 2013-62.

44 82 T.C. 766, 777 (1984), aff'd per curiam, 793 F.2d 139 (6th Cir. 1986).

45 See, e.g., *Hill v. Comm'r*, T.C. Memo. 2013-265 (concluding there was no evidence of reasonable cause presented when the taxpayer reported all “zeros” on his return and offered only frivolous arguments).

46 See *Turner v. Comm'r*, T.C. Memo. 2004-251, and the numerous cases cited therein.

47 *Hill v. Comm'r*, T.C. Memo. 2013-265.

48 See, e.g., *U.S. v. Meehan*, 530 F. App'x 155 (3d Cir. 2013), aff'g 108 A.F.T.R.2d (RIA) 5619 (illness); *Alexander v. Comm'r*, T.C. Memo. 2013-203 (reliance on agent).

49 IRC § 6651(a)(2), (g)(2).

50 See *Wheeler v. Comm'r*, 127 T.C. 200, 210, (2006), aff'd, 521 F.3d 1289 (10th Cir. 2008).

51 T.C. Memo. 2014-25.

the court held the IRS did not meet its burden of production under IRC § 7491(c), because the forms did not adequately prove the SFRs had been created.

### **Estimated Tax Penalty**

Courts routinely found taxpayers liable for the IRC § 6654 estimated tax penalty when the IRS proved the taxpayer

- Had a tax liability;
- Had no withholding credits;
- Made no estimated tax payments for that year; and
- Offered no evidence to refute the IRS.<sup>52</sup>

The IRS has the burden of production under IRC § 7491(c) to produce evidence that a taxpayer was required to make an annual payment under IRC § 6654(d)(1)(B). In *Winterroth v. Commissioner*,<sup>53</sup> the IRS did not produce any evidence the taxpayer had a tax liability for 2007. Without the 2007 return, and without knowing if the taxpayers had a liability for that year, the court was unable to calculate the taxpayers' estimated annual payment for 2008, if any. However, the IRS established that the taxpayer was obligated to file a return for 2008 but did not do so and did not make the requisite 2009 payments. Therefore, the IRS did not meet its burden of production of information showing that the taxpayers had a required payment under IRC § 6654 for 2008, but did show that the taxpayer was required to make a payment for 2009.

### **Penalty for Raising Frivolous Arguments**

In four cases where the IRS had asserted either the failure to file penalty, failure to pay penalty, estimated tax penalty, or some combination, the courts also imposed the IRC § 6673 penalty for making frivolous arguments.<sup>54</sup> In one of these cases, the taxpayer failed to file a return because he believed neither compensation nor dividends were taxable income.<sup>55</sup> The Tax Court held the taxpayer liable for fraudulent failure to file, failure to pay tax, and failure to pay estimated income tax, and imposed a \$50,000 penalty under IRC § 6673 (\$25,000 in each consolidated case).<sup>56</sup>

## **CONCLUSION**

The IRS did not prevail in full in seven of 56 (or 13 percent) of the failure to file penalty, failure to pay penalty, and the estimated tax penalty cases analyzed in this report. This is similar to the prior year, when the IRS did not prevail in 17 percent of cases.<sup>57</sup> Despite a rather high IRS success rate, the litigation represents a significant impact on IRS resources and a burden on taxpayers.

In an effort to reduce the burden on taxpayers and save resources, it is important the IRS clearly explain to taxpayers the requirements of reasonable cause. In a number of cases, it appeared that taxpayers did

<sup>52</sup> See, e.g., *Duggan v. Comm'r*, T.C. Memo. 2014-17, appeal docketed, No. 14-71645 (9th Cir. June 16, 2014).

<sup>53</sup> T.C. Memo. 2014-28.

<sup>54</sup> See Most Litigated Issue: *Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions, infra*.

<sup>55</sup> *Jones v. Comm'r*, T.C. Memo. 2014-101.

<sup>56</sup> *Id.*

<sup>57</sup> National Taxpayer Advocate 2013 Annual Report to Congress at 384.

not fully understand what type of situations would establish reasonable cause.<sup>58</sup> This disconnect may result in unnecessary litigation, putting the taxpayer at risk for sanctions under IRC § 6673.

Additionally, it is critical that IRS employees look closely and thoroughly at the case facts when assessing reasonable cause claims, rather than solely relying on the Reasonable Cause Assistant (RCA) software,<sup>59</sup> which is designed to help IRS employees make fair and consistent abatement determinations.<sup>60</sup> The RCA program allows IRS employees to override the result in certain circumstances, but employees must understand the definition of reasonable cause in order to apply the override.<sup>61</sup> Thus, a close review by an employee is essential to ensure the penalty is imposed appropriately. To promote voluntary compliance, taxpayers must believe the facts of their individual cases have been carefully considered.

The National Taxpayer Advocate reiterates her recommendation that Congress implement a one-time abatement of the failure to file penalty for taxpayers who comply with their filing obligations, but in an untimely manner.<sup>62</sup> She also continues to recommend a repeal of the failure to pay penalty, which could be replaced by a market rate of interest equal to the rate on an unsecured loan.<sup>63</sup>

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58 See, e.g., *Wolfington v. Comm'r*, T.C. Memo. 2014-45.

59 The Reasonable Cause Assistant can only consider Failure to File or Failure to Pay penalties on certain individual tax returns, and the Failure to Deposit penalty only on certain business returns.

60 National Taxpayer Advocate 2010 Annual Report to Congress 198 (Most Serious Problem: *The IRS's Over-Reliance on Its "Reasonable Cause Assistant" Leads to Inaccurate Penalty Abatement Determinations*). See also IRS, Reasonable Cause Assistant (RCA) Usability Test Final Report Summary 4 (May 28, 2010). The test showed that employees using the RCA determined penalty abatement requests correctly in only 45 percent of the cases. An even more disturbing finding was that all of the employees in the study believed they were making correct legal determinations based on reasonable cause.

61 IRM 20.1.1.3.6.10(3) (Nov. 25, 2011) ("Fair and consistent application of penalties requires employees to make a final penalty relief determination consistent with the RCA conclusion. Because the individual facts and circumstances vary for each case and that there may be unique facts and circumstances in certain cases that RCA cannot consider, an 'override (abort)' function is available in RCA.").

62 IRM 20.1.1.3.6 (Nov. 25, 2011). The Reasonable Cause Assistant (RCA) will be used when considering penalty relief due to reasonable cause. RCA is to be used after normal case research has been performed, (i.e., applying missing deposits/payments, adjusting tax, researching for missing extensions of time to file, etc.). See National Taxpayer Advocate 2001 Annual Report to Congress 188. A provision to waive the failure to file penalty for first-time, unintentional, minor errors was included in the House-passed Taxpayer Protection and IRS Accountability Act of 2003. See H.R. 1528, 108th Cong. § 106 (2003). Although the IRS has provided for a one-time administrative waiver of the failure to file penalty in IRM 20.1.1.3.6.1 (Nov. 25, 2011), the National Taxpayer Advocate continues to recommend a statutory waiver similar to IRC § 6656(c).

63 See National Taxpayer Advocate 2001 Annual Report to Congress 182.

**MLI  
#7****Civil Actions to Enforce Federal Tax Liens or to Subject Property  
to Payment of Tax Under IRC § 7403****SUMMARY**

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or subject any of the delinquent taxpayer's property to the payment of tax. We identified 52 opinions issued between June 1, 2013, and May 31, 2014, that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 47 of these cases. The total number of cases represents a 58 percent increase from the previous year.<sup>1</sup>

**PRESENT LAW**

IRC § 7403 authorizes the United States to enforce a federal tax lien with respect to a taxpayer's delinquent tax liability, or to subject any property, right, title or interest in property of the delinquent taxpayer to the payment of a liability, by initiating a civil action against the taxpayer in the appropriate United States District Court.<sup>2</sup> All parties having liens on or otherwise claiming interest in the relevant property shall be made parties to the action.<sup>3</sup> The law of the state where the property is located determines the nature of a taxpayer's legal interest in the property.<sup>4</sup> However, if it is determined that the taxpayer has an interest in the property, federal law controls whether the property is exempt from attachment of the lien.<sup>5</sup>

The court may order that the property be sold by an officer of the court and the proceeds applied to the delinquent tax liability.<sup>6</sup> However, based on the Supreme Court case *United States v. Rodgers*, the court is not required to authorize a forced sale and may exercise limited equitable discretion.<sup>7</sup> When a forced sale involves the interests of a non-delinquent third party, the court should consider four factors from *Rodgers* when determining whether the property should be sold:

1. The extent to which the government's financial interests would be prejudiced if they were relegated to a forced sale of the partial interest of the delinquent taxpayer;
2. Whether the innocent third party with a separate interest in the property, in the normal course of events, has a legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or taxpayer's creditors;
3. The likely prejudice to the third party in personal dislocation costs and inadequate compensation; and
4. The relative character and value of the non-liable and liable interests held in the property.<sup>8</sup>

<sup>1</sup> National Taxpayer Advocate 2013 Annual Report to Congress 403.

<sup>2</sup> IRC § 7403(a); Treas. Reg. § 301.7403-1(a).

<sup>3</sup> IRC § 7403(b).

<sup>4</sup> *United States v. National Bank of Commerce*, 472 U.S. 713, 722 (1985).

<sup>5</sup> *United States v. Rodgers*, 461 U.S. 677 (1983).

<sup>6</sup> IRC § 7403(c).

<sup>7</sup> 466 U.S. 677 (1983).

<sup>8</sup> *Rodgers*, 461 U.S. at 709-11.

At the sale of the property in which it holds a first lien, the United States may bid an amount equal to or less than the amount of the lien, plus selling expenses.<sup>9</sup> Additionally, the United States may intervene in foreclosure actions initiated by other creditors to assert any lien on the property that is the subject of such action.<sup>10</sup>

The United States may also remove the case to a U.S. District Court if the case was initiated in a state court.<sup>11</sup> However, junior federal tax liens may be effectively extinguished in a foreclosure and sale under state law, even if the United States is not a party to the proceeding.<sup>12</sup> Additionally, the Code specifically authorizes the court to appoint a receiver to enforce the lien and, upon the government's certification that it is in the public interest, to appoint a receiver with all powers of a receiver in equity to preserve and operate the property prior to the sale.<sup>13</sup>

In 2013, the IRS clarified its procedures for referring cases to the Department of Justice (DOJ) when seeking to recommend a suit to foreclose on a taxpayer's principal residence.<sup>14</sup> When a tax lien attaches to the principal residence of a taxpayer or a residence owned by the taxpayer but occupied by the taxpayer's spouse, former spouse, or minor child, the IRS can use two methods to enforce the tax lien. The IRS can request that the DOJ:

- File suit to foreclose the federal tax lien against the principal residence under IRC § 7403; or
- Commence a proceeding to obtain a court order allowing administrative seizure of a principal residence under IRC § 6334(e)(1).<sup>15</sup>

Prior to the issuance of this guidance, the Internal Revenue Manual (IRM) provisions related to referring a case to the DOJ for administrative seizure of a principal residence under IRC § 6334(e)(1) required the IRS to consider who is living in the residence in determining whether referral was appropriate. The IRM provisions regarding referring cases to DOJ, to request the commencement of a foreclosure action of a principal residence, were not as clear about the considerations the IRS should make prior to referring a case.

9 IRC § 7403(c).

10 However, if the application of the United States to intervene is denied, the adjudication will have no effect upon the federal tax lien on the property. IRC § 7424. Under 28 U.S.C. § 2410, the United States may be named a party in any civil action or suit in any district court, or in any state court having jurisdiction of the subject matter. IRC § 7424.

11 28 U.S.C. § 1444.

12 *United States v. Brosnan*, 363 U.S. 237 (1960).

13 IRC §§ 7403(d) and 7402(a).

14 IRS Interim Guidance Memorandum (IGM) SBSE-05-0414-0032 (Apr. 18, 2014) (reissuing IRS Interim Guidance Memorandum SBSE-05-0413-035 (Apr. 30, 2013) (Principal Residence Suit Foreclosure Recommendations)), available at [http://www.irs.gov/pub/foia/ig/spder/SBSE-05-0414-0032\[1\].pdf](http://www.irs.gov/pub/foia/ig/spder/SBSE-05-0414-0032[1].pdf). This guidance is the result of action by TAS leadership. In 2012, TAS Systemic Advocacy developed and issued to the IRS an Advocacy Proposal recommending that the IRS consider the negative impact on the taxpayer of a suit to foreclose on a principal residence prior to forwarding the case to the DOJ. TAS, *Memorandum for Director, Collection Policy* (Aug. 20, 2012). The National Taxpayer Advocate followed this advocacy proposal with a legislative recommendation that Congress amend IRC § 7403 to require that the IRS, before recommending that the Attorney General file a suit to foreclose, first determine that the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, and that the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer. National Taxpayer Advocate 2012 Annual Report to Congress 537-43 (Legislative Recommendation: Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences). Following this recommendation, Systemic Advocacy consulted extensively with the IRS to develop the IGM, which adopted the recommendations set forth by the National Taxpayer Advocate.

15 IRC § 6334(e)(1) requires that the IRS obtain court approval prior to administratively seizing a principal residence.

The interim guidance clarifies that the procedures for developing suit referral recommendations under IRC § 6334(e) apply to referrals under IRC § 7403 as well.<sup>16</sup> The guidance also emphasizes that the IRS should pursue a suit to foreclose a lien on a residence only when it has considered hardship issues and there are no reasonable administrative remedies.

## ANALYSIS OF LITIGATED CASES

We reviewed 52 opinions issued between June 1, 2013, and May 31, 2014 that involved civil actions to enforce federal tax liens. Table 7 in Appendix III contains a detailed list of those cases. Fifty percent of the taxpayers appeared *pro se* and 50 percent were represented. Taxpayers with representation received full relief in one case and partial relief in two cases. *Pro se* taxpayers received full relief in one case and partial relief in another.

### ***Foreclosure of Tax Liens Against Property that Has Been Transferred to a Third Party***

In *Smith v. United States*,<sup>17</sup> a husband and wife bought a residence in 1993. In August 2001, while their divorce proceeding was pending, a *lis pendens*<sup>18</sup> was recorded by the wife on the residence. In March 2003, the IRS assessed income taxes against only the husband for the 2000 and 2001 tax years. In July 2003, the husband and wife were divorced, and the divorce decree stated that the husband's interest in the residence was to be transferred to the wife.

On August 14, 2003, a court order conveying title in the residence to the wife was recorded in the local land records. On September 15, 2003, the IRS filed a Notice of Federal Tax Lien (NFTL) against the husband for his 2000 and 2001 income tax liabilities. In June 2011, another NFTL was recorded against the wife as nominee of her now ex-husband. The nominee NFTL did list the wife's correct address and did not contain language stating that the lien attaches specifically to the residence. In response to the nominee lien filing, the wife filed a quiet title action seeking to remove the liens filed by the United States from the residence. In response, the United States filed a counterclaim seeking to foreclose the liens on the residence.

The wife argued that enforcement of the lien was inappropriate because her due process rights were violated, because she was not given notice of the existence of the lien prior to the entry of the divorce decree. The United States argued that it notified her ex-husband and was not required to give her notice. The Court agreed with the United States finding that the statute only requires the IRS to provide notice to the liable taxpayer.<sup>19</sup> The Court went on to say that the wife cannot also argue that she was denied due process because she was not given sufficient notice of the lien since she received notice of the lien in July 2011, well before any foreclosure proceeding started. The court noted that actual notice of the commencement of a foreclosure proceeding is all that due process requires.

The wife also argued that the NFTL filed in 2003 was not valid because her ex-husband had no interest in the residence at the time the assessments were made, because the residence was conveyed to her before

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<sup>16</sup> The IGM follows the legislative recommendation made by the National Taxpayer Advocate in 2012. National Taxpayer Advocate 2012 Annual Report to Congress, 537-43 (Legislative Recommendation: Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences).

<sup>17</sup> 113 A.F.T.R.2d (RIA) 1231 (D. Conn. 2014).

<sup>18</sup> A “*lis pendens*” is a “notice, recorded in the chain of title to real property, required or permitted in some jurisdictions to warn all persons that certain property is the subject matter of litigation, and that any interests acquired during the pendency of the suit are subject to its outcome.” *Black’s Law Dictionary* 9th ed. (2009).

<sup>19</sup> IRC § 6303(a).

the tax liens were recorded, and the *lis pendens* filed in 2001 was effective from the date filed. The United States argued that the *lis pendens* was not effective until the judgment was entered in the divorce proceeding, so the ex-husband's interest in the real property was not extinguished until that time.

The court found the ex-husband did have an interest in the property as a lien on the property arose in March 2003 when the taxes were assessed, which was before the divorce judgment was entered. The prior *lis pendens* does not affect the validity of the lien. With respect to the nominee lien filed in 2011, the United States conceded that it did not mean to suggest the wife is a nominee of the husband as the term is defined in law and that the lien was filed purely to provide record notice of the United States' claim to the property. Thus, the court found the 2011 lien invalid.

Because the wife was a non-liable third party, the court then applied the *Rodgers* factors to determine whether foreclosure of the liens on the residence was appropriate.<sup>20</sup> The court found the wife had little expectation of foreclosure—she had sole ownership interest in the property after divorcing her husband in 2003, and a title search conducted in 2005 showed that her interest was unencumbered. The court also found that foreclosure would cause significant prejudice to the wife, as she had lived on the property for over 20 years, and the forced sale of her home could foreseeably cause her to incur significant relocation costs. The court determined that only one of the *Rogers* factors may have weighed slightly in favor of the government—financial prejudice to the government. Thus, the court concluded that it was appropriate to use its limited discretion under *Rodgers* and deny the sale of the property.

In determining the appropriateness of foreclosure, the courts frequently consider whether a transfer of the property to another party extinguished the federal tax lien.<sup>21</sup> For the lien to remain valid after property has been transferred to a subsequent purchaser, an NFLT must have been filed before the transfer. However, if the third party is not a true purchaser under IRC § 6323(h)(6), the lien will be enforceable, even if an NFLT has not been filed.<sup>22</sup>

For example, in *United States v. Chambers*, the taxpayer refused to file an income tax return for tax years 1996 through 2001 and 2003.<sup>23</sup> Based on information returns filed by third parties, the IRS computed the taxpayer's tax liability and sent him a statutory notice of deficiency (SNOD) proposing an assessment. The taxpayer did not file a Tax Court petition or otherwise respond to the SNOD; thus, the liabilities proposed in the SNOD were assessed.

After the assessment, but before a notice of federal tax lien (NFLT) was filed for tax years 1997 through 2001 and 2003, the taxpayer transferred real property to his children, who paid ten dollars in consideration. Based on these facts, the court determined the government had demonstrated that it properly assessed the liabilities, that the liabilities remained unpaid after notice and demand for payment, and that a federal tax lien arose upon assessment that attached to all the taxpayer's property, including the property transferred to his children. The court found that because the taxpayer's children did not qualify

20 113 A.F.T.R.2d (RIA) 1231 (D. Conn. 2014). For an explanation of the *Rodgers* factors, see discussion in Present Law section, *supra*.

21 A federal tax lien arises “If any person liable to pay any tax neglects or refuses to pay the same after demand.” IRC § 6321. This lien is called a “secret lien” because it arises upon assessment; nothing is filed publicly. Conversely, an NFLT is filed in the public record (e.g., local courthouse) and provides public notice to creditors.

22 Under IRC § 6323(a), the lien is not valid against a purchaser until notice has been filed that meets the requirements of IRC § 6323(f).

23 113 A.F.T.R.2d (RIA) 2195 (M.D. Fla. 2014).

as a “purchaser” under IRC § 6323(h)(6), the tax lien remained on the property and thus it was subject to foreclosure.<sup>24</sup>

In *United States v. Denneny*,<sup>25</sup> the court considered whether it was appropriate to foreclose on property transferred to a third party after the federal tax lien arose and the IRS filed an NFTL. Since an NFTL was filed at the time the third party purchased the property, the property was purchased subject to the NFTL. It was appropriate for the United States to enforce the liens against the property via a foreclosure action.<sup>26</sup> Applying similar reasoning, the court in *United States v. Woodruff* found that, because the taxpayer transferred properties to his wife after federal tax liens arose and NFTLs were filed, the liens remained on the properties.<sup>27</sup>

### Foreclosure of Tax Liens Against Property that Is Held by a Taxpayer’s Nominee or Alter Ego

Several opinions involved foreclosure of federal tax liens against property titled in the name of a taxpayer’s nominee or alter ego. A nominee is “one who holds bare legal title to property for the benefit of another.”<sup>28</sup> Courts typically look at a number of factors to determine whether an entity is a nominee of a taxpayer, such as whether:

- The nominee paid no or inadequate consideration;
- The property was placed in the name of the nominee in anticipation of the tax debt or litigation;
- There is a close relationship between the transferor and the nominee;
- The parties to the transfer never recorded the conveyance;
- The transferor retained control; and
- The transferor continues to enjoy the benefits of property.<sup>29</sup>

In *United States v. Gilbert*,<sup>30</sup> the court held the trust set up by the taxpayer was the nominee of the taxpayer. The court based this conclusion on the fact that the taxpayer was convicted of tax evasion, in part, for using the trust to evade the payment of his federal income tax liabilities. In particular, the taxpayer was both a transferor of property to the trust and the managing trustee, and the taxpayer turned funds from the trust’s bank account to his own personal use.

In *Fourth Investment LP v. United States*,<sup>31</sup> the taxpayers transferred title of their home and a commercial building to two limited partnerships, which the government argued were not functionally partnerships but were simply the taxpayers’ nominees. The Ninth Circuit Court of Appeals agreed with the government, noting the transfers were made through a complex series of transactions involving shell entities

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24 If a taxpayer transfers property subject to a federal tax lien to a purchaser before the government files an NFTL, the lien no longer attaches and the purchaser acquires the property free of the lien. IRC § 6323(a). A purchaser is defined in the Code as a person who for adequate consideration acquires an interest (other than a lien or security interest) in property that is valid under local law against subsequent purchasers without actual notice. IRC § 6323(h)(6).

25 112 A.F.T.R.2d (RIA) 7445 (E.D. Pa. 2013).

26 *Id.*

27 113 A.F.T.R.2d (RIA) 1062 (D.N.H. 2014).

28 *United States v. Sabby*, 113 A.F.T.R.2d (RIA) 1335 (D. Minn. 2014) (quoting *Scoville v. United States*, 250 F.3d 1198, 1202 (8th Cir. 2001)).

29 *Id.*

30 113 A.F.T.R.2d (RIA) 620 (W.D. Ky. 2014).

31 720 F.3d 1058 (9th Cir. 2013), aff’g *Leeds LP v. United States*, 807 F. Supp. 2d 946 (S.D. Cal. 2011).

created and controlled by the taxpayers.<sup>32</sup> Specifically, when considering the above-mentioned factors, the court found the entities were nominees because consideration received by the taxpayer for the transfer of real property was inadequate, and the taxpayer retained benefits and possession of the real property.

The court in *United States v. Powell*<sup>33</sup> reached a similar decision. The taxpayers formed a corporation with the taxpayer's wife as sole shareholder to hold a residence purchased with the taxpayers' money, and the residence was subject to a federal tax lien. After noting that the taxpayers lived at the residence and paid all the related expenses and taxes, the court held that the corporation was the nominee of the taxpayers and the taxpayer was the true beneficiary and equitable owner of the property. Thus, the court ordered the foreclosure of the tax liens on the properties held by the nominee entities.<sup>34</sup>

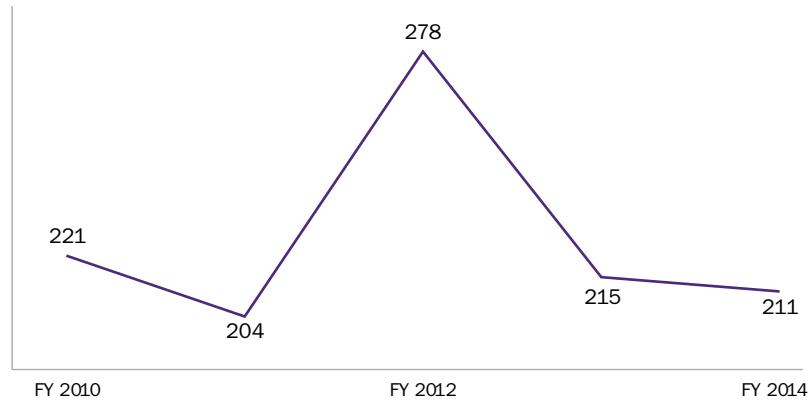
## CONCLUSION

In the 2012 Annual Report to Congress, we predicted that one might see more court opinions involving lien enforcement in the coming years due to an increase in the number of cases referred to the DOJ by the IRS.<sup>35</sup> While there was a marked increase in lien opinions issued this year, it does not appear this increase was due to a greater number of cases being referred to DOJ. Compared with the FY 2012, the IRS referred fewer lien suits in both FY 2013 and FY 2014. However, because the number of cases referred to DOJ in FYs 2013 and 2014 is similar to years before FY 2012, it may be that FY 2012 was an outlier and the number of lien referrals has remained steady.

Figure 3.7.1, shows the number of cases referred to the DOJ by fiscal year.<sup>36</sup>

**FIGURE 3.7.1**

**Lien cases referred to U.S. Department of Justice  
by year, FY 2010-FY 2014**



32 720 F.3d 1058 (9th Cir. 2013), aff'g Leeds LP v. United States, 807 F. Supp. 2d 946 (S.D. Cal. 2011).

33 113 A.F.T.R.2d (RIA) 1382 (2014).

34 *Id.*

35 National Taxpayer Advocate 2012 Annual Report to Congress 639.

36 DOJ Tax Division, *Suits to Foreclose Tax Lien - Summary by Fiscal Year of Case Receipt* (Oct. 3, 2012) and DOJ Tax Division, *Suits to Foreclose Tax Lien - Summary by Fiscal Year of Case Receipt* (Oct. 18, 2013).

The overall number of referrals to DOJ has not significantly diminished during this reporting period, notwithstanding the publication of the interim guidance memorandum in 2013. Because the guidance was primarily aimed at ensuring the IRS considers collection alternatives and equitable factors such as hardship prior to requesting the DOJ foreclose the lien on a personal residence, we believe that the number of cases like *Smith v. United States*, involving a personal residence where the *Rogers* factors weighed heavily in favor of the property owner, should diminish. However, the guidance may not impact the overall number of foreclosure referrals as some of the cases being worked by the IRS will not involve situations covered by the guidance.

Taxpayers have the *right to privacy*, which means that any enforcement action should be no more intrusive than necessary.<sup>37</sup> The interim guidance recognizes this right by requiring the IRS to take into account how foreclosure of a taxpayer's home will affect the taxpayer. The National Taxpayer Advocate anticipates the interim guidance will continue to have a positive effect on taxpayer rights in future years, as the IRS refers fewer suits to foreclose tax liens on taxpayers undergoing a hardship or in situations where there are reasonable alternatives. The National Taxpayer Advocate will work with the IRS to formally incorporate the interim guidance into the Internal Revenue Manual. In addition, it would be best for Congress to adopt the National Taxpayer Advocate's previous legislative recommendation to codify the approach used in the interim guidance.<sup>38</sup>

37 See IRS, Taxpayer Bill of Rights, <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014); IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

38 The National Taxpayer Advocate recommended Congress amend IRC § 7403 to require that the IRS, before recommending that the Attorney General file a suit to foreclose, first determine that the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, and that the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer. National Taxpayer Advocate 2012 Annual Report to Congress 537-43 (Legislative Recommendation: Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences).

**MLI  
#8****Frivolous Issues Penalty Under IRC § 6673 and Related  
Appellate-Level Sanctions****SUMMARY**

From June 1, 2013, through May 31, 2014, the federal courts issued decisions in at least 22 cases involving the Internal Revenue Code (IRC) § 6673 “frivolous issues” penalty, and at least ten cases involving analogous penalties at the appellate level. These penalties may be imposed against taxpayers for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.<sup>1</sup> In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future.<sup>2</sup> Nonetheless, we include these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

**PRESENT LAW**

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.<sup>3</sup> The maximum penalty is \$25,000.<sup>4</sup> In some cases, the IRS requests that the Tax Court impose the penalty;<sup>5</sup> in other cases, the court exercises its discretion, *sua sponte*,<sup>6</sup> to do so.

Taxpayers who institute actions under IRC § 7433<sup>7</sup> for certain unauthorized collection actions can be subject to a maximum penalty of \$10,000 if the court determines the taxpayer’s position is frivolous or groundless.<sup>8</sup> In addition, IRC § 7482(c)(4),<sup>9</sup> §§ 1912 and 1927 of Title 28 of the U.S. Code,<sup>10</sup> and Rule

1 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts may impose the penalty under IRC § 6673(b)(1). U.S. Courts of Appeals generally impose sanctions under IRC § 7482(c)(4), 28 U.S.C. § 1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.

2 See, e.g., *Aldrich v. Comm'r*, T.C. Memo. 2013-201.

3 IRC § 6673(a)(1)(A), (B), and (C).

4 IRC § 6673(a)(1).

5 The standards for the IRS’s decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual (CCDM). See CCDM 35.10.2, *Special Procedures When Attorneys’ Fees and Sanctions Are Sought, Penalties and Sanctions* (Aug. 11, 2004). For sanctions under IRC § 6673(a)(2) of attorneys or other persons admitted to practice before the Tax Court, all requests for sanctions are reviewed by the designated agency sanctions officer (currently the Associate Chief Counsel (Procedure & Administration)). This review ensures uniformity on a national basis. See, e.g., CCDM 35.10.2.2.3, *Sanctions Requiring National Office Review* (Aug. 11, 2004).

6 “Sua sponte” means without prompting or suggestion; on its own will or motion. *Black’s Law Dictionary* (10th ed. 2014), available at [www.westlaw.com](http://www.westlaw.com). Thus, for conduct that it finds particularly offensive, the Tax Court can choose to impose a penalty under IRC § 6673 even if the IRS has not requested the penalty. See, e.g., *Toth v. Comm'r*, T.C. Memo. 2013-142.

7 IRC § 7433(a) allows a taxpayer a civil cause of action against the United States if an IRS employee intentionally or recklessly, or by reason of negligence, disregards any IRC provision or Treasury regulation in connection with collecting the taxpayer’s federal tax liability.

8 IRC § 6673(b)(1).

9 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court’s decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer’s position in the appeal was frivolous or groundless.

10 28 U.S.C. § 1912 provides that when the Supreme Court or a United States Court of Appeals affirms a judgment, the court has the discretion to award to the prevailing party just damages for the delay, and single or double costs. 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and vexatiously multiplying proceedings; such person may be required to personally pay the excess costs, expenses, and attorneys’ fees reasonably incurred because of his/her conduct.

38 of the Federal Rules of Appellate Procedure<sup>11</sup> (among other laws and rules of procedure) authorize federal courts to impose penalties against taxpayers or their representatives for raising frivolous arguments or using litigation tactics primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in nontax cases, this report focuses primarily on the IRC § 6673 penalty.

## ANALYSIS OF LITIGATED CASES

We analyzed twenty-two opinions issued between June 1, 2013, and May 31, 2014 that addressed the IRC § 6673 penalty. Eighteen of these opinions were issued by the Tax Court and four by U.S. Courts of Appeals in cases where taxpayers sought review of the Tax Court's imposition of the penalty. The Courts of Appeals sustained the Tax Court's position in all cases.

In ten cases, the Tax Court imposed penalties under IRC § 6673, with the amounts ranging from \$1,500 to \$225,000.<sup>12</sup> In three cases, taxpayers prevailed when the IRS asked the court to impose a penalty but in all of these cases, the court warned the taxpayers not to bring similar arguments in the future.<sup>13</sup> Two taxpayers were represented by attorneys or other persons admitted to practice before the Tax Court; all sixteen others appeared *pro se* (represented themselves). The taxpayers in these cases presented a wide variety of arguments that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts almost invariably cited the language set forth in *Crain v. Commissioner*:

We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system—including the role played within that system by the Internal Revenue Service and the Tax Court—has long been established.<sup>14</sup>

In the Tax Court cases we reviewed, taxpayers raised the following issues that the court deemed frivolous. Consequently, the taxpayers were subject to a penalty under IRC § 6673(a)(1) (or, in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future if the taxpayers maintained the same positions):

- **Taxes and procedures to collect taxes are unconstitutional:** Taxpayers in at least four cases argued that taxes, or the actions used by the IRS or the courts to collect them, violate their constitutional rights.<sup>15</sup> Taxpayers generally argued that taxes and the courts' actions were unconstitutional, as well as arguing specifically that taxes and the collection of taxes violated the First, Fourth, Fifth, and Sixteenth Amendments. The IRS prevailed on the issue of sanctions in three of the cases. In

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<sup>11</sup> Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.

<sup>12</sup> The maximum penalty is \$25,000 in a Tax Court proceeding, but in *Jones v. Comm'r*, T.C. Memo. 2014-101, the Tax Court imposed \$225,000 (nine cases consolidated and the penalty was imposed in each of the nine cases).

<sup>13</sup> See, *Carothers v. Comm'r*, T.C. Memo. 2013-165, *Haag v. Commissioner*, T.C. Memo 2014-11, and *MacDonald v. Comm'r*, T.C. Memo. 2014-42.

<sup>14</sup> *Crain v. Comm'r*, 737 F.2d 1417, 1417-18 (5th Cir. 1984).

<sup>15</sup> See, e.g., *Buckhardt v. Comm'r*, 548 F. App'x 433 (9th Cir. 2013), aff'd T.C. Docket No. 22131-10 (Oct. 13, 2011) (taxpayer argued that the Tax Court violated his First, Fourth, and Fifth Amendment rights).

the fourth case, the court upheld the § 6673 penalty but declined to impose any additional sanctions under 28 U.S.C. § 1912 or the Federal Rules of Appellate Procedure.<sup>16</sup>

- **IRS forms invalidate tax assessments:** In at least two cases, taxpayers argued that various IRS forms invalidated the tax assessments.<sup>17</sup> One taxpayer argued the tax was not properly imposed since it was not validated on a Form 23C, “Assessment Certificate-Summary Record of Assessments” and the other taxpayer argued that IRS forms violate the Paperwork Reduction Act of 1995. Both courts declined to impose any penalties, but warned the taxpayers that further similar conduct could result in penalties.
- **Only income earned from the United States government or entities associated with the United States government is taxable:** Taxpayers in at least six cases argued that only federal government employees, public servants, or those who earn income from the United States government or military are subject to the income tax.<sup>18</sup> The IRS prevailed in four cases and the court raised the issue *sua sponte* in the other two cases, deciding not to impose the penalty in the present cases but warning the taxpayers not to raise similar arguments in the future.

## CONCLUSION

Taxpayers in the cases analyzed this year presented the same or similar arguments raised and repeated year after year, which the courts routinely and universally reject.<sup>19</sup> Taxpayers avoided the IRC § 6673 penalty in only three cases where the IRS requested it, demonstrating the willingness of the courts to penalize taxpayers when they offer frivolous arguments or institute a case merely for delay. Whether the taxpayer has a history of making frivolous or groundless arguments may result in a larger penalty being imposed, but that may not always be the case.<sup>20</sup>

Where the IRS has not requested the penalty, the court may nonetheless raise the issue *sua sponte*, and in many cases imposes the penalty or cautions the taxpayer that similar future behavior will result in a penalty.<sup>21</sup> Finally, the U.S. Courts of Appeals have shown their willingness to uphold the IRC § 6673 penalties imposed by the Tax Court without fail in the cases analyzed for the period between June 1, 2013, and May 31, 2014, continuing a trend of upholding all penalties in cases we have analyzed since June 2005.

16 See *Herriman v. Comm'r*, 521 F. App'x 912 (11th Cir. 2013), aff'd T.C. Docket. No. 25048-11 (May 8, 2012) (court granted IRS's motion for sanctions pursuant to the Federal Rules of Appellate Procedure); *Golub v. Comm'r*, T.C. Memo. 2013-196 (court, *sua sponte*, imposed sanctions under IRC § 6673); *Young v. Comm'r*, 551 F. App'x 229 (5th Cir. 2014), aff'd T.C. Docket No. 4664-12 (Mar. 20, 2013) (court affirmed § 6673 penalty and granted IRS's motion for sanctions pursuant to the Federal Rules of Appellate Procedure); *Buckhardt v. Comm'r*, 548 F. App'x 433 (9th Cir. 2013), aff'd T.C. Docket. No. 22131-10 (Oct. 13, 2011) (court affirmed IRC § 6673 penalty but denied IRS's motion for sanctions pursuant to 28 U.S.C. § 1912 and the Federal Rules of Appellate Procedure).

17 See *Pflum, U.S. v.*, 112 A.F.T.R.2d (RIA) 7200 (W.D. Wash. 2013), aff'd 112 A.F.T.R.2d (RIA) 7303 (E.D. Wash. 2013); *Burt v. Comm'r*, T.C. Memo. 2013-140, appeal docketed, No. 13-1946 (6th Cir. Oct. 17, 2013).

18 See, e.g., *Hill v. Comm'r*, T.C. Memo. 2013-265; *Jones v. Comm'r*, T.C. Memo. 2014-101.

19 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 399-402.

20 See, e.g., *Golub v. Comm'r*, T.C. Memo. 2013-196 (court imposed \$15,000 penalty and had imposed \$10,000 penalty in an earlier case). Compare with *Burt v. Comm'r*, T.C. Memo. 2013-140, appeal docketed, No. 13-1946 (6th Cir. Oct. 17, 2013) (court declined to impose the IRC § 6673 penalty even though the taxpayer was no stranger to the court and had been penalized \$20,000 in an earlier case).

21 See, e.g., *Aldrich v. Comm'r*, T.C. Memo. 2013-201 (court raised the issue *sua sponte* and warned the taxpayer not to assert similar arguments in the future).

**MLI  
#9****Charitable Deductions Under IRC § 170****SUMMARY**

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes for contributions of cash or other property to or for the use of charitable organizations.<sup>1</sup> In order to take a charitable deduction, taxpayers must contribute to a qualifying organization<sup>2</sup> and substantiate contributions of \$250 or more. Litigation generally arises over one or more of these four issues:

- Whether the donation is made to a charitable organization;
- Whether contributed property qualifies as a charitable contribution;
- Whether the amount taken as a charitable deduction equals the fair market value of the property contributed; and
- Whether the taxpayer has substantiated the contribution.

We reviewed 30 cases decided between June 1, 2013 and May 31, 2014 with charitable deductions as a contested issue. The IRS prevailed in 25 cases, with taxpayers prevailing in no cases and the remaining five resulting in split decisions. Taxpayers represented themselves (appearing *pro se*) in 13 of the 30 cases (43 percent), with two of these *pro se* cases resulting in split decisions and the IRS prevailing in the remaining 11 cases.

**PRESENT LAW**

Taxpayers must itemize in order to claim any charitable contribution deduction<sup>3</sup> and generally are able to take a deduction for charitable contributions made within the taxable year. Transfers to charitable organizations are deductible only if they are contributions or gifts<sup>4</sup> and not if they are payments for goods or services.<sup>5</sup> A contribution or gift will be allowed as a deduction under IRC § 170 only if it is made “to” or “for the use of” a qualifying organization.<sup>6</sup>

For individuals, charitable contribution deductions are generally limited to 50 percent of the taxpayer’s contribution base (adjusted gross income computed without regard to any net operating loss carryback to the taxable year under IRC § 172).<sup>7</sup> However, subject to certain limitations, individual taxpayers can carry forward unused charitable contributions in excess of the 50 percent contribution base for up to five years.<sup>8</sup> Corporate charitable deductions are generally limited to ten percent of the taxpayer’s taxable

1 Internal Revenue Code (IRC) § 170.

2 To claim a charitable contribution deduction, a taxpayer must establish that a gift was made to a qualified entity organized and operated exclusively for an exempt purpose, no part of the net earnings of which insures to the benefit of any private shareholder or individual. IRC § 170(c)(2).

3 IRC §§ 63(d) and (e); 161; 170(a).

4 The Supreme Court of the United States has defined “gift” as a transfer proceeding from a “detached and disinterested generosity.” *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960).

5 See also Treas. Reg. § 1.170A-1(g) (no deduction for contribution of services).

6 IRC § 170(c).

7 IRC § 170(b)(1)(A), (G).

8 IRC § 170(d)(1).

income.<sup>9</sup> Taxpayers cannot deduct services that they offer to charitable organizations; however, incidental expenditures incurred while serving a charitable organization and not reimbursed may constitute a deductible contribution.<sup>10</sup>

### Substantiation

For cash contributions, taxpayers must maintain receipts from the charitable organization, copies of cancelled checks, or other reliable records showing the name of the organization, the date, and the amount contributed.<sup>11</sup> Deductions for single charitable contributions of \$250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.<sup>12</sup>

The donor is generally required to obtain the contemporaneous written acknowledgment no later than the date he or she files the return for the year in which the contribution is made, and it must include:

- The name of the charitable organization;
- The amount of any cash contribution;
- A description (but not the value) of any non-cash contribution;
- A statement that no goods or services were provided by the organization in return for the contribution, if that was the case;
- A description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution; and
- A statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits, if that was the case.<sup>13</sup>

For each contribution of property other than money, taxpayers generally must maintain a receipt showing the name of the recipient, the date and location of the contribution, and a description of the property.<sup>14</sup> When property other than money is contributed, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.<sup>15</sup> This general rule is subject to certain exceptions that in some cases limit the deduction to the taxpayer's cost basis in the property.<sup>16</sup> Moreover, for claimed contributions exceeding \$5,000, a qualified appraisal prepared by a qualified appraiser is required.<sup>17</sup>

## ANALYSIS OF LITIGATED CASES

We reviewed 30 decisions entered between June 1, 2013 and May 31, 2014, involving charitable contribution deductions claimed by taxpayers. Table 9 in Appendix III contains a detailed list of those cases. Of the 30 cases, 13 involved the taxpayers' substantiation (or lack thereof) of the claimed contribution,

9 IRC § 170(b)(2).

10 Treas. Reg. § 1.170A-1(g). Meal expenditures in conjunction with offering services to qualifying organizations are not deductible unless the expenditures are away from the taxpayer's home. *Id.* Likewise, travel expenses associated with contributions are not deductible if there is a significant element of personal pleasure involved with the travel. IRC § 170(j).

11 Treas. Reg. § 1.170A-13(a)(1).

12 IRC § 170(f)(8); see also Treas. Reg. § 1.170A-13(f).

13 IRS Pub. 1771, *Charitable Contributions Substantiation and Disclosure Requirements* (Rev. 7-2013).

14 Treas. Reg. §§ 1.170A-13(b)(1)(i) to (iii).

15 Treas. Reg. § 1.170A-1(c)(1).

16 *Id.*

17 IRC § 170(f)(11)(C). "Qualified appraisal," and "qualified appraiser" are defined in IRC §§ 170(f)(11)(E)(i) and (ii), respectively.

eight cases involved a dispute over the valuation of property contributed,<sup>18</sup> at least eight involved the contribution of an easement, one case involved the issue of whether the recipient was a qualified charitable organization, and one case involved whether the taxpayer actually bore the burden of the contribution.<sup>19</sup>

### Qualifying Charitable Organization

A gift will qualify as a deductible contribution under IRC § 170 only if it is made “to” or “for the use of” a qualifying organization.<sup>20</sup> The Tax Court rejected a claimed charitable deduction in one case for the taxpayer’s failure to establish that the donee organization qualified as a charitable organization under IRC § 170(c).<sup>21</sup>

In *Golit v. Commissioner*, the taxpayer claimed a deduction for cash contributions to the Church of the Immaculate Conception (Immaculate Conception), a Catholic church in Jos, Nigeria within the Catholic Archdiocese of Jos.<sup>22</sup> Section 170(c) defines “charitable contribution” as a contribution or gift “to or for the use of” an organization “created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States.”<sup>23</sup> The taxpayer did not prove that Immaculate Conception was created or organized within the United States or any of its possessions, or under any law of the United States, any State, the District of Columbia, or any possession of the United States. Therefore, the taxpayer failed to show the donee was a qualifying organization within the meaning of section 170(c) and the court sustained the IRS’s disallowance of the deduction.<sup>24</sup>

### Qualified Contribution

For a gift to constitute a qualified contribution under IRC § 170, the donor-taxpayer must possess a transferable interest in the property and intend to irrevocably relinquish all rights, title, and interest to the property without any expectation of some benefit in return.<sup>25</sup> Taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayers’ entire interest in that property.<sup>26</sup> Nevertheless, taxpayers may deduct the value of a contribution of a partial interest in property that constitutes a “qualified conservation contribution,”<sup>27</sup> also known as a conservation easement. A contribution will constitute a qualified conservation contribution only if it is of a “qualified real property interest” made to a “qualified organization” “exclusively for conservation purposes.”<sup>28</sup>

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<sup>18</sup> In several of the eight valuation cases, the key issue surrounding the valuation of the contribution was the appropriateness of the taxpayer’s appraisal on the donated property.

<sup>19</sup> Cases addressing more than one described issue are counted for each issue. For example, cases addressing the valuation of easements are counted once as a valuation issue case and again as an easement issue case. As a result, the breakdown of case issues above will not add up to the total number of cases reviewed by TAS.

<sup>20</sup> IRC § 170(c).

<sup>21</sup> *Golit v. Comm'r*, T.C. Memo. 2013-191.

<sup>22</sup> *Id.*

<sup>23</sup> IRC § 170(c)(2)(A).

<sup>24</sup> *Golit*, T.C. Memo. 2013-191.

<sup>25</sup> IRC § 170(f)(3).

<sup>26</sup> *Id.*

<sup>27</sup> IRC § 170(b)(1)(E).

<sup>28</sup> IRC § 170(h)(1)(A)-(C). IRC § 170(h)(4)(B)(i) provides that, in the case of a contribution that consists of a restriction with respect to the exterior of a certified historic structure, the contribution must satisfy two requirements in order to be considered “exclusively for conservation purposes”: 1) the interest must include a restriction which preserves the entire exterior of the building; and 2) the interest must prohibit any change to the exterior of the building that is inconsistent with the historic character of the exterior.

In *61 York Acquisition, LLC v. Commissioner*, the taxpayer (a partnership) purchased a partial interest in a property in Chicago, Illinois that has a Chicago landmark designation.<sup>29</sup> The property was used for both office and residential purposes; the taxpayer owned the office portion, but not the residential portion of the building.<sup>30</sup> Further, the property was subject to a declaration of Covenants, Conditions, Restrictions, and Easements agreed to by the prior owner of the office portion of the building and the owner of the residential portion of the property. The declaration set out the rights and responsibilities of each owner. The declaration specified the taxpayer, as owner of the office portion of the property, owned the “Facade” but not the entire exterior of the property; the owner of the office property is responsible for “Maintenance of the Facade and maintenance of other portions of the facade of the building;” and an owner who wishes to make an addition, improvement, or alteration that “materially alters the Facade of the Building” must obtain prior written consent of the other owner.

The partnership granted a “Conservation Deed of Easement” (easement) in the property to the National Architectural Trust, Inc. (NAT). The easement terms required the grantor to obtain prior written consent from the NAT before making any change to the “Protected Facades,” which included “the existing facades on the front, sides and rear of the Building and the measured height of the Building.”<sup>31</sup>

The court held that the taxpayer could not assign an easement in the entire exterior of the property to the NAT, because its ownership right to the exterior was restricted by the declaration of Covenants, Conditions, Restrictions, and Easements. Specifically, the court held the partnership only had rights to the Facade, as defined by the agreement, and not to the entire exterior. The taxpayer argued that the partnership had an assignable right in the entire exterior because the partnership had an obligation under the declaration to maintain the entire facade of the building. However, the court was unconvinced an obligation created a right.<sup>32</sup>

In sum, the taxpayer’s contribution was not a “qualified conservation contribution” under section 170(h)(1) because the easement granted to the NAT did not restrict and preserve the entire exterior of the certified historic structure and therefore did not satisfy the requirement that the contribution be “exclusively for conservation purposes.”<sup>33</sup>

### Valuation

To receive a deduction for most contributions of property in excess of \$5,000, taxpayers must provide a qualified appraisal of the property that is donated.<sup>34</sup> In *Kaufman v. Commissioner*, the taxpayer contributed a facade easement to the NAT and claimed a charitable deduction for the contribution.<sup>35</sup> Since there was no market by which the easement could be valued (*i.e.*, there was no substantial record of sales of easements comparable to the donated easement), the appraisers and the Tax Court determined the value (if any) of the facade easement by applying the before-and-after method. Under this method, the fair market value of the easement “is equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property

29 T.C. Memo. 2013-266.

30 *Id.*

31 *Id.*

32 *Id.*

33 *Id.*

34 IRC § 170(f)(11)(C).

35 T.C. Memo. 2014-52, *appeal docketed*, No. 14-1863 (1st Cir. Aug. 20, 2014).

after the granting of the restriction.”<sup>36</sup> Both the taxpayer and the IRS relied heavily on expert opinion testimony as to the pre- and post-contribution values of the property. Because the restrictions of the easement were no more burdensome than the local zoning restrictions already applicable to the property, due to its location in a historic district, the court held the value of property was unchanged after the taxpayers granted easement, and therefore the court further held the facade easement had no fair market value when conveyed to the NAT.<sup>37</sup>

When using the before-and-after test to determine the value of an easement placed on property that is later claimed as a charitable contribution, the property’s “highest and best use” is used when determining the property’s value before an easement. In *Esgar Corp. v. Commissioner*, the taxpayers donated a conservation easement on three parcels of property to the Greenland Reserve, granting them the right to preserve the natural condition of the land and protect its biological, ecological, and environmental characteristics.<sup>38</sup> The grant specifically prohibited the mining of sand, gravel, rock, or any other minerals on the properties. The taxpayers hired an appraiser who determined that had the conservation easements not been granted, the properties would have realized their greatest potential as a gravel mining operation, even though the properties were currently being used for agriculture. The taxpayers claimed a charitable deduction for the contribution based on the property’s before easement value, which the taxpayers figured by using gravel mining as the property’s best potential use. The IRS disallowed the charitable deduction on the basis that the value of the conservation easement was improper and specifically disputed the property’s “before restriction” value determination.<sup>39</sup>

The appellate court upheld the Tax Court’s ruling that using gravel mining as the property’s best potential use to determine before value was improper.<sup>40</sup> The appellate court further held the properties’ current use—agriculture—was its highest and best use. It affirmed the Tax Court’s conclusions it was unlikely the properties would have been developed into gravel mines in absence of the easement, because the market in the region would not support another gravel mine nor was an increase in future demand reasonably foreseeable.<sup>41</sup>

### **Substantiation**

Thirteen cases involved the substantiation of deductions for charitable contributions. When determining whether a claimed charitable contribution deduction is adequately substantiated, courts tend to follow a strict interpretation of IRC § 170. Treasury Regulation §1.170A-13(a)(1) requires the taxpayer to maintain a canceled check or a receipt from the donee organization to substantiate a cash contribution. In the absence of a canceled check or a receipt from the donee organization, the taxpayer must maintain other reliable written records showing the name of the donee and the date and the amount of the contribution.

In *Brooks v. Commissioner*,<sup>42</sup> the taxpayer testified to being a Jehovah’s Witness and to making cash contributions in 2005 and 2006 to the Jehovah’s Witnesses. The taxpayer also testified she contributed \$3,000 to a tsunami relief fund in 2006 through the Jehovah’s Witnesses.

36 Treas. Reg. § 1.170A-14(h)(3)(i).

37 T.C. Memo. 2014-52, *appeal docketed*, No. 14-1863 (1st Cir. Aug. 20, 2014).

38 744 F.3d 648, 651 (10th Cir. 2014), aff’g T.C. Memo. 2012-35.

39 744 F.3d 648, 651-52 (10th Cir. 2014), aff’g T.C. Memo. 2012-35.

40 *Id.* at 658.

41 *Id.* See also Treas. Reg. § 1.170A-14(h)(3)(ii) (discussing fair market value of property before and after restriction).

42 *Brooks v. Comm'r*, T.C. Memo. 2013-141.

To substantiate her \$3,000 contribution, the taxpayer provided a photocopy of two receipts. The first receipt showed DaimlerChrysler Corporation made a payment to the taxpayer in the amount of \$15,782. The second receipt, a customer receipt from Bank of America, showed a deposit of \$12,782 into the taxpayer's account. However, these receipts made no reference to a charitable contribution. The documentation merely established the taxpayer did not deposit into her Bank of America account all of the proceeds from the DaimlerChrysler Corporation payment. The court held the charitable deductions were properly disallowed because the taxpayer provided no other evidence that the \$3,000 withheld from the DaimlerChrysler Corporation check was used to make a charitable contribution. Additionally, the taxpayer had failed to provide documentation for other charitable contributions.

Gifts of charitable contributions of \$250 or more must be substantiated by a contemporaneous written acknowledgement from the donee organization that must include:

- The amount of cash and a description (but not value) of any property other than cash contributed;
- Whether the donee organization provided any goods or services in consideration, in whole or in part; and
- A description and good faith estimate of the value of any goods or services or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.<sup>43</sup>

In *Wachter v. Commissioner*, the IRS moved for summary judgment, asserting that the taxpayers did not satisfy the requirement of a valid contemporaneous written acknowledgment.<sup>44</sup> The taxpayers provided letters to the IRS for substantiation purposes, but the IRS asserted that the letters did not mention the donee provided goods or services to the taxpayers each year, were not addressed to the taxpayers, and did not mention the value of goods and services. One piece of correspondence predated the contribution check by two days and was unsigned.

The taxpayers asserted that the checks and letters for each year, as well as a 2004 donation agreement,<sup>45</sup> could be taken together to meet the requirements of a contemporaneous written acknowledgment. The court denied the IRS motion for summary judgment because a series of documents may constitute a contemporaneous written acknowledgment and the taxpayers may yet be able to authenticate disputed documents and provide additional documents to supplement those they have included with the stipulation of facts.<sup>46</sup>

## CONCLUSION

IRC § 170 and the accompanying Treasury Regulations provide detailed requirements that taxpayers must strictly comply with, and become more stringent as deductions increase in size. As one court has observed, the "hoops become longer and tighter as the value of donated property rises."<sup>47</sup>

43 IRC § 170(f)(8)(A) and (B).

44 142 T.C. No. 7 (2014).

45 142 T.C. No. 7 at \*2. Owners of Wind River signed an agreement dated February 26, 2004 with North Dakota Natural Resource Trust (NRT) agreeing to donate \$170,000 by March 1, 2004.

46 The case concluded with a stipulated decision entered on Nov. 6, 2014. Taxpayers were ordered to pay deficiencies in income for the years 2004, 2005 and 2006 in the amounts of \$60,381, \$47,163 and \$33,877, respectively. However, no penalties were due for any of these years. See, *Patrick J. Wachter & Louise M. Wachter v. Comm'r*, Tax Court Docket No. 9213-11, (Nov. 6, 2014).

47 *Estate of Evenchik v. Comm'r*, T.C. Memo. 2013-34.

A majority of charitable contribution cases reviewed this year addressed either issues regarding substantiation or the rules surrounding the donation of easements. It is critical that taxpayers include every statutorily required item of information in any mandated agreement and ensure the integrity of any necessary valuations of donated property.

When donating a conservation easement, taxpayers should pay particular attention to the valuation of the easement, ensuring the valuation determination can be adequately supported. Additionally, the cases pertaining to a qualified conservation contribution illustrate the importance of paying close attention to the technicalities. Easement deeds should be reviewed for ambiguity, especially as to whether use restrictions have been granted in perpetuity to the donee.

**MLI  
#10****Passive Activity Losses (PAL) Under IRC § 469****SUMMARY**

This is the first time the disallowance of the passive activity loss and credit (PAL) under Internal Revenue Code (IRC) § 469 has been among the Most Litigated Issues in the National Taxpayer Advocate's Annual Report to Congress.<sup>1</sup> A possible explanation for this increase in cases may be the IRS having nine Compliance Initiative Programs (CIP) between the tax years of 2007-2012, which specifically addressed compliance issues involving PAL.<sup>2</sup>

We identified and reviewed 28 federal court opinions involving a PAL issue that were issued between June 1, 2013 and May 31, 2014. The 28 opinions do not reflect the full number of PAL cases because the courts do not always publish an opinion. Some cases are resolved through settlements, or taxpayers do not pursue litigation after filing a petition or complaint with the court. The courts also dispose of some cases by issuing unpublished orders. Table 10 in Appendix III provides a detailed list of the PAL opinions we reviewed. The courts affirmed the IRS position in the vast majority of cases (23 out of 28, approximately 82 percent), while taxpayers fully prevailed only about 14 percent of the time (in four out of 28 cases). The remaining case resulted in a split decision.

**PRESENT LAW**

Generally, IRC §§ 162 and 212 allow taxpayers to deduct ordinary and necessary expenses paid or incurred in carrying on a trade or business or for the production of income.<sup>3</sup> In 1986, Congress enacted IRC § 469 to address concerns regarding abusive tax shelters.<sup>4</sup> IRC § 469 generally disallows passive activity losses from trade or business activities in which the taxpayer does not materially participate and from rental activities.<sup>5</sup>

- A passive activity loss is the aggregate of losses from all passive activities for the taxable year over the aggregate of income from all passive activities for the year.<sup>6</sup>
- A passive activity credit is the sum of the credits from all passive activities allowable for the taxable year over the regular tax liability of the taxpayer for the taxable year allocable to all passive activities.<sup>7</sup>

1 See National Taxpayer Advocate 1998-2013 Annual Reports to Congress.

2 IRS Compliance Initiative Projects, *National CIP Database* (Sep. 16, 2014). See SBSE, Project Code 0031, *PAL Limitations - Rental Real Estate*; SBSE, Project Code 0189, *PAL Limitation - Modified AGI Greater than \$100000*; SBSE, Project Code 0553, *High Income/High Wealth with Large Investment Income and Low Earnings*; SBSE, Project Code 0685, *Self-Rented Property - FY 05 & 06*; SBSE, Project Code 0685, *Self Rental Property*; SBSE, Project Code 0688, *Investment Interest Expense - FY 05 & 06*; SBSE, Project Code 0688, *Investment Interest Expense*; SBSE, Project Code 0711, *Real Estate Sales - Principal Residence*; and SBSE, Project Code 0793, *Other Income Deduction PAL*. CIPs are used to identify taxpayer compliance issues. One of the fundamental principles of CIPs is to “[i]dentify trends on non-compliance and improper treatment of tax issues.” IRM 4.17.1.2(2), *Compliance Initiative Projects* (Feb. 25, 2010).

3 IRC § 469(c)(6)(A), (B). See also Most Litigated Issue: *Trade and Business Expenses*, *supra*.

4 Tax Reform Act of 1986, Pub. L. No. 99-514, § 501(a), 100 Stat. 2085, 2233 (1986).

5 IRC § 469(c)(1).

6 IRC § 469(d)(1)(A), (B); Temp. Treas. Reg. § 1.469-2T(b)(1).

7 IRC § 469(d)(2)(A), (B).

The PAL limitation applies to individuals, estates, trusts, closely held subchapter C corporations, and personal service corporations.<sup>8</sup> Passive activity loss rules apply at the individual taxpayer level, *i.e.*, at a partner or shareholder level rather than the passthrough entity level.<sup>9</sup> Any loss or credit from passive trade or business activities for the taxable year exceeding passive activity income may not be deducted or credited in that year, but will be carried forward to reduce future passive activity income.<sup>10</sup>

In 1993, Congress created a special rule for taxpayers in real property businesses, permitting them to treat certain rental real estate activities as nonpassive activities. To qualify for this special rule under § 469(c)(7), more than half of a taxpayer's personal services performed during a tax year must be performed in real property trades or businesses in which the taxpayer materially participates, and the taxpayer must perform more than 750 hours in real property trades or businesses in which the taxpayer materially participates during the tax year.<sup>11</sup>

The taxpayer must also materially participate with respect to each rental real estate activity. For this purpose, each interest in rental real estate of the taxpayer is treated as a separate activity unless the taxpayer elects to treat all rental real estate interests as one activity. Judicial interpretation of IRC § 469 and the related regulations is focused on review of specific facts and circumstances.

### **What is a trade or business?**

The Supreme Court has interpreted "trade or business" for purposes of § 162 to mean an activity conducted with "continuity and regularity" for the primary purpose of earning income or making profit.<sup>12</sup> IRC § 469 provides that "trade or business" includes any activity:

- Involving research or experimentation (within the meaning of IRC § 174);<sup>13</sup>
- In connection with a trade or business,<sup>14</sup> or
- With respect to which expenses are allowable as a deduction under IRC § 212.<sup>15</sup>

### **What is material participation?**

Generally, a taxpayer can materially participate in an activity only if the participation is regular, continuous, and substantial.<sup>16</sup> A limited partner in a limited partnership cannot generally meet this requirement except as provided in the regulations.<sup>17</sup> Under the temporary regulations for § 469(h), an individual materially participates if and only if he or she satisfies any one of seven material participation tests:<sup>18</sup>

1. The individual participates in the activity for more than 500 hours during the taxable year;
2. The individual's participation constitutes substantially all of the participation in the activity of all individuals (including non-owners) for the taxable year;

<sup>8</sup> IRC § 469(a)(2); Temp. Treas. Reg. § 1.469-1T(b).

<sup>9</sup> Temp. Treas. Reg. § 1.469-2T(e)(1).

<sup>10</sup> IRC § 469(b).

<sup>11</sup> Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13143(a) and (b), 107 Stat. 312, 440-41 (1993). The special rule remedied the unfairness of treating real estate professionals as passive investors. See also IRC § 469(c)(7).

<sup>12</sup> *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

<sup>13</sup> IRC § 469(c)(5).

<sup>14</sup> IRC § 469(c)(6).

<sup>15</sup> *Id.*

<sup>16</sup> IRC § 469(h).

<sup>17</sup> *Id.*; Temp. Treas. Reg. § 1.469-5T(e) (containing exceptions).

<sup>18</sup> Temp. Treas. Reg. § 1.469-5T.

3. The individual participates in the activity for more than 100 hours during the taxable year, and his or her participation is not less than that of any other person;
4. The activity is a significant participation activity for the taxable year, and the individual's aggregate participation in all significant participation activities during the taxable year exceeds 500 hours;<sup>19</sup>
5. The individual materially participated in the activity for any five taxable years of the ten tax years immediately preceding the taxable year in question;<sup>20</sup>
6. The activity is personal service activity and the individual materially participated in the activity for any three taxable years preceding the taxable year in question;<sup>21</sup> or
7. Based on all facts and circumstances, the individual participates in the activity on a regular, continuous, and substantial basis during the tax year subject to the following requirements:
  - The individual's services in managing the activity will not be taken into account unless no other person receives compensation for performing management services in the activity;
  - No individual performs management services that exceed (by hours) the services performed by the individual; and
  - The individual participates in the activity greater than 100 hours during the taxable year.<sup>22</sup>

However, under IRC § 469 material participation is generally not relevant for rental activities, and is generally not required for working interests in oil and gas properties as long as the taxpayer holds the interest directly or the form of ownership does not limit the liability of the taxpayer.<sup>23</sup>

### What are the special rules for taxpayers engaged in real property trades or businesses?

IRC § 469(c)(7) provides a special rule for taxpayers engaged in real property trades or businesses (commonly referred to as the “real estate professional” exception). Under this rule, the rental real estate activities in which the taxpayer materially participates will not be treated as passive activities. For this purpose, each interest in rental real estate of a qualifying taxpayer will be treated as a separate activity unless the taxpayer elects to treat all interests in rental real estate as one activity.<sup>24</sup> A taxpayer will qualify for this exception only if the following two requirements are met: (i) more than half of the personal services performed by the taxpayer in trades or businesses were performed in real property trades or businesses in which the taxpayer materially participated and (ii) the taxpayer performed and materially participated in more than 750 hours of services during the taxable year in real property trades or businesses.<sup>25</sup>

<sup>19</sup> A significant participation activity is one in which the individual has more than 100 hours of participation during the tax year but fails to satisfy any other test for material participation. A rental activity may not be included in the significant participation test. If the sum of all the time spent in significant participation activities exceeds 500 hours, such activities are considered nonpassive. Temp. Treas. Reg. § 1.469-5T(c).

<sup>20</sup> The five tax years need not be consecutive.

<sup>21</sup> A personal service activity is one that involves the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor. Temp. Treas. Reg. § 1.469-5T(d).

<sup>22</sup> Temp. Treas. Reg. § 1.469-5T(b)(2).

<sup>23</sup> IRC § 469(c)(4), (7)(A), and (3)(A).

<sup>24</sup> IRC § 469(c)(7)(A); Treas. Reg. § 1.469-9(e)(1).

<sup>25</sup> IRC § 469(c)(7)(B). “Real property trade or business” is defined as “any business that deals in any real property development, construction, redevelopment, reconstruction, acquisition, rental, conversion, operation, leasing, management, or brokerage trade or business.” IRC § 469(c)(7)(C).

In the event of a joint return, these requirements are satisfied only if at least one spouse separately satisfies both statutory requirements.<sup>26</sup> This means the spouses' activities cannot be aggregated to satisfy either requirement, *i.e.*, the requirements will not be satisfied if one spouse meets one of the requirements and the other spouse satisfies the other prong.<sup>27</sup> For example, in *Adeyemo v. Commissioner*, discussed below, the court noted that the two requirements for the real-estate professional exception must be independently satisfied by one of the spouses in the case of a joint return.<sup>28</sup> However, in determining whether a taxpayer materially participates in a real property trade or business for this purpose, the work performed by the taxpayer's spouse will count as work performed by the taxpayer.<sup>29</sup>

### What is the \$25,000 offset for rental real estate activities?

Except as provided in § 469(c)(7), any losses from the taxpayer's rental activities are treated as passive activity losses. However, under § 469(i)(1), the taxpayer may be eligible to annually deduct up to \$25,000 of the losses attributable to rental real estate activities in which he or she actively participated during the taxable year.<sup>30</sup> This special allowance begins to phase out when a taxpayer's modified adjusted gross income (MAGI) exceeds \$100,000.<sup>31</sup> The \$25,000 offset amount is reduced by 50 percent of the amount by which the taxpayer's MAGI exceeds \$100,000,<sup>32</sup> and phases out entirely when the MAGI equals or exceeds \$150,000.<sup>33</sup>

The deduction is also subject to the phase-out amounts for the rehabilitation credit, commercial revitalization deduction, and low-income housing credit.<sup>34</sup> There are also special rules for estates, surviving spouses, married individuals filing separately, and taxpayers not living apart.<sup>35</sup>

### ANALYSIS OF LITIGATED CASES

We reviewed 28 decisions entered between June 1, 2013, and May 31, 2014, involving passive activity loss deductions and credits claimed by taxpayers. Table 10 in Appendix III contains a list of the cases. The IRS prevailed in full in 23 cases (82 percent), the taxpayers prevailed in full in four cases (14 percent) and one case (four percent) resulted in a split decision.

Taxpayers appeared *pro se* (without representation) in 17 cases (61 percent) and convinced the court to allow their loss deduction in one (six percent) of those cases.<sup>36</sup> Represented taxpayers fared slightly better, achieving full or partial relief in their ability to claim a PAL deduction in four of the 11 cases

26 IRC § 469(c)(7)(B). See also Temp. Treas. Reg. § 1.469-5T(f)(3).

27 IRC § 469(c)(7)(B).

28 T.C. Memo. 2014-1.

29 Treas. Reg. § 1.469-9(c)(4).

30 Generally, taxpayers that have less than 10 percent of an interest in rental real estate activity are not considered as actively participating. IRC § 469(i)(6)(A). Active participation is a lesser standard than material participation in that there is no requirement for "regular, continuous, and substantial participation" and there are no requirements involving rehabilitation and low-income housing credits, or commercial revitalization deductions as a result of real estate activity. IRC § 469(i)(6)(B).

31 IRC § 469(i)(3)(A), (F)(iv). Computed without regard to passive activity losses.

32 IRC § 469(i)(3)(A), (F).

33 IRC § 469(i)(3)(A).

34 IRS § 469(i).

35 *Id.*

36 The taxpayer was *pro se* and won a favorable outcome in *Montgomery v. Comm'r*, T.C. Memo. 2013-151.

(36 percent); business taxpayers represent two of these cases.<sup>37</sup> Figure 3.10.1 shows the breakdown of *pro se* and represented taxpayer cases and the decisions rendered by the courts.

**FIGURE 3.10.1. Pro Se and Represented Taxpayer Cases and Decisions**

Court Decisions	Pro Se Taxpayers		Represented Taxpayers	
	Volume	% of Total	Volume	% of Total
Decided for IRS	16	94%	7	64%
Decided for Taxpayer	1	6%	3	27%
Split Decisions	0	0%	1	9%
<b>Totals</b>	<b>17</b>	<b>100%</b>	<b>11</b>	<b>100%</b>

All twenty-eight cases addressed whether the taxpayer's activity was a passive activity and 15 of the 28 involved the taxpayers' qualification for the exemption under § 469(i). Twenty-three cases were related to rental real estate, four cases were related to business activity, two of which dealt with breeding animals, and one was related to an aircraft rental.<sup>38</sup> The other issue discussed, which also affected the court's analysis in some cases, was the lack of substantiation or poor recordkeeping to substantiate claimed expenses or hours worked.

### Cases Not Involving Real Estate Activities

In cases not involving real estate activities, the most prevalent issue was whether the taxpayer materially participated in the trade or business.<sup>39</sup> Courts generally upheld the IRS's determinations that losses claimed by taxpayers were passive and non-deductible within the meaning of IRC § 469.

For example, in *Bartlett v. Commissioner*,<sup>40</sup> the taxpayers sought to deduct a loss related to bull breeding. The taxpayers claimed to have materially participated in the operation. The Tax Court disagreed and decided the taxpayers did not materially participate and did not allow the claimed losses to be deducted because the taxpayers failed to provide documentary evidence to prove that they met the 500-hour or 100-hour tests.<sup>41</sup> Conversely, the taxpayers in *Tolin v. Commissioner*<sup>42</sup> sought to deduct losses related to their thoroughbred horse breeding activity under IRC § 469. The Tax Court agreed that they materially participated in the business and their activity was not passive, and allowed the loss deduction.

In *Moreno v. United States*,<sup>43</sup> the taxpayer owned an aircraft leasing business and leased out a Lear jet. The U.S. District Court found this activity was not passive and allowed the taxpayer's deductions because the average period of customer use was less than seven days and therefore was a trade or business activity and

<sup>37</sup> Two of the cases are designated as business taxpayers, which includes corporations, partnerships, trusts, and sole proprietorships – Schedule C, E, and F filers.

<sup>38</sup> In several of the 23 rental real estate cases, the courts did not always use the term "rental real estate," and instead used more generic terms when describing these activities, such as real estate.

<sup>39</sup> Temp. Treas. Reg. 1.469-5T(a). An individual taxpayer is considered to have materially participated in an activity if and only if any one of the seven tests that are prescribed in the regulations is met.

<sup>40</sup> T.C. Memo. 2013-182.

<sup>41</sup> Temp. Reg. 1.469-5T(a).

<sup>42</sup> T.C. Memo. 2014-65.

<sup>43</sup> *Moreno v. U.S.*, 113 A.F.T.R.2d (RIA) 2149 (W.D. La. 2014). One of the four business taxpayers in our review.

not a rental activity for purposes of § 469. The IRS had conceded that the taxpayers materially participated with respect to the airplane leasing activity.<sup>44</sup>

In *Montgomery v. Commissioner*,<sup>45</sup> married taxpayers were members of a limited liability company that was treated as an S-Corporation for tax purposes and sought to deduct losses from their business activity. The IRS determined the wife did not materially participate in the engineering business and her activity was passive. However, the taxpayers prevailed in Tax Court by showing that the wife materially participated by working more than 500 hours during the tax year.

### Activities of Rental Real Estate Businesses or Professionals

Rental real estate activities of real estate professionals may qualify for the exception under § 469(c)(7) but the taxpayers must show that they materially participate in their rental real estate activities in addition to meeting the two qualification tests as real estate professionals. In the majority of these cases, the taxpayers struggled with substantiating that they met the two qualifying tests, and the courts determined their rental real estate activities were passive.<sup>46</sup> However, in some cases the court considered whether the taxpayer qualified for the \$25,000 offset for rental real estate activities under IRC § 469(i). As discussed above, the \$25,000 offset allows for a deduction of up to \$25,000 in rental real estate losses on the taxpayer's tax return, which may be deducted against the taxpayer's non-passive income.

For example, in *Herwig v. Commissioner*,<sup>47</sup> the taxpayers were married business partners who claimed a loss deduction from "suspended" passive losses after Fifth Third Bank foreclosed on their Florida condominium units.<sup>48</sup> The Tax Court disallowed the deduction of the suspended passive losses under § 469(g), ruling that a foreclosure of a rental real estate property is not a disposition of the taxpayers' entire interest in their rental real estate activity.<sup>49</sup> In *Almquist v. Commissioner*,<sup>50</sup> the taxpayer could not substantiate the number of hours he worked. The Tax Court held the taxpayer did not qualify as a real estate professional; therefore, his rental real estate activity was passive and the passive activity loss was disallowed.<sup>51</sup> In *Oderio v. Commissioner*,<sup>52</sup> married taxpayers filed separate returns and claimed a rental loss deduction that the IRS disallowed. The Tax Court held that a married filing separately taxpayer must separately satisfy the requirements of § 469(c)(7)(B) in order to avoid *per se* passive activity loss treatment.<sup>53</sup> The taxpayers, who filed married filing separate, could not combine their efforts under § 469(c)(7)(B)(i) and (ii). The Tax Court stated that the taxpayers could only claim spousal attribution under Temp. Treas. Reg. § 1.469-5T(f)(3) to satisfy the § 469(c)(7)(B) requirements under material participation, however;

<sup>44</sup> *Moreno v. U.S.*, 113 A.F.T.R.2d (RIA) 2149 (W.D. La. 2014) (stating that "an activity involving the use of tangible property is not a rental activity for a taxable year if for such taxable year – (A) the average period of customer use for such property is seven days or less ..." quoting IRC § 1.469-1T(e)(3)(i)).

<sup>45</sup> T.C. Memo. 2013-151.

<sup>46</sup> See *Adeyemo v. Comm'r*, T.C. Memo. 2014-1; *Graffia v. Comm'r*, T.C. Memo. 2013-211; *Merino v. Comm'r*, T.C. Memo. 2013-167; and *Ohana v. Comm'r*, T.C. Memo. 2014-83.

<sup>47</sup> T.C. Memo. 2014-95, *appeal docketed*, No. 14-13644, (11th Cir. Aug. 14, 2014). A business taxpayer case.

<sup>48</sup> A "suspended" passive activity loss is a loss or credit that was disallowed for a taxable year and treated as a credit or deduction carried forward to and arising in the next taxable year. See IRC § 469(b). A taxpayer's suspended losses from an activity may be "freed up" and allowable as a deduction against non-passive income in the taxable year in which the taxpayer disposes of the entire interest in the activity giving rise to the loss in a fully taxable transaction to an unrelated party. See IRC § 469(g).

<sup>49</sup> T.C. Memo. 2014-95.

<sup>50</sup> T.C. Memo. 2014-40.

<sup>51</sup> *Id.*

<sup>52</sup> T.C. Memo. 2014-39.

<sup>53</sup> *Id.*, citing IRC § 469(c)(7)(B) and Treas. Reg. § 1.469-9(c)(4).

spousal attribution was not allowed in meeting the other requirements, *i.e.*, that a taxpayer perform more than one half of his or her personal services and more than 750 hours in a real estate trade or business.<sup>54</sup>

However, in *Graffia v. Commissioner*,<sup>55</sup> married taxpayers filed joint returns and were shareholders of an S corporation. The husband materially participated in the business, but the wife did not, and they claimed a business loss deduction. The Tax Court ruled in favor of the taxpayers and held a married shareholder's participation in an activity will be treated as participation of the shareholder's spouse in that activity, regardless of whether the spouses filed a joint return. In *Adeyemo v. Commissioner*,<sup>56</sup> the taxpayers filed a joint return and claimed losses related to rental real estate activity, but the Tax Court determined that their activity was passive, the \$25,000 offset was phased out, and the passive activity loss deduction was disallowed.<sup>57</sup> In *Ohana v. Commissioner*,<sup>58</sup> the taxpayers sought to deduct rental and non-rental expenses. The Tax Court found the taxpayers were not involved in a business of real estate development, their rental real estate activities did not amount to a trade or business and therefore were passive activities, and the taxpayers could only deduct their rental expenses to the extent of their rental income.

In *Gragg v. United States*,<sup>59</sup> a married couple filed a joint return and one spouse was a real estate professional. The taxpayers claimed they were not required to show material participation in their rental real estate activities before deducting losses from those activities under IRC § 469(c)(7). The U.S. District Court for the Northern District of California held that in order to deduct losses from a rental real estate activity, the taxpayers were required to establish that they materially participated in each rental real estate activity listed on their return.<sup>60</sup>

Finally, in *Frank Aragona Trust v. Commissioner*,<sup>61</sup> a trust with rental real estate properties claimed loss deductions and the IRS determined the rental real estate activities were passive.<sup>62</sup> The Tax Court found this case to be of first impression. It decided the trust:

- Was capable of performing "personal services" in real-property trades or businesses and qualified as a real estate professional;<sup>63</sup>
- Materially participated in its rental real estate activity through the work performed by its trustees in that activity; and therefore
- Was allowed to deduct its rental real-estate losses.<sup>64</sup>

54 T.C. Memo. 2014-39.

55 T.C. Memo. 2013-211, *appeal docketed*, No. 13-3757 (7th Cir. Dec. 11, 2013).

56 T.C. Memo. 2014-1.

57 See also, *Azimzadeh v. Comm'r*, T.C. Memo. 2013-169 (married taxpayers' rental activity was passive, the \$25,000 offset under § 469(i) completely phased out and the Tax Court disallowed their passive activity loss deduction) and *Merino v. Commissioner*, T.C. Memo. 2013-167 (the Tax Court denied the passive activity loss deduction because married taxpayers failed to prove they materially participated in their business activity and the Tax Court ruled that the activity was passive, and they exceeded the \$150,000 MAGI amount under § 469(i) and therefore were not eligible for the \$25,000 offset for rental real estate activities).

58 T.C. Memo. 2014-83.

59 *Gragg v. United States*, 113 A.F.T.R.2d (RIA) 1647 (N.D. Cal. 2014) (not reported in F.Supp.2d), *appeal docketed*, No. 14-16053, (9th Cir. May 30, 2014).

60 *Id.*

61 *Frank Aragona Trust v. Comm'r*, 142 T.C. No. 9 (2014).

62 *Id.*

63 IRC § 469(c)(7)(B)(i). The regulations define "personal services" as "work performed by an individual in connection with a trade or business." Treas. Reg. § 1.469-9(b)(4).

64 *Frank Aragona Trust v. Comm'r*, 142 T.C. No. 9 (2014).

## CONCLUSION

The courts upheld the IRS's determination regarding passive activity losses in 23 of the 28 cases. Taxpayers appear to be confused by the application of IRC § 469; specifically the substantiation requirements (recordkeeping and consistent documentation of participation) and the Temp. Treas. Reg. § 1.469-5T(a)(4) requirement to log the taxpayer's hours (taxpayers did not keep logs or did not know the required hours needed). The courts largely favored the IRS's disallowance of passive activity loss deductions, relying on IRC § 469; Treas. Reg. § 1.469-1; and Temp. Treas. Reg. §§ 1.469-4T and 1.469-5T (and the seven material participation tests therein). While most taxpayers struggled with the substantiation requirements, the courts' application of the specific facts and circumstances analysis provided positive outcomes for four taxpayers.

Given that this is the first time the disallowance of passive activity loss and credit under IRC § 469 has appeared in this report and the frequency that substantiation appeared in the courts' analysis, we recommend that the IRS highlight the available passive activity loss guidance on its website (with specific attention to rental real estate taxpayers). Due to the complex nature of these laws, the IRS also should undertake additional efforts to educate taxpayers, advisors, and return preparers through webinars, news releases, social media, and similar outreach. By educating taxpayers on the application of IRC § 469 and by suggesting best practices for substantiating real estate activities, the IRS can help taxpayers avoid having their passive loss deductions denied.

## TAS CASE ADVOCACY

### FUNCTIONS OF THE OFFICE OF THE TAXPAYER ADVOCATE

The National Taxpayer Advocate leads TAS in all aspects of its statutory mission. Under Internal Revenue Code (IRC) § 7803(c)(2)(A), the Office of the Taxpayer Advocate has four principal functions:

- Assist taxpayers in resolving problems with the IRS;
- Identify areas in which taxpayers are experiencing problems with the IRS;
- Propose changes in the administrative practices of the IRS to mitigate problems taxpayers are experiencing with the IRS; and
- Identify potential legislative changes that may be appropriate to mitigate such problems.

The first function described in the statute relates to TAS's case advocacy, which involves assisting taxpayers with their cases. The next three functions involve identifying and proposing changes to systemic problems affecting taxpayers. In addition to helping taxpayers resolve specific cases and individual problems, TAS employees advocate systemically by

- Identifying IRS procedures that adversely affect taxpayer rights or create taxpayer burden; and
- Recommending solutions, either administrative or legislative, to improve tax administration.<sup>1</sup>

TAS serves as the voice of the taxpayer within the IRS by providing the taxpayer's viewpoint on IRS policies, procedures, or programs. While systemic advocacy is the responsibility of everyone in TAS, primary oversight of systemic advocacy efforts belongs to the Office of Systemic Advocacy. Additionally, TAS administers the Low Income Taxpayer Clinic (LITC) grant program<sup>2</sup> and oversees the Taxpayer Advocacy Panel (TAP).<sup>3</sup>

### TAS CASE RECEIPT CRITERIA

Taxpayers typically seek TAS assistance with specific issues when:

- They have experienced a tax problem that causes financial difficulty;
- They have been unable to resolve their issues directly with the IRS; or
- An IRS action or inaction has caused or will cause them to suffer a long-term adverse impact, including a violation of taxpayer rights.

1 Taxpayers and practitioners can use the Systemic Advocacy Management System (SAMS) to submit systemic issues to TAS at <http://www.irs.gov/Advocate/Systemic-Advocacy-Management-System-SAMS>.

2 The LITC program provides matching grants to qualifying organizations to operate clinics that represent low income taxpayers in disputes with the IRS, and educate taxpayers for whom English is a second language about their taxpayer rights and responsibilities. LITCs provide services to eligible taxpayers for free or for no more than a nominal fee. See IRC § 7526.

3 TAP is a Federal Advisory Committee established by the Department of the Treasury to provide a taxpayer perspective on improving IRS service to taxpayers. TAS provides oversight and support to the TAP program. The Federal Advisory Committee Act (5 U.S.C. Appendix) prescribes standards for establishing advisory committees when those committees will furnish advice, ideas, and opinions to the federal government. See also 41 C.F.R. Part 102-3.

TAS generally accepts cases in four categories: economic burden, systemic burden, best interests of the taxpayer, and public policy.

1. **Economic Burden** – TAS classifies four categories of receipts as economic burden cases:
  - a) A taxpayer is experiencing or is about to suffer economic harm;
  - b) A taxpayer is facing an immediate threat of adverse action;
  - c) A taxpayer will incur significant costs if relief is not granted; and
  - d) A taxpayer will suffer irreparable injury or long term adverse impact if relief is not granted.

In many of these cases, time is critical. If the IRS does not act quickly (*e.g.*, to remove a levy or release a lien), the taxpayer will experience additional economic harm.<sup>4</sup>

2. **Systemic Burden** – Systemic burden cases involve situations where:
  - a) A taxpayer has experienced a delay of more than 30 days to resolve a tax account problem;
  - b) A taxpayer has not received a response by the date promised; or
  - c) A system or procedure has either failed to operate as intended or failed to resolve the taxpayer's problem or dispute within the IRS.<sup>5</sup>
3. **Best Interest of the Taxpayer** – Best interest of the taxpayer cases involve situations where the manner in which the tax laws are being administered raises considerations of equity, or has impaired or will impair a taxpayer's rights.<sup>6</sup> On June 10, 2014, the National Taxpayer Advocate incorporated violations of the Taxpayer Bill of Rights into this criterion.<sup>7</sup>
4. **Public Policy** – Public policy cases are those where the National Taxpayer Advocate has determined that compelling public policy warrants assistance to an individual or group of taxpayers. The National Taxpayer Advocate has the sole authority to determine which issues are included in this criterion and will designate them by memorandum.<sup>8</sup>

### **Revised Case Acceptance Criteria to Focus on TAS's Core Mission**

To ensure that it has adequate resources to address its inventory and effectively advocate for taxpayers, TAS identified certain types of systemic burden cases that the IRS usually resolves without the need for TAS engagement. In fiscal year (FY) 2011, TAS suspended acceptance of original return processing, amended return processing, injured spouse claims, and unpostable/rejected return cases. This guidance remains in effect, so that TAS can provide effective and timely service to taxpayers who are in most need of assistance.<sup>9</sup>

<sup>4</sup> IRC § 7803(c)(2)(A)(i); Internal Revenue Manual (IRM) 13.1.7.2.1, *TAS Case Criteria 1-4, Economic Burden* (Aug. 24, 2007).

<sup>5</sup> IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.2 (July 23, 2007).

<sup>6</sup> IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.3 (July 23, 2007).

<sup>7</sup> TAS Interim Guidance Memo (IGM), TAS-13-0614-005, *Interim Guidance on Accepting Cases Under Taxpayer Advocate Service (TAS) Case Criteria 8, Best Interest of the Taxpayer* (June 10, 2014).

<sup>8</sup> IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.4 (Apr. 26, 2011). The current memo that sets forth the Case Criteria 9 can be found at TAS IGM, TAS-13-0414-001, *Interim Guidance on Accepting Cases Under TAS Case Criteria 9, Public Policy* (Apr. 2, 2014).

<sup>9</sup> In September 2012, TAS reissued the interim guidance memorandum (IGM) to reiterate the changes to TAS case-acceptance criteria – 16M TAS-13-0912-019 (Sept. 25, 2012). In September 2013, TAS again reissued the guidance – 16M TAS-13-0913-009 (Sept. 27, 2013). This guidance will be incorporated into IRM Part 13 during FY 2015.

TAS continues to accept cases involving the four categories listed above, if the taxpayer:

- Is suffering an economic burden;
- Has related issues (*e.g.*, needs an amended return processed quickly to eliminate or minimize the tax liability to alleviate or avoid collection activity);<sup>10</sup>
- Is referred by a Congressional office; or
- Specifically requests TAS assistance.

The change in case acceptance criteria was the first step in a long-term strategy to strengthen our focus on our primary mission and to serve the most vulnerable taxpayers. TAS must continually adjust to limited resources, growing case complexity, an increase in economic burden cases, and the IRS's inability, on occasion, to address taxpayer issues timely and effectively. The next phase of TAS's strategy is exploring new approaches and alternative services on certain issues, to allow TAS to continue providing vital service to those suffering economic burden and preventing negative consequences. This strategy will involve identifying and testing self-help tools for taxpayers in resolving requests for expedited refunds, returned or stopped refunds, and requests for copies of certain documents (returns, reports, determination letters, etc.).

For example, TAS will release *Guaranteed Installment Agreements*, the first in a series of short videos for taxpayers with downloadable forms and simple guidelines for taxpayers in early FY 2015. Also, the strategy will include identifying opportunities where intake advocates (TAS employees who handle the initial contact with the taxpayer) can direct taxpayers to automated IRS tools, so they can resolve their issues independently and expeditiously.

## TAS RECEIPT TRENDS

Although the number of TAS case receipts decreased, the number, complexity, and urgency of issues has increased.

### Volume of Cases

In FY 2014, TAS received 216,697 cases of all types, a nearly 12 percent decrease from FY 2013. TAS provided relief to taxpayers in approximately 78 percent of cases closed in FY 2014, which was consistent with FY 2013.<sup>11</sup> Figure 4.1 below compares FY 2013 and FY 2014 receipts and relief rates by case acceptance category.

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10 A substitute for return is a return prepared for a taxpayer by the IRS when it has no record of receiving a return and has not been able to obtain one from someone who was expected to file. IRC § 6020(b) allows the IRS to prepare a return on behalf of the taxpayer based on available information.

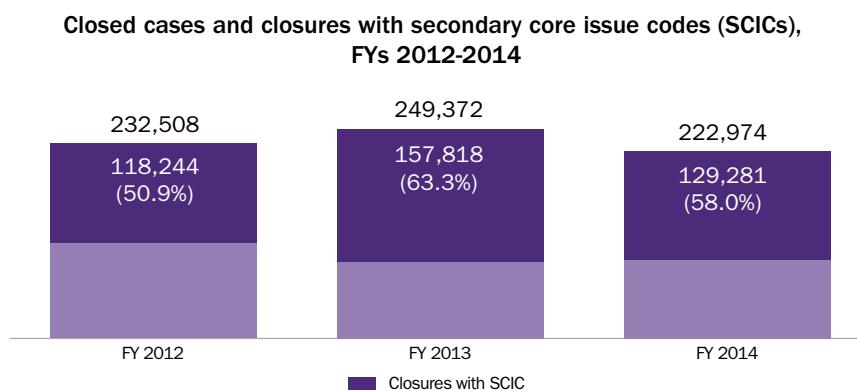
11 TAS determines relief rates based upon whether TAS can provide full or partial relief or assistance on the issue initially identified by the taxpayer. Because TAS frequently provides relief on issues that differ from the ones initially identified, the relief rate as calculated is understated. Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2014). TAS uses TAMIS to record, control, and process cases, and analyze the issues that bring taxpayers to TAS.

**FIGURE 4.1, TAS case receipts and relief rates, FYs 2013–2014<sup>12</sup>**

Case Categories	Receipts FY 2013	Receipts FY 2014	Relief Rates FY 2013	Relief Rates FY 2014
Economic Burden	156,130	124,732	77.1%	75.4%
Systemic Burden	88,598	91,545	81.3%	81.4%
Best Interest of Taxpayers	160	195	70.6%	77.9%
Public Policy	68	225	70.8%	81.5%
<b>Total Cases</b>	<b>244,956</b>	<b>216,697</b>	<b>78.5%</b>	<b>77.9%</b>

### Complexity

TAS measures case complexity in a number of ways, including whether a case involves multiple issues or multiple tax periods and whether technical advice is needed,<sup>13</sup> thus requiring more resources to resolve the matter.<sup>14</sup> Whether the case issues are linked or separate, the case advocate must resolve all issues before closing the case.<sup>15</sup> Case advocates must identify primary and secondary issues on cases, which they record in TAMIS.<sup>16</sup> Fifty-eight percent of all closed cases in FY 2014 involved two or more issues, as shown in Figure 4.2.<sup>17</sup>

**FIGURE 4.2<sup>18</sup>**

12 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014).

13 IRM 13.1.12.1.1 (Mar. 1, 2012) states in part that “Technical Advisors are responsible for resolving the most technically complex or sensitive issues using effective research, communication, coordination, and negotiating skills.”

14 In 2010, TAS implemented a complexity factor screen to its case management system. This screen contains 24 factors, where the presence of any one of these factors indicates greater case complexity. For example, one factor is whether the case involves analysis of the assessment, collection, or refund statute date to determine if it is about to expire. TAS is using this data for purposes of developing its new case management system, Taxpayer Advocate Service Integrated System (TASIS), and will use the factors to assign cases. See National Taxpayer Advocate FY 2014 Objectives Report to Congress, Section VII for a full discussion of TASIS.

15 IRM 13.1.21.1.1 (Aug. 24, 2012).

16 IRM 13.1.16.13.1 (June 22, 2012). The Primary Core Issue Code (PCIC) is a three-digit code that defines the most significant issue, policy or process within the IRS that needs to be resolved. The Secondary Core Issue Code (SCIC) identifies secondary issues and is used when a case has multiple issues.

17 Data obtained from TAMIS (Oct. 1, 2014).

18 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014).

While the percentage of cases with secondary issue codes TAS closed declined over the last year, from 63 percent in FY 2013 to 58 percent in FY 2014, these cases are still a significant portion of TAS's inventory.<sup>19</sup>

In addition to cases with multiple issues, six percent of TAS closed cases in FY 2014 required the assistance of a technical advisor to understand and resolve the complexities of the case.<sup>20</sup> Finally, in FY 2014, nearly 28 percent of TAS closed cases involved multiple tax periods, compared to 25 percent in FY 2013.<sup>21</sup> Any one of these factors can increase the time TAS spends resolving a taxpayer's overall issue.

For example, identity theft cases, which are inherently complex,<sup>22</sup> remain the top source of TAS work, accounting for one-fifth of total receipts in FY 2014, as reflected in Figure 4.4 below.<sup>23</sup> Erroneous information resulting from identity theft can affect a victim's account for multiple tax periods and cause multiple issues, impacting the Accounts Management, Examination, and Collection functions. Other complex cases include collection cases (such as levy release with an alternative collection solution, return of the levy proceeds, offers in compromise (OIC), or seizure prevention), examination cases with multiple periods, or income verification cases for self-employed persons with or without Earned Income Tax Credit (EITC) issues.

### Economic Burden Cases

Economic burden cases often occur where IRS processes are not functioning smoothly, or taxpayers experience other systemic problems. For the third consecutive fiscal year, more than half of TAS receipts involved taxpayers experiencing economic burden, as shown by Figure 4.3 below. Because these taxpayers face potential immediate adverse financial consequences, TAS requires employees to work the cases using accelerated timeframes.<sup>24</sup>

19 In FY 2013, of the 249,372 cases closed, 157,818 cases involved more than one issue. In FY 2014, of the 222,974 cases closed, 129,281 cases involved more than one issue. Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014).

20 Data obtained from TAMIS (Dec. 17, 2014).

21 *Id.*

22 See National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance That Minimizes Burden and Anxiety for Such Taxpayers*) for a detailed discussion of the identity theft.

23 Data obtained from TAMIS (Oct. 1, 2014).

24 IRM 13.1.16.12(1) (Mar. 23, 2011) (Upon acceptance into the TAS program, cases are ready for assignment to Case Advocates. Assign cases to Case Advocates within two workdays of the Taxpayer Advocate Received Date (TARD) for Criteria 1-4 cases and three workdays of the TARD for Criteria 5-9 cases.). IRM 13.1.18.3(1) (Feb. 1, 2011) (CA (Case Advocate) to contact the taxpayer or representative by telephone within 3 workdays of the TARD for criteria 1-4 cases, and within 5 workdays of the TARD for criteria 5-9 cases to notify of TAS's involvement.).

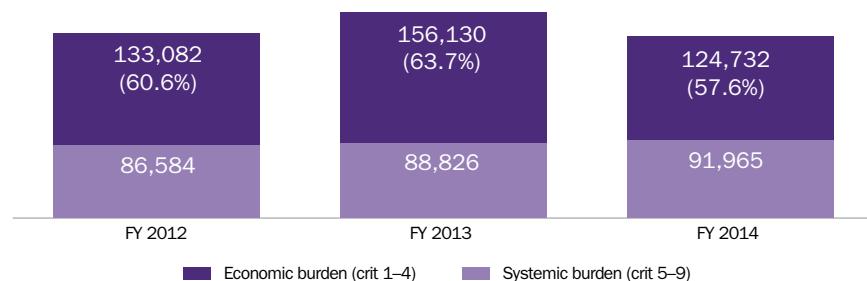
**FIGURE 4.3<sup>25</sup>****TAS economic burden and systemic burden receipts, FYs 2012–2014**

Figure 4.4 below represents the top ten sources of TAS receipts by PCIC categories from all sources without regard to TAS criteria, comparing FY 2013 and FY 2014. “Other TAS Receipts” encompasses the remaining PCICs not in the top ten.

**FIGURE 4.4, Top 10 issues for cases received in TAS, FYs 2013-2014, cumulative<sup>26</sup>**

Rank	Issue Description	FY 2013	FY 2014	FY 2014 Percent of Total	Percent Change FY 2013 to FY 2014
1	Identity Theft	57,929	43,690	20.2%	-24.6%
2	Pre-Refund Wage Verification Hold	26,136	35,220	16.3%	34.8%
3	Earned Income Tax Credit (EITC)	11,980	13,450	6.2%	12.3%
4	Processing Amended Return	10,441	10,245	4.7%	-1.9%
5	Levies (Including Federal Levy Payment Program)	8,829	8,086	3.7%	-8.4%
6	Processing Original Return	8,714	7,664	3.5%	-12.0%
7	Injured Spouse Claim	8,021	7,284	3.4%	-9.2%
8	Reconsideration of Audits and Substitute for Return under IRC § 6020(b)	7,527	6,768	3.1%	-10.1%
9	Open Audit (Not EITC)	6,734	5,302	2.5%	-21.3%
10	IRS Offset	4,992	4,789	2.2%	-4.1%
Total TAS Receipts		244,956	216,697		-11.5%

While identity theft cases account for more than 20 percent of all TAS cases, TAS received over 14,000 fewer cases in FY 2014 compared to FY 2013. However, TAS received slightly over 9,000 additional pre-refund wage verification hold cases in FY 2014 compared to FY 2013, an indication that while the IRS’s identity theft processes are improving, its ability to handle pre-refund wage verification hold cases is declining.

25 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014). TAS retrieved the data on the first day of the month following the end of each fiscal year.

26 Data obtained from TAMIS (Oct. 1, 2013; Oct 1, 2014).

Figure 4.5 below shows the top five issues driving economic burden receipts. These five issues represent the bulk of the increase in economic burden cases and overall caseloads.

**FIGURE 4.5, Top five issues causing economic burden (EB) cases, FYs 2013–2014<sup>27</sup>**

Rank	Issue Description	FY 2013	EB Receipts as % Total EB Receipts for Issue FY 2013	FY 2014	EB Receipts as % Total EB Receipts for Issue FY 2014	EB Percent Change FY 2013 to FY 2014
1	Identity Theft	43,695	28.0%	31,160	25.0%	-28.7%
2	Pre-Refund Wage Verification Hold	18,200	11.7%	20,917	16.8%	14.9%
3	Earned Income Tax Credit	9,968	6.4%	10,519	8.4%	5.5%
4	Levies (Including Federal Levy Payment Program)	7,871	5.0%	7,206	5.8%	-8.4%
5	Injured Spouse Claim	7,015	4.5%	6,104	4.9%	-13.0%

TAS dedicates significant resources to resolving the systemic causes of these issues, as discussed in the Most Serious Problems section of this and past reports.

## IDENTITY THEFT

Identity theft continued as the number one reason that taxpayers sought TAS assistance in FY 2014, comprising 20 percent of all receipts and 25 percent of economic burden receipts. The National Taxpayer Advocate first addressed the issue as a Most Serious Problem affecting taxpayers in 2005, identifying further problems and recommending solutions in subsequent reports.<sup>28</sup>

The IRS's procedures for verifying the identity of the innocent taxpayer, moving the incorrect tax information off the account, and processing the innocent taxpayer's tax return are cumbersome. In addition, identity theft cases often involve related collection and examination issues, as well as multiple years. Victims often come to TAS when they are experiencing a hardship to obtain expedited resolution. In an effort to improve identity theft case-processing by achieving end-to-end accountability, the IRS is consolidating identity theft claims in Wage and Investment division (W&I) Accounts Management to assure timely and consistent case-handling following uniform guidance in a single IRM, while developing system enhancements to fine-tune case processing. As reported in this year's Volume 2, TAS has conducted a research study to identify those cases, resolution of which requires a single IRS employee assigned to the

27 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014). TAS computed the top five economic burden issue codes using only (PCIC). Often TAS cases involve more than one issue and TAS tracks this data; however, these are not included within this computation to avoid counting a case more than once.

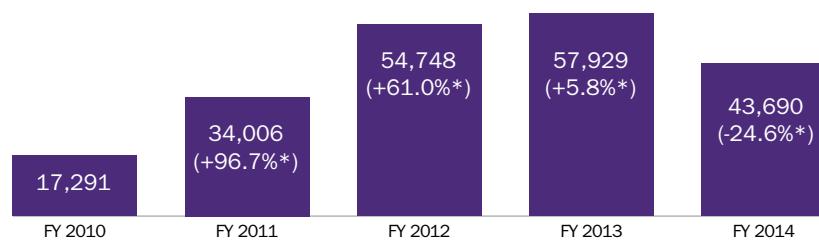
28 See National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48-68 (Most Serious Problem: *Tax Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307-11 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79-93 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96-115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2005 Annual Report to Congress 180-91 (Most Serious Problem: *Identity Theft*).

case.<sup>29</sup> TAS will use the results of the study to engage the IRS on improving the process and ensuring the taxpayer's ability to easily and independently navigate IRS processes.

In FY 2014, TAS obtained relief for a significant majority of taxpayers in identity theft cases. Nearly 82 percent of taxpayers received relief in these cases with an average timeframe of 81 days, which is a seven percent improvement from FY 2013. As Figures 4.6 and 4.7 below demonstrate, TAS inventories have declined from FY 2013 and FY 2014. TAS's timeframes for completing identity theft cases are improving over time.

**FIGURE 4.6<sup>30</sup>**

**TAS identity theft case receipts and percentage increases, FY 2010–2014**

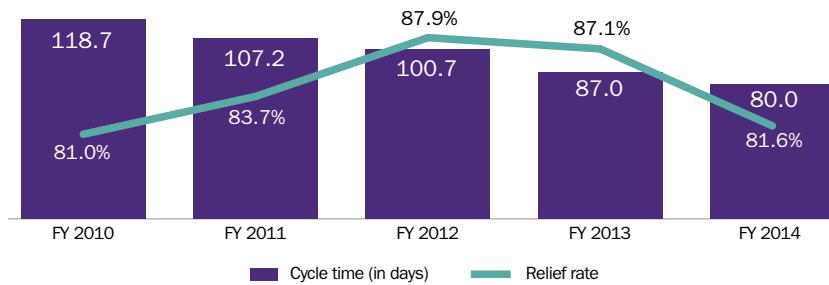


\*Change compared to prior year

Since 2010, TAS has helped over 207,000 identity theft victims resolve their account problems.

**FIGURE 4.7<sup>31</sup>**

**Identity theft relief rate and cycle time, FYs 2010–2014**



29 National Taxpayer Advocate 2014 Annual Report to Congress Vol. 2, *infra* (*Identity Theft Case Review Report: A Statistical Analysis of IDT Cases Closed in June 2014*).

30 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct 1, 2014).

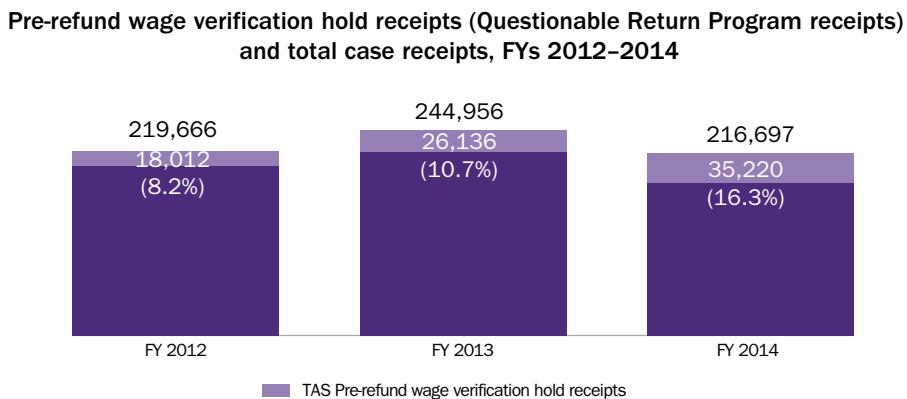
31 *Id.*

## PRE-REFUND WAGE VERIFICATION HOLDS

The IRS employs various filters in an attempt to prevent fraudulent returns from being processed and refunds issued. These preventive measures also stop innocent taxpayers' returns from timely processing, preventing receipt of refunds. When the IRS receives more questionable returns than it has resources to evaluate properly, it places holds on the associated refunds. In the past, these efforts have raised significant taxpayer rights issues, and brought increasing numbers of taxpayers to TAS.<sup>32</sup>

Pre-refund wage verification holds under the Return Integrity and Compliance Services Program (RICS) constitute the second most frequent reason that taxpayers come to TAS for assistance. This category experienced the largest volume increase in receipts in FY 2014. As noted above, the increase in TAS pre-refund wage verification hold case receipts has almost offset the decrease in identity theft receipts. Pre-refund wage verification hold cases almost doubled between FYs 2012 and 2014. These data indicate significant systemic and procedural issues in the RICS program.<sup>33</sup>

**FIGURE 4.8<sup>34</sup>**



Generally, TAS achieves over a 75 percent relief rate<sup>35</sup> and a 92 percent customer satisfaction rate in these cases.<sup>36</sup>

<sup>32</sup> See National Taxpayer Advocate 2005 Annual Report to Congress 25, addressing the IRS's Questionable Refund Program (subsequently called the RICS program) that failed to provide taxpayers adequate due process protections and failed to maintain an adequate system to vet IRS concerns about taxpayer refund claims.

<sup>33</sup> For additional discussion, see National Taxpayer Advocate FY 2015 Objectives Report to Congress 143-45 (*TAS Receipts Suggest the IRS Needs to Enhance Efforts to Detect and Prevent Refund Fraud*).

<sup>34</sup> Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014).

<sup>35</sup> Data obtained from TAMIS (Oct. 1, 2014).

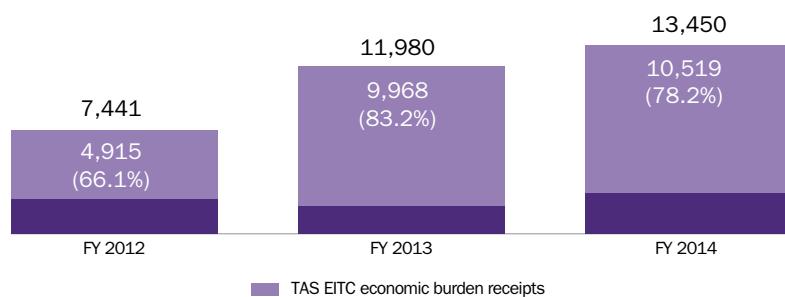
<sup>36</sup> TAS customer satisfaction is determined using a survey administered by a contractor. Customer satisfaction is measured by the percent of taxpayers who indicate they are very satisfied or somewhat satisfied with the service provided by TAS. The FY 2013 year-to-date results are from the Taxpayer Advocate Service National Report (June 2014).

## EARNED INCOME TAX CREDIT CASES

The Earned Income Tax Credit is a refundable tax credit that provides an important economic benefit for low income taxpayers who have earned income.<sup>37</sup> TAS's FY 2014 EITC receipts issue codes showed the second highest upsurge, increasing by more than 12 percent over FY 2013 and more than 80 percent since FY 2012.<sup>38</sup> Over 78 percent of the FY 2014 cases involved taxpayers experiencing an economic burden, an increase of more than five percent from FY 2013.<sup>39</sup>

**FIGURE 4.9<sup>40</sup>**

**TAS EITC economic burden and total case receipts, FYs 2012–2014**



The EITC is complex, yet its recipients tend to be in the lower economic strata and often least able to navigate complicated processes. TAS taxpayers typically face difficulty substantiating the EITC's residency and relationship requirements.<sup>41</sup> Taxpayers experiencing the most problems are those with non-traditional family relationships (where the child is not the biological child of the taxpayer claiming the credit), for whom documentation requirements can be overwhelming (*e.g.*, the need to obtain birth certificates for various individuals to establish the required relationship for a niece, nephew, or other extended relative).<sup>42</sup>

37 The benefit is available for low income taxpayers without children, but is more significant for those with children. The maximum benefit for 2013 was \$6,044 with three or more qualifying children and only \$487 with no qualifying children. IRS Publication 596, *Earned Income Credit (EIC)*, 26-34 (Nov. 20, 2013).

38 Data obtained from TAMIS (Oct. 1, 2013).

39 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014).

40 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014).

41 In order to claim a child for the EITC, the child must be a “qualifying child” and must meet three tests: age, relationship, and residency. Pursuant to IRC § 32(c)(3)(A), the EITC generally relies on the definition of qualifying child found in IRC § 152. The Relationship test requires that the child be the taxpayer’s child (including an adopted child, stepchild or eligible foster child), brother, sister, stepbrother, stepsister, or descendant of one of these relatives. See IRC §§ 152(c)(2) and 152(f)(1). The Residency test requires that the qualifying child must live with the taxpayer for more than half of the tax year (exceptions apply for temporary absences for special circumstances, *e.g.*, children who were born or died during the year, children of divorced or separated parents, and kidnapped children). See IRC § 152(c)(1)(B), (e), (f)(6); Treas. Reg. § 1.152-1(b). The Age test requires the child be younger than the taxpayer and fall under one of these age categories: under age 19, under age 24 and a full-time student, or a child of any age who is permanently and totally disabled. See IRC § 152(c)(3).

42 National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Credit Exam Issues*); Taxpayer Advocate Service, *Challenges for Taxpayers Claiming the Earned Income Tax Credit (EITC), From Interviews with Low Income Tax Clinics* (Sept. 2005). See *supra* note 2, for further description of the LITC program.

TAS studies demonstrate the importance of timely and clear communications to enable taxpayers to claim and to receive the EITC to which they are entitled.<sup>43</sup> TAS is improving its own EITC casework through a number of initiatives, as well as engaging W&I to develop more effective ways to administer EITC examinations.<sup>44</sup> In addition, TAS members serve on the cross-functional EITC Audit Improvement Team to recommend improvements to the EITC verification request document sent to taxpayers (Form 886-H-EIC). This team revised the format of the document to make it easily understandable, as well as to specify the documents a taxpayer could submit to show qualification for the credit under each of the tests.<sup>45</sup> The team also proposed changes to the tele-tax script to assure its clarity and recorded a video to expand taxpayers' understanding of EITC requirements, with a planned release in early FY 2015.

TAS continues to pursue its advocacy with the IRS to promote acceptance of TAS's comprehensive list of alternative documentation from third parties that taxpayers can use in lieu of the more restrictive IRS approach.<sup>46</sup> TAS also continues to advocate for the adoption and implementation of the Affidavit form, in which a third party attests under penalties of perjury as to his or her knowledge (personal or through records) of the principal residence of the child.<sup>47</sup>

An emerging EITC issue involves the IRS banning a taxpayer from claiming EITC on future income tax returns. When the IRS determines that a taxpayer has made a prior fraudulent or reckless EITC claim, the IRS may ban the taxpayer from claiming EITC for two years if the IRS determines the taxpayers claim was due to reckless or intentional disregard of the rules and regulations (but not due to fraud) or ten years if the taxpayer's EITC claim was fraudulent.<sup>48</sup> IRS procedures used to determine when to apply a ban are not clear and could result in a determination to impose a ban where there is little or no evidence that the taxpayer acted with reckless or intentional disregard of the rules.<sup>49</sup>

For example, the procedures state that an examiner should impose the two-year ban when the examiner "can determine the taxpayer's claim was due to reckless or intentional disregard rather than misunderstanding or confusion of the rule." However, there is no indication of what evidence the technician must consider to reach that conclusion.

43 For example, see National Taxpayer Advocate 2004 Annual Report to Congress, Vol. 2 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*). In a study of EITC audit reconsideration cases by TAS Research, 43 percent of taxpayers seeking audit reconsideration had a favorable outcome. This means that 43 percent of the taxpayers had valid (or at least partially valid) claims but could not successfully complete the examination process. The taxpayers received on average approximately 94 percent of the EITC originally claimed on their returns.

44 EITC cases present TAS leadership with an improvement opportunity. In FY 2014, the average relief rate on EITC cases was 65 percent compared to approximately 78 percent for all cases. TAS has taken a number of steps to improve its service to these taxpayers, including EITC training, led by the National Taxpayer Advocate, for field employees, decentralization of all EITC casework so these cases can be worked in local offices, and EITC case reviews by TAS leadership to identify which offices need additional training. Data obtained from TAMIS Oct. 1, 2014.

45 See *supra* note 41.

46 Attachment 1 to the TAS Interim Guidance Memorandum TAS-13-1213-011, *Reissuance of Interim Guidance on Advocating for Taxpayers Claiming Earned Income Tax Credit (EITC) with Respect to a Qualifying Child* (Dec 23, 2013). This document was reissued, pending incorporation into the IRM.

47 See National Taxpayer Advocate 2009 Annual Report to Congress, 97-98 (Most Serious Problem: *Running Social Programs Through the Tax System*), for a discussion of IRS studies of the use of an affidavit for verifying the principal residence of a qualifying child. See also National Taxpayer Advocate 2005 Annual Report to Congress, 106-08 (Most Serious Problem: *Earned Income Tax Credit (EITC) Exam Issues*).

48 IRC § 32(k)(1).

49 IRM 4.19.14.6.1 includes a table of "if-then" scenarios that the examiner should use as a starting point to help determine if the two-year ban is appropriate.

It is difficult for an examiner to assess whether a taxpayer knew or understood the rules, let alone to determine the taxpayer's state of mind or motivation. It is possible that the taxpayer understood the rules and made a good-faith attempt to follow them, but that the examiner would not accept the documents submitted as proof of EITC eligibility. This is just one example of the lack of clarity when implementing this ban. TAS provided case advocates with training on how to advocate for taxpayers where the IRS has or is considering applying the EITC ban at the beginning of FY 2014 and will continue to advocate extensively on behalf of these taxpayers.

## COLLECTION CASES

While still a significant source of cases, collection issues continued to decline between FY 2013 and FY 2014, in line with the decrease in the IRS's use of liens and levies during that period, as shown below.<sup>50</sup>

**FIGURE 4.10, IRS lien volume and TAS lien case receipts, FYs 2010–2014<sup>51</sup>**

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
TAS Lien Receipts	4,927	4,637	3,527	3,147	2,946
IRS Lien Volume	1,096,376	1,042,230	707,768	602,005	535,580

**FIGURE 4.11, IRS levy volume and TAS levy case receipts, FYs 2010–2014<sup>52</sup>**

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
TAS Levy Receipts	18,015	15,466	11,419	8,829	8,086
IRS Levy Volume	3,606,818	3,748,884	2,961,162	1,855,095	1,995,987

In FY 2014, collection issues accounted for more than 12 percent of all economic burden receipts and ten percent of TAS's total caseload.<sup>53</sup> These issues are vitally important to the affected taxpayers, because while IRS collection tools (bank levies, wage levies, personal residence seizures, and the filing of Notices of Federal Tax Lien) significantly affect all taxpayers, they can have a particularly devastating impact on those with low incomes.

Collection cases also present a challenge for TAS to undertake more effective advocacy on behalf of these taxpayers, as TAS provided relief in about 71 percent of these cases in FY 2014, compared to approximately 78 percent on all issues.<sup>54</sup> TAS is working to advocate better in collection cases through enhanced guidance and detailed training for employees. For example, in FY 2014, all case advocacy employees received the *Collection Case Study: Return of Levied Proceeds* training to improve development of requests

50 From FY 2010 to 2014, levies issued by the IRS decreased by 45 percent, and lien filings decreased by 51 percent. IRS, Collection Activity Reports, NO-5000-24, *Levy and Seizure Report* (FY 2010 to 2014); IRS, Collection Activity Reports, NO-5000-25, *Liens Report* (FY 2010 to 2014).

51 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014). IRS, 5000-23 Collection Workload Indicators (Mar. 22, 2011; Oct. 11, 2011); IRS, 5000-25 Collection Activity Report (Oct. 1, 2012; Sept. 30, 2013; Sept. 29, 2014).

52 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014). IRS, 5000-23 Collection Workload Indicators (Mar. 22, 2011; Oct. 11, 2011); IRS, 5000-24 Collection Activity Report (Oct. 9, 2012; Oct. 22, 2013); IRS, 5000-254 Collection Activity Report (Oct. 6, 2014).

53 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014).

54 Data obtained from TAMIS (Oct. 1, 2014).

for the return of levy proceeds. TAS issued 62 Taxpayer Assistance Orders (TAOs) on levy cases in FY 2014, compared to 20 or fewer in each of the three previous fiscal years. TAS leadership will conduct training for employees, using collection case studies in our effort to increase technical knowledge and enhance skills in advocating for taxpayers. In FY 2015, TAS will complete other face-to-face training on collection issues, including financial analysis. TAS provided four mandatory briefings to all case advocacy staff, stressing that liens and levies are not permissible to collect Shared Responsibility Payments (SRP) from taxpayers under the Affordable Care Act (ACA). TAS is also providing in-depth ACA training to all of its employees on how to handle ACA cases and advocate for taxpayers. Additional collection-focused training is forthcoming as the IRS develops its ACA collection policies.

In FY 2014, TAS issued 37 TAOs<sup>55</sup> in collection cases where the IRS did not agree with TAS's case-specific recommendations. Of these 37 TAOs, the IRS complied with 30 (including two where TAS modified the TAO), three are still in process, and TAS rescinded four after further discussion.<sup>56</sup> In two of the rescinded scenarios, Collection was taking the requested actions before TAS issued the TAO, but had not made TAS aware of its actions.

## TAX-EXEMPT ORGANIZATIONS

TAS's FY 2014 cases involving applications for exempt status increased by almost 67 percent since FY 2012 and nearly 43 percent over FY 2013.<sup>57</sup> Nearly 25 percent of the FY 2014 cases met economic burden criteria, and almost 74 percent were Congressional referrals.<sup>58</sup> This continued growth in exempt organization (EO) cases demonstrates that the IRS's processes are creating significant hardship for both new organizations and those whose exempt status was automatically revoked. Overall, TAS provided relief to 3,467 organizations seeking to resolve exempt status application issues in FY 2014.<sup>59</sup> TAS resolved these cases in an average of 86 days and provided some form of relief in 85.3 percent of the cases, an increase of 7.6 percent from FY 2013.<sup>60</sup>

## TAS OPERATIONS ASSISTANCE REQUEST TRENDS FOR FY 2014

To serve taxpayers more efficiently, the Commissioner delegated to the National Taxpayer Advocate certain tax administration authorities that do not conflict with or undermine TAS's unique statutory mission but allow TAS to resolve routine problems.<sup>61</sup> When TAS lacks the statutory or delegated authority to directly resolve a taxpayer's problem, it works with the responsible IRS operating division (OD) or function to resolve the issue, a process necessary in 66 percent of all TAS cases closed in FY 2012 and FY 2013 and 67 percent in FY 2014.<sup>62</sup> After independently reviewing the facts and circumstances of the case and communicating with the taxpayer, TAS uses Form 12412, *Operations Assistance Request*, to

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<sup>55</sup> For a detailed discussion of TAOs, see *TAS Uses Taxpayer Assistance Orders to Advocate Effectively in Taxpayer Cases*, *infra*. TAO compliance data is as of Oct. 1, 2014.

<sup>56</sup> Data obtained from TAMIS (Oct. 1, 2014).

<sup>57</sup> Data obtained from TAMIS (Oct. 1, 2010, Oct. 2011, Oct. 2012, and Oct. 2013). See Most Serious Problem: EXEMPT ORGANIZATIONS: The IRS Continues To Struggle With Revocation Processes and Erroneous Revocations of Exempt Status, *supra*.

<sup>58</sup> Data obtained from TAMIS (Oct. 1, 2014).

<sup>59</sup> *Id.*

<sup>60</sup> Data obtained from TAMIS (Oct. 1, 2013; Oct 1, 2014).

<sup>61</sup> IRM 1.2.50.3(1), *Delegation Order 13-2 (Rev. 1) (Authority of the National Taxpayer Advocate to Perform Certain Administrative Functions)* (Mar. 3, 2008).

<sup>62</sup> TAS closed 152,775 cases requiring an OAR in FY 2012, 165,003 in 2013, and 149,484 in FY 2014. Data obtained from TAMIS (Oct. 18, 2013; Oct. 6, 2014).

convey a recommendation or requested action for the IRS to resolve the issue, along with documentation. The Operations Assistance Request (OAR) also serves as an advocacy tool by:

- Giving the IRS a second chance to resolve the issue;
- Giving TAS and the OD a chance to resolve the issue without having to elevate it; and
- Documenting systemic trends that could lead to improvements in IRS processes.

Each IRS Business Operating Division (BOD) has agreed to work TAS cases on a priority basis and expedite the process for taxpayers whose circumstances TAS has determined to warrant immediate handling. Service Level Agreements require the BODs to direct resources to process OARs. The OAR process alerts the BODs to the number of taxpayers who seek TAS assistance because they have not been able to resolve their problems through regular channels within the BODs' control and for what issues. Form 12412 also includes an "expedite" box that TAS case advocates can check when the BOD needs to act immediately to relieve the taxpayer's hardship. Figure 4.12 reflects the number of OARs issued by BOD needing expedited action.

**FIGURE 4.12, Expedited and non-expedited OARs issued by BOD for FY 2014<sup>63</sup>**

Business Operating Division	FY 2014 OARs Issued Requesting Expedite Action	FY 2014 OARs Issued without Expedite Request	FY 2014 Total OARs Issued
Appeals	316	533	849
Criminal Investigation	37	58	95
Large Business & International	101	406	507
Small Business/Self-Employed	18,615	26,693	45,308
Tax Exempt/Governmental Entity	1,599	2,120	3,719
Wage & Investment	98,113	93,433	191,546
<b>Total</b>	<b>118,781</b>	<b>123,243</b>	<b>242,024</b>

TAS generally sends one or more OARs on individual cases to secure action by the IRS, but a single OAR may be used to work the same issue for multiple taxpayers, as previously described. For example, during the 2014 filing season, TAS issued a mass OAR on behalf of 803 identity theft victims, who had unprotected but validated TAS taxpayer accounts. TAS took this action to ensure timely marking of these accounts to allow the taxpayers to receive Identity Protection PINs.<sup>64</sup> TAS worked with the IRS to quickly update the 803 accounts, allowing the taxpayers to file returns without having to worry that an identity thief would file first using their Social Security numbers (SSNs), causing processing problems for the taxpayers.

63 Data obtained from TAMIS (Oct. 1, 2014).

64 *Id.* An IP PIN is a single-use six-digit identification number the IRS issues to ID theft victims so that they can file their returns with the assurance that the identity thief cannot file first. The process of validating a taxpayer's identity and marking the account must be complete before the IRS sends the IP PIN notices prior to the commencement of the filing season.

## TAS USES TAXPAYER ASSISTANCE ORDERS TO ADVOCATE EFFECTIVELY

The TAO is a powerful statutory tool delegated by the National Taxpayer Advocate to the Local Taxpayer Advocates (LTAs) to resolve taxpayer cases.<sup>65</sup> An LTA may issue a TAO to order the IRS to take certain actions, cease certain actions, or refrain from taking certain actions.<sup>66</sup> A TAO may order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level.<sup>67</sup> When a taxpayer faces significant hardship and the facts support relief, an LTA may issue a TAO when the IRS refuses or otherwise fails to take the action TAS has requested to resolve the case.<sup>68</sup> Once TAS issues a TAO, the OD can comply with the request or appeal the issue for resolution at higher levels.<sup>69</sup>

In FY 2014, TAS issued 362 TAOs,<sup>70</sup> including 44 in cases where the IRS failed to respond to an OAR. Of these 44 TAOs, the IRS complied with 41 in an average of 16 days.<sup>71</sup> Figure 4.13 reflects the results of the TAOs. Figure 4.14 shows the TAOs issued by fiscal year.

**FIGURE 4.13, Actions taken on FY 2014 TAOs issued<sup>72</sup>**

Action	Total
IRS Complied with the TAO	257
IRS Complied after the TAO was modified	17
TAS Rescinded the TAO	18
TAO Pending in Process	70
<b>Total</b>	<b>362</b>

**FIGURE 4.14, TAOs issued to the IRS, FYs 2011–2014<sup>73</sup>**

Fiscal Year	TAOs Issued
2011	422
2012	434
2013	353
2014	362

The following examples illustrate the use of TAOs to obtain taxpayer relief. To comply with IRC § 6103, which generally requires the IRS to keep taxpayers' returns and return information confidential, the details of the fact patterns have been changed. In certain examples, TAS has obtained the written consent of the taxpayer to provide more detailed facts.

<sup>65</sup> IRC § 7811. IRC § 7811(f) states that for “purposes of this section, the term ‘National Taxpayer Advocate’ includes any designee of the National Taxpayer Advocate.”

<sup>66</sup> IRC § 7811(b); Treas. Reg. § 301.7811-1(c)(3); IRM 13.1.20.3 (Dec. 15, 2007).

<sup>67</sup> Treas. Reg. § 301.7811-1(c)(3); IRM 13.1.20.3 (Dec. 15, 2007).

<sup>68</sup> IRC § 7811(a)(1); Treas. Reg. § 301.7811-1(a)(1) and (c).

<sup>69</sup> IRM 13.1.20.5(2) (Dec 15, 2007).

<sup>70</sup> Data obtained from TAMIS (Oct. 1, 2014).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> Data obtained from TAMIS (Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014).

## TAOs Involving Account Resolution

As discussed above, identity theft can adversely affect taxpayers. Approximately 75 percent of individual taxpayers filing returns claim refunds, averaging about \$2,700.<sup>74</sup> In an identity theft situation, where the IRS has processed a false return before the actual taxpayer files a return, the IRS will not issue a refund to the actual taxpayer until the IRS fully resolves the SSN ownership, which can take 180 days.<sup>75</sup> In FY 2014, TAS issued 33 TAOs involving identity theft, seven of which were issued because the IRS failed to respond to OARs by the negotiated completion date.<sup>76</sup> The IRS complied with all seven of these TAOs within an average of 11 days.<sup>77</sup> TAS issued 24 TAOs in cases that met economic burden case criteria and thus needed expedited case handling.<sup>78</sup> Specific examples of hardships encountered by these taxpayers, which were exacerbated by IRS delays, include:

- Taxpayer being evicted;
- Taxpayer needed to pay rent and utilities; and
- Taxpayer behind on bills and needed to repair auto to get to work.

TAS issued TAOs involving account resolution for other issues. One example is below:

Without the taxpayer's knowledge, his ex-spouse electronically filed joint returns and under-reported the taxpayer's income to receive the maximum EITC, which the ex-spouse kept. The taxpayer wanted to correct the accounts but the OD refused to process his single returns, citing the law that one cannot file separately after filing jointly after the April 15 filing deadline, which did not apply because the taxpayers were not married and he did not file the returns. TAS issued the TAO to obtain all account corrections flowing from the invalid joint returns, and place the total debt for the disallowed items on the ex-spouse's single account. The OD corrected the accounts and issued four refunds to the TAS taxpayer.<sup>79</sup>

## TAS Issues TAOs Where IRS Inaction Exacerbates Return Preparer Misconduct

As discussed in the National Taxpayer Advocate's preface to this report and in previous reports, we outlined the issues surrounding the IRS's current policy on assisting victims of tax return preparer misconduct.<sup>80</sup> Taxpayers seek TAS assistance when they become aware of preparer misconduct, which generally only happens after the IRS:

- Reviews or audits the return;
- Disallows the incorrect deductions, withholding, or credits;

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<sup>74</sup> IRS, 2014 IMF Filing Season Report, Week Ending May 30, 2014. Through May 31, 2013, the IRS received 136,090 million individual tax returns, of which 102,902 million claimed a refund averaging \$2,655. Through May 30, 2014, the IRS received 137,875 million individual tax returns, of which 103,232,000 claimed a refund averaging \$2,689.

<sup>75</sup> IRM 21.9.2.2.1 (May 29, 2013).

<sup>76</sup> Under the Service Level Agreements between TAS and the business operating divisions, the TAS employee will contact the assigned IRS employee to negotiate or renegotiate the earliest possible requested completion date.

<sup>77</sup> Data obtained from TAMIS (Oct. 1, 2014).

<sup>78</sup> *Id.*

<sup>79</sup> Signed release from the taxpayer dated August 12, 2014.

<sup>80</sup> See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 4 (Preface: *The IRS is Actively Harming Victims of Return Preparer Fraud by Delaying the Release of Refunds for Years*); National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 22-34 (*Return Preparer Fraud: A Sad Story*). See also National Taxpayer Advocate 2013 Annual Report to Congress 94-102; National Taxpayer Advocate 2012 Annual Report to Congress 68-94 (Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully*); National Taxpayer Advocate 2011 Annual Report to Congress 420-26 (Most Serious Problem: *The IRS Procedures for Replacing Stolen Direct Deposit Refunds Are Not Adequate*).

- Holds the taxpayer liable for the resulting increased tax assessment; or
- Prevents the taxpayer from obtaining the portion of the refund he or she was entitled to and did not actually receive.

In FY 2014, TAS continued to raise the problem, issuing 51 TAOs due to return preparer misconduct.<sup>81</sup> Since FY 2010, 118 TAOs for this issue have been elevated to the National Taxpayer Advocate and 25 of these were elevated to the Commissioner.<sup>82</sup>

Taxpayers in these cases are usually low income<sup>83</sup> and depend on their refunds to meet basic living expenses. Some have been waiting years to receive their proper refunds. The following are typical examples of taxpayer experiences:

- The preparer altered the taxpayer's return to inflate the refund and re-directed it to his own account. The taxpayer filed an amended return, showing the correct tax liability, but the IRS still held the taxpayer liable for the false refund the preparer received. TAS had multiple cases in which this preparer defrauded taxpayers.
- After the taxpayer received a printed copy of his return that reflected his own bank account number, the preparer altered the direct deposit account on the return before filing it electronically. The bank confirmed that the account on the return was not the taxpayer's and no funds were present. TAS developed the facts about the return preparer fraud with a police report and full explanation.
- The IRS correctly stopped a refund from a false return. TAS secured account corrections to obtain the proper refund for the taxpayer, but the IRS did not update the direct deposit information, and wrongly released the taxpayer's true refund to the preparer's account. The IRS's failure to void the preparer's false Form 8888, *Allocation of Refund*, caused the loss of the funds. TAS advised this situation fell within W&I's guidance.<sup>84</sup>

### TAOs to Examination Functions

In FY 2014, TAS issued 69 TAOs to examination units for a variety of issues, including return preparer misconduct, the earned income tax credit (EITC), audit reconsiderations, actions to complete open audits of original returns, penalty abatements, identity theft, and appeal rights.

EITC cases involved a variety of hardships. Some examples follow:

- A taxpayer was a single parent with a utility shutoff looming, needing medication, living in public housing, and receiving food stamps. The IRS denied TAS's request, stating that the residency test was not met. TAS disagreed and issued a TAO, and the IRS accepted the documents and allowed the refund.
- To substantiate an EITC claim, TAS worked with a taxpayer to obtain a notarized statement from the property owner, signed under penalties of perjury, affirming who lived in the home and for

<sup>81</sup> Data obtained from TAMIS (Oct. 1, 2014).

<sup>82</sup> *Id.*

<sup>83</sup> National Taxpayer Advocate 2013 Annual Report to Congress 94-102 (Most Serious Problem: *RETURN PREPARER FRAUD: The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds*); National Taxpayer Advocate 2012 Annual Report to Congress 68-94 (Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully*).

<sup>84</sup> See Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012), superseded by Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013).

how long. The IRS challenged the landlord's statement. TAS confirmed through public records that the person who signed the statement was the property owner, and issued a TAO. The LTA spoke to the IRS manager, who felt she did not have the latitude to accept the landlord's statement. After seeking guidance from headquarters, the manager complied with the TAO.

- The taxpayer was unemployed, battling cancer, and needed money for medical treatment. TAS issued a TAO when the IRS did not accept documents proving the claimed children lived with the taxpayer. The IRS accepted the documents for the taxpayer's son, but not for an unrelated child. TAS agreed with this decision. The IRS complied with the modified TAO.
- The taxpayer was being evicted. TAS issued a TAO to avoid increased taxpayer burden and time delays. The IRS agreed that a statement from the public housing authority (corroborated by court documents) substantiated the residency requirement for the EITC. The IRS complied with the TAO.
- The taxpayer claimed her child and grandchildren as qualifying children for the EITC. The IRS determined the relationship tests were substantiated, but not the residency tests. In making the decision to disallow the children, the IRS ignored certain documents provided by the taxpayer. TAS issued a TAO that logically analyzed the facts and applied the law. After securing further guidance, the IRS complied with the TAO to allow the credits claimed on the return.

### **TAOs to TE/GE**

Tax Exempt and Government Entity (TE/GE) cases present vitally important advocacy opportunities for TAS, both on substantive legal determinations and on processing issues.<sup>85</sup> Tax-exempt organizations contribute religious, educational, scientific, social welfare, and other positive benefits to the public good. Many of these exempt organizations are small entities, staffed by volunteers.<sup>86</sup> Entities pursuing tax exempt status under IRC § 501(c)(3) will often not operate in advance of IRS's approval of the organization's exempt status. Therefore, the timeliness of the application approval process is crucial to the goals of the organization. Without the IRS's determination on the tax exemption, the entity will struggle to solicit funds from donors, who are motivated in part by the ability to deduct contributions made to an approved IRC § 501(c)(3) tax exempt entity. While some exempt organizations under IRC § 501(c) may operate without the need to seek an IRS determination, it is TAS's experience with IRC § 501(c) cases that many entities are reluctant to operate without IRS approval.<sup>87</sup> TAS advocates for these taxpayers on both the procedural issues surrounding the application process and the substantive aspects of the determination process.

In FY 2014, TAS issued 19 TAOs to the TE/GE operating division, compared with three in FY 2011, six in FY 2012 (four of which were rescinded), and 42 in FY 2013.<sup>88</sup> Of the 19 TAOs issued to TE/GE in

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<sup>85</sup> See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013); National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013).

<sup>86</sup> See also National Taxpayer Advocate 2009 Annual Report to Congress 287, addressing the need for targeted research and increased collaboration to meet the needs of tax exempt organizations; National Taxpayer Advocate 2005 Annual Report to Congress 293, discussing inadequate service to exempt organization resulting in unnecessary penalties; National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013).

<sup>87</sup> Some organizations are not required to obtain formal recognition of tax-exempt status from the IRS, but may obtain such formal recognition by submitting IRS Form 1024. Of the 19 cases TAS received, three taxpayers withdrew their applications because of the excess burden and delays. National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* 3 (June 30, 2013), available at [www.taxpayeradvocate.irs.gov/2014ObjectivesReport/Special-Report](http://www.taxpayeradvocate.irs.gov/2014ObjectivesReport/Special-Report).

<sup>88</sup> Data obtained from TAMIS (Oct. 1, 2014).

FY 2014, four were due to TE/GE's failure to respond to TAS's OARs. Thirteen others involved untimely action or case assignment. Three also involved an apparent systemic issue on the Select Check system, which provides a list of IRS recognized tax-exempt organizations. TAS is investigating this systemic problem. The IRS complied with 16 of the 19 TAOs in FY 2014, in an average of 26 days.<sup>89</sup> TAS issued TAOs in FY 2014 primarily due to issues surrounding:

- Delays in processing Forms 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, and Form 1024, *Application for Recognition of Exemption Under Section 501(a)*; and
- Automatic revocations of exempt status under the Pension Protection Act, which requires tax-exempt organizations to file an annual return or notice with the IRS or face revocation after three consecutive years of non-filing.<sup>90</sup>

With respect to delays in processing, TAS has encountered problems with TE/GE understanding TAS's statutory authority. The National Taxpayer Advocate has written about these issues in the past.<sup>91</sup> Despite improvements, TAS remains concerned about IRS treatment of taxpayers applying for exempt status. TAS's advocacy efforts are focused on ensuring that certain applications are worked based on taxpayer need.

The National Taxpayer Advocate discussed the numerous problems surrounding the automatic revocation requirement at length in last year's report.<sup>92</sup> TAS advocacy in the typical fact pattern for an exempt organization revocation follows.

An exempt organization learns from its donors and grant-making foundations that it is no longer on the list of Exempt Organizations authorized to receive tax-deductible contributions, discovering the IRS revoked its exempt status. The organization files an application for reinstatement and pays the required user fee. The organization learns that the IRS has not reinstated its status when the organization applies for grants. The IRS responds to inquiries by informing the organization that IRS needs another six to eight weeks to respond. Often, the IRS makes multiple extensions when the organization seeks a status update. TAS conducts research to determine a recommended action, secures proof of grants that are being lost, and issues an OAR to the Exempt Organization OD, recommending that the IRS reinstate the exempt status promptly, due to the lost funding. If the OD does not respond within the established timeframe, TAS issues a TAO. The OD usually complies by reinstating the organization's exempt status.

### TAOs on Collection Issues

In FY 2014, levy issues were the fourth-largest source of TAS economic burden receipts,<sup>93</sup> as shown in Figure 4.5 above. If the IRS does not act quickly in these cases, the taxpayer may experience even greater financial harm. TAS issued 62 TAOs on levy cases in FY 2014, compared to 20 in FY 2013, 17 in FY 2012, and 11 in FY 2011. The IRS complied with 55 of the 62 TAOs for levies in FY 2014.<sup>94</sup> TAS

<sup>89</sup> *Id.*

<sup>90</sup> The Pension Protection Act of 2006, Pub. L. No. 109-280, § 1223, 120 Stat. 780, 1090 (2006).

<sup>91</sup> National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 35-70; National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013).

<sup>92</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 165-72 (Most Serious Problem: EXEMPT ORGANIZATIONS: *The IRS Continues To Struggle with Revocation Processes and Erroneous Revocations of Exempt Status*).

<sup>93</sup> Data obtained from TAMIS (Sept 1, 2014).

<sup>94</sup> Data obtained from TAMIS (Oct. 1, 2014).

issued 37 TAOs to obtain the return of levy proceeds for taxpayers experiencing economic burden. Some examples were:

- The taxpayer was two months behind on rent, according to the landlord. The IRS levied the taxpayer's pay. The employer sent an excess amount and refused to correct the error. The taxpayer sought the aid of her congressional representative and requested an IRS installment agreement (IA) for \$200 per month. TAS issued a TAO to secure a levy release, process the IA, and return the levy proceeds due to the taxpayer's hardship. The IRS complied.<sup>95</sup>
- A business taxpayer provided Forms W-2, *Wage and Tax Statements*, and Form W-3, *Transmittal of Wage and Tax Statements*, to the IRS's Civil Penalty Unit (CPU), when notified that the IRS had not received the documents. However, the CPU never resolved the issue. While the matter was still open with the CPU, the IRS levied all the working capital from the business' bank account to pay the penalty assessments, preventing the taxpayer from paying its employees. The taxpayer's account did not show receipt of Forms W-2 or W-3, although another system indicated the IRS had them. TAS issued a TAO asking the IRS to reconsider its determination not to return the levy proceeds due to the hardship of the taxpayer not being able to meet its payroll. The IRS complied. TAS also secured abatement of the civil penalty, so the taxpayer no longer owed the debt.<sup>96</sup>

Other examples of TAO situations in collection include:

- When the taxpayer came to TAS in 2014, he had lost his disability income, was only receiving Social Security Administration benefits, and was homeless. In April 2012, the taxpayer requested a direct debit installment agreement (DDIA) for \$100 per month. The taxpayer's collection information statement (CIS) showed he qualified for a currently not collectible (CNC) determination. However, the IRS processed the DDIA for \$420 per month, telling the taxpayer he had no choice but to accept that amount. The taxpayer made the payments until he depleted his funds, and the IRS defaulted the DDIA for insufficient payments. After TAS issued an OAR, the IRS placed the taxpayer's account in CNC status, but refused TAS's request to return the DDIA payments. TAS's position was that the agreement was illegal, because it forced the taxpayer into an economic hardship,<sup>97</sup> and all payments were improperly obtained. The IRS then removed the account from CNC status based on out-of-date data. TAS found several of the IRS's actions to be inconsistent with the IRM. Originally, the IRS coded the account to allow CNC status if a default occurred, an indication the IRS knew the DDIA was improper. When TAS advised that it would issue a TAO, the IRS placed the taxpayer's account in CNC status again but would not return any funds. After TAS issued the TAO, the first-level manager agreed to return the levy payments received after the default, but not the "voluntary" DDIA payments, stating the IRS had no authority to do so. TAS modified the TAO to secure the return of all the levied payments. The IRS complied.<sup>98</sup>

<sup>95</sup> Release signed by taxpayer dated April 9, 2014.

<sup>96</sup> *Id.*

<sup>97</sup> IRC § 6343(a)(1) states in part: "Under regulations prescribed by the Secretary, the Secretary shall release the levy upon all, or part of, the property or rights to property levied upon and shall promptly notify the person upon whom such levy was made that such levy has been released if... (D) the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer."

<sup>98</sup> Release signed by the taxpayer on August 18, 2014. The National Taxpayer Advocate is investigating the legal authority to return the remaining payments.

- The IRS approved an offer in compromise for the taxpayer, but did not input the OIC coding correctly. As a result, the IRS applied a refund for a period after the year in which the OIC was approved to the compromised tax debt, an action that was not authorized under the OIC. The taxpayer, a single parent with three children, desperately needed the refund. The adjustment to correct the problem went unpostable multiple times. TAS issued a TAO. The IRS corrected the account and issued the refund.<sup>99</sup>

### TAOs to Appeals

TAS issued 13 TAOs on a variety of issues during FY 2014 to the Office of Appeals, which complied with eight of these TAOs. TAS rescinded one after further research by a TAS attorney advisor; four TAOs remain in process. TAS cases involving Appeals continue to reflect a misunderstanding on the part of Appeals employees about TAS's statutory authority to advocate for taxpayers.<sup>100</sup> Some Appeals employees attempted to limit TAS's actions on the taxpayer's behalf, believing incorrectly that communicating with TAS violated the prohibition on Appeals from "*ex parte* communications" with functions, that TAOs may violate Appeals' independence, or exceed the National Taxpayer Advocate's authority.<sup>101</sup>

Despite these difficulties, TAS worked cooperatively with Appeals in many areas through a team. For example, Appeals personnel briefed the team on the Appeals Judicial Approach and Culture (AJAC) initiative. TAS is developing an awareness video presentation about the AJAC for release early in FY 2015. However, as stated elsewhere in this report, the National Taxpayer Advocate has several concerns about the AJAC initiative and has designated it a Most Serious Problem for the 2015 Annual Report to Congress.<sup>102</sup>

### CONGRESSIONAL CASE TRENDS

TAS is responsible for responding to certain tax account inquiries sent to the IRS by members of Congress. As shown in Figure 4.15, entity, refund, and document processing issues made up the top three categories of congressional inquiries in FY 2014.<sup>103</sup>

99 Release signed by the taxpayer dated August 17, 2014.

100 Data obtained from TAMIS (Oct. 1, 2014).

101 See Rev. Proc. 2012-18, 2012-10 I.R.B. 455. An "*ex parte* communication" is a communication that takes place between any Appeals employee and employees of other IRS functions without the taxpayer (or representative) being given an opportunity to participate in the communication. This Revenue Procedure expressly states that communications initiated by TAS to Appeals are permissible as it is presumed that the TAS employee is acting at the request of the taxpayer.

102 See Most Serious Problem: *COLLECTION DUE PROCESS: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*, *supra*.

103 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2014).

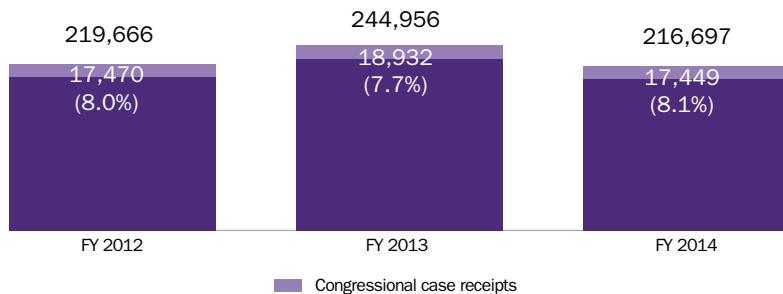
**FIGURE 4.15, TAS congressional inquiries by issue group, FY 2013–2014**<sup>104</sup>

Issue Category	FY 2013	FY 2014	Percent Change
Entity Issues	5,558	5,022	-9.6%
Refund Issues	2,577	2,602	1.0%
Document Processing Issues	3,034	2,497	-17.7%
Audit Issues	2,258	2,166	-4.1%
Collection Issues	2,407	2,149	-10.7%
Technical, Procedural, or Statute Issues	1,322	1,306	-1.2%
Penalty Issues	989	964	-2.5%
Payment or Credit Issues	426	424	-0.5%
Appeals Issues	268	225	-16.0%
Other Issues	37	48	29.7%
Interest Issues	44	40	-9.1%
Criminal Investigation Issues	12	6	-50.0%
<b>Totals</b>	<b>18,932</b>	<b>17,449</b>	<b>-7.8%</b>

Figure 4.16 shows the total receipts from congressional offices.

**FIGURE 4.16**<sup>105</sup>

#### TAS congressional receipts and total case receipts, FYs 2012–2014



<sup>104</sup> Data obtained from TAMIS (Oct. 1, 2013; Sept. 1, 2014).

<sup>105</sup> Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014).

## Top 25 Case Advocacy Issues for FY 2014 by TAMIS\* Receipts

Issue Code	Description	FY 2014 Case Receipts
425	Identity Theft	43,690
045	Pre-Refund Wage Verification Hold	35,220
63x - 640	Open Earned Income Tax Credit (EITC) Audits, Certification, Reconsideration, Recertification	13,450
330	Processing Amended Return	10,245
71x	Levies (including Federal Payment Levy Program)	8,086
310	Processing Original Return	7,664
340	Injured Spouse Claim	7,284
620	Reconsideration of Audits and Substitute for Return Under IRC § 6020(b)	6,768
610	Open Audit, Non-EITC	5,302
060	IRS Offset	4,789
670	Closed Automated Underreporter	3,821
315	Unpostable or Rejected Returns	3,751
090	Other Refund Inquiries or Issues	3,740
75x	Installment Agreements	3,737
460	Application for Exempt Status (Forms 1023/1024)	3,589
040	Returned or Stopped Refunds	3,271
72x	Liens	2,946
520	Failure to File (FTF) / Failure to Pay (FTP) Penalty	2,598
020	Expedite Refund Request	2,564
540	Civil Penalties other than Trust Fund Recovery Penalty	2,416
790	Other Collection Issues	2,416
010	Lost or Stolen Refunds	2,167
390	Other Document Processing Issues	2,061
320	Math Error	2,052
180	Refund Statute (RSED)	1,955
<b>Total Top 25 Receipts</b>		<b>185,582</b>
<b>Total TAS Receipts</b>		<b>216,697</b>

\* Taxpayer Advocate Management Information System.

## Glossary of Acronyms

Acronym	Definition	Acronym	Definition
ABA	American Bar Association	ATAO	Application for Taxpayer Assistance Order
ACA	Affordable Care Act	ATFRS	Automated Trust Fund Recovery System
ACE	Automated Correspondence Exam	ATIN	Adoption Taxpayer Identification Number
ACH	Automated Clearinghouse	ATP	Abusive Transaction Program
ACS	Automated Collection System	AUR	Automated Underreporter
ACTC	Additional Child Tax Credit or Advance Child Tax Credit	AWSS	Agency Wide Shared Services
ADA	Americans With Disabilities Act	BFS	Bureau of the Fiscal Service
ADR	Alternative Dispute Resolution or Address Research System	BMF	Business Master File
AEITC	Advanced Earned Income Tax Credit	BOD	Business Operating Division
AGI	Adjusted Gross Income	BOSS	Bond and Option Sales Strategy
AIA	Anti-Injunction Act	BNA	Bureau of National Affairs
AICPA	American Institute of Certified Public Accountants	BPR	Business Performance Review
AIS	Automated Insolvency System	BRTF	Business Returns Transaction File
AIQ	(IRS Office of) Advisory, Insolvency and Quality	BSA	Bank Secrecy Act
AJCA	American Jobs Creation Act of 2004	BTA	Board of Tax Appeals
AIMS	Audit Information Management System	CAA	Certifying Acceptance Agent
AJAC	Appeals Judicial Approach and Culture	CADE2	Customer Account Data Engine 2
ALE	Allowable Living Expenses	CAF	Centralized Authorization File
ALS	Automated Lien System	CAP	CAWR Automated Program
AM	Accounts Management	CARE	Customer Assistance, Relationships & Education
AMS	Accounts Management System	CAS	Customer Account Services
AMT	Alternative Minimum Tax	CAWR	Combined Annual Wage Reporting
AMTAP	Accounts Management Taxpayer Assurance Program	CBO	Congressional Budget Office
ANMF	Automated Non Master File	CBOC	Community-Based Outpatient Clinic
ANPR	Advance Notice of Proposed Rulemaking	CBPP	Center on Budget & Policy Priorities
AO/SO	Appeals or Settlement Officer	CBRS	Currency & Banking Retrieval System
AOIC	Automated Offer In Compromise	CC	Chief Counsel (Office of)
APA	American Payroll Association or Administrative Procedure Act	CCA	Chief Counsel Advice
APO/FPO	Army Post Office/Fleet Post Office	CCISO	Cincinnati Centralized Innocent Spouse Operation
APTC	Advance Premium Tax Credit	CCP-LU	Centralized Case Processing
AQC	Automated Questionable Credits	CCR	Call Center Representative
AQR	Automated Questionable Refund	CDP	Collection Due Process
ARAP	Accelerated Revenue Assurance Program	CDPTS	Collection Due Process Tracking System
ARC	Annual Report to Congress	CDE	Compliance Data Environment
ARRA	America Recovery and Reinvestment Act	CDW	Compliance Data Warehouse
ASA	Average Speed of Answer	CEAP	Correspondence Examination Assessment Project
ASED	Assessment Statute Expiration Date	CFf	Collection Field Function
ASFR	Automated Substitute for Return	CFIF	Check Forgery Insurance Fund
		CI	Criminal Investigation (Division)
		CIP	Compliance Initiative Project

Acronym	Definition	Acronym	Definition
CIS	Correspondence Imaging System	DPC	Designated Payment Code
CJEs	Critical Job Elements	DSO	Designated School Official
CLD	Communications, Liaison and Disclosure	EA	Enrolled Agent
CNC	Currently Not Collectible	EAC	Examination Activity Code
COBRA	Consolidated Omnibus Budget Reconciliation Act	EAJA	Equal Access to Justice Act
CODI	Cancellation Of Debt Income	EAR	Electronic Account Resolution
COIC	Centralized Offer In Compromise	EBE	Employee Business Expense
COTR	Contract Officer Technical Representative	EBT	Electronic Benefits Transfer
CONOPS	Concept of Operations	ECS	Enterprise Collections Strategy
CPAIT	Civil Penalties Administration Improvement Team	EGTRRA	Economic Growth and Tax Relief Reconciliation Act (of 2001)
CPAT	Compliance Post Adjustment Team	EFDS	Electronic Fraud Detection System
CPE	Continuing Professional Education	EFS	Enterprise Fax Storage
CPS	Collection Process Study	EFTPS	Electronic Federal Tax Payment System
CQMS	Collection Quality Management System	EFW	Electronic Funds Withdrawal
CRIS	Compliance Research Information System	EIC	Earned Income Credit
CSCO	Compliance Services Collection Operations	EIN	Employer Identification Number
CSED	Collection Statute Expiration Date	EITC	Earned Income Tax Credit
CSI	Campus Specialization Initiative	ELMS	Enterprise Learning Management System
CSO	Communications and Stakeholder Outreach	ELS	Electronic Lodgment Service
CSR	Customer Service Representative	ERIS	Enforcement Revenue Information System
CTC	Child Tax Credit	EO	Exempt Organization
DA	Disclosure Authorization	EP	Employee Plans
DAC	Disability Access Credit	EQRS	Embedded Quality Review System
DART	Disaster Assistance Review Team	ERIS	Enforcement Revenue Information System
DATC	Doubt As To Collectibility	ERO	Electronic Return Originator
DATL	Doubt As To Liability	ERISA	Employee Retirement Income Security Act
DCI	Data Collection Instrument	ERSA	Employee Retirement Savings Account
DD	Direct Deposit	ES	Estimated Tax Payments
DDb	Dependent Data Base	ESA	Economic Stimulus Act
DDIA	Direct Deposit Installment Agreement	ESC	Executive Steering Committee
DDP	Daily Delinquency Penalty	ESL	English as a Second Language
DFO	Designated Federal Official	ESOP	Employee Stock Ownership Plan
DHS	Department of Homeland Security	ESP	Economic Stimulus Payment
DI	Desktop Integration or Debt Indicator	ESRP	Employer Shared Responsibility Payment
DIF	Discriminant Income Function	ETA	Effective Tax Administration
DJA	Declaratory Judgment Act	ETACC	Electronic Tax Administration Advisory Committee
DLN	Document Locator Number	ETARC	Electronic Tax Administration and Refundable Credits
DMF	Death Master File	ETLA	Electronic Tax Law Assistance
DNS	Domain Name Server	FA	Field Assistance
DOD	Department of Defense	FAFSA	Free Application for Financial Student Aid
DOJ	Department of Justice	FATCA	Foreign Account Tax Compliance Act
DoMA	Defense of Marriage Act		

Acronym	Definition	Acronym	Definition
FBAR	Foreign Bank Account Report	GAO	Government Accountability Office or General Accounting Office
FBU	Federal Benefits Unit	HCTC	Health Coverage Tax Credit
FCR	Federal Case Registry	HMRC	Her Majesty's Revenue and Customs
FCRA	Fair Credit Reporting Act	HRRC	Human Resources Reporting Center
FDC	Fraud Detection Center	IA	Installment Agreement
FDCPA	Federal Debt Collection Procedures Act	IAT	Integrated Automation Technologies
FDIC	Federal Deposit Insurance Corporation	IBC	International Business Compliance
FEIE	Foreign Earned Income Exclusion	IBTF	In Business, Trust Fund
FEMA	Federal Emergency Management Agency	ICAS	Internet Customer Account Services
FFI	Foreign Financial Institution	ICMM	International Compliance Management Model
FFCD	Future Field Collection Design	ICP	Integrated Case Processing
FFFF	Free File Fillable Forms	ICS	Integrated Collection System
FICA	Federal Insurance Contribution Act	IDAP	IDRS Decision Assisting Program
FIFO	First In, First Out	IDM	International Data Management
FIRPTA	Foreign Investment in Real Property Tax Act	IDRS	Integrated Data Retrieval System
FLSA	Fair Labor Standards Act	IDS	Inventory Delivery System
FMV	Fair Market Value	IDT	Identity Theft
FMS	Financial Management Service	IFC	International Finance Corporation
FOIA	Freedom Of Information Act	IGRA	Indian Gaming Regulatory Act
FPAA	Final Partnership Administrative Adjustment	IGM	Interim Guidance Memorandum
FPL	Federal Poverty Level	IITA	International Individual Taxpayer Assistance Team
FPLP	Federal Payment Levy Program	IMD	Internal Management Document
FRA	Federal Records Act	IMF	Individual Master File
FSA	Facilitated Self-Assistance	IMRS	Issue Management Resolution System
FSRP	Facilitated Self-Assistance Research Project	IRCP	Individual Reporting Compliance Model
FTA	First-Time Abatement or Federal Tax Application	IP	Internet Protocol
FTC	Federal Trade Commission or Foreign Tax Credit	IPM	Integrated Production Model
FTD	Federal Tax Deposit or Failure To Deposit	IPO	ITIN Program Office
FTE	Full-Time Equivalent	IPOC	International Planning and Operations Council
FTF	Failure To File	IP PIN	Identity Protection Personal Identification Number
FTHBC	First-Time Homebuyer Credit	IPSU	Identity Protection Specialized Unit
FTI	Federal Tax Information	IRB	Internal Revenue Bulletin
FTL	Federal Tax Lien	IRC	Internal Revenue Code
FTP	Failure To Pay	IRCM	Individual Reporting Compliance Model
FTS	Fast Track Settlement	IRDM	Information Reporting Document Matching
FUTA	Federal Unemployment Tax Act	IRM	Internal Revenue Manual
FY	Fiscal Year	IRMF	Information Returns Master File
GCM	General Counsel Memorandum	IRP	Information Returns Processing
GE	Government Entities	IRPTR	Information Returns Processing Transcript Requests
GLD	Governmental Liaison and Disclosure	IRS	Internal Revenue Service

Acronym	Definition
IRSAC	Internal Revenue Service Advisory Council
IRSN	Internal Revenue Service Number
IRSOB	Internal Revenue Service Oversight Board
ISRP	Individual Shared Responsibility Payment
ITA	Interactive Tax Assistance
ITAAG	Identity Theft Assessment and Action Group
ITAR	Identity Theft Assistance Request
ITG	Indian Tribal Government
ITIN	Individual Taxpayer Identification Number
IVO	Integrity Verification Operations
IVR	Interactive Voice Response
JCT	Joint Committee on Taxation
JOC	Joint Operations Center
LATIS	IRS's Legislative Analysis, Tracking and Implementation Services
LB&I	Large Business and International Operating Division
LCCI	Last Chance Compliance Initiative
LCTU	Large Corporation Technical Unit
LEM	Law Enforcement Manual
LEP	Limited English Proficiency
LIF	Low Income Filter
LIHTC	Low Income Housing Tax Credit
LITC	Low Income Taxpayer Clinic
LLC	Limited Liability Company
LLP	Limited Liability Partnership
LOS	Level of Service
LP	Limited Partnership
LSB	Language Services Branch
LTA	Local Taxpayer Advocate
M&P	Media and Publications
MAGI	Modified Adjusted Gross Income
MEC	Minimal Essential Coverage
MFDRA	Mortgage Forgiveness Debt Relief Act
MFT	Master File Transaction
MIRSA	My IRS Account Application
MLI	Multilingual Initiative or Most Litigated Issue
MSCP	Market Segmentation Compliance Program
MSP	Most Serious Problem
MWP	Making Work Pay Credit
NAEA	National Association of Enrolled Agents
NCOA	National Change of Address
NEH	Non-Economic Hardship

Acronym	Definition
NFTL	Notice of Federal Tax Lien
NMF	Non-Master File
NOD	Notice of Deficiency
NQRS	National Quality Review System
NRP	National Research Program
NTA	National Taxpayer Advocate
NTIS	National Technical Information Service
NYSBA	New York State Bar Association
OAR	Operations Assistance Request
OD	Operating Division
OIC	Offer in Compromise
OECD	Organisation for Economic Co-Operation and Development
OLS	(IRS Office of) Online Services
OMB	Office of Management and Budget
OMM	Operation Mass Mail
OPERA	Office of Program Evaluation, Research, & Analysis
OPI	Office of Penalty and Interest Administration or Over the Phone Interpreter
OSI	Office of Servicewide Interest
OPR	Office of Professional Responsibility
OSP	Office of Servicewide Penalties
OTA	Office of Tax Analysis
OTBR	Office of Taxpayer Burden Reduction
OTC	Office of Taxpayer Correspondence
OTP	Office of Tax Policy
OUO	Official Use Only
OVC	Office for Victims of Crime
OVCI	Offshore Voluntary Compliance Initiative
OVD	Offshore Voluntary Disclosure
OVDI	Offshore Voluntary Disclosure Initiative
OVDP	Offshore Voluntary Disclosure Program
PC	Project Code
PCA	Private Collection Agency
PCAOB	Public Company Accounting Oversight Board
PCI	Potentially Collectible Inventory
PGLD	Privacy, Governmental Liaison and Disclosure (Office of)
PIC	Primary Issue Code
PNI	Potential New Inventory
PLR	Private Letter Ruling
POA	Power Of Attorney
POP	Phone Optimization Project

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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Acronym	Definition	Acronym	Definition
PPBR	Printing and Postage Budget Reduction	SEC	Securities and Exchange Commission
PPIA	Partial Payment Installment Agreement	SEP	Special Enforcement Program
PPS	Practitioner Priority Service	SERP	Servicewide Electronic Research Program
PRA	Paperwork Reduction Act	SEVP	Student and Exchange Visitor Program
PRP	Problem Resolution Program	SFR	Substitute for Return
PSC	Philadelphia Service Center	SL	Stakeholder Liaison
PSP	Payroll Service Provider	SLA	Service Level Agreement
PREA	Premature Referral and Acceptance	SMP	Secure Messaging Portal
PTC	Premium Tax Credit	SMS	Secure Messaging System
PTIN	Preparer Tax Identification Number	SNOD	Statutory Notice of Deficiency
PTSD	Post-Traumatic Stress Disorder	SO	Settlement Officer
PY	Processing Year	SOI	Statistics of Income
QBU	Qualified Business Unit	SP	Submission Processing
QETP	Questionable Employment Tax Practices	SPC	Submission Processing Center(s)
QRP	Questionable Refund Program	SPDER	Office of Servicewide Policy, Directives, and Electronic Research
RA	Revenue Agent or Reporting Agent	SPEC	Stakeholder Partnerships, Education & Communication
RAS	(Office of) Research, Analysis and Statistics	SPOC	Single Point of Contact
RCA	Reasonable Cause Assistant	SRP	Shared Responsibility Payment
RCP	Reasonable Collection Potential	SSA	Social Security Administration
RGS	Report Generating Software	SSDI	Social Security Disability Insurance
RICS	Return Integrity and Correspondence Services	SSI	Supplemental Security Income
RO	Revenue Officer	SSMC	Services, Support and Modernization Committee
ROFT	Record of Federal Tax Liability	SSN	Social Security Number
ROI	Return on Investment	STC	Student Tax Clinic
ROTTERS	Records of Tax Enforcement Results	STO	Student Tuition Organization
RPS	Revenue Protection Strategy	SVC	Stored Value Card
RPVP	Return Preparer Visitation Program	TAB	Taxpayer Assistance Blueprint
RRA 98	Internal Revenue Service Restructuring and Reform Act of 1998	TAC	Taxpayer Assistance Center
RPC	Return Preparer Coordinator	TACT	Taxpayer Communications Taskgroup
RPO	Return Preparer Office	TAD	Taxpayer Advocate Directive
RPS	Revenue Protection Strategy	TAMIS	Taxpayer Advocate Management Information System
RPP	Return Preparer Program	TAMRA	Technical and Miscellaneous Revenue Act (of 1988)
RRP	Return Review Program	TAO	Taxpayer Assistance Order
RSED	Refund Statute Expiration Date	TAP	Taxpayer Advocacy Panel
RTTS	Real-Time Tax System	TAS	Taxpayer Advocate Service
SA	Systemic Advocacy	TASIS	Taxpayer Advocate Service Integrated System
SAMS	Systemic Advocacy Management System	TBOR	Taxpayer Bill of Rights
SBA	Small Business Administration	TC	Transaction Code
SBDC	Small Business Development Center	TCE	Tax Counseling for the Elderly
SB/SE	Small Business/Self Employed Operating Division	TDA	Taxpayer Delinquent Account
S/E	Self-Employed		

Acronym	Definition
TDC	Taxpayer Digital Communications
TDI	Taxpayer Delinquency Investigation
TE	Tax Examiner or Tax Exempt
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
TEC	Taxpayer Education and Communication
TE/GE	Tax Exempt & Government Entities Operating Division
TEFRA	Tax Equity and Fiscal Responsibility Act
TFP	Tax Forms & Publications
TFRP	Trust Fund Recovery Penalty
TGR	Total Gross Receipts
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
TIPRA	Tax Increase Prevention and Reconciliation Act (of 2005)
TOP	Treasury Offset Program
TOS	Terms of Service
TPE	Taxpayer Education
TPI	Total Positive Income
TPNC	Taxpayer Notice Code
TPP	Third-Party Payer or Taxpayer Protection Program
TPPA	Third Party Payroll Agent
TPU	Taxpayer Protection Unit
TRA	Tax Reform Act
TRHCA	Tax Relief and Health Care Act (of 2006)
TTB	(Alcohol and Tobacco) Tax and Trade Bureau

Acronym	Definition
TTG	Telephone Transfer Guide
TY	Tax Year
UAA	Undeliverable As Addressed
UAL	Uniform Acknowledgement Letter
UCR	Uniform Call Routing
UDOC	Uniform Definition of a Child
ULC	Universal Location Code
UPU	Universal Postal Union
URF	Unidentified Remittances File
URP	Underreporter
USPS	United States Postal Service
USPTO	United States Patent and Trademark Office
UWR	Uniform Work Request
VAT	Value-Added Tax
VCP	Voluntary Compliance Program
VFTF	Virtual Face-to-Face
VITA	Volunteer Income Tax Assistance
VSD	Virtual Service Delivery
VTO	Virtual Translation Office
W3C	World Wide Web Consortium
W & I	Wage and Investment Operating Division
WFTRA	Working Families Tax Relief Act
WIRA	Wage and Investment Research & Analysis
WO	Whistleblower Office
XSF	Excess Collection File

**TABLE 1 Accuracy-Related Penalty Under IRC §§ 6662(b)(1), (2), and (3)**

Case Citation	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>			
Alexander v. Comm'r, T.C. Summ. Op. 2014-18	6662(b)(1) – TPs (H&W) acted with reasonable cause and in good faith with reliance on tax professional	No	TP
Alonso v. Comm'r, T.C. Summ. Op. 2013-93	6662(b)(2) – TP substantially understated income tax; failure to argue reasonable cause and good faith	Yes	IRS
Andersen v. Comm'r, T.C. Summ. Op. 2013-100	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith	Yes	TP
Avilez v. Comm'r, T.C. Summ. Op. 2013-99	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Berks v. Comm'r, T.C. Summ. Op. 2014-2	6662(b)(1) – TPs (H&W) negligent in failing to report income and to maintain records; failure to establish reasonable cause and good faith	No	IRS
Black v. Comm'r, T.C. Memo. 2014-27	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Bobrow v. Comm'r, T.C. Memo. 2014-21	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Brach v. Comm'r, T.C. Summ. Op. 2013-96	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith with reliance on tax professional	No	TP
Brooks v. Comm'r, T.C. Memo. 2013-141	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
Bruce v. Comm'r, T.C. Summ. Op. 2014-46	6662(b)(1) & (2) – TP acted with reasonable cause and in good faith	Yes	TP
Buckardt v. Comm'r, 548 F. App'x 433 (9th Cir. 2013), aff'g T.C. Memo 2010-145	6662(b)(1) & (2) – TP negligent and substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
Chandler v. Comm'r, 142 T.C. No. 16 (2014)	6662(b)(1) & (3) – TPs (H&W) acted with reasonable cause and in good faith for some, but not all, underpayments	No	Split
Cheramie v. Comm'r, T.C. Summ. Op. 2013-92	6662(b)(1) & (2) – TP acted with reasonable cause and in good faith with reliance on tax professional and an attorney	Yes	TP
Cohen v. U.S., 113 A.F.T.R.2d (RIA) 1077 (S.D.N.Y. 2014)	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith; lacking substantial authority	No	IRS
Defrancis v. Comm'r, T.C. Summ. Op. 2013-88	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith	No	TP
Edge v. Comm'r, T.C. Summ. Op. 2013-68	6662(b)(1) & (2) – TP acted with reasonable cause and in good faith	Yes	TP
Ellis v. Comm'r, T.C. Memo. 2013-245, appeal docketed, No. 14-1310 (8th Cir. Feb. 10, 2014)	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
Eram v. Comm'r, T.C. Memo. 2014-60	6662(b)(1) – TP negligent in failing to maintain records; failure to offer evidence on reasonable cause and good faith	Yes	IRS
Fall v. Comm'r, T.C. Summ. Op. 2013-89	6662(b)(1) – TPs (H&W) negligent in failing to report income; failure to establish reasonable cause and good faith	Yes	IRS
Taylor v. Comm'r, T.C. Memo. 2013-143	6662(b)(2) – TP acted with reasonable cause and in good faith	No	TP
Gist v. Comm'r, T.C. Summ. Op. 2014-1	6662(b)(1) – TPs (H&W) negligent in failing to report income and to maintain records; failure to establish reasonable cause and good faith	No	IRS

Table 1: Accuracy-Related Penalty Under IRC §§ 6662(b)(1), (2), and (3)

Case Citation	Issue(s)	Pro Se	Decision
<i>Golit v. Comm'r</i> , T.C. Memo. 2013-191	6662(b)(1) & (2) – TP negligent in attempting to comply with provisions of the tax code and substantially understated income; failure to establish reasonable cause and good faith	No	IRS
<i>Goralski v. Comm'r</i> , T.C. Memo. 2014-87	6662(b)(1) & (2) – TPs acted with reasonable cause and in good faith	No	TP
<i>Gorra v. Comm'r</i> , T.C. Memo. 2013-254	6662(b)(3) – TPs (H&W) grossly misstated value of conservation easement contributed to charitable organization; penalty for gross valuation misstatement does not violate the Eighth Amendment	No	IRS
<i>Green v. Comm'r</i> , T.C. Memo. 2014-23	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Henson v. Comm'r</i> , T.C. Summ. Op. 2014-36	6662(b)(1) – TP negligent in failing to maintain records to substantiate return items; failure to establish reasonable cause and good faith	Yes	IRS
<i>Johnson v. Comm'r</i> , T.C. Memo. 2014-67	6662(b)(1) & (2) – TP acted with reasonable cause and in good faith with reliance on a competent tax professional	No	TP
<i>Kaufman v. Comm'r</i> , T.C. Memo. 2014-52, remanded from <i>Kaufman v. Shulman</i> , 687 F.3d 21 (1st Cir. 2012), vacating <i>Kaufman v. Comm'r</i> , 134 T.C. 182 (2010), appeal docketed, No. 14-1863 (1st Cir. Aug. 20, 2014)	6662(b)(1)-(3) – TPs (H&W) negligent, substantially understated income, and grossly misstated the value of easement contributed to charitable organization	No	IRS
<i>Kellam v. Comm'r</i> , T.C. Memo. 2013-186	6662(b)(1) – TP negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	Yes	IRS
<i>Kososki v. Comm'r</i> , T.C. Summ. Op. 2014-28	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>McGraw v. Comm'r</i> , T.C. Memo. 2013-152	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Mountanos v. Comm'r</i> , T.C. Memo. 2013-138, appeal docketed, No. 14-71580 (9th Cir. June 6, 2014)	6662(b)(3) – TP grossly misstated value of conservation easement contributed to charitable organization	No	IRS
<i>Murray v. Comm'r</i> , T.C. Summ. Op. 2013-103	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Payne v. Comm'r</i> , T.C. Summ. Op. 2013-64	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Rahman v. Comm'r</i> , T.C. Summ. Op. 2014-35	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Rand v. Comm'r</i> , 141 T.C. 376 (2013)	6662(b)(1) – TPs (H&W) negligent in claim credits they were not entitled to; in determining the amount of underpayment, refundable credits cannot reduce amount of tax shown on return below zero	No	IRS
<i>Richardson v. Comm'r</i> , T.C. Summ. Op. 2014-9	6662(b)(1) & (2) – TPs (H&W) negligent in claiming dependency exemption and child tax credits for children removed from their home; in determining the amount of the underpayment; refundable credits cannot reduce the amount of tax shown on the return below zero, therefore, 2008 penalty recomputed at lower underpayment amount to TP's benefit	Yes	Split
<i>Richmond, Estate of v. Comm'r</i> , T.C. Memo. 2014-26	6662(b)(5) – Estate substantially misstated the value of its assets; failure to establish reasonable cause and good faith	No	IRS
<i>Roberts v. Comm'r</i> , 141 T.C. No. 19 (2013)	6662(b)(2) – TP understated income tax; failure to establish reasonable cause and good faith	No	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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TABLE 1: Accuracy-Related Penalty Under IRC §§ 6662(b)(1), (2), and (3)

Case Citation	Issue(s)	Pro Se	Decision
<i>Rogers v. Comm'r</i> , T.C. Memo. 2013-177	6662(b)(1) & (2) – Mistake of law was not reasonable; failure to establish reasonable cause and good faith with reliance on tax professional; however, TPs (H&W) not negligent for 2007 tax year	No	Split
<i>Sharp v. Comm'r</i> , T.C. Memo. 2013-290	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Shaw v. Comm'r</i> , T.C. Memo. 2013-170, appeal docketed, No. 13-73687 (9th Cir. Oct. 18, 2013)	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Snow v. Comm'r</i> , 141 T.C. 238 (2013)	6662(b)(2) – TP substantially understated income tax	Yes	IRS
<i>Toombs v. Comm'r</i> , T.C. Summ. Op. 2013-51	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith	No	TP
<i>Van Alen v. Comm'r</i> , T.C. Memo. 2013-235, appeal docketed, No. 14-71317 (9th Cir. May 6, 2014)	6662(b)(1) – TPs (siblings) negligent in failing to report income; failure to establish reasonable cause and good faith	No	IRS
<i>Weaver-Adams v. Comm'r</i> , T.C. Memo. 2014-73	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Xuye Li v. Comm'r</i> , T.C. Summ. Op. 2013-97	6662(a) – TP had no underpayment because refundable credits cannot reduce the amount of tax shown on the return below zero	Yes	TP
<b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedule C, E, F)</b>			
<i>Abelitis v. Comm'r</i> , T.C. Summ. Op. 2014-44	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Adeyemo v. Comm'r</i> , T.C. Memo. 2014-1	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Aivatzidis v. Comm'r</i> , T.C. Summ. Op. 2013-105	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Alexander v. Comm'r</i> , T.C. Memo. 2013-203	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Almquist v. Comm'r</i> , T.C. Memo. 2014-40	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Alpert v. Comm'r</i> , T.C. Memo. 2014-70	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Ames-Mechelke v. Comm'r</i> , T.C. Memo. 2013-176	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Austin Otology Assocs. v. Comm'r</i> , T.C. Memo. 2013-293	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Azimzadeh v. Comm'r</i> , T.C. Memo. 2013-169	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith for some, but not all, underpayments	Yes	Split
<i>Ballesteros v. Comm'r</i> , T.C. Summ. Op. 2013-108	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Bartlett v. Comm'r</i> , T.C. Memo. 2013-182	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Bigdeli v. Comm'r</i> , T.C. Memo. 2013-148	6662(b)(1) – TPs (H&W) negligent in attempting to comply with provisions of the tax code; failure to present argument on penalties	Yes	IRS
<i>Billeci v. Comm'r</i> , T.C. Summ. Op. 2014-38	6662(b)(2) – TP acted with reasonable cause and in good faith	No	TP

Case Citation	Issue(s)	Pro Se	Decision
<i>Blum v. Comm'r</i> , 737 F.3d 1303 (10th Cir. 2013), aff'd T.C. Memo. 2012-16	6662(b)(1) & (3) – TPs (H&W) negligent in attempting to comply with provisions of the tax code; provided inaccurate information to the promoter; failure to establish reasonable cause and good faith with reliance on tax professional	No	IRS
<i>Boree v. Comm'r</i> , T.C. Memo. 2014-85	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Bowerman v. Comm'r</i> , T.C. Summ. Op. 2014-26	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Brown v. Comm'r</i> , T.C. Memo. 2013-275	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Bugarin v. Comm'r</i> , T.C. Summ. Op. 2013-61	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Cahill v. Comm'r</i> , T.C. Memo. 2013-220	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to present evidence on reasonable cause and good faith	Yes	IRS
<i>Campion v. Comm'r</i> , T.C. Memo. 2013-146	6662(b)(1) – TPs (H&W) negligent in failing to report income; failure to establish reasonable cause and good faith	Yes	IRS
<i>Canatella v. Comm'r</i> , T.C. Memo. 2014-102	6662(b)(1) & (2) – TP substantially understated income tax; negligent in failing to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Chapin v. Comm'r</i> , T.C. Summ. Op. 2014-31	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to argue reasonable cause and good faith	Yes	IRS
<i>Chapman v. Comm'r</i> , T.C. Memo. 2014-82	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Chemtech Royalty Assocs., L.P v. U.S.</i> , 112 A.F.T.R.2d (RIA) 5080 (M.D. La. 2013), appeal aff'd in part, vacated and remanded in part, No. 13-30887 (5th Cir. Sept. 10, 2014)	6662(b)(1) & (2) – TP negligent, substantially understated income tax, and grossly misstated value of its assets	No	IRS
<i>Chen v. Comm'r</i> , T.C. Summ. Op. 2014-6	6662(b)(1) – TPs (H&W) not engaged in acting trade or business; failed to establish reasonable cause and good faith	No	IRS
<i>Chisolm v. Comm'r</i> , T.C. Summ. Op. 2014-45	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Chow, Estate of v. Comm'r</i> , T.C. Memo. 2014-49	6662(b)(1) – TP negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	No	IRS
<i>Cor v. Comm'r</i> , T.C. Memo. 2013-240	6662(b)(1) – TPs (H&W) negligent in deducting personal expenses; failure to establish reasonable cause and good faith	Yes	IRS
<i>Craig v. Comm'r</i> , T.C. Summ. Op. 2013-58	6662(b)(1) – TPs (H&W) negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	Yes	IRS
<i>Curtis v. Comm'r</i> , T.C. Memo. 2014-19	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Daoud v. Comm'r</i> , 548 F. App'x 441 (9th Cir. 2013), aff'd T.C. Memo. 2010-282	6662(b)(1) – TPs (H&W) negligent in distinguishing personal expenses (jewelry) from business expenses; failure to establish reasonable cause and good faith	Yes	IRS
<i>Douglas v. Comm'r</i> , T.C. Memo. 2014-104	6662(b)(1) & (2) – TPs (H&W) negligent and substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
Case Citation	Issue(s)	Pro Se	Decision	
<i>Douglas v. Comm'r</i> , T.C. Summ. Op. 2014-7	6662(b)(1) & (2) – TPs (H&W) substantially understated income tax; negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Dudek v. Comm'r</i> , T.C. Memo. 2013-272, <i>appeal docketed</i> , No. 14-1597 (3d Cir. Mar. 13, 2014)	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Dunford v. Comm'r</i> , T.C. Memo. 2013-189	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS	
<i>Dupre v. Comm'r</i> , T.C. Memo. 2013-287	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Edwards v. Comm'r</i> , T.C. Memo. 2014-57	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Elick v. Comm'r</i> , T.C. Memo. 2013-139, <i>appeal docketed</i> , No. 13-73837 (9th Cir. Oct. 31, 2013)	6662(b)(1) – TPs (H&W) negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	No	IRS	
<i>Endicott v. Comm'r</i> , T.C. Memo. 2013-199	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Flake v. Comm'r</i> , T.C. Memo. 2014-76	6662(b)(1) – TPs (H&W) negligent in deducting personal expenses; failure to maintain adequate records; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Fontayne v. Comm'r</i> , T.C. Summ. Op. 2013-54	6662(b)(1) & (2) – TPs (H&W) negligent in preparing the return; substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Franklin v. Comm'r</i> , T.C. Summ. Op. 2013-87	6662(b)(1) & (2) – TPs (H&W) acted with reasonable cause and in good faith reliance on return preparer	No	TP	
<i>Gateway Hotel Partners, LLC v. Comm'r</i> , T.C. Memo. 2014-5	6662(b)(1) – TP negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	No	IRS	
<i>Gluckman v. Comm'r</i> , 545 F. App'x 59 (2d Cir. 2013), <i>aff'g</i> T.C. Memo. 2012-329	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to present evidence on reasonable cause and good faith	No	IRS	
<i>Graffia v. Comm'r</i> , T.C. Memo. 2013-211, <i>appeal docketed</i> , No. 13-3757 (7th Cir. Dec. 11, 2013)	6662(b)(1) & (2) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Gullion v. Comm'r</i> , T.C. Summ. Op. 2013-65	6662(b)(1) – TP acted with reasonable cause and in good faith	Yes	TP	
<i>Hall v. Comm'r</i> , T.C. Memo. 2014-16	6662(b)(1) – TP negligent in failing to maintain records substantiating income and expenses; failure to argue reasonable cause and good faith	Yes	IRS	
<i>Hardnett v. Comm'r</i> , T.C. Summ. Op. 2013-56	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Harloff v. Comm'r</i> , T.C. Summ. Op. 2014-20	6662(b)(2) – TP acted with reasonable cause and in good faith for some, but not all, underpayments	No	Split	
<i>Haskett v. Comm'r</i> , T.C. Summ. Op. 2013-76	6662(b)(1) – TPs (H&W) negligent in failing to maintain adequate records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS	
<i>Hershberger v. Comm'r</i> , T.C. Memo. 2014-63	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS	

Case Citation	Issue(s)	Pro Se	Decision
<i>Herwig v. Comm'r</i> , T.C. Memo. 2014-95, appeal docketed, No. 14-13644 (11th Cir. Aug. 14, 2014)	6662(b)(1) – TPs (H&W) negligent in attempting to comply with provisions of the tax code; failure to present evidence on reasonable cause and good faith	No	IRS
<i>Hoelscher v. Comm'r</i> , T.C. Memo. 2013-236	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Hom v. Comm'r</i> , T.C. Memo. 2013-163, appeal docketed, No. 13-74335 (9th Cir. Dec. 17, 2013)	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to present evidence on reasonable cause and good faith	Yes	IRS
<i>Humboldt Shelby Holding Corp. v. Comm'r</i> , T.C. Memo. 2014-47, appeal docketed, No. 14-3428 (2d Cir. Sept. 12, 2014)	6662(b)(3) – TP grossly misstated adjusted basis of interest in a sham partnership; failure to establish reasonable cause and good faith	No	IRS
<i>Humphrey v. Comm'r</i> , T.C. Memo. 2013-198	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Iheke v. Comm'r</i> , T.C. Summ. Op. 2013-75	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Jordan v. Comm'r</i> , T.C. Summ. Op. 2013-91	6662(b)(1) – TPs negligent in attempting to comply with provisions of the tax code; failure to challenge penalties	No	IRS
<i>Karch v. Comm'r</i> , T.C. Memo. 2013-237, appeal docketed, No. 14-3179 (3d Cir. July 3, 2014)	6662(b)(1) & (2) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; may have substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Kobel v. Comm'r</i> , T.C. Memo. 2013-158	6662(b)(1) & (2) – TPs (H&W) negligent in failing to report income but not in resolving deduction issues via stipulation; possible substantial underpayment; failure to establish reasonable cause and good faith	Yes	Split
<i>Krohn v. Comm'r</i> , T.C. Summ. Op. 2014-12	6662(b)(1) & (2) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Lakhani v. Comm'r</i> , 142 T.C. No. 8 (2014), appeal docketed, No. 14-72577 (9th Cir. Aug. 21, 2014)	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Limberea, Estate of v. Comm'r</i> , T.C. Summ. Op. 2013-50	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to present evidence on reasonable cause and good faith	Yes	IRS
<i>Linzy v. Comm'r</i> , T.C. Memo. 2013-219	6662(b)(1) – TP negligent in deducting personal expenses and in failing to maintain records to substantiate other deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Long v. Comm'r</i> , T.C. Memo. 2013-233, appeal docketed, No. 14-10288 (11th Cir. Jan. 22, 2014)	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Lustig v. Comm'r</i> , T.C. Memo. 2014-91	6662(b)(1) – TPs (H&W) negligent in failing to report income and review returns; failure to establish reasonable cause and good faith	No	IRS
<i>Maguire v. Comm'r</i> , T.C. Summ. Op. 2013-53	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Markell Co., Inc. v. Comm'r</i> , T.C. Memo. 2014-86	6662(b)(3) – TP grossly misstated basis of its assets; failure to establish reasonable cause and good faith	No	IRS
<i>Mathis v. Comm'r</i> , T.C. Memo. 2013-294	6662(b)(1) & (2) – TP acted with reasonable cause and in good faith with reliance on a competent tax professional	No	TP

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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Case Citation	Issue(s)	Pro Se	Decision
<i>McLauchlan v. Comm'r</i> , 113 A.F.T.R.2d (RIA) 1188 (5th Cir. 2014), aff'g T.C. Memo. 2011-289	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Merino v. Comm'r</i> , T.C. Memo. 2013-167	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to present any evidence on reasonable cause	Yes	IRS
<i>Mikhail v. Comm'r</i> , T.C. Summ. Op. 2014-40	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith reliance on a competent tax professional	Yes	TP
<i>Moore v. Comm'r</i> , T.C. Memo. 2013-249	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith reliance on a competent tax professional	No	TP
<i>Nelson v. Comm'r</i> , T.C. Memo. 2013-259	6662(b)(1) – TP negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	No	IRS
<i>Nevada Partners Fund, L.L.C. v. U.S.</i> , 720 F.3d 594 (5th Cir. 2013), vacated and remanded on other grounds, 134 S. Ct. 903 (2014)	6662(b)(1) – TP negligent in entering a transaction that was too good to be true; failure to establish reasonable cause and good faith	No	IRS
<i>NPR Invs., L.L.C. v. U.S.</i> , 740 F.3d 998 (5th Cir. 2014), rev'g 732 F. Supp. 2d 676 (E.D. Tex. 2010)	6662(b)(3) – Gross value misstatement penalty applies provisionally; failure to establish reasonable cause and good faith; TP liability must be determined at the partner level	No	Split
<i>Oderio v. Comm'r</i> , T.C. Memo. 2014-39	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Ofoegbu v. Comm'r</i> , T.C. Summ. Op. 2013-79	6662(b)(1) & (2) – TP acted with reasonable cause and in good faith with reliance on a competent tax professional	No	TP
<i>Ohana v. Comm'r</i> , T.C. Memo. 2014-83	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Palmer Ranch Holdings Ltd. V. Comm'r</i> , T.C. Memo. 2014-79, appeal docketed, No. 14-14167 (11th Cir. Sept. 16, 2014)	6662(b)(1) & (3) – TP acted with reasonable cause and in good faith	No	TP
<i>Pawar v. Comm'r</i> , T.C. Memo. 2013-257	6662(b)(1) & (2) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; substantially understated income tax; acted with reasonable cause and in good faith for only a part of the underpayment	No	Split
<i>Phillips v. Comm'r</i> , T.C. Memo. 2013-215	6662(b)(1) & (2) – TP negligent in failing to maintain records to substantiate deductions; substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Rael v. Comm'r</i> , T.C. Summ. Op. 2013-78	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Roberts v. Comm'r</i> , T.C. Memo. 2014-74	6662(b)(2) – TP acted with reasonable cause and in good faith	No	TP
<i>Rodriguez v. Comm'r</i> , T.C. Memo. 2013-221	6662(b)(1) & (2) – TPs acted with reasonable cause and in good faith	No	TP
<i>Rogers v. Comm'r</i> , 728 F.3d 673 (7th Cir. 2013), aff'g T.C. Memo. 2011-277	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Rovakat, LLC v. Comm'r</i> , 529 F. App'x 124 (3d Cir. 2013), aff'g T.C. Memo. 2011-225	6662(b)(3) – TP grossly misstated basis of its assets; failure to establish reasonable cause and good faith	No	IRS
<i>Safakish v. Comm'r</i> , T.C. Summ. Op. 2013-107	6662(b)(1) & (2) – TP substantially understated income tax; failure to offer any argument or evidence on reasonable cause and good faith	Yes	IRS
<i>Salem Fin., Inc. v. U.S.</i> , 112 Fed. Cl. 543 (2013), appeal docketed, No. 14-5027 (Fed. Cir. Dec. 12, 2013)	6662(b)(1) & (2) – TP negligent in entering a transaction that was too good to be true; substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS

Case Citation	Issue(s)	Pro Se	Decision
<i>Sampson v. Comm'r</i> , T.C. Memo. 2013-212	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	No	IRS
<i>Santiago v. Comm'r</i> , T.C. Summ. Op. 2013-45	6662(b)(1) – TPs (H&W) negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Schlievert v. Comm'r</i> , T.C. Memo. 2013-239	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to argue reasonable cause and good faith	Yes	IRS
<i>Scully v. Comm'r</i> , T.C. Memo. 2013-229	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Seismic Support Servs., LLC v. Comm'r</i> , T.C. Memo. 2014-78, appeal docketed, No. 14-72814 (9th Cir. Sept. 12, 2014)	6662(b)(1) – TP negligent in attempting to comply with provisions of the tax code; failure to establish reasonable cause and good faith	Yes	IRS
<i>Somogyi v. Comm'r</i> , T.C. Summ. Op. 2014-33	6662(b)(2) – TP substantially understated income tax; failure to establish reasonable cause and good faith with reliance on a tax professional	Yes	IRS
<i>Superior Trading, LLC v. Comm'r</i> , 728 F.3d 676 (7th Cir. 2013), aff'd 137 T.C. 70 (2011)	6662(b)(3) – TPs grossly misstated basis of its assets; failure to establish reasonable cause and good faith	No	IRS
<i>Terry v. Comm'r</i> , T.C. Summ. Op. 2013-69	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to establish reasonable cause and good faith	Yes	IRS
<i>Thunstedt v. Comm'r</i> , T.C. Memo. 2013-280	6662(b)(1) – TP negligent in failing to maintain records to substantiate deductions; failure to present evidence on reasonable cause and good faith	Yes	IRS
<i>TIFD III-E Inc. v U.S.</i> , 113 A.F.T.R.2d (RIA) 1557 (D. Conn. 2014), remand from 666 F.3d 836 (2d Cir. 2012), rev'd 660 F. Supp. 2d 367 (D. Conn. 2009), remanded from 459 F.3d 220 (2d Cir. 2006), rev'd 342 F. Supp. 2d 94 (D. Conn. 2004), appeal docketed, No. 14-1952 (2d Cir. June 9, 2014 )	6662(b)(1) – TP acted with reasonable cause and in good faith	No	TP
<i>Tocher v. Comm'r</i> , T.C. Summ. Op. 2014-34	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>U.S. v. Woods</i> , 134 S. Ct. 557 (2013), rev'd 471 F. App'x 320 (5th Cir. 2012), aff'd 794 F. Supp. 2d 714 (W.D. Tex. 2011)	6662(b)(3) – Gross value misstatement penalty applies provisionally; TP liability must be determined at the partner level	No	Split
<i>Viola v. Comm'r</i> , T.C. Memo. 2013-213	6662(b)(2) – TPs (H&W) substantially understated income tax; TPs acted with reasonable cause and in good faith for some of the underpayment	No	Split
<i>Williams v. Comm'r</i> , T.C. Summ. Op. 2013-60	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Williams v. Comm'r</i> , T.C. Summ. Op. 2013-63	6662(b)(2) – TPs (H&W) substantially understated income tax; failure to establish reasonable cause and good faith	Yes	IRS
<i>Windross v. Comm'r</i> , T.C. Summ. Op. 2013-52	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith	Yes	TP
<i>Zavadil v. Comm'r</i> , T.C. Memo. 2013-222, appeal docketed, No. 14-1053 (8th Cir. Jan. 9, 2014)	6662(b)(1) – TPs (H&W) negligent in attempting to comply with provisions of the tax code; failure to argue reasonable cause and good faith	No	IRS

**TABLE 2 Trade or Business Expenses Under IRC § 162 and Related Sections**

Case Citation	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>			
<i>Alonso v. Comm'r</i> , T.C. Summ. Op. 2013-93	Deduction denied for unreimbursed employee expenses for failure to substantiate; deduction denied for vehicle and cell phone for failure to meet § 274 substantiation requirements	Yes	IRS
<i>Batchelor-Robjohns v. U.S.</i> , 112 A.F.T.R.2d (RIA) 5960 (S.D. Fla. 2013), <i>appeal docketed</i> , No. 14-10742 (11th Cir. Feb. 21, 2014)	Deduction denied for settlement payments related to sale of company because they were capital losses	No	IRS
<i>Bogarin v. Comm'r</i> , T.C. Summ. Op. 2013-67	Deduction denied for vehicle expenses because expenses were personal; deduction for work tools allowed	Yes	Split
<i>Bogue v. Comm'r</i> , 522 F. App'x 169 (3d Cir. 2013), <i>aff'g</i> T.C. Memo. 2011-164, <i>cert. denied</i> , No. 13-1030 (Mar. 31, 2014)	Deduction denied for cell phone for failure to substantiate; deduction denied for books because expensed in prior years; deduction denied for travel because the expense was personal	Yes	IRS
<i>Cor v. Comm'r</i> , T.C. Memo. 2013-240	Deduction denied for unreimbursed employee expenses	Yes	IRS
<i>Daco v. Comm'r</i> , T.C. Summ. Op. 2013-71	Deduction denied for vehicle expenses for failure to meet § 274 substantiation requirements	Yes	IRS
<i>Endicott v. Comm'r</i> , T.C. Memo. 2013-199	Deduction denied for stock trading expenses for failure to establish that activity qualified as a trade or business within § 162(a)	Yes	IRS
<i>Franklin v. Comm'r</i> , T.C. Summ. Op. 2013-87	Deduction for advertising, internet, real estate, and gift expenses allowed to the extent substantiated; deduction denied for vehicle, travel, meals and entertainment, and cell phone for failure to meet § 274 substantiation requirements; deduction denied for home office for failure to show required for employment; deduction denied for phone, fax, and radio because expenses were personal; deduction denied for satellite/cable, bank charges and office supplies for failure to prove ordinary and necessary in business	No	Split
<i>Golit v. Comm'r</i> , T.C. Memo. 2013-191	Deduction allowed for union dues and uniform expenses to the extent substantiated; deduction denied for other expenses for failure to substantiate	No	Split
<i>Hart v. Comm'r</i> , T.C. Memo. 2013-289	Deduction denied for education expense for failure to establish that activity qualified as a trade or business within § 162(a)	Yes	IRS
<i>Humphrey v. Comm'r</i> , T.C. Memo. 2013-198	Deduction denied for vehicle, travel, and home office for failure to prove non personal business purpose; deduction denied for meals and entertainment, and cell phone for failure to meet § 274 substantiation requirements; deduction denied for other expenses for failure to substantiate	Yes	IRS
<i>Lamb v. Comm'r</i> , T.C. Summ. Op. 2013-70	Deduction denied for unreimbursed employee expenses because expenses were personal	Yes	IRS
<i>McGovern v. Comm'r</i> , T.C. Summ. Op. 2013-74	Deduction denied for employee expenses for failure to substantiate; deduction denied for travel and meals and entertainment for failure to meet § 274 substantiation requirements; deduction denied for education expenses for failure to prove ordinary and necessary	Yes	IRS
<i>Ohana v. Comm'r</i> , T.C. Memo. 2014-83	Deduction denied for real estate expenses for failure to establish that activity qualified as a trade or business within § 162(a); deduction denied for travel because expense was personal	No	IRS

TABLE 2: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	Pro Se	Decision
<i>Pelot v. Comm'r</i> , T.C. Summ. Op. 2014-23	Deduction allowed for vehicle and conference expenses to extent substantiated; deduction denied for travel for failure to substantiate; deduction denied for meals and entertainment for failure to meet § 274 substantiation requirements	Yes	Split
<i>Powers v. Comm'r</i> , T.C. Summ. Op. 2013-106	Deduction allowed for vehicle expenses to the extent substantiated; deduction denied for home office because deduction duplicated on TP's Schedule A	No	Split
<i>Rael v. Comm'r</i> , T.C. Summ. Op. 2013-78	Deduction denied for vehicle expenses for failure to meet § 274 substantiation requirements; deduction denied for employee business expenses and rental expenses for failure to substantiate	Yes	IRS
<i>Richards v. Comm'r</i> , T.C. Memo. 2014-88	Deduction denied for business expense for failure to show eligibility for employer reimbursement; deduction denied for travel for failure to meet § 274 substantiation requirements	No	IRS
<i>Scully v. Comm'r</i> , T.C. Memo. 2013-229	Deduction for music performance activities allowed to the extent substantiated; deduction denied for home office and employee expenses for failure to substantiate	Yes	Split
<i>Snellman v. Comm'r</i> , T.C. Summ. Op. 2014-10	Deduction allowed for vehicle, meal, and lodging expenses to the extent substantiated; deduction denied for parking fees and tolls for failure to substantiate; deduction denied for miscellaneous expenses because expenses were personal	Yes	Split
<i>Terry v. Comm'r</i> , T.C. Summ. Op. 2013-69	Deduction denied for employee expenses for failure to substantiate	Yes	IRS
<i>Thompson v. Comm'r</i> , T.C. Summ. Op. 2013-49	Deduction denied for vehicle and computer expenses for failure to meet § 274 substantiation requirements; deduction denied for home office and uniform expenses for failure to show exclusive non personal use	Yes	IRS
<i>Weiss v. Comm'r</i> , T.C. Summ. Op. 2014-25	Deduction denied for employee expenses for failure to disprove eligibility for employer reimbursement; deduction denied for travel, meals and entertainment for failure to meet § 274 substantiation requirements; deduction denied for employee clothing and use of residence expenses for failure to prove non personal exclusive business use; deduction denied for miscellaneous employee expenses for failure to substantiate	Yes	IRS
<b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedule C, E, F)</b>			
<i>Abelitis v. Comm'r</i> , T.C. Summ. Op. 2014-44	Deduction denied for travel and accounting expenses for failure to substantiate	Yes	IRS
<i>Adeyemo v. Comm'r</i> , T.C. Memo. 2014-1	Deduction denied for business expenses for failure to substantiate	Yes	IRS
<i>Aivatzidis v. Comm'r</i> , T.C. Summ. Op. 2013-105	Deduction denied for employee expenses and repair and maintenance expenses for failure to substantiate; deduction denied for real estate expenses because expenses were personal	Yes	IRS
<i>Alexander v. Comm'r</i> , T.C. Memo. 2013-203	Deduction denied for grain farming expenses for failure to substantiate	No	IRS
<i>Ash Grove Cement Co. v. U.S.</i> , 562 F. App'x 697 (10th Cir. 2014), aff'g 111 A.F.T.R.2d (RIA) 767 (D. Kan. 2013)	Deduction denied for corporate acquisition litigation expenses for failure to prove ordinary and necessary in business	No	IRS
<i>Assaderaghi v. Comm'r</i> , T.C. Memo. 2014-33	Deduction denied for stock trading losses for failure to establish activity qualified as a trade or business within § 162(a)	No	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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TABLE 2: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	Pro Se	Decision
<i>Austin Otology Assocs. v. Comm'r</i> , T.C. Memo. 2013-293	Deduction denied for vacation home; deduction denied for hunting and home security because expenses were personal; deduction denied for vehicle GPS for failure to prove business purpose; deduction allowed for depreciation to the extent vehicle was used in business; deduction denied for other business expenses for failure to substantiate	No	Split
<i>Azimzadeh v. Comm'r</i> , T.C. Memo. 2013-169	Deduction for business expenses allowed to the extent substantiated; deduction denied for travel for failure to meet § 274 substantiation requirements	Yes	Split
<i>Bagley v. U.S.</i> , 963 F. Supp. 2d 982 (C.D. Cal 2013)	Deduction allowed for litigation expenses because TP was a subject matter expert witness and the expenses were ordinary and necessary to a trade or business	No	TP
<i>Bigdeli v. Comm'r</i> , T.C. Memo. 2013-148	Deduction denied for vehicle and travel expenses because expenses were personal; deduction denied for meals and entertainment and insurance for failure to substantiate	Yes	IRS
<i>Bowerman v. Comm'r</i> , T.C. Summ. Op. 2014-26	Deduction denied for employee expenses, mortgage interest, and legal expenses for failure to substantiate; deductions allowed for labor and cost of goods to the extent substantiated	Yes	Split
<i>Bristol v. Comm'r</i> , T.C. Memo. 2014-84	Deduction denied for business expenses for failure to maintain records to substantiate	Yes	IRS
<i>Brown v. Comm'r</i> , T.C. Memo. 2013-275	Deduction denied for airplane depreciation since it was not placed in service during the tax year	No	IRS
<i>Broz v. Comm'r</i> , 727 F.3d 621 (6th Cir. 2013), aff'd 137 T.C. 46 (2011)	Deduction denied for business expenses for failure to establish that activity qualified as a trade or business within § 162(a)	No	IRS
<i>Burley v. Comm'r</i> , 113 A.F.T.R.2d (RIA) 984 (6th Cir. 2013), aff'd T.C. Memo. 2011-262	Deduction denied for vehicle expenses for failure to substantiate	No	IRS
<i>Cahill v. Comm'r</i> , T.C. Memo. 2013-220	Deduction denied for business expenses and employee expenses for failure to substantiate; deduction denied for other expenses for failure to meet § 274 substantiation requirements	Yes	IRS
<i>Canatella v. Comm'r</i> , T.C. Memo. 2014-102	Deductions denied for law practice expenses for failure to prove ordinary and necessary in business	Yes	IRS
<i>Cedar Valley Bird Co., LLP v. Comm'r</i> , T.C. Memo. 2013-153	Deduction denied for business expenses for failure to substantiate	Yes	IRS
<i>Chaganti v. Comm'r</i> , T.C. Memo. 2013-285	Deduction denied for per diem expenses since incurred in a prior year; deduction denied for court-ordered fines	Yes	IRS
<i>Chapin v. Comm'r</i> , T.C. Summ. Op. 2014-31	Deduction denied for travel expenses for failure to meet § 274 substantiation requirements	Yes	IRS
<i>Chapman v. Comm'r</i> , T.C. Memo. 2014-82	Deduction allowed for labor costs because proved ordinary and necessary in business	No	TP
<i>Charuka-Justin v. Comm'r</i> , T.C. Summ. Op. 2013-85	Deduction denied for dog breeding expenses because not engaged in for profit under § 183	Yes	IRS
<i>Chen v. Comm'r</i> , T.C. Summ. Op. 2014-6	Deduction denied for real estate expenses because failed to establish that activity qualified as a trade or business within § 162(a)	No	IRS
<i>Chisolm v. Comm'r</i> , T.C. Summ. Op. 2014-45	Deduction denied for business expenses for failure to substantiate	Yes	IRS
<i>Chow, Estate of, v. Comm'r</i> , T.C. Memo. 2014-49	Deduction denied for gambling expenses because not engage in for profit under § 183	Yes	IRS

Case Citation	Issue(s)	Pro Se	Decision
<i>Cohen v. Comm'r</i> , T.C. Summ. Op. 2013-44	Deduction denied for business expenses for failure to substantiate; deduction denied for meals and entertainment, travel, vehicle, and phone for failure to meet § 274 substantiation requirements; deduction denied for home office for failure to show non personal exclusive business use	Yes	IRS
<i>Craig v. Comm'r</i> , T.C. Summ. Op. 2013-58	Deduction denied for horse activity because not engaged in for profit under § 183	Yes	IRS
<i>Curtis v. Comm'r</i> , T.C. Memo. 2014-19	Deduction denied for real estate rental losses because failed to establish activity qualified as a trade or business within § 162(a)	Yes	IRS
<i>Daniels v. Comm'r</i> , T.C. Summ. Op. 2014-16	Deduction denied for vehicle expenses for failure to meet § 274 substantiation requirements	Yes	IRS
<i>Daoud v. Comm'r</i> , 548 F. App'x 441 (9th Cir. 2013), aff'g T.C. Memo. 2010-282	Deduction denied for travel and entertainment for failure to meet § 274 substantiation requirements	Yes	IRS
<i>Dargie v. U.S.</i> , 742 F.3d 243 (6th Cir. 2014), aff'g 113 A.F.T.R.2d (RIA) 817 (W.D. Tenn. 2013)	Deduction denied for repayment of student loans because expense was personal	No	IRS
<i>Douglas v. Comm'r</i> , T.C. Summ. Op. 2014-7	Deduction for travel and business expenses allowed to the extent substantiated; deduction denied for employee training expenses for failure to show required for employment; deduction denied for employee travel and union dues for failure to substantiate	Yes	Split
<i>Dunford v. Comm'r</i> , T.C. Memo. 2013-189	Deduction denied for motor home because expense was personal; deduction denied for home office for failure to show exclusive use; deduction denied for vehicle, travel, and meals for failure to meet § 274 substantiation requirements; deduction denied for depreciation, insurance, license, professional fees, and utilities expenses for failure to substantiate; deduction for other expenses allowed to the extent substantiated	No	Split
<i>Dupre v. Comm'r</i> , T.C. Memo. 2013-287	Deduction denied for home office for failure to show non personal exclusive business use; deduction denied for employee expenses and Schedule C flute making expenses for failure to maintain records to substantiate, insufficient evidence to invoke Cohan rule	Yes	IRS
<i>Edem v. Comm'r</i> , T.C. Memo. 2013-238	Deduction denied for business expenses for failure to substantiate	No	IRS
<i>Edwards v. Comm'r</i> , T.C. Memo. 2014-57	Deduction denied for travel for failure to meet § 274 substantiation requirements; deduction denied for labor and business expenses for failure to substantiate	Yes	IRS
<i>Elick v. Comm'r</i> , T.C. Memo. 2013-139, appeal docketed, No. 13-73837 (9th Cir. Oct. 31, 2013)	Deduction denied for management fees for failure to prove ordinary and necessary in business	No	IRS
<i>Flake v. Comm'r</i> , T.C. Memo. 2014-76	Deduction denied for vehicle expenses for failure to substantiate	Yes	IRS
<i>Fontayne v. Comm'r</i> , T.C. Summ. Op. 2013-54	Deduction denied for home office for failure to show required for employment; however, deduction for home office while TP was employed as an independent contractor was allowed to the extent substantiated; deduction denied for phone because expense was personal; deduction denied for repairs because expenditure was capital expense; deduction denied for maintenance for failure to substantiate	Yes	Split
<i>Geyer v. Comm'r</i> , T.C. Summ. Op. 2013-90	Deduction denied for business expenses because not engaged in for profit under § 183	No	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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Case Citation	Issue(s)	Pro Se	Decision
<i>Gorokhovsky v. Comm'r</i> , 549 F. App'x 527 (7th Cir. 2013), aff'd T.C. Memo. 2012-206	Deduction denied for business expenses for failure to substantiate	Yes	IRS
<i>Graffia v. Comm'r</i> , T.C. Memo. 2013-211, aff'd, No. 13-3757 (7th Cir. Oct. 17, 2014)	Deduction denied for royalty payments, credit card expenditures, and other business expenses for failure to substantiate	Yes	IRS
<i>Gullion v. Comm'r</i> , T.C. Summ. Op. 2013-65	Deduction for music business expenses allowed to the extent substantiated; deduction denied for commuting and violin expenses because expenses were personal	Yes	Split
<i>Hall v. Comm'r</i> , T.C. Memo. 2014-16	Deduction denied for travel and business expenses for failure to substantiate	Yes	IRS
<i>Hardnett v. Comm'r</i> , T.C. Summ. Op. 2013-56	Deduction for professional fees allowed to the extent substantiated; deduction denied for vehicle expenses for failure to meet § 274 substantiation requirements	Yes	Split
<i>Hart, U.S. v.</i> , 111 A.F.T.R.2d (RIA) 2235 (D. Idaho 2013)	Deduction denied for business expenses for failure to substantiate; deduction denied for travel for failure to meet § 274 substantiation requirements; deduction denied for book writing expenses for failure to demonstrate carrying on a business for profit under § 183; deduction denied for home office deduction for failure to show exclusive use	No	IRS
<i>Haskett v. Comm'r</i> , T.C. Summ. Op. 2013-76	Deduction for some vehicle and travel expenses allowed to the extent substantiated; deduction denied for other vehicle expenses because expenses were personal and for failure to meet § 274 substantiation requirements; deduction denied for continuing education for failure to substantiate	Yes	Split
<i>Hoelscher v. Comm'r</i> , T.C. Memo. 2013-236	Deduction denied for ranching activities because not engaged in for profit under § 183	No	IRS
<i>Hom v. Comm'r</i> , T.C. Memo. 2013-163, appeal docketed, No. 13-74335 (9th Cir. Dec. 17, 2013)	Deduction denied for transportation and lodging expenses for failure to meet § 274 substantiation requirements; deduction for tournament entry fees allowed to the extent substantiated; deduction denied for gambling losses because they were wagering losses under § 165(d); deduction denied for other business expenses for failure to substantiate	Yes	Split
<i>Houchin v. Comm'r</i> , T.C. Summ. Op. 2014-29	Deduction denied for travel for failure to meet § 274 substantiation requirements	Yes	IRS
<i>Humboldt Shelby Holding Corp. v. Comm'r</i> , T.C. Memo. 2014-47, appeal docketed, No. 14-3428 (2d Cir. Sept. 12, 2014)	Deduction denied for legal expenses because transaction did not have economic substance; deduction denied for consulting expense because it was capital loss	No	IRS
<i>Iheke v. Comm'r</i> , T.C. Summ. Op. 2013-75	Deduction denied for business expenses because paid in prior year	Yes	IRS
<i>In re Walmsley</i> , 112 A.F.T.R.2d (RIA) 6238 (Bankr. D. Or. 2013)	Deduction denied for business expenses for failure to substantiate	No	IRS
<i>J &amp; M Futon Covers Corp. v. Comm'r</i> , 523 F. App'x 54 (2d Cir. 2013), aff'd T.C. Docket No. 009373-11 (Aug. 13, 2012)	Deduction denied for commuting because expense was personal	No	IRS
<i>John Hancock Life Ins. Co. v. Comm'r</i> , 141 T.C. 1 (2013)	Deduction denied for depreciation and interest deductions because transactions lacked economic substance	No	IRS
<i>Jordan v. Comm'r</i> , T.C. Summ. Op. 2013-91	Deduction denied for repair expenses for failure to prove ordinary and necessary in business	No	IRS
<i>Karch v. Comm'r</i> , T.C. Memo. 2013-237, appeal docketed, No. 14-3179 (3d Cir. July 3, 2014)	Deduction for wage, mortgage, and contract service expenses allowed to the extent substantiated; deduction denied for other business expenses for failure to substantiate	Yes	Split
<i>Kornhauser v. Comm'r</i> , T.C. Memo. 2013-230, appeal docketed, No. 13-73850 (9th Cir. Nov. 1, 2013)	Deduction denied for business expenses for failure to substantiate	Yes	IRS

Case Citation	Issue(s)	Pro Se	Decision
<i>Krohn v. Comm'r</i> , T.C. Summ. Op. 2014-12	Deduction denied for meal, travel, and vehicle expenses for failure to meet § 274 substantiation requirements; deduction denied for veterinary expense because expense was personal; deduction for other business expenses allowed to extents substantiated	Yes	Split
<i>Lakhani v. Comm'r</i> , 142 T.C. No. 8 (2014), appeal docketed, No. 14-72577 (9th Cir. Aug. 21, 2014)	Deduction denied for gambling losses because the “takeout” is not an expense of the bettor; § 165(d) does not violate the Equal Protection Clause	Yes	IRS
<i>Lamb v. Comm'r</i> , T.C. Memo. 2013-155	Deduction denied for business expenses for failure to establish activity qualified as a trade or business within § 162(a); deduction denied for business expenses for failure to substantiate	No	IRS
<i>Limberea, Estate of, v. Comm'r</i> , T.C. Summ. Op. 2013-50	Deduction denied for business expenses for failure to substantiate	Yes	IRS
<i>Linzy v. Comm'r</i> , T.C. Memo. 2013-219	Deduction denied for travel because expense was personal; deduction denied for meals and entertainment for failure to prove business purpose; deduction denied for rent for failure to show exclusive use; deduction denied for gambling losses for failure to substantiate	Yes	IRS
<i>Maguire v. Comm'r</i> , T.C. Summ. Op. 2013-53	Deduction denied for vehicle expenses for failure to prove business purpose and failure to substantiate; deduction denied for meals and entertainment for failure to meet § 274 substantiation requirements; deduction denied for office expenses for failure to substantiate	Yes	IRS
<i>Mathis v. Comm'r</i> , T.C. Memo. 2013-294	Deduction denied for horse breeding expenses because not engaged in for profit under § 183	No	IRS
<i>McLauchlan v. Comm'r</i> , 558 F. App'x 374 (5th Cir. 2014), aff'g T.C. Memo. 2011-289	Deduction denied for partnership expenses because expenditures were not required; deduction denied for unreimbursed partnership expenses for failure to disprove eligibility for employer reimbursement; deduction denied for vehicle for failure to meet § 274 substantiation requirements	No	IRS
<i>Mikhail v. Comm'r</i> , T.C. Summ. Op. 2014-40	Deduction denied for Amway business expenses because not engaged in for profit under § 183	Yes	IRS
<i>Nelson v. Comm'r</i> , T.C. Memo. 2013-259	Deduction denied for stock trading expenses for failure to establish activity qualified as a trade or business within § 162(a)	No	IRS
<i>Nielsen v. Comm'r</i> , T.C. Memo. 2013-144	Deduction denied for business expenses for failure to prove ordinary and necessary in business	Yes	IRS
<i>Ofoegbu v. Comm'r</i> , T.C. Summ. Op. 2013-79	Deduction denied for rent expenses because one expenditure was paid in subsequent year, and two other expenditures denied for failure to substantiate	No	IRS
<i>Oros v. Comm'r</i> , 551 F. App'x 340 (9th Cir. 2013), aff'g T.C. Memo. 2012-4	Deduction denied for living expenses for failure to establish that activity qualified as a trade or business within § 162(a)	Yes	IRS
<i>Peterson v. Comm'r</i> , T.C. Memo. 2013-271	TPs' (H&W) partnership denied deduction for contributions to wife's retirement plan because their partnership entity was disregarded for Federal income tax purposes and found not to be engaged in a trade or business under § 162; however, the same deduction was allowed to the TP(W) individually on her Schedule C	No	Split
<i>Phillips v. Comm'r</i> , T.C. Memo. 2013-215	Deduction denied for bowling expenses because not engaged in for profit under § 183	Yes	IRS
<i>Phillips v. Comm'r</i> , T.C. Memo. 2013-250	Deduction denied for business expenses for failure to substantiate	Yes	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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Case Citation	Issue(s)	Pro Se	Decision
<i>Rasmussen v. Comm'r</i> , 562 F. App'x 544 (8th Cir. 2014), aff'g T.C. Memo. 2012-353	Deduction denied for business expenses	Yes	IRS
<i>Rayhill v. Comm'r</i> , T.C. Memo. 2013-181	Deduction denied for business expenses for failure to prove ordinary and necessary in business	Yes	IRS
<i>Rent-A-Center, Inc. v. Comm'r</i> , 142 T.C. No. 1 (2014)	Deduction allowed for insurance expenses because the corporation's relationship with its subsidiary constituted an insurance agreement	No	TP
<i>Roberts v. Comm'r</i> , T.C. Memo. 2014-74	Deduction denied for horse racing expenses in first two years because not engaged in for profit under § 183; deduction permitted in subsequent two years because engaged in for profit under § 183	No	Split
<i>Rodriguez v. Comm'r</i> , 111 A.F.T.R.2d (RIA) 2222 (S.D. Texas 2013)	Deduction denied for business expenses for failure to substantiate	Yes	IRS
<i>Rodriguez v. Comm'r</i> , T.C. Memo. 2013-221	Deduction denied for horse breeding expenses because not engaged in for profit under § 183	No	IRS
<i>Safakish v. Comm'r</i> , T.C. Summ. Op. 2013-107	Deduction denied for legal, travel, and vehicle expenses for failure to prove business purpose; deduction allowed for rent expense to the extent substantiated	Yes	Split
<i>Santiago v. Comm'r</i> , T.C. Summ. Op. 2013-45	Deduction denied for home office for failure to show non personal exclusive business use; deduction for vehicle expenses allowed to the extent substantiated; deduction denied for other business expenses for failure to substantiate	Yes	Split
<i>Schlievert v. Comm'r</i> , T.C. Memo. 2013-239	Deduction denied for music recording expenses because not engaged in for profit under § 183	Yes	IRS
<i>Shaw v. Comm'r</i> , T.C. Summ. Op. 2014-37	Deduction allowed under Cohan rule for interest expenses; deductions denied for repairs and maintenance, janitor and waste, and banking charges for failure to substantiate; deduction for legal services, supplies and office expenses allowed to extent substantiated; deduction denied for charitable contributions for failure to prove ordinary and necessary in business; deduction denied for business use of personal residence for failure to prove principal place of business	Yes	Split
<i>Stanback v. Comm'r</i> , T.C. Summ. Op. 2014-49	Deduction denied for living expenses for failure to substantiate and failure to prove non personal business purpose; insufficient evidence to use Cohan rule; deduction for travel expenses denied for failure to meet § 274 substantiation requirement	Yes	IRS
<i>Stephens v. Comm'r</i> , 565 F. App'x 795 (11th Cir. 2014), aff'g T.C. Memo. 2013-47	Deduction denied for business expenses for failure to substantiate	Yes	IRS
<i>Suriel v. Comm'r</i> , 141 T.C. No. 16 (2013), appeal docketed, No. 14-11533 (11th Cir. Apr. 8, 2014)	Deduction for MSA payments allowed to extent they were paid in the tax year they were claimed; deduction denied for interest payments because not paid in year claimed	No	Split
<i>Thunstedt v. Comm'r</i> , T.C. Memo. 2013-280	Deduction denied for per diem and credit card expenses for failure to substantiate; deduction denied for home office for failure to show non personal exclusive business use	Yes	IRS
<i>Tocher v. Comm'r</i> , T.C. Summ. Op. 2014-34	Deduction denied for vehicle expenses for failure to meet § 274 substantiation requirements	Yes	IRS
<i>UnionBanCal &amp; Subsidiaries v. U.S.</i> , 113 Fed. Cl. 117 (Fed. Cl. 2013)	Deduction denied for rent expense because transaction did not have economic substance	No	IRS
<i>Van Velzor v. Comm'r</i> , T.C. Memo. 2014-71	Deduction denied for labor expenses for failure to substantiate	No	IRS
<i>Zavadil v. Comm'r</i> , T.C. Memo. 2013-222, appeal docketed, No. 14-1053 (8th Cir. Jan. 9, 2014)	Deduction denied for employee compensation payments because expense was not incurred to promote business; deduction denied for consulting expenses for failure to substantiate	No	IRS

**TABLE 3 Summons Enforcement Under IRC §§ 7602, 7604, and 7609**

Case Citation	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>			
<i>Abusch v. U.S.</i> , 112 A.F.T.R.2d (RIA) 7089 (E.D. La. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 7088 (E.D. La. 2013)	TPs' motion to quash third-party summons dismissed; lacked subject matter jurisdiction	Yes	IRS
<i>Abusch, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5031 (E.D. La. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 5029 (E.D. La. 2013)	Powell requirements satisfied; enforcement of summons ordered; TP presented no facts	No	IRS
<i>Abusch v. U.S.</i> , 113 A.F.T.R.2d (RIA) 2027 (E.D. La. 2014), <i>adopting</i> 2014 U.S. Dist. LEXIS 63745 (E.D. La. 2014)	TPs' motion to quash third-party summons dismissed; lacked subject matter jurisdiction	Yes	IRS
<i>Ali, U.S. v.</i> , 2014 WL 1660280 (D. Md. 2014)	TP's documents within the required records doctrine must be given to the IRS; further proceedings for other documents requested by summons	No	IRS
<i>Barnett, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5363 (W.D. Tenn. 2013)	Powell requirements satisfied; show cause hearing will proceed	Yes	IRS
<i>Beakley v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1848 (N.D. Tex. 2014), <i>adopting</i> 113 A.F.T.R.2d (RIA) 1846 (N.D. Tex. 2014)	TP's motion to quash third-party summons dismissed; lacked subject matter jurisdiction	No	IRS
<i>Bone v. U.S.</i> , 2013 U.S. Dist. LEXIS 127631 (D. Idaho 2013), <i>adopting</i> 2013 U.S. Dist. LEXIS 127748 (D. Idaho 2013)	Powell requirements satisfied; TP's motion to quash third-party summonses denied	Yes	IRS
<i>Bruce, U.S. v.</i> , 2013 U.S. Dist. LEXIS 180177 (W.D. Mo. 2013), <i>adopting</i> 2013 U.S. Dist. LEXIS 180177 (W.D. Mo. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Canul, U.S. v.</i> , 2014 WL 46771 (N.D. Cal. 2014)	TP found in contempt	Yes	IRS
<i>Cephas v. U.S.</i> , 112 A.F.T.R.2d (RIA) 6483 (D. Md. 2013)	Powell requirements satisfied; TP's motion to quash third-party summons denied	Yes	IRS
<i>Charles v. U.S.</i> , 112 A.F.T.R.2d (RIA) 6656 (W.D. Mich. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 6652 (W.D. Mich. 2013)	Powell requirements satisfied; TP's motion to quash third-party summons denied	No	IRS
<i>Charles v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1793 (E.D. Mich. 2014)	Powell requirements satisfied; TP's motion to quash third-party summons denied; TP's bad faith argument rejected	No	IRS
<i>Chen, U.S. v.</i> , 952 F. Supp. 2d 321 (D. Mass. 2013), <i>appeal docketed</i> , No. 14-2003 (1st Cir. Sept. 30, 2014)	Powell requirements satisfied; TP's motion to quash summons denied; Internal Revenue Agents have authority to issue and serve summonses	No	IRS
<i>Ciccone, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1019 (C.D. Cal. 2014)	Enforcement of summons ordered	Yes	IRS
<i>Curcio v. Comm'r</i> , 113 A.F.T.R.2d (RIA) 790 (D. Conn. 2014), <i>adopting</i> 113 A.F.T.R.2d (RIA) 789 (D. Conn. 2013)	TP's motion to quash third-party summons dismissed; lacked subject matter jurisdiction	No	IRS
<i>Dissinger v. U.S.</i> , 543 F. App'x 620 (9th Cir. 2013)	TPs' motion to quash third-party summons dismissed for improper service	Yes	IRS
<i>Does, In re</i> , 112 A.F.T.R.2d (RIA) 5466 (N.D. Pa. 2013)	IRS can issue summonses	Yes	IRS
<i>Fisher v. U.S.</i> , 112 A.F.T.R.2d (RIA) 6971 (E.D. Wis. 2013)	TP's motion to quash third-party summons dismissed; lacked subject matter jurisdiction	Yes	IRS
<i>Fisher v. U.S.</i> , 112 A.F.T.R.2d (RIA) 6982 (W.D. Tex. 2013)	TP's motion to quash third-party summons denied; lacked subject matter jurisdiction	Yes	IRS
<i>Fisher v. U.S.</i> , 112 A.F.T.R.2d (RIA) 7011 (E.D. Va. 2013)	Powell requirements satisfied; TP's motion to quash third-party summons dismissed	Yes	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	Pro Se	Decision
<i>Fisher v. U.S.</i> , 112 A.F.T.R.2d (RIA) 7337 (D. Ariz. 2013)	TPs' motion to quash third-party summons dismissed; lacked subject matter jurisdiction	Yes	IRS
<i>Fisher v. U.S.</i> , 113 A.F.T.R.2d (RIA) 848 (W.D. Wis. 2014)	TPs' motions to quash third-party summons dismissed; lacked subject matter jurisdiction	Yes	IRS
<i>Fisher v. U.S.</i> , 2013 U.S. Dist. LEXIS 160841 (D. Minn. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 6854 (D. Minn. 2013)	TPs' motion to quash third-party summons dismissed; lacked subject matter jurisdiction	Yes	IRS
<i>Flaherty, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5904 (M.D. Fla. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 5903 (M.D. Fla. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Gamboa, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 2194 (E.D. Cal. 2014)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Hall, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1069 (N.D. Cal. 2013)	Enforcement of summons ordered	Yes	IRS
<i>Hapgood, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5287 (D.N.H. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 5286 (D.N.H. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Hernandez, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 444 (M.D. Fla. 2014), <i>adopting</i> 113 A.F.T.R.2d (RIA) 442 (M.D. Fla. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Hunkler v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1788 (S.D. Oh. 2014)	Powell requirements satisfied; TP's motion to quash third-party summons denied	Yes	IRS
<i>Ide, IRS v.</i> , 111 A.F.T.R.2d (RIA) 2384, (D. Mont. 2013), <i>adopting</i> 111 A.F.T.R.2d (RIA) 1764 (D. Mont. 2013)	TP's motion to quash third-party summons dismissed	Yes	IRS
<i>Isaacs v. U.S.</i> , 112 A.F.T.R.2d (RIA) 5570 (N.D. Cal. 2013)	TP's motion to quash third-party summons dismissed; lacked subject matter jurisdiction	Yes	IRS
<i>Jewell v. U.S.</i> , 749 F.3d 1295 (10th Cir. 2014), <i>rev'g</i> 111 A.F.T.R.2d (RIA) 1005 (W.D. Okla. 2013), <i>aff'g</i> 111 A.F.T.R.2d (RIA) 1129 (E.D. Okla. 2013)	Powell requirements not satisfied; TP's motion to quash third-party summons granted	No	TP
<i>John Does, In re Tax Liabilities of</i> , 112 A.F.T.R.2d (RIA) 5982 (N.D. Ca. 2013)	IRS can issue summonses	Yes	IRS
<i>Kalra v. U.S.</i> , 113 A.F.T.R.2d (RIA) 692 (N.D. Ill. 2014)	Powell requirements satisfied; TP's motion to quash third-party summons denied	No	IRS
<i>Kamp v. U.S.</i> , 112 A.F.T.R.2d (RIA) 6630 (E.D. Cal. 2013)	Powell requirements satisfied; TP's motion to quash third-party summons denied; TP failed to state a claim	Yes	IRS
<i>Kessler, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7196 (S.D. Fla. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Kinney, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7296 (E.D. La. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 7295 (E.D. La. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Knudsen v. U.S.</i> , 112 A.F.T.R.2d (RIA) 6397 (D. Ariz. 2013)	TP's motion to quash third-party summons dismissed; TP does not have standing	Yes	IRS
<i>Lawrence, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1933 (S.D. Fla. 2014)	Enforcement of summons ordered for some documents; 5th Amendment protected the TP from producing other documents	No	Split
<i>Lehtinen, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1074 (S.D. Fla. 2014)	Enforcement of summons ordered	No	IRS
<i>Lenderman, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 739 (S.D. Cal. 2014)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS

Most Serious Problems	Legislative Recommendations	Most Litigated Issues	Case Advocacy	Appendices
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TABLE 3: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	Pro Se	Decision
<i>Lund, U.S. v.</i> , 550 F. App'x 469 (9th Cir. 2013), <i>aff'g</i> 109 A.F.T.R.2d (RIA) 913 (D. Or. 2012)	Powell requirements satisfied; TP's motion to quash summons denied; Internal Revenue Agents have authority to issue and serve summonses; TP's 5th Amendment argument had no merit	Yes	IRS
<i>Madanian v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1358 (D. Mass. 2014)	TP's motion to quash third-party summons denied; lacked subject matter jurisdiction	No	IRS
<i>Mahrle, U.S. v.</i> , 2013 U.S. Dist. LEXIS 184711 (W.D. Wis. 2013)	Enforcement of summons ordered	Yes	IRS
<i>Mann, U.S. v.</i> , 2013 U.S. Dist. LEXIS 182150 (D. Mass. 2013), <i>adopting</i> 2013 U.S. Dist. LEXIS 182076 (D. Mass. 2013)	Enforcement of summons ordered	Yes	IRS
<i>Marafiole, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 440 (M.D. Fla. 2014), <i>adopting</i> 113 A.F.T.R.2d (RIA) 439 (M.D. Fla. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Masciantonio v. U.S.</i> , 528 F. App'x 120 (3d Cir. 2013), <i>cert. denied</i> , No. 14-43 (Oct. 9, 2014), <i>aff'g</i> 111 A.F.T.R.2d (RIA) 2322 (W.D. Pa. 2013), <i>adopting</i> 111 A.F.T.R.2d (RIA) 2321 (W.D. Pa. 2013)	Powell requirements satisfied; TP's motion to quash third-party summons denied; enforcement of summons ordered	Yes	IRS
<i>McClintic, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 330 (D. Or. 2013)	Enforcement of summons ordered for some documents; 5th Amendment protected TP from answering questions and producing documents pertaining to his income since such was potentially self-incriminating	No	IRS
<i>McCreary, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 2099 (S.D. Cal. 2014)	Enforcement of summons ordered for some questions posed by IRS interview; 5th Amendment protected TP from answering other questions the court deemed potentially self-incriminating	Yes	IRS
<i>Miranda, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7043 (S.D. Cal. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Mockler, U.S. v.</i> , 2014 U.S. Dist. LEXIS 74911 (E.D. Tex. 2014), <i>adopting</i> 2014 U.S. Dist. LEXIS 75419 (E.D. Tex. 2014)	Enforcement of summons ordered	Yes	IRS
<i>Murphy, U.S. v.</i> , 2013 WL 3205695 (S.D. Cal. 2013)	Information obtained from summons was suppressed	No	TP
<i>Nevius v. Tomlinson</i> , 113 A.F.T.R.2d (RIA) 1872 (W.D. Mo. 2014)	Powell requirements satisfied; TP's motion to quash summons denied; TP failed to state a claim	Yes	IRS
<i>Pattah, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7236 (S.D. Cal. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Plagge, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 831 (D.N.M. 2013)	TP's motion to quash summons denied; TP found in contempt	Yes	IRS
<i>Pontius v. IRS</i> , 113 A.F.T.R.2d (RIA) 1869 (E.D. Cal. 2014), <i>adopting</i> 113 A.F.T.R.2d (RIA) 996 (E.D. Cal. 2014)	Powell requirements satisfied; TP's motion to quash summons denied; Internal Revenue Agents have authority to issue and serve summonses	Yes	IRS
<i>Powers, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 2032 (S.D. Ill. 2014), <i>adopting</i> 113 A.F.T.R.2d (RIA) 2029 (S.D. Ill. 2014)	Powell requirements satisfied; enforcement of summons ordered; TP presented no facts	Yes	IRS
<i>Rice, U.S. v.</i> , 522 F. App'x 540 (11th Cir. 2013), <i>aff'g</i> 111 A.F.T.R.2d (RIA) 2351 (N.D. Ga. 2012)	Powell requirements satisfied; enforcement of summons ordered	No	IRS
<i>Russell, U.S. v.</i> , 2013 U.S. Dist. LEXIS 83394 (M.D.N.C. 2013), <i>adopting</i> 111 A.F.T.R.2d (RIA) 2122 (M.D.N.C. 2013)	Enforcement of summons ordered	Yes	IRS
<i>Ryder v. U.S.</i> , 113 A.F.T.R.2d (RIA) 706 (C.D. Cal. 2014)	Powell requirements satisfied; TP's motion to quash summons denied; enforcement of summons ordered	No	IRS

Case Citation	Issue(s)	Pro Se	Decision
<i>Sanders, U.S. v., 112 A.F.T.R.2d (RIA) 6454 (S.D. Ill. 2013), adopting 111 A.F.T.R.2d (RIA) 6450 (S. Ill. 2013)</i>	Powell requirements satisfied; enforcement of summons ordered; TP found in contempt	No	IRS
<i>Scugoza, U.S. v., 112 A.F.T.R.2d (RIA) 7269 (S.D. Oh. 2013)</i>	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Sellman v. U.S., 112 A.F.T.R.2d (RIA) 7183 (S.D. Ind. 2013), rev'g 111 A.F.T.R.2d (RIA) 408 (S.D. Ind. 2012)</i>	Powell requirements satisfied; TP's motion to quash third-party summons denied	Yes	IRS
<i>Sharp, U.S. v., 112 A.F.T.R.2d (RIA) 6122 (D. Ariz. 2013)</i>	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Skaug, U.S. v., 2014 U.S. Dist. LEXIS 9750 (D. Minn. 2014), adopting 2014 U.S. Dist. LEXIS 10361 (D. Minn. 2014)</i>	Powell requirements satisfied; order to enforce summons entered except for years TP has complied with summons	Yes	IRS
<i>Smith v. U.S., 111 A.F.T.R.2d (RIA) 2210 (E.D. Mich. 2013), adopting 111 A.F.T.R.2d (RIA) 2207 (E.D. Mich. 2013)</i>	TP's motion to quash third-party summons denied; lacked subject matter jurisdiction	Yes	IRS
<i>Soong, U.S. v., 113 A.F.T.R.2d (RIA) 1589 (N.D. Cal. 2014), appeal docketed, No. 14-15987 (9th Cir. May 20, 2014)</i>	Powell requirements satisfied; TPs' motion to quash summons denied; service was proper	No	IRS
<i>Tagle, U.S. v., 113 A.F.T.R.2d (RIA) 1818 (N.D. Cal. 2014)</i>	TPs' motion to quash summons denied; 5th Amendment protected TPs from information sought by oral testimony; enforcement of summons ordered for the production of documents	No	Split
<i>Thornton, U.S. v., 113 A.F.T.R.2d (RIA) 1403 (S.D. Ga. 2014), adopting 113 A.F.T.R.2d (RIA) 1402 (S.D. Ga. 2014)</i>	Enforcement of summons ordered	Yes	IRS
<i>Tillman v. U.S., 113 A.F.T.R.2d (RIA) 1723 (D. Md. 2014)</i>	Powell requirements satisfied; TP's motion to quash third-party summons denied	No	IRS
<i>Trowbridge v. IRS, 113 A.F.T.R.2d (RIA) 6891 (S.D. Tex. 2013)</i>	TP's challenge was prevented by statute	Yes	IRS
<i>Vanderpool, U.S. v., 2013 Dist. LEXIS 179665 (W.D. Mo. 2013), adopting 2013 U.S. Dist. LEXIS 180175 (W.D. Mo. 2013)</i>	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Varrasso v. U.S., 112 A.F.T.R.2d (RIA) 7202 (S.D. Cal. 2013)</i>	Powell factors satisfied; TP's motion to quash third-party summons dismissed; TP presented no facts	No	IRS
<i>Waller v. U.S., 113 A.F.T.R.2d (RIA) 691 (C.D. Cal. 2014)</i>	TP's motion to quash third-party summons dismissed	Yes	IRS
<i>Ware, U.S. v., 112 A.F.T.R.2d (RIA) 5255 (M.D. La. 2013), adopting 112 A.F.T.R.2d (RIA) 5255 (M.D. La. 2013)</i>	Enforcement of summons ordered	Yes	IRS
<i>Whittington v. U.S., 112 A.F.T.R.2d (RIA) 5171 (W.D. Wash. 2013)</i>	TP's motion to quash third-party summons dismissed	Yes	IRS
<i>Woods, U.S. v., 112 A.F.T.R.2d (RIA) 5276 (D.N.H. 2013), adopting 112 A.F.T.R.2d (RIA) 5725 (D.N.H. 2013)</i>	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Worsham v. Dep't. of Treasury, 112 A.F.T.R.2d (RIA) 6315 (D. Md. 2013)</i>	Powell requirements satisfied; TP's motion to quash third-party summons denied	Yes	IRS
<i>Zelen v. U.S., 113 A.F.T.R.2d (RIA) 1205 (C.D. Cal. 2014), appeal docketed, No. 14-55657 (9th Cir. April 23, 2014)</i>	Powell requirements satisfied; TP's motion to quash third-party summons denied	Yes	IRS

Most Serious Problems	Legislative Recommendations	Most Litigated Issues	Case Advocacy	Appendices
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Case Citation	Issue(s)	Pro Se	Decision
<b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedule C, E, F)</b>			
<i>Action Recycling Inc. v. U.S.</i> , 721 F.3d 1142 (9th Cir. 2013), <i>aff’g</i> 109 A.F.T.R.2d (RIA) 1311 (E.D. Wash. 2012)	Powell requirements satisfied, TP’s motion to quash summons denied	No	IRS
<i>Azis v. IRS</i> , 522 F. App’x 770 (11th Cir. 2013), <i>aff’g</i> 109 A.F.T.R.2d (RIA) 2535 (S.D. Fla. 2013), <i>adopting</i> 109 A.F.T.R.2d (RIA) 2530 (S.D. Fla. 2012)	Powell requirements satisfied; TP’s motion to quash third-party summons denied; TP was not prejudiced by minor error	Yes	IRS
<i>Barrera, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 6440 (E.D. Cal. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 6248 (E.D. Cal. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Bouchard, U.S. v.</i> , 2013 WL 2631862, (D.N.H. 2013), <i>adopting</i> 2013 WL 4522268 (D.N.H. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Esgar, Estate of, v.</i> , U.S., 113 A.F.T.R.2d (RIA) 607 (D. Colo. 2014)	Powell requirements satisfied; enforcement of third-party summons ordered	No	IRS
<i>Gangi v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1175 (D. Mass. 2014)	Powell requirements satisfied; TP’s motion to quash third-party summons denied	No	IRS
<i>Gendreau, U.S. v.</i> , 2014 WL 464754 (S.D.N.Y. 2014)	Enforcement of summons ordered	No	IRS
<i>Kommesar v. U.S.</i> , 112 A.F.T.R.2d (RIA) 5975 (N.D. Ill. 2013)	Powell requirements satisfied; TP’s motion to quash summons denied	Yes	IRS
<i>Lund v. U.S.</i> , 113 A.F.T.R.2d (RIA) 379 (D. Or. 2013)	Powell requirements satisfied; TP’s motion to quash summons denied	Yes	IRS
<i>Lynn v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1977, <i>adopting</i> 113 A.F.T.R.2d (RIA) 1972 (S.D. Ind. 2014)	TP’s motions to quash third-party summonses dismissed; lacked subject matter jurisdiction	No	IRS
<i>Mahmood v. U.S.</i> , 112 A.F.T.R.2d (RIA) 7338 (S.D. Cal. 2013)	Powell requirements satisfied; TP’s motion to quash third-party summonses denied; Internal Revenue Agents have the power to issue and serve summonses	Yes	IRS
<i>Mar. Bldg. Operating, Co., LLC v. U.S.</i> , 112 A.F.T.R.2d (RIA) 6589 (E.D. La. 2013)	Powell requirements satisfied; TP’s motion to quash summons denied	No	IRS
<i>Ottovich, U.S. v.</i> , 2013 WL 6486919 (N.D. Cal. 2013)	TP found in contempt; TP’s motion for terminating summons denied	Yes	IRS
<i>Ruggiero v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1160 (S.D. Fla. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Ruggiero v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1161 (S.D. Fla. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Schaeffler v. U.S.</i> , 2014 WL 2208057 (S.D.N.Y. 2014), <i>appeal docketed</i> , No. 14-1965 (2d Cir. June 9, 2014)	TP’s motion to quash third-party summons denied; Tax Practitioner privilege was waived; Work product doctrine does not apply	No	IRS
<i>Schoop v. Comm'r</i> , 112 A.F.T.R.2d (RIA) 6327 (N.D. Cal. 2013), <i>appeal docketed</i> , No. 13-17090 (9th Cir. Oct. 18, 2013)	Powell requirements satisfied; TP’s motion to quash summons dismissed; enforcement of summons ordered; TP provided no facts	No	IRS
<i>Smith v. U.S.</i> , 112 A.F.T.R.2d (RIA) 5679 (D.R.I. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 5677 (D.R.I. 2013)	TP’s motions to quash third-party summonses dismissed; lacked subject matter jurisdiction	No	IRS
<i>Sorenson, U.S. v.</i> , 2014 U.S. Dist. LEXIS 24294 (D. Minn. 2014) <i>adopting</i> 2014 U.S. Dist. LEXIS 25275 (D. Minn. 2014)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
<i>Suk, U.S. v.</i> , 2013 WL 7017693 (N.D. Cal. 2013), <i>adopting</i> 112 A.F.T.R.2d (RIA) 7008 (N.D. Cal. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS

Case Citation	Issue(s)	Pro Se	Decision
<i>Troy, U.S. v.,</i> 112 A.F.T.R.2d (RIA) 5200 (D. Minn. 2013), aff'g 112 A.F.T.R.2d (RIA) 5198 (D. Minn. 2013)	Service was proper; enforcement of summons ordered	No	IRS
<i>Vidurek v. Miller</i> , 113 A.F.T.R.2d (RIA) 1099 (S.D.N.Y. 2014)	IRS third-party summons valid	Yes	IRS
<i>Wells Fargo and Co. v. U.S.</i> , 112 A.F.T.R.2d (RIA) 5380 (D. Minn. 2013)	Powell requirements satisfied; TP's motion to quash summonses denied in part; order to enforce summonses granted in part	No	Split

**TABLE 4 Gross Income Under IRC § 61 and Related Sections**

Case Citation	Issues	Pro Se	Decision
<b>Individual Taxpayers (But not Sole Proprietorships)</b>			
<i>Aldrich v. Comm'r</i> , T.C. Memo. 2013-201	Unreported wage, dividend, capital asset proceeds, unemployment compensation, and retirement income	Yes	IRS
<i>Alexander v. Comm'r</i> , T.C. Summ. Op. 2014-18	Unreported distribution from IRA	No	IRS
<i>Berks v. Comm'r</i> , T.C. Summ. Op. 2014-2	Unreported distributions from IRA	No	IRS
<i>Black v. Comm'r</i> , T.C. Memo. 2014-27	Unreported taxable gain from terminated life insurance contract	Yes	IRS
<i>Blue v. U.S.</i> , 111 Fed. Cl. 812 (2013)	Unreported pension income	Yes	IRS
<i>Bobrow v. Comm'r</i> , T.C. Memo. 2014-21	Unreported distributions from IRAs	Yes	Split
<i>Brach v. Comm'r</i> , T.C. Summ. Op. 2013-96	Unreported taxable gain from terminated life insurance contract	No	IRS
<i>Brogan v. Comm'r</i> , T.C. Summ. Op. 2013-95	Unreported taxable gain from life insurance contract	Yes	IRS
<i>Campion v. Comm'r</i> , T.C. Memo. 2013-146	Unreported income	Yes	IRS
<i>Cheramie v. Comm'r</i> , T.C. Summ. Op. 2013-92	Unreported alimony income	Yes	IRS
<i>Craighead v. Comm'r</i> , T.C. Memo. 2013-246	Unreported wage income, royalty income, annuity distribution, unemployment income, and Social Security income	Yes	Split
<i>Curtis v. Comm'r</i> , T.C. Memo. 2014-19	Unreported involuntary conversion of property income	Yes	IRS
<i>Debough v. Comm'r</i> , 142 T.C. No. 17 (2014), appeal docketed, No. 14-3036 (8th Cir. Aug. 4, 2014)	Unreported long term capital gain income	No	IRS
<i>Duggan v. Comm'r</i> , T.C. Memo. 2014-17, appeal docketed, No. 14-71645 (9th Cir. June 16, 2014)	Unreported retirement income, distribution from IRA, and interest income	Yes	IRS
<i>Ellis v. Comm'r</i> , T.C. Memo. 2013-245, appeal docketed, No. 14-1310 (8th Cir. Feb. 10, 2014)	Unreported distribution from IRA	No	IRS
<i>Eram v. Comm'r</i> , T.C. Memo. 2014-60	TP's tax home was Iraq during relevant period and foreign earned income was excludable	No	TP
<i>Estes v. Comm'r</i> , T.C. Memo. 2014-9, aff'd, 14-1104 (4th Cir. July 7, 2014)	Unreported wage income and non-employee compensation	Yes	IRS
<i>Fall v. Comm'r</i> , T.C. Summ. Op. 2013-89	Unreported 1099 income	Yes	IRS
<i>Furnish v. Comm'r</i> , T.C. Summ. Op. 2013-81	Unreported distribution from life insurance contract	Yes	TP
<i>Gist v. Comm'r</i> , T.C. Summ. Op. 2014-1	Unreported distributions from IRAs	No	IRS
<i>Gluckman v. Comm'r</i> , 545 F. App'x 59 (2d Cir. 2013)	Unreported value of life insurance policies	No	IRS
<i>Green v. Comm'r</i> , T.C. Memo. 2014-23	Settlement proceeds under IRC § 104(a)(2)	Yes	IRS
<i>Gunkle v. Comm'r</i> , 753 F.3d 502 (5th Cir. 2014)	Unreported income	Yes	IRS
<i>Henson v. Comm'r</i> , T.C. Summ. Op. 2014-36	Unreported alimony income and other income	Yes	IRS
<i>Hershberger v. Comm'r</i> , T.C. Memo. 2014-63	Unreported rental income	Yes	IRS
<i>Hoang v. Comm'r</i> , 113 A.F.T.R.2d (RIA) 1982 (11th Cir. 2014), aff'd, No. 13-14398 (11th Cir. May 2, 2014)	Unreported capital gains income, interest income, and other income	Yes	IRS
<i>Kadir v. Comm'r</i> , T.C. Summ. Op. 2014-43	Unreported settlement income	No	TP
<i>Malonzo v. Comm'r</i> , T.C. Summ. Op. 2013-47	Unreported long term capital gains income	Yes	IRS
<i>Molina v. Comm'r</i> , T.C. Memo. 2013-226	Settlement proceeds under IRC § 104(a)(2)	Yes	IRS

TABLE 4: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issues	Pro Se	Decision
<i>Nelson v. Comm'r</i> , 540 F. App'x 924 (11th Cir. 2013)	Unreported wage income	Yes	IRS
<i>Nix v. Comm'r</i> , 553 F. App'x 960 (11th Cir. 2014), aff'd, No. 13-15585 (11th Cir. Oct. 15, 2014)	Unreported wage income	Yes	IRS
<i>Park v. Comm'r</i> , 722 F.3d 384 (D.C. Cir. 2013)	Unreported gambling income	No	TP
<i>Ray v. U.S.</i> , 113 A.F.T.R.2d (RIA) 382 (S.D. Ohio 2014)	Unreported payments received from state for providing care for TP's son cannot be excluded as foster care payments	No	IRS
<i>Rayhill v. Comm'r</i> , T.C. Memo. 2013-181	Unreported disability income	Yes	IRS
<i>Roberts v. Comm'r</i> , 141 T.C. No. 19 (2013)	Unreported distributions from IRAs	No	TP
<i>Schlussel v. Comm'r</i> , T.C. Memo. 2013-185	Unreported income from criminal activity	Yes	IRS
<i>Sharp v. Comm'r</i> , T.C. Memo. 2013-290	Settlement proceeds under IRC § 104(a)(2)	No	IRS
<i>Simpson v. Comm'r</i> , 141 T.C. 331 (2013), appeal docketed, No. 14-72372 (9th Cir. Aug. 4, 2014)	Settlement proceeds under IRC § 104(a)(2)	No	Split
<i>Tirfe v. Comm'r</i> , T.C. Summ. Op. 2013-42	Settlement proceeds under IRC § 104(a)(1) and 104(a)(2)	Yes	IRS
<i>Toombs v. Comm'r</i> , T.C. Summ. Op. 2013-51	Unreported retirement plan distributions	No	IRS
<i>Walbaum v. Comm'r</i> , T.C. Memo. 2013-173	Unreported non-employee compensation	Yes	IRS
<i>Wang v. Comm'r</i> , T.C. Summ. Op. 2014-39	Unreported fellowship grant	Yes	IRS
<i>Weaver-Adams v. Comm'r</i> , T.C. Memo. 2014-73	Unreported 401(k) distribution	Yes	IRS
<i>Weiss v. Comm'r</i> , T.C. Summ. Op. 2014-25	Unreported retirement income	Yes	IRS
<i>Winterroth v. Comm'r</i> , T.C. Memo. 2014-28	Unreported wage income and distribution from IRA	Yes	IRS
<b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)</b>			
<i>Abdallah v. Comm'r</i> , T.C. Memo. 2013-279	Unreported business income	No	IRS
<i>Adeyemo v. Comm'r</i> , T.C. Memo. 2014-1	Unreported cancellation of debt income	Yes	IRS
<i>Ames-Mechelke v. Comm'r</i> , T.C. Memo. 2013-176	Unreported constructive dividends and transfers from trust funds	No	IRS
<i>Austin Otology Associates v. Comm'r</i> , T.C. Memo. 2013-293	Unreported constructive dividends	No	Split
<i>Azimzadeh v. Comm'r</i> , T.C. Memo. 2013-169	Unreported business income	Yes	IRS
<i>Ball ex. rel. Ball v. Comm'r</i> , 742 F.3d 552 (3d Cir. 2014)	Qsub election did not create an ascension to wealth, just a different tax treatment, and as a result trusts had unreported capital gains income	No	IRS
<i>Bristol v. Comm'r</i> , T.C. Memo. 2014-84	Underreported business income	Yes	IRS
<i>Burley v. Comm'r</i> , 113 A.F.T.R.2d (RIA) 984 (6th Cir. 2014), aff'd, No. 12-1802 (6th Cir. Sept. 9, 2013)	Underreported income	No	IRS
<i>Cahill v. Comm'r</i> , T.C. Memo. 2013-220	Unreported income and distribution from 401k	Yes	IRS
<i>Cedar Valley Bird Co., LLP v. Comm'r</i> , T.C. Memo. 2013-153	Unreported interest income and commission income	Yes	IRS
<i>Chow, Estate of, v. Comm'r</i> , T.C. Memo. 2014-49	Unreported gambling income	Yes	IRS
<i>Close v. Comm'r</i> , T.C. Memo. 2014-25	Unreported income	Yes	TP
<i>Colonna v. Comm'r</i> , T.C. Memo. 2014-7	Unreported embezzlement income	Yes	IRS

TABLE 4: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issues	Pro Se	Decision
<i>Crescent Holdings, LLC v. Comm'r</i> , 141 T.C. No. 15 (2013)	Undistributed partnership allocations	No	TP
<i>Daco v. Comm'r</i> , T.C. Summ. Op. 2013-71	Unreported interest income	Yes	IRS
<i>Douglas v. Comm'r</i> , T.C. Memo. 2014-104	Unreported LLC income, S Corporation income, and other income	Yes	IRS
<i>Edem v. Comm'r</i> , T.C. Memo. 2013-238	Unreported gross receipts and dividend income	No	IRS
<i>Edwards v. Comm'r</i> , T.C. Memo. 2014-57	Unreported gross receipts	Yes	IRS
<i>Gassaway v. Comm'r</i> , 544 F. App'x 579 (5th Cir. 2013), aff'd, No. 13-60289 (5th Cir. Nov. 8, 2013)	Unreported business income	Yes	IRS
<i>Gateway Hotel Partners, LLC v. Comm'r</i> , T.C. Memo. 2014-5	Unreported sale of state tax credit income and return of principal payment made to developer fee fund	No	Split
<i>Graffia v. Comm'r</i> , T.C. Memo. 2013-211, appeal docketed, No. 13-3757 (7th Cir. Dec. 11, 2013)	TPs did not have constructive receipt of any royalty payments and therefore may not include royalties in gross income	Yes	IRS
<i>Hall v. Comm'r</i> , T.C. Memo. 2014-16	Unreported business income	Yes	IRS
<i>Haury v. Comm'r</i> , 751 F.3d 867 (8th Cir. 2014), aff'd in part, rev'd in part, and remanded in part, No. 13-1780 (8th Cir. May 12, 2014)	Unreported IRA distribution	No	TP
<i>Hessing v. Comm'r</i> , T.C. Memo. 2013-179	Unreported real estate income	No	TP
<i>Hill v. Comm'r</i> , T.C. Memo. 2013-265	Unreported self-employment and capital gains income	Yes	IRS
<i>Hill v. Comm'r</i> , T.C. Memo. 2013-264	Unreported self-employment income, dividend income, capital gains income, and interest income	Yes	IRS
<i>Hom v. Comm'r</i> , T.C. Memo. 2013-163	Unreported wage income	Yes	IRS
<i>Jones v. Comm'r</i> , T.C. Memo. 2014-101	Unreported business income, capital gains income, rental income, and social security income	Yes	IRS
<i>Kobel v. Comm'r</i> , T.C. Memo. 2013-158	Unreported business income	Yes	IRS
<i>Kumar v. Comm'r</i> , T.C. Memo. 2013-184	Unreported S Corporation income	No	IRS
<i>Lamb v. Comm'r</i> , T.C. Memo. 2013-155	Unreported business income	No	Split
<i>Limbera, Estate of, v. Comm'r</i> , T.C. Summ. Op. 2013-50	Unreported 1099-MISC income	Yes	IRS
<i>Long v. Comm'r</i> , T.C. Memo. 2013-233, appeal docketed, No. 14-10288 (11th Cir. Jan. 22, 2014)	Unreported ordinary income	Yes	IRS
<i>Mingo v. Comm'r</i> , T.C. Memo. 2013-149, appeal docketed, No. 13-60801 (5th Cir. Nov. 8, 2013)	Unreported ordinary income	No	IRS
<i>Mohler v. Comm'r</i> , T.C. Memo. 2014-90	Unreported non-employee compensation	No	IRS
<i>Pawar v. Comm'r</i> , T.C. Memo. 2013-257	Unreported business income	No	IRS
<i>Phillips v. Comm'r</i> , T.C. Memo. 2013-250	Unreported distribution from IRA and interest income	Yes	IRS
<i>Principal Life Insurance Co. and Subsidiaries v. Comm'r</i> , 116 Fed. Cl. 82 (2014)	Custodial share receipts income is includable in gross income	No	IRS
<i>Rogers v. Comm'r</i> , T.C. Memo. 2013-177	Parsonage allowance is income where no evidence of an official rental allowance exists	No	IRS
<i>Route 231, LLC v. Comm'r</i> , T.C. Memo. 2014-30, appeal docketed, No. 14-1983 (4th Cir. Sept. 19, 2014)	Unreported ordinary income	No	IRS
<i>Sultan v. Comm'r</i> , T.C. Memo. 2013-282	Unreported gross receipts	Yes	IRS

TABLE 4: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issues	Pro Se	Decision
<i>Terry v. Comm'r</i> , T.C. Summ. Op. 2013-69	Unreported state income tax refund and capital gains income	Yes	IRS
<i>Welle v. Comm'r</i> , 140 T.C. 420 (2013)	Unreported constructive dividend	No	TP
<i>Williams v. Comm'r</i> , T.C. Summ. Op. 2013-60	Parsonage income must be established officially by church prior to payment to be excludable from income	Yes	IRS

**TABLE 5 Appeals From Collection Due Process Hearings Under IRC  
§§ 6320 and 6330**

Case Citation	Lien or Levy	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>				
<i>Adell, Estate of, v. Comm'r, T.C. Memo. 2014-89</i>	Lien/Levy	Determination by Appeals Office to uphold notice of collection action sustained since officer relied on appropriate factors	No	IRS
<i>Adighibe v. Comm'r, T.C. Memo. 2013-296</i>	Levy	No abuse of discretion in rejecting installment agreement since TP did not provide the information requested	Yes	IRS
<i>Ang v. Comm'r, T.C. Memo. 2014-53</i>	Levy	No abuse of discretion in sustaining jeopardy levy since TP was engaged in scheme to conceal assets from IRS; no abuse of discretion in rejecting offer since TP did not provide information requested	No	IRS
<i>Arede v. Comm'r, T.C. Memo. 2014-29</i>	Levy	No abuse of discretion in denying installment agreement since TP did not provide information requested	Yes	IRS
<i>Barrett v. Comm'r, T.C. Memo. 2013-256</i>	Levy	No abuse of discretion in denying "currently-not-collectible" status since TP did not provide the information requested and did not offer collection alternative	No	IRS
<i>Best v. Comm'r, T.C. Memo. 2014-72</i>	Levy	No abuse of discretion in relying on computer transcripts to verify assessment; no requirement that Appeals Officer provide TP with copy of Form 23C; penalty assessed for frivolous position	No	IRS
<i>Bibby v. Comm'r, T.C. Memo. 2013-281</i>	Levy	No abuse of discretion in sustaining the jeopardy levy since TP was seeking to dissipate funds	No	IRS
<i>Blackman v. Comm'r, T.C. Memo. 2013-194</i>	Lien	No abuse of discretion in sustaining lien to guard against default on installment agreement	No	IRS
<i>Boulware v. Comm'r, T.C. Memo. 2014-80, appeal docketed, No. 14-1147 (D.C. Cir. Aug. 4, 2014)</i>	Lien/Levy	No abuse of discretion in denying installment agreement since TP was not in compliance with tax laws and refused to liquidate assets; no abuse of discretion in denying face-to-face hearing since TP was not eligible for installment agreement	No	IRS
<i>Buchanan v. Comm'r, T.C. Memo. 2014-68</i>	Levy	No abuse of discretion in rejecting collection alternative since TP did not provide evidence that property was overvalued	Yes	IRS
<i>Byers v. Comm'r, 740 F.3d 668 (D.C. 2014), aff'g T.C. Memo. 2012-27, cert. denied, S. Ct. Docket No. 14-74 (Oct. 6, 2014)</i>	Levy	No evidence of improper ex parte communications; Appointments Clause and Chenery arguments were untimely made; tax year 2003 issue was moot	Yes	IRS
<i>Carothers v. Comm'r, T.C. Memo. 2013-165</i>	Levy	Summary judgment granted on motion to sustain levy; no penalty for frivolous position since it was raised for the first time in response to motion for summary judgment	Yes	IRS
<i>Carter, U.S. v., 113 A.F.T.R.2d (RIA) 2383 (D.N.M. 2014), appeal docketed, No. 14-2180 (10th Cir. Oct. 8, 2014)</i>	Lien	IRS's motion for summary judgment granted since no issue of material fact remained as to the amounts due	Yes	IRS
<i>Chambers v. Comm'r, T.C. Memo. 2013-252, appeal docketed, No. (9th Cir. Jan. 13, 2014)</i>	Levy	No abuse of discretion since TP did not provide the information requested and did not offer a collection alternative	Yes	IRS
<i>Cheli v. Comm'r, T.C. Memo. 2013-200</i>	Lien/Levy	No abuse of discretion in denying request for collection alternative since TP did not provide information requested	Yes	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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TABLE 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	Pro Se	Decision
<i>Dalla v. Comm'r</i> , T.C. Memo. 2014-37	Levy	No abuse of discretion in denying “currently-not-collectible” status since payments did not cause hardship	No	IRS
<i>Dixon v. Comm'r</i> , 141 T.C. 173 (2013)	Levy	Levy was an abuse of discretion since Commissioner is required to honor designation of tax payments to TP's liability	No	TP
<i>Dixon v. Comm'r</i> , T.C. Memo. 2013-207	Levy	TPs (H&W) adequately proved amounts of tax withheld during years at issue	No	TP
<i>Estes v. Comm'r</i> , T.C. Memo. 2014-9, aff'd, No. 14-1104 (4th Cir. July 1, 2014)	Levy	TP entitled to challenge the underlying liabilities; liabilities upheld; no abuse of discretion	Yes	IRS
<i>Fatehi v. Comm'r</i> , T.C. Summ. Op. 2013-101	Lien	No abuse of discretion in sustaining lien since TP did not provide information requested	Yes	IRS
<i>Gentile v. Comm'r</i> , T.C. Memo. 2013-175, appeal docketed, No. 13-15554 (11th Cir. Dec. 5, 2013)	Levy	TP precluded from challenging underlying liability; no abuse of discretion in sustaining levy	Yes	IRS
<i>Giaquinto v. Comm'r</i> , T.C. Memo. 2013-150	Lien/Levy	TP precluded from challenging § 6672 penalties because of deliberate failure to claim delivery of Letter 1153	No	IRS
<i>Gibson v. Comm'r</i> , T.C. Summ. Op. 2014-5	Levy	No abuse of discretion in sustaining levy since TP did not participate in hearing	Yes	IRS
<i>Glossop v. Comm'r</i> , T.C. Memo. 2013-208	Levy	No abuse of discretion in sustaining levy since TP had assets in excess of offer amount	No	IRS
<i>Golub v. Comm'r</i> , T.C. Memo. 2013-196	Levy	Determination to apply overpayment to existing tax liabilities sustained; penalty assessed because TP's positions were frivolous	Yes	IRS
<i>Grant v. Comm'r</i> , T.C. Summ. Op. 2013-83	Levy	No abuse of discretion in rejecting installment agreement	Yes	IRS
<i>Gray v. Comm'r</i> , 723 F.3d 790 (7th Cir. 2013), aff'g 140 T.C. 163 (2013), cert. denied, S. Ct. Docket No. 13-9002 (May 27, 2014)	Lien/Levy	Petition properly dismissed for late filing	Yes	IRS
<i>Havard v. Comm'r</i> , T.C. Summ. Op. 2014-48	Levy	No abuse of discretion in sustaining levy since TP did not respond to installment agreement offer	Yes	IRS
<i>Holland v. Comm'r</i> , T.C. Memo. 2013-205	Levy	No abuse of discretion in failing to consider offer since TP did not submit proper form	Yes	IRS
<i>Hull v. Comm'r</i> , T.C. Memo. 2014-36	Levy	No abuse of discretion in refusing abatement of interest since there was no unreasonable delay	No	IRS
<i>Isley v. Comm'r</i> , 141 T.C. 349 (2013)	Lien/Levy	No abuse of discretion in rejecting offer since it was precluded by § 7122(a); no abuse of discretion in rejecting offer since TP understated assets and income; no violation of impartial officer requirement; no abuse of discretion in keeping § 7122(c) payment since there was no false representation; no abuse of discretion in sustaining liens; Appeals decision to sustain levies was premature, remanded to consider collection alternatives	No	Split
<i>Janshen v. Comm'r</i> , T.C. Summ. Op. 2013-73	Levy	No abuse of discretion in sustaining levy since TP did not provide information requested	Yes	IRS
<i>Kaplan v. Comm'r</i> , 552 Fed. App'x 77 (2d Cir. 2014), aff'g T.C. Docket No. 016452-12 (Nov. 5, 2012)	Levy	No error in dismissal for failure to timely file petition since notice was properly mailed and actual notice is not required	Yes	IRS

Most Serious Problems	Legislative Recommendations	Most Litigated Issues	Case Advocacy	Appendices
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TABLE 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	Pro Se	Decision
<i>Karagozian v. Comm'r</i> , T.C. Memo. 2013-164, appeal docketed, No. 13-4230 (2d Cir. Nov. 5, 2013)	Levy	Equitable recoupment does not apply since 2008 is only year at issue; no abuse of discretion in denying collection alternatives since TP failed to provide necessary information	Yes	IRS
<i>Klingenberg v. Comm'r</i> , 551 F. App'x 354 (9th Cir. 2014), aff'g T.C. Memo. 2011-247	Lien	Decision to permit collection action affirmed since TP failed to timely file petition	Yes	IRS
<i>Kraft v. Comm'r</i> , 142 T.C. No. 14 (2014)	Levy	No abuse of discretion in denying request to levy on trust since Commissioner may levy on any TP property	Yes	IRS
<i>Kurka v. Comm'r</i> , T.C. Memo. 2014-96	Levy	Collection action was properly sustained and penalty was proper because TP's position was frivolous	Yes	IRS
<i>LaForge v. Comm'r</i> , T.C. Memo. 2013-183	Levy	No abuse of discretion in denying installment agreement and face-to-face hearing since TP did not provide information requested	No	IRS
<i>Largent v. Comm'r</i> , 576 Fed. App'x 684 (9th Cir. 2014), aff'g T.C. Docket No. 004304-11 (Mar. 1, 2012)	Levy	Summary judgment affirmed since TP did not discharge liability in bankruptcy	Yes	IRS
<i>Lengua v. Comm'r</i> , T.C. Memo. 2013-197	Levy	No abuse of discretion in sustaining levy since TP had sufficient assets to pay	Yes	IRS
<i>Lyons v. Comm'r</i> , T.C. Memo. 2014-32	Levy	No abuse of discretion in denying collection alternatives since TP did not provide information requested	Yes	IRS
<i>Macdonald v. Comm'r</i> , T.C. Memo. 2014-42	Lien	No abuse of discretion in sustaining lien; remanded on notice issue to consider whether Commissioner can appeal from hearing	Yes	IRS
<i>Matick v. Comm'r</i> , T.C. Summ. Op. 2013-72	Levy	No abuse of discretion in rejecting offer since Appeals considered relevant factors	Yes	IRS
<i>Mayhugh v. Comm'r</i> , T.C. Memo. 2014-98	Lien	No abuse of discretion in refusing to withdraw lien and denying collection alternatives since TP did not provide information requested	Yes	IRS
<i>McCarthy v. Comm'r</i> , T.C. Memo. 2013-214	Lien/Levy	No abuse of discretion in sustaining collection action since Appeals officer properly used county tax assessments to value property	No	IRS
<i>Mfum v. Comm'r</i> , 523 F. App'x 183 (3d Cir. 2013), aff'g T.C. Docket No. 9065-11 (July 27, 2012)	Levy	TP precluded from challenging underlying liability; no abuse of discretion in location of face-to-face hearing; no abuse of discretion in conduct of hearing	Yes	IRS
<i>Moore v. Comm'r</i> , T.C. Memo. 2013-278	Levy	No abuse of discretion in rejecting offer since TP had sufficient assets to pay	No	IRS
<i>Moosally v. Comm'r</i> , 142 T.C. No. 10 (2014)	Lien	TP is entitled to new CDP hearing since appeals officer had prior involvement in case	No	TP
<i>O'Donnell v. Comm'r</i> , T.C. Memo. 2013-247	Levy	No abuse of discretion in sustaining levy since officer not required to engage in unlimited exchanges to verify information	No	IRS
<i>Osband v. Comm'r</i> , T.C. Memo. 2013-188	Lien/Levy	No abuse of discretion in assessing frivolous return penalties; no abuse of discretion in denying offer since TP did not provide information requested	Yes	IRS
<i>Pohl v. Comm'r</i> , T.C. Memo. 2013-291	Levy	No abuse of discretion in sustaining levy since TP's positions were frivolous	Yes	IRS
<i>Porro v. Comm'r</i> , T.C. Memo. 2014-81, appeals docketed, No. 14-12465 (11th Cir. June 5, 2014)	Levy	No abuse of discretion since TP's circumstances were properly considered	No	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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TABLE 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	Pro Se	Decision
<i>Reed v. Comm'r</i> , 141 T.C. 248 (2013), <i>opinion supplemented on denial of reconsideration by T.C. Memo.</i> 2014-41	Levy	No abuse of discretion in sustaining levy since dissipated funds are included in calculation and TP failed to meet current tax obligations; Commissioner not required to reopen rejected offer	No	IRS
<i>Reed v. Comm'r</i> , T.C. Memo. 2014-41, <i>prior opinion at 141 T.C. 248 (2013)</i>	Levy	Motion for reconsideration denied; no abuse of discretion in sustaining levy	No	IRS
<i>Shaw v. Comm'r</i> , T.C. Summ. Op. 2014-37	Lien	No abuse of discretion in filing notice of lien since TP did not offer collection alternative or provide information requested	Yes	IRS
<i>Shirley v. Comm'r</i> , T.C. Memo. 2014-10	Lien/Levy	No abuse of discretion in denying face-to-face hearing since TP did not provide the information requested	Yes	IRS
<i>Sigale v. Comm'r</i> , T.C. Summ. Op. 2014-19	Levy	No abuse of discretion in sustaining levy since previous installment agreement covered different years, no abuse of discretion in crediting payments since TP did not specify which years they were for; no abuse of discretion in denying face-to-face hearing; no abuse of discretion in refusing economic hardship designation since TP had sufficient income	Yes	IRS
<i>Stevenson v. Comm'r</i> , T.C. Memo. 2013-284	Levy	TP precluded from challenging underlying liability; no abuse of discretion in sustaining levy since TP did not provide information requested	Yes	IRS
<i>Streiffert v. Comm'r</i> , T.C. Memo. 2014-62	Lien/Levy	TP precluded from challenging underlying liability since TP had prior opportunities to challenge; personal interview not mandatory	Yes	IRS
<i>Thompson v. Comm'r</i> , T.C. Memo. 2013-260	Lien	TP precluded from challenging underlying liability from tax year 2000 for failure to timely petition; remanded for administrative hearing with respect to 2008 liability since TP timely filed petition	No	Split
<i>Truex v. Comm'r</i> , T.C. Memo. 2014-64	Levy	Notice was properly mailed; no abuse of discretion in sustaining levy; TP's arguments were frivolous	Yes	IRS
<i>Tucker v. Comm'r</i> , T.C. Memo. 2014-103	Lien/Levy	No abuse of discretion in denying collection alternatives since TP did not provide information requested	No	IRS
<i>Vercel v. Comm'r</i> , T.C. Memo. 2014-20	Levy	No jurisdiction to review interest abatement; addition to tax proper since attributable to willful neglect	No	IRS
<i>Wessner v. Comm'r</i> , T.C. Memo. 2013-159	Levy	TP precluded from challenging underlying liability; no abuse of discretion in sustaining levy since TP did not provide information requested or propose collection alternative	Yes	IRS
<i>Zumo v. Comm'r</i> , T.C. Summ. Op. 2013-66	Lien	No abuse of discretion in calculating TP's income and expenses; no abuse of discretion in sustaining lien since officer offered to subordinate it to facilitate a loan	Yes	IRS

**Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedule C, E, F)**

<i>Bogart v. Comm'r</i> , T.C. Memo. 2014-46	Levy	An underdeveloped record revealed that the IRS had not fully considered the TP's (H&W) offer; case remanded	No	TP
<i>Burt v. Comm'r</i> , T.C. Memo. 2013-140, <i>aff'd</i> , No. 13-1946 (6th Cir. May 15, 2014)	Lien/Levy	TP does not have available credits from overpayment; notices of determination upheld since TP's arguments were frivolous	Yes	IRS
<i>Creditron Fin. Corp. v. Comm'r</i> , T.C. Memo. 2013-217	Lien/Levy	Court lacked jurisdiction to review levies and liens	No	IRS
<i>Dickes v. Comm'r</i> , T.C. Memo. 2013-210	Lien/Levy	TP subject to additions to tax for failure to timely file returns; Appeals Officer denied TP opportunity to submit offer, remanded to consider offer	Yes	Split

TABLE 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	Pro Se	Decision
<i>Fincourt B Shelton PC v. Comm'r, T.C. Memo. 2013-273</i>	Levy	Offer not valid since TP failed to submit Form 656 with payment; no abuse of discretion	Yes	IRS
<i>Hellman v. Comm'r, T.C. Memo. 2013-190</i>	Lien/Levy	No abuse of discretion in sustaining collection actions since TP's liability under § 6672 as a responsible person is distinct from employer's liability for trust fund penalties	Yes	IRS
<i>J &amp; S Auto Painting, Inc. v. Comm'r, T.C. Memo. 2013-232</i>	Levy	No abuse of discretion in sustaining levy since TP had sufficient assets to pay; no abuse of discretion in denying face-to-face hearing since TP was not in current compliance	No	IRS
<i>Law Offices of Robert A. Cushman, LLC v. Comm'r, T.C. Summ. Op. 2013-48</i>	Lien	No abuse of discretion in rejecting collection alternatives and refusing to reschedule face-to-face hearing since TP did not provide information requested	Yes	IRS
<i>Stevens Techs., Inc. v. Comm'r, T.C. Memo. 2014-13</i>	Lien/Levy	TP precluded from challenging underlying liability; no reasonable cause for failure to pay employment taxes; summons for trust-fund-recovery penalties was proper since unrelated to employment tax proceedings; no abuse of discretion	Yes	IRS
<i>Stotts v. Comm'r, T.C. Summ. Op. 2013-46</i>	Levy	No abuse of discretion in relying on local standard allowances for calculating installment agreement; no abuse of discretion in refusing to consider offer during litigation	Yes	IRS
<i>Szekely v. Comm'r, T.C. Memo. 2013-227</i>	Levy	Abuse of discretion in proceeding with levy because the Appeals Officer did not treat TP in a fair and rational manner; case remanded to consider TP's offer	Yes	TP

**TABLE 6 Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654**

Case Citation	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>			
<i>Aldrich v. Comm'r</i> , T.C. Memo. 2013-201	6651(a)(1), (a)(2) no reasonable cause; 6654 IRS met its burden of production	Yes	IRS
<i>Anderson v. Comm'r</i> , T.C. Memo. 2014-77	6654 IRS met its burden of proof and no exceptions applied	Yes	IRS
<i>Billicci v. Comm'r</i> , T.C. Summ. Op. 2014-38	6651(a)(1) no reasonable cause	No	IRS
<i>Cheramie v. Comm'r</i> , T.C. Summ. Op. 2013-92	6651(a)(1) CPA not having proper information to file return did not establish reasonable cause	Yes	IRS
<i>Chow, Estate of, v. Comm'r</i> , T.C. Memo. 2014-49	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>Close v. Comm'r</i> , T.C. Memo. 2014-25	6651(a)(1) imposition proper; 6651(a)(2) IRS did not meet its burden of production; 6654 imposition not proper because TP had no liability for the preceding year	Yes	Split
<i>Curtis v. Comm'r</i> , T.C. Memo. 2014-19	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>DeCrescenzo v. Comm'r</i> , 563 Fed. App'x 858 (2d Cir. 2014), aff'g T.C. Memo. 2012-50	6651(a)(2) IRS filed returns were treated as returns filed by the TP for the purpose of 6651(a)(2)	Yes	IRS
<i>Dickes v. Comm'r</i> , T.C. Memo. 2013-210	6651(a)(1), (a)(2) no reasonable cause; 6654 IRS met its burden of production	Yes	IRS
<i>Duggan v. Comm'r</i> , T.C. Memo. 2014-17, appeal docketed, No. 14-71645 (9th Cir. June 16, 2014)	6651(a)(1) no evidence of reasonable cause; 6654 IRS met its burden of production	Yes	IRS
<i>Elick v. Comm'r</i> , T.C. Memo. 2013-139, appeal docketed, No. 13-73837 (9th Cir. Oct. 31, 2013)	6651(a)(1) no reasonable cause	No	IRS
<i>Ellis v. Comm'r</i> , T.C. Memo. 2013-245, appeal docketed, No. 14-1310 (8th Cir. Feb. 10, 2014)	6651(a)(1) no deficiency for tax year in which penalty was imposed	No	TP
<i>Estes v. Comm'r</i> , T.C. Memo. 2014-9, aff'd, No. 14-1104 (4th Cir. July 1, 2014)	6651(a)(1), (a)(2) no reasonable cause; 6654 exception did not apply	Yes	IRS
<i>Fonteneaux v. Comm'r</i> , 539 Fed. App'x 442 (5th Cir. 2013), aff'g T.C. Memo. 2012-44	6651(a)(1) unsigned return was improper and no evidence of reasonable cause	Yes	IRS
<i>Fowlke v. Comm'r</i> , 537 Fed. App'x 783 (10th Cir. 2013), aff'g T.C. Docket No. 24767-10 (Mar. 15, 2012)	6651(a)(1), 6651(a)(2), 6654 IRS motion for summary judgment on the pleadings was granted since TP arguments were meritless	Yes	IRS
<i>Jones v. Comm'r</i> , T.C. Memo. 2014-101	6651(a)(2), 6654 no exceptions applied	Yes	IRS
<i>Kaplan v. Comm'r</i> , T.C. Memo. 2014-43, appeal docketed, No. 14-2342 (8th Cir. June 9, 2014)	6651(a)(1), (a)(2) no evidence of reasonable cause; 6654 IRS met its burden of production	No	IRS
<i>Karch v. Comm'r</i> , T.C. Memo. 2013-237, appeal docketed, No. 14-3179 (3d Cir. July 3, 2014)	6651(a)(1) no reasonable cause	No	IRS
<i>Keanney v. Comm'r</i> , T.C. Memo. 2013-206	6651(a)(1) no reasonable cause	Yes	IRS
<i>Kelly v. Comm'r</i> , T.C. Memo. 2014-24	6651(a)(1) no reasonable cause	Yes	IRS
<i>Kornhauser v. Comm'r</i> , T.C. Memo. 2013-230, appeal docketed, No. 13-73850 (9th Cir. Nov. 1, 2013)	6651(a)(1) TP did not argue that acted with ordinary business care; 6651(a)(2) IRS conceded; 6654 IRS met its burden of production	Yes	Split

TABLE 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	Pro Se	Decision
<i>Meehan, U.S. v.</i> , 530 Fed. App'x 155 (3d Cir. 2013), aff'g 108 A.F.T.R.2d (RIA) 5619 (E.D. Pa. 2011)	6651(a)(2) no reasonable cause	Yes	IRS
<i>Montgomery v. Comm'r</i> , T.C. Memo. 2013-151	6651(a)(1) no reasonable cause	Yes	IRS
<i>Phillips v. Comm'r</i> , T.C. Memo. 2013-250	6651(a)(1), (a)(2) not liable because TP paid more than was required to be shown on return; 6654 IRS met its burden of production	Yes	Split
<i>Pool v. Comm'r</i> , T.C. Memo. 2014-3	6651(a)(1) TP raised no arguments	No	IRS
<i>Rayhill v. Comm'r</i> , T.C. Memo. 2013-181	6651(a)(1), (a)(2) disability was not reasonable cause because TP carried on business affairs	Yes	IRS
<i>Ruggeri v. Comm'r</i> , T.C. Memo. 2013-242.	6651(a)(1) deficiency upon which penalty was calculated was correct; (a)(2) no evidence of reasonable cause	Yes	IRS
<i>Schlussel v. Comm'r</i> , T.C. Memo. 2013-185	6651(a)(2) 6654 IRS met its burden of production	Yes	IRS
<i>Shaw v. Comm'r</i> , T.C. Memo. 2013-170, <i>appeal docketed</i> , No. 13-73687 (9th Cir. Oct. 18, 2013)	6651(a)(1) insufficient evidence of timely mailed return	No	IRS
<i>Shaw v. Comm'r</i> , T.C. Summ. Op. 2014-37	6651(a)(1) no evidence of reasonable cause for late return filing	Yes	IRS
<i>Terry v. Comm'r</i> , T.C. Summ. Op. 2013-69	6651(a)(1) no reasonable belief that e-filed extension was received by IRS	Yes	IRS
<i>Toth v. Comm'r</i> , T.C. Memo. 2013-142	6651(a)(1), (a)(2), and 6654 IRS motion for summary judgment granted; Court found TP's arguments frivolous and groundless	Yes	IRS
<i>Vercel v. Comm'r</i> , T.C. Memo. 2014-20	6651(a)(2) failure to pay attributable to willful neglect	No	IRS
<i>Walbaum v. Comm'r</i> , T.C. Memo. 2013-173, <i>motion to transfer venue granted</i> , No. 13-3746 (8th Cir. Jan. 24, 2014 ), <i>appeal dismissed for failure to pay the monetary sanctions imposed against appellant in a prior Tax Court appeal</i> , No. 14-70239 (9th Cir. Apr. 11, 2014)	6651(a)(2) failure to pay due to willful neglect; 6654 no exceptions apply	Yes	IRS
<i>Winterroth v. Comm'r</i> , T.C. Memo. 2014-28	6651(a)(1), (a)(2) no evidence of reasonable cause; 6654 IRS met its burden of production	Yes	IRS
<i>Wolfington v. Comm'r</i> , T.C. Memo. 2014-45	6651(a)(1), (a)(2) no evidence of reasonable cause; 6654 reasonable cause defense does not apply to this penalty	Yes	IRS
<b>Business Taxpayers (Corporations, Partnerships, Trust, and Sole Proprietorships – Schedules C, E, F)</b>			
<i>American Contractors Indem. Co. v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1462 (N.D. Cal. 2014)	6651(a)(1) IRS motion for summary judgment denied; trier of fact to determine if reasonable cause exists	No	TP
<i>Alexander v. Comm'r</i> , T.C. Memo. 2013-203	6651(a)(2) no evidence of reasonable cause; 6654 exception did not apply	No	IRS
<i>Azimzadeh v. Comm'r</i> , T.C. Memo. 2013-169	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>Cahill v. Comm'r</i> , T.C. Memo. 2013-220	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>Canatella v. Comm'r</i> , T.C. Memo. 2014-102	6651(a)(1) reliance on accountant did not establish reasonable cause	Yes	IRS
<i>Glass Blocks Unlimited v. Comm'r</i> , T.C. Memo. 2013-180	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>Hill v. Comm'r</i> , T.C. Memo. 2013-265	6651(a)(1), (a)(2) no evidence of reasonable cause; 6654 IRS met its burden of production	Yes	IRS

TABLE 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	Pro Se	Decision
<i>Lamb v. Comm'r</i> , T.C. Memo. 2013-155	6651(a)(1), (a)(2) no evidence of reasonable cause; 6654 IRS met its burden of production	No	IRS
<i>Maguire v. Comm'r</i> , T.C. Summ. Op. 2013-53	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>Merino v. Comm'r</i> , T.C. Memo. 2013-167	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>Pawar v. Comm'r</i> , T.C. Memo. 2013-257	6651(a)(1) no evidence of reasonable cause	No	IRS
<i>Raisig v. Comm'r</i> , T.C. Summ. Op. 2013-55	6651(a)(1) IRS motion for summary judgment denied	Yes	TP
<i>Ries Enters., Inc. v. Comm'r</i> , T.C. Memo. 2014-14, appeal docketed, No. 14-2094 (8th Cir. May 13, 2014)	6651(a)(1), (a)(2) TP raised no arguments of reasonable cause	Yes	IRS
<i>Roberts v. Comm'r</i> , T.C. Memo. 2014-74	6651(a)(1) destroyed documents did not establish reasonable cause	No	IRS
<i>Safekish v. Comm'r</i> , T.C. Summ. Op. 2013-107	6651(a)(1) no evidence of reasonable cause	Yes	IRS
<i>Scully v. Comm'r</i> , T.C. Memo. 2013-229	6651(a)(1) TP raised no arguments of reasonable cause	Yes	IRS
<i>Sean McAlary Ltd., Inc. v. Comm'r</i> , T.C. Summ. Op. 2013-62	6651(a)(1) reliance on advice from tax professional did not establish reasonable cause	Yes	IRS
<i>Stevens Tech., Inc. v. Comm'r</i> , T.C. Memo. 2014-13	6651(a)(1), (a)(2) illness and family problems did not establish reasonable cause	No	IRS
<i>Thunstedt v. Comm'r</i> , T.C. Memo. 2013-280	6651(a)(1) medical problems and duress did not establish reasonable cause	Yes	IRS
<i>Ungvar v. Comm'r</i> , T.C. Memo. 2013-161	6651(a)(1) TP did not have filing requirement	No	TP

**TABLE 7 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403**

Case Citation	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>			
<i>Acheff v. Lazare</i> , 113 A.F.T.R.2d (RIA) 725 (D.N.M. 2014), <i>appeal docketed</i> , No. 14-2033 (10th Cir. Feb. 25, 2014)	Federal tax lien valid and foreclosed on TP's property; transfer to nominee disregarded	No	IRS
<i>Augustine, U.S. v.</i> , 530 F. App'x 606 (8th Cir. 2013), <i>aff'g</i> 110 A.F.T.R.2d (RIA) 6899 (D. Minn. 2012)	Affirmed lower court's decision that federal tax lien valid and foreclosed on TPs' (H&W) real property	Yes	IRS
<i>Baxley, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1977 (N.D. Fla. 2014), <i>approved by</i> 113 A.F.T.R.2d (RIA) 1982 (N.D. Fla. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	Yes	IRS
<i>Berryman, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 2117 (D. Colo. 2014), <i>adopted by</i> 113 A.F.T.R.2d (RIA) 2120 (D. Colo. 2014)	Federal tax lien valid and foreclosed on real property held by TP's nominee	Yes	IRS
<i>Bowden, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1563 (M.D. Tenn. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property; transfer to nominee disregarded	Yes	IRS
<i>Campbell, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5235 (E.D. Cal. 2013) <i>adopted by</i> 112 A.F.T.R.2d (RIA) 5782 (E.D. Cal. 2013)	Federal tax lien valid and foreclosed on TPs' (H&W) real property despite transfer to trusts	No	IRS
<i>Cardaci, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 6679 (D.N.J. 2013), <i>appeal docketed</i> , No. 14-4237 (3d Cir. Oct. 27, 2014)	Federal tax lien valid and attached to TP's real property; motion to foreclose denied because TP's wife has interest as tenant by the entirety	No	Split
<i>Chambers, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 2195 (M.D. Fla. 2014)	Federal tax lien valid and foreclosed on TP's real property despite transfer to heirs	No	IRS
<i>Colon v. Strawberry</i> , 112 A.F.T.R.2d (RIA) 7071 (N.D. Fla. 2013), <i>adopted by</i> 112 A.F.T.R.2d (RIA) 7074 (N.D. Fla. 2013)	Federal tax lien valid and attached to TP's deferred compensation	Yes	IRS
<i>Cone, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 6603 (M.D. Fla. 2013), <i>adopted by</i> 112 A.F.T.R.2d (RIA) 6607 (M.D. Fla. 2013)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	Yes	IRS
<i>Denneny, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7445 (E.D. Pa. 2013)	Federal tax lien valid and foreclosed on TP's real property despite sale to third party	Yes	IRS
<i>DeSerio, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 917 (D. Ariz. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	No	IRS
<i>Dimacale, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 770 (C.D. Cal. 2014)	Government's summary judgment motion to foreclose federal tax liens denied	No	TP
<i>Evsoroff, U.S. v.</i> , 2014-1 USTC P 50, 142 (E.D.N.Y. 2014)	Federal tax lien valid and TP ordered to vacate real property despite erroneous release of lien; receiver appointed to sell real property	No	IRS
<i>Gallagher, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5024 (D.N.J. 2013)	Federal tax lien valid and foreclosed on TPs' real and personal property	Yes	IRS
<i>Gallegos v. Rocky Mountain Chiropractic Corp.</i> , 113 A.F.T.R.2d (RIA) 1095 (D. Colo. 2014)	Federal tax lien valid and has priority; funds held in trust to be turned over to government	No	IRS
<i>Gilbert, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 620 (W.D. Ky. 2014)	Federal tax lien valid and foreclosed on TP's real property despite fraudulent transfer to trust	Yes	IRS
<i>Goodman, U.S. v.</i> , 527 F. App'x 697 (10th Cir. 2013), <i>aff'g</i> 110 A.F.T.R.2d (RIA) 5447 (D. Colo. 2012), <i>adopting</i> 110 A.F.T.R.2d (RIA) 5444 (D. Colo. 2012)	Affirmed lower court's decision that federal tax lien valid and foreclosed on TP's real property	Yes	IRS

Appendices	Case Advocacy	Most Litigated Issues	Legislative Recommendations	Most Serious Problems
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TABLE 7: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	Pro Se	Decision
<i>Gregg, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7359 (W.D. Pa. 2013)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	Yes	IRS
<i>Gross v. Comm'r</i> , 556 F. App'x 631 (9th Cir. 2014), <i>aff'd</i> T.C. Memo. 2010-176	Affirmed lower court's decision that federal tax lien valid and attached to TP's interest in ERISA-qualified pension plan account despite discharge of personal tax liability in bankruptcy	No	IRS
<i>Harris, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1837 (N.D. Fla. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	Yes	IRS
<i>Hart, U.S. v.</i> , 111 A.F.T.R.2d (RIA) 2235 (D. Idaho 2013)	Federal tax lien valid and attached to TP's real property despite transfers to third parties	No	IRS
<i>Hawthorne, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 2266 (N.D. Ohio 2014)	Federal tax lien valid and foreclosed on TP's interest in real property despite transfer to wife	Yes	IRS
<i>Ippolito, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7191 (M.D. Fla. 2013)	Federal tax lien valid and foreclosed on TP's real property; transfer of property disregarded as fraudulent	No	IRS
<i>Jackson, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 6986 (E.D. Va. 2013), <i>adopted by</i> 112 A.F.T.R.2d (RIA) 6991 (E.D. Va. 2013)	Federal tax lien valid and foreclosed on TPs' (H&W) real property despite transfer to third party	Yes	IRS
<i>Kolb, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 6436 (W.D. Ark. 2013)	Federal tax lien valid and foreclosed on TP's real property	No	IRS
<i>Latos, U.S. v.</i> , 948 F. Supp. 2d 203 (D.R.I. 2013), <i>appeal dismissed</i> , No. 13-1871 (1st Cir. Dec. 6, 2013), <i>cert. denied</i> , No. 13-10798 (Oct. 6, 2014)	Federal tax lien valid and foreclosed on TP's real property	Yes	IRS
<i>Leathers v. Leathers</i> , 113 A.F.T.R.2d (RIA) 1151 (D. Kan. 2014)	Federal tax lien valid and foreclosed on some but not all of TPs' (brothers) royalty payments from mineral interest rights	No	Split
<i>Lindsey, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5501 (D. Haw. 2013)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	Yes	IRS
<i>Lorenzo, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1522 (W.D. Pa. 2014)	Federal tax lien valid and foreclosed on TP's real property	No	IRS
<i>Mattox, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 444 (E.D. Wis. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property despite wife's death	No	IRS
<i>Melot, U.S. v.</i> , 562 F. App'x 646 (10th Cir. 2014), <i>aff'd</i> 2012 U.S. Dist. LEXIS 65384 (D.N.M. 2012), <i>petition for cert. filed</i> , No. 14-6458 (Sept. 22, 2014)	Affirmed lower court's decision that federal tax lien valid and foreclosed on TPs' (H&W) property	Yes	IRS
<i>Melton v. Dep't of Treasury</i> , 113 A.F.T.R.2d (RIA) 639 (W.D. Mo. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) property	Yes	IRS
<i>Mingucci, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 343 (D.N.J. 2013)	Federal tax lien valid; TP's interest in estate assigned to the government	No	IRS
<i>Patras, U.S. v.</i> , 544 F. App'x 137 (3d Cir. 2013), <i>aff'd</i> 909 F. Supp. 2d 400 (D.N.J. 2012), <i>cert. denied</i> , No. 13-978 (Mar. 31, 2014)	Affirmed lower court's decision that federal tax lien valid and attached to TPs' (H&W) real property; transfer to nominee disregarded	No	IRS
<i>Payton, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 791 (E.D.N.C. 2014), <i>aff'd</i> , No. 14-1143 (4th Cir. Sept. 25, 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property; transfer to nominee disregarded as fraudulent	Yes	IRS
<i>Perez, U.S. v.</i> , 111 A.F.T.R.2d (RIA) 2381 (N.D. Okla. 2013)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	No	IRS
<i>Powell, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1382 (N.D. Miss. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	No	IRS
<i>Sabby, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1335 (D. Minn. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property; transfer to nominee disregarded	No	IRS

TABLE 7: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

Case Citation	Issue(s)	Pro Se	Decision
<i>Smith v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1231 (D. Conn. 2014)	Federal tax lien valid and attached to TP's real property; motion to foreclose denied after analysis under <i>Rogers</i>	Yes	Split
<i>Troyer, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 387 (D. Wyo. 2013), <i>aff'd</i> , No. 14-8021 (10th Cir. Oct. 7, 2014)	Federal tax lien valid and foreclosed on TP's real property	Yes	IRS
<i>Tyler, U.S. v.</i> , 528 F. App'x 193 (3d Cir. 2013), <i>aff'g</i> 109 A.F.T.R.2d (RIA) 1383 (E.D. Pa. 2012)	Federal tax lien valid and attached to TP's real property despite TP's death; government entitled to half of proceeds from real property sale	No	IRS
<i>Whisenhunt, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1500 (N.D. Tex. 2014), <i>adopting in part</i> 113 A.F.T.R.2d (RIA) 1491 (N.D. Tex. 2014)	Federal tax lien valid and foreclosed on TP's estate despite distributions to beneficiaries	No	IRS
<i>Whitman, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 5366 (E.D. Cal. 2013), <i>adopted by</i> 112 A.F.T.R.2d (RIA) 5947 (E.D. Cal. 2013)	Federal tax lien valid and attached to TPs' (H&W) real property; transfer to nominee disregarded as fraudulent	Yes	IRS
<i>Whitman, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1184 (E.D. Cal. 2014), <i>adopted by</i> 113 A.F.T.R.2d (RIA) 1791 (E.D. Cal. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property; transfer to nominee disregarded as fraudulent	Yes	IRS
<i>Willis, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 2164 (N.D. Ohio 2014)	Federal tax lien valid and foreclosed on TP's real property	No	IRS
<i>Woodruff, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 1062 (D.N.H. 2014)	Federal tax lien valid and foreclosed on TP's real property despite transfer to wife	Yes	IRS
<i>Worley, U.S. v.</i> , 113 A.F.T.R.2d (RIA) 856 (M.D. Pa. 2014), <i>appeal docketed</i> , No. 14-2062 (3d Cir. Apr. 30, 2014), <i>adopted by</i> 113 A.F.T.R.2d (RIA) 861 (M.D. Pa. 2014)	Federal tax lien valid and foreclosed on TPs' (H&W) real property	Yes	IRS
<b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedule C, E, F)</b>			
<i>Fourth Inv. LP v. U.S.</i> , 720 F.3d 1058 (9th Cir. 2013), <i>aff'g</i> <i>Leeds LP v. U.S.</i> , 807 F. Supp. 2d 946 (S.D. Cal. 2011)	Affirmed lower court's decision that federal tax lien valid and attached to TPs' (H&W) property; transfer to nominee disregarded	No	IRS
<i>Heart K Land &amp; Cattle Co., Inc. v. Long</i> , 113 A.F.T.R.2d (RIA) 760 (D. Mont. 2014), <i>adopted by</i> 113 A.F.T.R.2d (RIA) 768 (D. Mont. 2014)	Government's summary judgment motion to foreclose federal tax liens denied	Yes	TP
<i>Kansky, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 6492 (D. Mass. 2013), <i>adopted by</i> 2013 U.S. Dist. LEXIS 175903 (D. Mass. 2013)	Federal tax lien valid and foreclosed on TP's real property despite transfer to trusts	No	IRS
<i>Stewart Mechanical Enters., Inc., U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7130 (W.D. Ky. 2013)	Federal tax lien valid and foreclosed on TP's lien against third party's real property; TP's lien valid and foreclosed on third party real property	No	IRS

**TABLE 8 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions**

Case Citation	Issue(s)	Pro Se	Decision	Amount
<b>Individual Taxpayers (But not Sole Proprietorships)</b>				
<i>Best v. Comm'r</i> , T.C. Memo. 2014-72	TPs (H&W) petitioned for redetermination of IRS decision to proceed with collection and challenged the use of a transcript to verify assessments and accused the IRS of abuse of discretion and maintained solely to delay collection	No	IRS	\$5,000
<i>Carothers v. Comm'r</i> , T.C. Memo. 2013-165	TP petitioned for review of IRS decision to proceed with levy and argued that an earlier transcript and letter from the IRS showed no assessment, therefore there was no assessment at a later time either and that if there were an assessment he satisfied it by sending a "demand" or "bond" to the Secretary of Treasury	Yes	TP	
<i>Duggan v. Comm'r</i> , T.C. Memo. 2014-17, appeal docketed, No. 14-71645 (9th Cir. June 16, 2014)	TP petitioned for redetermination of deficiency and maintained proceedings solely to delay	Yes	IRS	\$5,000
<i>Golub v. Comm'r</i> , T.C. Memo. 2013-196	TP petitioned for review of IRS decision to proceed with collection and argued that the courts and the IRS were depriving him of his constitutional rights	Yes	IRS	\$15,000
<i>Haag v. Comm'r</i> , T.C. Memo. 2014-11	TP petitioned for review of IRS decision to deny her request for innocent spouse relief and maintained proceedings solely to delay	No	TP	
<i>Hill v. Comm'r</i> , T.C. Memo. 2013-264	TP petitioned for redetermination of deficiency and argued he was not involved in the public sector so he has no business income as defined by the Internal Revenue Code	Yes	IRS	\$20,000
<i>Hill v. Comm'r</i> , T.C. Memo. 2013-265	TP petitioned for redetermination of deficiency and argued he was not involved in the public sector so he has no business income as defined by the Internal Revenue Code	Yes	IRS	\$10,000
<i>Jones v. Comm'r</i> , T.C. Memo. 2014-101	TP petitioned for redetermination of deficiency and argued he is not subject to the income tax, only those working directly for the federal government must pay income tax and the Internal Revenue Code does not establish liability for income tax	Yes	IRS	\$225,000
<i>MacDonald v. Comm'r</i> , T.C. Memo. 2014-42	TP petitioned for review of IRS determination to sustain filing of notice of federal tax lien and did not cooperate with proceedings	Yes	TP	
<i>Streiffert v. Comm'r</i> , T.C. Memo. 2014-62	TP petitioned for review of IRS decision to sustain a levy and notice of federal tax lien and argued he was entitled to an in-person examination interview to determine any liability	Yes	IRS	\$15,000
<i>Toth v. Comm'r</i> , T.C. Memo. 2013-142	TP petitioned for redetermination of deficiency and asserted frivolous arguments	Yes	IRS	\$1,500
<i>Waltner v. Comm'r</i> , T.C. Memo. 2014-35, appeal docket, No. 14-71531 (9th Cir., June 2, 2014)	TP petitioned for review of IRS decision to proceed with levy and argued that only employees and officers of the government are liable for taxes, he was not an officer of a corporation, did not receive wages, was not an employee, was not engaged in a trade or business, and other frivolous arguments	Yes	IRS	\$2,500

TABLE 8: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	Pro Se	Decision	Amount
<i>Winterroth v. Comm'r</i> , T.C. Memo. 2014-28	TP petitioned for redetermination of deficiency and argued he has no federal income tax liability	Yes	IRS	\$10,000
<b>Section 6673 Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments</b>				
<i>Aldrich v. Comm'r</i> , T.C. Memo. 2013-201	TP petitioned for redetermination of deficiency and argued that filing tax returns was a voluntary system of self-assessment and he could not be held liable for tax unless he filed a return	Yes		
<i>Burt v. Comm'r</i> , T.C. Memo. 2013-140, appeal docketed, No. 13-2417 (6th Cir. June 26, 2014)	TP petitioned for review of IRS decision to proceed with federal tax lien and argued IRS forms were not in compliance with the Paperwork Reduction Act of 1995	Yes		
<i>Pohl v. Comm'r</i> , T.C. Memo. 2013-291	TP petitioned for review of IRS decision to levy and argued that his wages are exempt from income tax because he is a non-federal worker	Yes		
<i>Truex v. Comm'r</i> , T.C. Memo. 2014-64	TP petitioned for review of IRS decision to levy and argued he owes no income tax since he is not a federal employee	Yes		
<i>Walbaum v. Comm'r</i> , T.C. Memo. 2013-173	TP petitioned for redetermination of deficiency and penalties and asserted frivolous arguments	Yes		
<b>US Courts of Appeals' Decisions on Appeal of Section 6673 Penalties Imposed by US Tax Court</b>				
<i>Buckhardt v. Comm'r</i> , 548 F. App'x 433 (9th Cir. 2013), aff'd T.C. Docket No. 22131-10 (Oct. 13, 2011)	Penalty affirmed	Yes	IRS	\$25,000
<i>Fowlke v. Comm'r</i> , 537 F. App'x 783 (10th Cir. 2013), aff'd T.C. Docket No. 24767-10 (Apr. 30, 2012)	Penalty affirmed	Yes	IRS	\$5,000
<i>Jacobsen v. Comm'r</i> , 551 F. App'x 950 (10th Cir. 2014), aff'd T.C. Docket No. 22536-12 (Feb. 12, 2013)	Penalty affirmed	Yes	IRS	\$1,000
<i>Young v. Comm'r</i> , 551 F. App'x 229 (5th Cir. 2014), aff'd T.C. Docket No. 4664-12 (Mar. 20, 2013)	Penalty affirmed	Yes	IRS	\$25,000
<b>U.S. Courts of Appeals' and Decisions on Sanctions Under Section 7482 (c)(4), FRAP Rule 38, or Other Authority</b>				
<i>Buckhardt v. Comm'r</i> , 548 F. App'x 433 (9th Cir. 2013), aff'd T.C. Docket No. 22131-10 (Oct. 13, 2011)	TP appealed Tax Court's decision to dismiss his petition challenging the notice of deficiency and argued the Tax Court violated his First, Fourth, and Fifth Amendment rights and was biased against him	Yes	TP	
<i>Herriman v. Comm'r</i> , 521 F. App'x 912 (11th Cir. 2013), aff'd T.C. Docket No. 25048-11 (May 8, 2012)	TP appealed Tax Court's decision to dismiss his petition for redetermination of deficiency and argued taxes are a violation of the Sixteenth Amendment	Yes	IRS	\$8,000
<i>Nelson v. Comm'r</i> , 540 F. App'x 924 (11th Cir. 2013), aff'd T.C. Memo. 2012-232	TP appealed Tax Court's decision on redetermination of deficiency and argued he did not perform services within District of Columbia, Commonwealth of Puerto Rico, Virgin Islands, Guam, or American Samoa, on or in connection with American vessel or aircraft under contract of service entered into within Commonwealth of Puerto Rico, Virgin Islands, Guam, or American Samoa, for the United States	Yes	IRS	\$2,000

TABLE 8: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	Pro Se	Decision	Amount
<i>Vaughn v. IRS</i> of the U.S., 557 F. App'x 605 (8th Cir. 2014), aff'd 112 A.F.T.R.2d (RIA) 6429 (E.D. Mo. 2013)	TP argued the IRS illegally collected taxes	Yes	IRS	\$2,000
<i>Worsham v. Comm'r</i> , 531 F. App'x 310 (4th Cir. 2013), aff'd T.C. Memo. 2012-219	TP petitioned for redetermination of deficiency and argued his earnings are not taxable because they include the basis value of his labor	Yes	TP	
<i>Young v. Comm'r</i> , 551 F. App'x 229 (5th Cir. 2014), aff'd T.C. Docket No. 4664-12 (Mar. 20, 2013)	TP appealed Tax Court's determination to uphold a notice of deficiency and argued that the income tax is unconstitutional because it is a direct tax and individuals are not responsible for paying income tax	Yes	IRS	\$8,000
<b>Section 7482 (c)(4), FRAP Rule 38, or Other Authority Penalty Not Requested or Imposed but Taxpayer Warned To Stop Asserting Frivolous Arguments</b>				
<i>Adamo v. IRS</i> , 2014 WL 1876197 (D.N.M. 2014)	TPs argued that they are non-taxpaying American Citizens during a petition to enforce administrative judgment	Yes		
<i>Goodman v. U.S.</i> , 2013 WL 5637772 (D. Colo. 2013)	TP asserted frivolous arguments during a motion by the U.S. to dismiss	Yes		
<i>Pflum, U.S. v.</i> , 112 A.F.T.R.2d (RIA) 7200 (W.D. Wash. 2013), aff'd 112 A.F.T.R.2d (RIA) 7303 (E.D. Wash. 2013)	TP filed for reconsideration of default judgment to foreclose federal tax liens and argued the tax assessment is invalid because it was not verified on a Form 23C	Yes		
<i>Poplawski v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1928 (S.D. Ohio 2014), <i>appeal docketed</i> , No. 14-3517 (6th Cir. May 29, 2014)	TP argued that wages are not taxable income during a U.S. motion for summary judgment	Yes		

**TABLE 9 Charitable Deductions Under IRC § 170**

Case Citation	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>			
<i>Adeyemo v. Comm'r</i> , T.C. Memo. 2014-1	Contribution unsubstantiated	Yes	IRS
<i>Alli v. Comm'r</i> , T.C. Memo. 2014-15, <i>appeal docketed</i> , No. 14-1630 (6th Cir. May 21, 2014)	Qualified appraisal did not meet all requirements	Yes	IRS
<i>Alonso v. Comm'r</i> , T.C. Summ. Op. 2013-93	Contribution unsubstantiated	Yes	IRS
<i>Belk v. Comm'r</i> , T.C. Memo. 2013-154, <i>appeal docketed</i> , No. 13-2161 (4th Cir. Sept. 19, 2013)	Conservation easement not in perpetuity	No	IRS
<i>Brooks v. Comm'r</i> , T.C. Memo. 2013-141	Contribution unsubstantiated	Yes	IRS
<i>Carpenter v. Comm'r</i> , T.C. Memo. 2013-172	Conservation easement not enforceable in perpetuity	No	IRS
<i>Chandler v. Comm'r</i> , 142 T.C. No. 16 (2014)	Valuation of conservation easement	No	IRS
<i>Chisolm v. Comm'r</i> , T.C. Summ. Op. 2014-45	Contribution unsubstantiated	Yes	IRS
<i>Cohen v. Comm'r</i> , T.C. Summ. Op. 2013-44	Contribution unsubstantiated	Yes	IRS
<i>Cor v. Comm'r</i> , T.C. Memo. 2013-240	Contribution unsubstantiated	Yes	IRS
<i>Friedberg v. Comm'r</i> , T.C. Memo. 2013-224	Appraisals qualified	No	Split
<i>Golit v. Comm'r</i> , T.C. Memo. 2013-191	Donee was not a qualified organization	No	IRS
<i>Gorra v. Comm'r</i> , T.C. Memo. 2013-254	Valuation of façade easement	No	IRS
<i>Graev v. Comm'r</i> , 140 T.C. 377 (2013)	Condition on conservation easement rendered it invalid	No	IRS
<i>Haskett v. Comm'r</i> , T.C. Summ. Op. 2013-76	Substantiated cash charitable contributions; unsubstantiated noncash contributions	Yes	Split
<i>Hershberger v. Comm'r</i> , T.C. Memo. 2014-63	Contribution unsubstantiated	Yes	IRS
<i>Humphrey v. Comm'r</i> , T.C. Memo. 2013-198	Some contribution unsubstantiated	Yes	Split
<i>Kaufman v. Comm'r</i> , T.C. Memo. 2014-52, <i>appeal docketed</i> , No. 14-1863 (1st Cir. Aug. 20, 2014)	Valuation of façade easement	No	IRS
<i>Mitchell v. Comm'r</i> , T.C. Memo. 2013-204, <i>appeal docketed</i> , No. 13-9003 (10th Cir. Dec. 19, 2013)	Easement was not protected in perpetuity	No	IRS
<i>Mountanos v. Comm'r</i> , T.C. Memo. 2013-138, <i>opinion supplemented by</i> T.C. Memo. 2014-38, <i>appeal docketed</i> , No. 14-71580 (9th Cir. June 6, 2014)	Valuation of easement	No	IRS
<i>Ofoegbu v. Comm'r</i> , T.C. Summ. Op. 2013-79	Contribution unsubstantiated	No	IRS
<i>Payne v. Comm'r</i> , T.C. Summ. Op. 2013-64	Contribution unsubstantiated	Yes	IRS
<i>Stanback v. Comm'r</i> , T.C. Summ. Op. 2014-49	Contribution unsubstantiated	Yes	IRS
<i>Thompson v. Comm'r</i> , T.C. Summ. Op. 2013-49	Contribution unsubstantiated	Yes	IRS
<i>Wachter v. Comm'r</i> , 142 T.C. No. 7 (2014)	State law prevented conservation easement from existing for perpetuity	No	IRS
<i>Zavadil v. Comm'r</i> , T.C. Memo. 2013-222, <i>appeal docketed</i> , No. 14-1053 (8th Cir. Jan. 9, 2014)	TP bore the burden of charitable contributions made before July of 2005, but did not bear the burden for contributions made after June 2005	No	Split

TABLE 9: Charitable Deductions Under IRC § 170

Case Citation	Issue(s)	Pro Se	Decision
<b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships – Schedules C, E, F)</b>			
<i>61 York Acquisition, LLC v. Comm'r</i> , T.C. Memo. 2013-266	Conservation easement was not exclusively for conservation purposes	No	IRS
<i>Esgar Corp. v. Comm'r</i> , 744 F.3d 648 (10th Cir. 2014)	A property may be valued at its highest and best use so long as closeness in time to the transaction and reasonable probability of the highest and best use exist	No	IRS
<i>Palmer Ranch Holdings Ltd. v. Comm'r</i> , T.C. Memo. 2014-79, appeal docketed, No. 14-14167 (11th Cir. Sept. 16, 2014)	A property may be valued at its highest and best use so long as closeness in time to the transaction and reasonable probability of the highest and best use exist	No	Split
<i>Trombetta, Estate of v. Comm'r</i> , T.C. Memo. 2013-234	Contribution was made by the trustee, not by the TP during her lifetime or by directive of her will	No	IRS

**TABLE 10 Passive Activity Losses (PAL) Under IRC § 469<sup>1</sup>**

Case Citation	Issue(s)	Pro Se	Decision
<b>Individual Taxpayers (But Not Sole Proprietorships)</b>			
<i>Adeyemo v. Comm'r</i> , T.C. Memo. 2014-1	TP's activity was passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Avatzidis v. Comm'r</i> , T.C. Summ. Op. 2013-15	IRC §280A prevented the TPs from claiming a PAL; rental real estate	Yes	IRS
<i>Almquist v. Comm'r</i> , T.C. Memo. 2014-40	TP's activity was passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Azimzadeh v. Comm'r</i> , T.C. Memo. 2013-169	TP's activity was passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Ballesteros v. Comm'r</i> , T.C. Summ. Op. 2013-108	TP's activity was passive; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Bartlett v. Comm'r</i> , T.C. Memo. 2013-182	TP's bull breeding activity was passive; PAL deduction disallowed	No	IRS
<i>Billeci v. Comm'r</i> , T.C. Summ. Op. 2014-38	TPs' activities were passive; IRC § 469(i) AGI exception partially phased out in Year 1 and completely phased out in Year 2; partial PAL deduction allowed in Year 1; PAL deduction disallowed in Year 2; rental real estate	No	IRS
<i>Bugarin v. Comm'r</i> , T.C. Summ. Op. 2013-61	TPs' activities were passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Daco v. Comm'r</i> , T.C. Summ. Op. 2013-71	TPs' activities were passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Gragg v. U.S.</i> , 113 A.F.T.R.2d (RIA) 1647 (N.D. Cal. 2014), <i>appeal docketed</i> , No. 14-16053 (9th Cir. May 30, 2014)	TP's activity was passive; PAL deduction disallowed; rental real estate	No	IRS
<i>Hardnett v. Comm'r</i> , T.C. Summ. Op. 2013-56	TP's activity was passive; TP did not qualify for IRC §§ 469(i) or 469(h) exceptions; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Harloff v. Comm'r</i> , T.C. Summ. Op. 2014-20	TP's rental activities were passive; IRC § 469(i) AGI exception partially phased out for one of the properties, PAL for that property deductible in part; otherwise, PAL deduction disallowed; rental real estate	No	Split
<i>Hofinga v. Comm'r</i> , T.C. Summ. Op. 2013-43	TPs' activities were passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	No	IRS
<i>Merino v. Comm'r</i> , T.C. Memo. 2013-167	TP's activity was passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Montgomery v. Comm'r</i> , T.C. Memo. 2013-151	TP's activity was not passive; loss deduction allowed; business activity	Yes	TP
<i>Oderio v. Comm'r</i> , T.C. Memo. 2014-39	MFS TPs cannot combine efforts to satisfy IRC §469(c)(7); TP's activity was passive; PAL deduction disallowed; rental real estate	Yes	IRS

<sup>1</sup> Rental Real Estate activity is used in the description whenever a taxpayer made claims relating to real estate property. A few cases do not specifically mention this term of art in their analyses.

TABLE 10: Passive Activity Losses (PAL) Under IRC § 469

Case Citation	Issue(s)	Pro Se	Decision
<i>Ohana v. Comm'r</i> , T.C. Memo. 2014-83	TP's rental activity was passive, PAL rules apply; rental expenses are deductible to extent of rental income; rental real estate	No	IRS
<i>Smith v. Comm'r</i> , T.C. Summ. Op. 2014-13	TPs' activities were passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Terry v. Comm'r</i> , T.C. Summ. Op. 2013-69	TP's activity was passive; IRC § 469(i) AGI exception partially phased out; partial PAL deduction allowed; rental real estate	Yes	IRS
<i>Tolin v. Comm'r</i> , T.C. Memo. 2014-65	TP's horse breeding activity was not passive; loss deduction allowed	No	TP
<i>White v. Comm'r</i> , T.C. Summ. Op. 2013-86	TP's activity was passive; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Williams v. Comm'r</i> , T.C. Summ. Op. 2013-63	TP's activity was passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Windross v. Comm'r</i> , T.C. Summ. Op. 2013-52	TP's activity was passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	Yes	IRS
<i>Wong v. Comm'r</i> , T.C. Summ. Op. 2013-43	TP's activity was passive; IRC § 469(i) AGI exception completely phased out; PAL deduction disallowed; rental real estate	No	IRS
<b>Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships - Schedule C, E, F)</b>			
<i>Frank Aragona Trust v. Comm'r</i> , 142 T.C. No. 9 (2014)	Trust (1st Impression) can qualify for IRC § 469(c)(7) exception; TP's activity was not passive; loss deduction allowed; rental real estate	No	TP
<i>Herwig v. Comm'r</i> , T.C. Memo. 2014-95, appeal docketed, No. 14-13644 (11th Cir. Aug. 14, 2014)	Requirement of IRC § 469(g) not satisfied; PAL remained suspended; rental real estate	No	IRS
<i>Graffia v. Comm'r</i> , T.C. Memo. 2013-211, appeal docketed, No. 13-3757 (7th Cir. Dec. 11, 2013)	TP's activity was passive; PAL deduction disallowed; business activity	Yes	IRS
<i>Moreno v. U.S.</i> , 113 A.F.T.R.2d (RIA) 2149 (W.D. La. 2014)	TP's activity was not passive; loss deduction allowed; aircraft leasing activity	No	TP

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 1220 SW 3rd Ave, Suite G004  
 Portland, OR 97204  
 Phone: 503-256-3591  
 Fax: 855-832-7118

**PENNSYLVANIA*****Philadelphia***

600 Arch St., Room 7426  
 Philadelphia, PA 19106  
 Phone: 267-941-6623  
 Fax: 855-821-2123

***Pittsburgh***

1000 Liberty Ave.  
 Room 1400  
 Pittsburgh, PA 15222  
 Phone: 412-404-9098  
 Fax: 855-821-2125

**RHODE ISLAND*****Providence***

380 Westminster St., 4th floor  
 Providence, RI 02903  
 Phone: 401-528-1921  
 Fax: 855-807-9696

**SOUTH CAROLINA****Columbia**

1835 Assembly St.  
Room 466, MDP-03  
Columbia, SC 29201  
Phone: 803-312-7901  
Fax: 855-821-0241

**SOUTH DAKOTA****Aberdeen**

115 4th Ave. SE  
Suite 413  
Aberdeen, SD 57401  
Phone: 605-377-1600  
Fax: 855-829-6038

**TENNESSEE****Nashville**

801 Broadway, Stop 22  
Nashville, TN 37203  
Phone: 615-250-5000  
Fax: 855-828-2719

**TEXAS****Austin**

300 East 8th Street  
Stop 1005-AUS  
Austin, TX 78701  
Phone: 512-499-5875  
Fax: 855-829-1827

**Dallas**

1114 Commerce St.  
MC: 1005DAL  
Dallas, TX 75242  
Phone: 214-413-6500  
Fax: 855-829-1829

**Houston**

1919 Smith St.  
MC 1005 HOU  
Houston, TX 77002  
Phone: 713-209-3660  
Fax: 855-829-3841

**UTAH****Salt Lake City**

50 S. 200 E.  
Stop 1005 SLC  
Salt Lake City, UT 84111  
Phone: 801-799-6958  
Fax: 855-832-7121

**VERMONT****Burlington**

128 Lakeside Ave, Ste 204  
Burlington, VT 05401  
Phone: 802-859-1052  
Fax: 855-874-1938

**VIRGINIA****Richmond**

400 North 8th Street  
Room 916, Box 25  
Richmond, VA 23219  
Phone: 804-916-3501  
Fax: 855-821-2127

**WASHINGTON****Seattle**

915 Second Avenue  
Stop W-405  
Seattle, WA 98174  
Phone: 206-946-3707  
Fax: 855-832-7122

**WEST VIRGINIA****Parkersburg**

425 Juliana Street  
Room 2019  
Parkersburg, WV 26101  
Phone: 304-420-8695  
Fax: 855-828-2722

**WISCONSIN****Milwaukee**

211 W. Wisconsin Ave.  
Room 507, Stop 1005 MIL  
Milwaukee, WI 53203  
Phone: 414-231-2390  
Fax: 855-833-8230

**WYOMING****Cheyenne**

5353 Yellowstone Road  
Cheyenne, WY 82009  
Phone: 307-633-0800  
Fax: 855-829-6041

**PUERTO RICO****Guaynabo**

City View Plaza II  
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