

INTRODUCTION: The Most Serious Problems Encountered by Taxpayers

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 2016, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 20 such problems. This year's report also includes a special focus on the IRS's Future State and the National Taxpayer Advocate's vision for a taxpayer-centric 21st century tax administration.

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 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 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 or groupings of issues for the report that is reflected in the selection of issues. For example, this year the themes are:

- *Elements of the Future State;*
- *Necessary Tools for Achieving the Future State; and*
- *Taxpayer Rights and Issue Resolution in the Future State.*

The 20 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 and adjust it where editorial or numerical 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 2016, a period spanning October 1, 2015, through September 30, 2016.

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 taxpayer 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**VOLUNTARY COMPLIANCE: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance****RESPONSIBLE OFFICIALS**

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TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM²

Insights from behavioral science (*e.g.*, psychology and behavioral economics) reveal that people generally do not perform an elaborate economic analysis when making decisions. For example, they may do what is easy, do what they think others are doing (*i.e.*, follow norms), respond more readily to messages that are clear and relevant, and cheat only if they can maintain a positive self-image (*e.g.*, tax morale).³

Such behavioral insights (BIs) help explain why economic deterrence is not the IRS’s only lever. They suggest the IRS can directly improve tax compliance by simplifying the rules, explaining them to taxpayers, highlighting apparent reporting and payment discrepancies, and responding promptly and clearly to inquiries, among other things. Moreover, tax administrators around the world have been using randomized controlled trials (RCT) to quantify the return on investment (ROI) and compliance gains that result from such alternative treatments.

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Behavioral Science Lessons for Taxpayer Compliance*, vol. 3, *infra*.
- 3 See *generally* Richard Thaler, *MISBEHAVING: THE MAKING OF BEHAVIORAL ECONOMICS* (2015) (overview); Dan Ariely, *PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS* (2008) (overview); Dan Ariely, *THE HONEST TRUTH ABOUT DISHONESTY: HOW WE LIE TO EVERYONE — ESPECIALLY OURSELVES* (2012) (discussing self-image); Daniel Kahneman, *THINKING, FAST AND SLOW* (2011) (discussing mental shortcuts); Jonah Berger, *INVISIBLE INFLUENCE: THE HIDDEN FORCES THAT SHAPE BEHAVIOR* (2016) (discussing norms).

Following recommendations by the National Taxpayer Advocate and an Executive Order, the IRS is also pursuing BI research using RCTs.⁴ However, it does not report the resulting “service” revenue or compliance gains as routinely as it reports so-called “enforcement” revenue and productivity.⁵ As a result, even if the IRS identifies effective alternative treatments, it may underuse them and overuse enforcement. Moreover, the taxpayer’s *right to privacy*, which includes the right to expect that any IRS inquiry or enforcement action will “be no more intrusive than necessary,” requires the IRS to try alternative treatments before resorting to coercion.⁶ Further, unnecessary coercion wastes resources, burdens taxpayers, and may even reduce voluntary compliance and overall tax revenue (*i.e.*, in other years or due from other taxpayers).⁷

ANALYSIS OF PROBLEM

Non-Economic Factors Affect Tax Compliance

Most people voluntarily report and pay their taxes. About 98 percent of all tax revenue results from voluntary compliance, as compared to about two percent from “enforcement” revenue.⁸ Taxpayers report nearly all of the income that is subject to withholding and third-party information reporting (*e.g.*, wage and salary income).⁹

Withholding and information reporting procedures use several BIs, such as the insight that people are motivated by:

- (1) Defaults and loss aversion: It is easier to report income already reflected on information returns and less painful to claim withholding credits for amounts already paid;
- (2) Timing: Information returns arrive when needed at year end;
- (3) Tax morale and visibility: It is more difficult to omit income that is visible on information returns while thinking of yourself as honest;

4 See, *e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 156-61 (Most Serious Problem: *Taxpayer Service and Behavioral Research*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-50 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*); National Taxpayer Advocate 2014 Annual Report to Congress 112-22 (Most Serious Problem: *The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy*); Executive Order 13707, 80 Fed. Reg. 56365 (Sept. 15, 2015), <https://www.gpo.gov/fdsys/granule/FR-2015-09-18/2015-23630>.

5 See, *e.g.*, IRS, *Fiscal Year 2015 Enforcement and Service Results* (Mar. 8, 2016), <https://www.irs.gov/uac/newsroom/fiscal-year-2015-enforcement-and-service-results>. When we use the term “enforcement” in quotes we are referring to its overly-broad definition (*e.g.*, any action by a so-called IRS “enforcement” function), and when we use it without quotes we are referring to its more natural meaning — the IRS’s use of coercive power to compel action (*e.g.*, assessment, summons, lien, levy, and the withholding of refunds). See THE OXFORD ENGLISH DICTIONARY, http://www.oxforddictionaries.com/us/definition/american_english/enforcement (“The act of compelling ...”) and Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*. For further discussion of this issue, see Nina Olson, *The Future of Tax Administration*, 2016 TNT 49-11 (Mar. 10, 2016).

6 TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

7 See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 1-14 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*); Norman Gemmill & Marisa Ratto, *Behavioral Responses to Taxpayer Audits: Evidence From Random Taxpayer Inquiries*, 65 NAT. TAX J. 33–58 (2012); National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-100 (*Audit Impact Study*).

8 In Fiscal Year (FY) 2015, the IRS collected total tax revenue of about \$3.3 trillion. Government Accountability Office (GAO), GAO-17-140, *Financial Audit: IRS’s Fiscal Years 2016 and 2015 Financial Statements* 25 (Nov. 10, 2016), <http://www.gao.gov/products/GAO-17-140>. Of that amount, it collected \$54.3 billion through enforcement actions. *Id.*

9 See IRS, Research, Applied Analytics & Statistics (RAAS), *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2008–2010*, 12 (May 2016), <https://www.irs.gov/pub/irs-soi/p1415.pdf> (estimating the net misreporting for wage and salary income at about one percent).

- (4) Social norms and salience: When a third party reports income to you on a Form W-2 or 1099, he or she identifies specific income and suggests that reporting it is the norm; and
- (5) Deterrence: The omission of income reported to the IRS by third parties is more likely to be detected and punished.¹⁰

Even where income is not subject to information reporting, some have suggested that relatively high levels of tax compliance cannot be explained by economic deterrence alone.¹¹ Taxpayers comply (or fail to do so) for a wide variety of non-economic reasons.¹² Research suggests that trust, social norms, fairness, reciprocity, tax morale, and similar non-economic factors also drive tax compliance.¹³ Virtually all taxpayers (94 percent) surveyed by the IRS Oversight Board in 2014 expressed non-economic motives, mostly or completely agreeing that “it is every taxpayer’s civic duty to comply.”¹⁴ Some tax administrators report that norms are the most important non-economic factor, though other factors can affect norms.¹⁵ For example, economic deterrence can either crowd out compliance norms (*e.g.*, by suggesting that most people do not comply without coercion) or support them.¹⁶

- 10 For a discussion of tax-related insights, see, *e.g.*, Andrew Reeson and Simon Dunstall, *Behavioural Economics and Complex Decision-Making Implications for the Australian Tax and Transfer System* iii (CMIS Rept. No. 09/110, 2009), http://taxreview.treasury.gov.au/content/html/commissioned_work/downloads/CSIRO_AFTS_Behavioural_economics_paper.pdf. See also Nina Mazar *et al.*, *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MARKETING RES. 633-644 (2008).
- 11 See, *e.g.*, Erich Kirchler *et al.*, *Why Pay Taxes?: A Review of Tax Compliance Decisions* 18 (Georgia State Univ., Int’l Studies Prog., Working Paper 07-30, 2007), <http://icepp.gsu.edu/files/2015/03/ispwp0730.pdf>. Similarly, one study found that about 20 percent fully paid a church tax, even though they knew the tax was not enforced. See Nadja Dwenger *et al.*, *Extrinsic and Intrinsic Motivations for Tax Compliance: Evidence from a Field Experiment in Germany*, 8 AM. ECON. J. 203, 204-05 (2016). Others have tried to explain how deterrence could produce the observed levels of compliance. See, *e.g.*, Mark Phillips, *Reconsidering the Deterrence Paradigm of Tax Compliance*, IRS Research Conference (2011).
- 12 Social scientists have identified at least eight types of noncompliance, including: Procedural, Lazy, Unknowing, Asocial, Brokered, Symbolic, Social, and Habitual. See Robert Kidder and Craig McEwen, *Taxpaying Behavior in Social Context: A Tentative Typology of Tax Compliance and Noncompliance*, in *TAXPAYER COMPLIANCE*, Vol. 2, 47-72 (Jeffrey Roth & John Scholz, eds., 1989).
- 13 See, *e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-50 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-28; OECD, Forum on Tax Administration, Small/Medium Enterprise (SME) Compliance Subgroup, *Understanding and Influencing Taxpayers’ Compliance Behaviour* (Nov. 2010); OECD, Forum on Tax Administration Subgroup, *Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012); Tom Tyler, *Why People Obey the Law* (2006); Tom Tyler, *Legitimacy and Criminal Justice: The Benefits of Self-Regulation*, 7 OHIO ST. J. CRIM. L. 307-359 (Fall 2009); Erich Kirchler, *THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOUR* (2007).
- 14 IRS Oversight Board, *2014 Taxpayer Attitude Survey* 8 (Dec. 2014), <https://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf>.
- 15 Organisation for Economic Co-operation and Development (OECD), Forum on Tax Administration, Small/Medium Enterprise (SME) Compliance Subgroup, *Understanding and Influencing Taxpayers’ Compliance Behaviour* 21 (Nov. 2010). This is consistent with studies finding that norms, trust for the government, and trust for the IRS are correlated with estimated reporting compliance by small business. See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*). In addition, these factors may vary by locale. See National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).
- 16 See, *e.g.*, Steven Sheffrin and Robert Triest, *Can Brute Deterrence Backfire? Perceptions and Attitudes in Taxpayer Compliance*, in *WHY PEOPLE PAY TAXES: TAX COMPLIANCE AND ENFORCEMENT* (Joel Slemrod, ed., 1992); Dan M. Kahn, *The Logic of Reciprocity: Trust, Collective Action, and Law*, 102 MICH. L. REV. 71 (2003); Bruno S. Frey & Lars P. Feld, *Deterrence and Morale In Taxation: An Empirical Analysis* 7 (CESifo Working Paper Series No. 760, 2002). See also James Heyman & Dan Ariely, *Effort for Payment: A Tale of Two Markets*, 15 PSYCH. SCI. 787, 792-93 (2004) (suggesting that because people sometimes expend more effort in exchange for no payment (a social market) than when they receive low payment (a monetary market), adding monetary incentives can reduce those efforts); Uri Gneezy & Aldo Rustichini, *A Fine Is a Price*, 29 J. LEGAL STUDIES 1 (2000) (introducing a fine for late daycare pickups increased late pickups).

Unnecessary Coercion Can Reduce Voluntary Compliance

When the IRS adopts fair procedures designed to help taxpayers comply, it makes compliance easier and sends the message that most people are trying to comply, supporting compliance norms. Fair procedures also promote the view that the agency is legitimate and trustworthy, potentially making it more difficult for people to justify noncompliance while maintaining a positive self-image.¹⁷ Perhaps because unnecessary coercion erodes these perceptions, research suggests that it can reduce voluntary compliance.¹⁸ As a result, the IRS's efforts could be misdirected if it focuses primarily on direct "enforcement" results and efficiencies (e.g., closures, cycle time, and dollars assessed or collected), which it often quantifies and highlights for stakeholders.¹⁹

The IRS May Underuse Alternative Treatments Because It Has Difficulty Measuring Their Effectiveness

During the 1990s, the IRS and its stakeholders recognized that to be effective the IRS would have to identify the root causes of noncompliance by specific taxpayer segments (e.g., confusion, local norms, competitive pressures, and economic conditions), and use a tailored multi-functional approach to address them (called "Compliance 2000").²⁰ Largely because it was difficult for the IRS to measure the revenue and compliance gains from such alternative treatments, however, Compliance 2000 lost support.²¹

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- 17 See generally Tom R. Tyler, *The Psychology of Self-Regulation: Normative Motivations for Compliance*, in EXPLAINING COMPLIANCE: BUSINESS RESPONSES TO REGULATION 78 (Christine Parker & Vibeke Nielsen eds., 2011); Kristina Murphy, *Procedural Justice and the Regulation of Tax Compliance*, in DEVELOPING ALTERNATIVE FRAMEWORKS FOR EXPLAINING TAX COMPLIANCE 191, 208 (James Alm et al. eds., 2010).
- 18 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 1-14 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*) (finding small businesses subject to an accuracy-related penalty had lower estimated subsequent compliance if the penalty was assessed by default, was abated, or was appealed, suggesting that penalties perceived as unfair may reduce future compliance); Norman Gemmill & Marisa Ratto, *Behavioral Responses to Taxpayer Audits: Evidence From Random Taxpayer Inquiries*, 65 NAT. TAX J. 33-58 (Mar. 2012) (suggesting that audits of compliant taxpayers may reduce voluntary compliance); National Taxpayer Advocate 2015 Annual Report to Congress vol. 2 1-100 (*Audit Impact Study*) (same). See also Colin Camerer & Richard H. Thaler, *Ultimatums, Dictators and Manners*, 9 J. ECON. PERSPECTIVES 209, 216-18 (1995), <https://www.aeaweb.org/articles?id=10.1257/jep.9.2.209> (observing that people seem to punish those who behave unfairly (i.e., reciprocity) even when no future encounters are expected because they "have simply adopted rules of behavior they think apply to themselves and others, regardless of the situation" (i.e., manners)).
- 19 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (*Most Serious Problem: IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*). For example, LB&I's "Key Stats" report contains 14 substantive worksheets. LB&I response to TAS information request (June 23, 2016). The first 12 worksheets contain detailed enforcement productivity statistics (e.g., closures, dollars per hour, yield, hours per return, cycle time, no change rates, etc.) broken out by type of taxpayer, income level and issue (i.e., activity code). *Id.* Only the last two worksheets are devoted to quality, customer and employee satisfaction, which are not broken out by activity code, and for the last few years have not been broken out by industry. *Id.* The report does not contain any behavioral response indicators such as measures of self-correction or future compliance.
- 20 GAO, GAO/GGD-96-109, *IRS Has Made Progress but Major Challenges Remain* 11 (June 1996), <http://www.gao.gov/assets/230/222671.pdf> ("about 63 percent of those [IRS officials] we [GAO] interviewed believed that this approach [Compliance 2000] will reduce the tax gap, and nearly 70 percent, who had knowledge of previous attempts, believed that it will be more cost effective."); National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 23 (1997), <http://www.house.gov/natcommirs/report1.pdf> ("The traditional enforcement approach ... [was not only] expensive, but it did not identify patterns of noncompliance. The new approach shifts emphasis to preventing noncompliance by identifying areas in which noncompliance is most likely to occur."). Similarly, traditional police enforcement is not as effective in reducing crime as working with community partners to address the underlying problems (called problem-oriented policing or POP). See, e.g., David Weisburd et al., *Is Problem-Oriented Policing Effective in Reducing Crime and Disorder? Findings From a Campbell Systematic Review*, 9 CRIM. & PUB. POL. 139, 141 (2010), http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd_et_al.pdf. Moreover, an excessive focus on reducing reported crimes, rather than on the means used, can lead to misreporting of crime, abuse of power, and a dysfunctional organizational culture. See, e.g., Malcolm Sparrow, *Handcuffed, What Holds Policing Back, and the Keys to Reform* 20-22 (2016).
- 21 GAO, GAO/GGD-96-109, *IRS Has Made Progress but Major Challenges Remain* 11 (June 1996). By contrast, POP is still widely supported by local enforcement agencies and the U.S. Department of Justice (DOJ). POP goes hand in hand with community oriented policing, which is so successful that the DOJ Office of Community Oriented Policing Services (COPS) provides grants to facilitate its adoption. DOJ, Congressional Justification, *FY 2017 Performance Budget* (Feb. 9, 2016), <https://www.justice.gov/jmd/file/821491/download>.

The IRS replaced Compliance 2000 with Compliance Initiative Projects (CIPs).²² CIPs enable exam to collaborate with other functions to implement alternative treatments,²³ but it uses them primarily to identify returns to examine.²⁴ If exam identifies an alternative treatment, the CIP process does not require anyone to pursue it.²⁵ Even if the IRS initiated an alternative treatment, it would not necessarily report on the results in connection with the CIP.²⁶ Rather, the IRS evaluates CIPs using exam productivity metrics (called “records of tax enforcement results” or ROTERS), such as dollars per hour, dollars per return, and the examination no-change rate.²⁷ It does not use RCTs or otherwise evaluate the impact of a CIP on taxpayer behavior (*e.g.*, self-correction or future compliance) or attitudes (*e.g.*, customer satisfaction with or trust for the agency).²⁸

Large Business and International’s (LB&I’s) new “campaigns” may be similar to Compliance 2000 projects (or CIPs) because they can involve alternative treatments, but LB&I has not disclosed how it will identify appropriate treatments or the metrics it will use.²⁹ The Tax Exempt and Government Entities (TE/GE) Employee Plans Compliance Unit’s (EPCU) projects have similar features, but EPCU does not always report the revenue and compliance gains from alternative treatments in its project reports.³⁰

22 See Internal Revenue Manual (IRM) 4.19.10.2.5 (Jan. 1, 2011).

23 IRM 4.17.1.4 (Feb. 25, 2010); IRM 4.17.4.4.1 (Feb. 25, 2010); Form 13498, *Compliance Initiative Project Authorization - Part Two* (Apr. 2009).

24 There may have been a few multifunctional CIPs, but they are not the norm. IRS response to TAS information request (June 22, 2016) (“SBSE Exam is not aware of any non-enforcement function working Compliance Initiative Projects.”); SB/SE response to TAS information request (Oct. 22, 2016) (“SBSE is still not aware of any non-enforcement functions working Compliance Initiative Projects.”); SB/SE response to TAS fact check (Nov. 21, 2016) (“During a cursory review of CIPs for this fact check request response, SB found two examples of multi-Functional CIPs ... We also have [six] examples where our Communication and Stakeholder Outreach function (CSO) [formerly known as Communication, Liaison, and Disclosure (CLD)] has worked with our Examination function on a CIP and signed off on the CIP”). Alternative treatments could be used in most CIPs. For example, the IRS could send soft notices and educational materials to all of the taxpayers with apparent discrepancies to give them an opportunity to self-correct so that an examination would not be necessary.

25 Only IRM parts 4 and 5, which apply to examination and collection employees, discuss the implementation of CIPs, and these IRMs do not direct enforcement employees to implement alternative treatments.

26 IRM Exhibit 4.17.2-1 (Feb. 25, 2010); Form 13497, *Compliance Initiative Project Authorization - Termination Report* (2008).

27 CIP analysts prepare and review monthly CIP data overview reports, which focus on ROTERS. IRM 4.17.2 (Feb. 25, 2010); IRM Exhibit 4.17.2-1 (Feb. 25, 2010). Similarly, the CIP Termination Report form asks for: number of returns examined, number of returns no-changed, number of returns surveyed, average time per return, average deficiency or adjustment (1120S, 1065), number of referrals to Criminal Investigation, and number of joint investigations from such referrals. IRS Form 13497, *Compliance Initiative Project Authorization - Termination Report* (2008).

28 *Id.*

29 See, *e.g.*, Dolores Gregory, *Corporate Taxes: LB&I to Focus on Audit Approach, Cultural Shift*, 008 DTR S-18 (Jan. 13, 2016) (a campaign “issue could be to initiate a number of audits, O’Donnell [LB&I Commissioner] told Bloomberg BNA in December. “But it could also be some other tailored treatment — specific guidance, change to a form, updated instructions — there are a host of things we could be doing ...”); LB&I response to TAS information request (June 22, 2016) (“Campaign Metrics will be specific to each campaign. We are in the process of developing metrics for our approved campaigns. We have just approved four campaigns. We do not have results at this time.”). But, LB&I does not accurately track audit adjustments by issue so that it knows where taxpayers are making the most significant errors. See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-30-089, *The Large Business and International Division’s Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 14, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630089fr.pdf>.

30 See IRS, *EPCU - Completed Projects - Projects With Summary Reports* (June 13, 2016), <https://www.irs.gov/retirement-plans/employee-plans-compliance-unit-epcu-completed-projects-projects-with-summary-reports>.

Alternative Treatments That Use Behavioral Insights Can Have a Significant and Measurable Return on Investment (ROI)

Small changes or “nudges” can remove barriers that impede public policy goals, such as hard-to-understand information, burdensome forms, or poorly presented choices.³¹ For example, financial aid applications pre-filled with information from tax returns can significantly increase qualifying applications and college attendance, even though there are already significant economic incentives for filling out the application and going to college.³² Because the government designs tax rules, procedures, and communications that create or minimize such barriers, it cannot avoid nudging taxpayers in one direction or another.

In 2010, the United Kingdom (U.K.) government created the Behavioural Insights Team (BIT or the “Nudge Unit”) to help various government agencies apply BIs, including Her Majesty’s Revenue and Customs (HMRC), the U.K. tax agency. It focused on BIs described using the acronym MINDSPACE:³³

- Messenger – we are heavily influenced by who communicates information;
- Incentives – our responses to incentives are shaped by predictable mental shortcuts such as strongly avoiding losses (rather than cost benefit computations);
- Norms – we are strongly influenced by what others do;
- Defaults – we ‘go with the flow’ of pre-set options;³⁴
- Salience – our attention is drawn to what is novel and relevant to us;
- Priming – our acts are often influenced by sub-conscious cues;
- Affect – our emotional associations can powerfully shape our actions;
- Commitments – we seek to be consistent with our public promises, and reciprocate acts; and
- Ego – we act in ways that make us feel better about ourselves.³⁵

31 See, e.g., Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449 (2003); Richard H. Thaler & Cass R. Sunstein, *NUDGE* (2008); Christine Jolls, Cass R. Sunstein, & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998).

32 Eric P. Bettinger et al., *The Role of Application Assistance and Information in College Decisions: Results from the H&R Block FAFSA Experiment*, 127 Q. J. ECON. 1205 (2012).

33 David Halpern, *Inside the Nudge Unit, How Small Changes Can Make A Big Difference* 50 (2015). MINDSPACE was later replaced by EAST, which means: Easy, Attractive, Social, and Timely. *Id.* at 60 and 149. For further discussion of the insights, see, e.g., BIT, *Applying Behavioural Insights to Reduce Fraud, Error and Debt* 4 (2012); Laura Haynes et al., Cabinet Office, BIT, *Test, Learn, Adapt: Developing Public Policy with Randomized Controlled Trials* (2012), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/62529/TLA-1906126.pdf.

34 For example, filing and reporting compliance might increase in the U.S. if taxpayers (and preparers) could easily download into their tax software the third-party information return data needed to prepare returns, as recommended by the National Taxpayer Advocate. National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 68, 79 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

35 BIT also found that treatments were more effective for taxpayers with a history of compliance. David Halpern, *INSIDE THE NUDGE UNIT, HOW SMALL CHANGES CAN MAKE A BIG DIFFERENCE* 131 (2015). Thus, spending extra resources to help first-time taxpayers and startups establish good tax compliance habits could help avoid the need to spend more resources to address noncompliance after bad habits develop.

Tax agencies have been using RCTs and field experiments to measure the effectiveness of various alternative treatments using BIs, as described below:³⁶

- HMRC and the Australian Office of State Revenue (OSR) revised tax delinquency letters to include norms statements such as “9 out of 10 UK citizens pay their self-assessment tax on time,” while increasing the clarity and salience of the letters.³⁷ The most successful message led to a five percentage point increase in payments in the U.K. and a three point increase in Australia, as compared to the standard notice.³⁸
 - HMRC found tailored messages, which increased the salience of the delinquency letters for a specific population (*e.g.*, doctors), increased the response rate from 3.8 percent to 35.3 percent.³⁹
 - By sending taxpayers directly to a form, rather than a webpage that contained the form, HMRC increased the response to delinquency notices by four percentage points.⁴⁰
- The U.S. Treasury’s Debt Management Service (DMS) prompted about 45 percent more individuals to pay online (from 1.5 to about 2.2 percent) by shortening the web address.⁴¹

36 See, *e.g.*, Laura Haynes *et al.*, Cabinet Office, BIT, *Test, Learn, Adapt: Developing Public Policy with Randomized Controlled Trials*, Policy Paper, (2012); World Bank, *Mind Society and Behavior* 198 (2015). <http://www.worldbank.org/content/dam/Worldbank/Publications/WDR/WDR%202015/WDR-2015-Full-Report.pdf>; BIT, *Applying Behavioural Insights to Reduce Fraud, Error and Debt* (2012), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/60539/BIT_FraudErrorDebt_accessible.pdf; Joana Sousa Lourenço *et al.*, *Behavioural Insights Applied to Policy*, European Report 2016, EUR 27726 (2016), http://publications.jrc.ec.europa.eu/repository/bitstream/JRC100146/kjna27726enn_new.pdf.

37 See Michael Hallsworth, *The Behavioralist As Tax Collector: Using Natural Field Experiments to Enhance Tax Compliance* (NBER Working Paper No. 20007, 2014), <http://www.nber.org/papers/w20007>; Premier & Cabinet Behavioural Insights Unit, *Understanding People, Better Outcomes: Behavioural Insights in NSW* (Oct. 2014), <http://bi.dpc.nsw.gov.au/assets/Behavioural-Insights/Library/Understanding-People-Better-Outcomes.pdf>. See also BIT, *Update Report 2013-2015*, 55 n.1 (2015) (referencing House of Lords, *Science and Technology Select Committee on Behaviour Change* (Nov. 2010), <http://www.parliament.uk/documents/lords-committees/science-technology/behaviourchange/BCOralandWrittenEvCompiled180711.pdf>); David Halpern, *INSIDE THE NUDGE UNIT, HOW SMALL CHANGES CAN MAKE A BIG DIFFERENCE* 113-15 (2015).

38 BIT, *EAST, Four Simple Ways to Apply Behavioural Insights* 5 (July 2015), http://www.behaviouralinsights.co.uk/wp-content/uploads/2015/07/BIT-Publication-EAST_FA_WEB.pdf; Premier & Cabinet Behavioural Insights Unit, *Understanding People, Better Outcomes Behavioural Insights in NSW* 4-5 (Oct. 2014).

39 BIT, *EAST, Four Simple Ways to Apply Behavioural Insights* 23 (July 2015). See also David Halpern, *INSIDE THE NUDGE UNIT, How Small Changes Can Make A Big Difference* 88 (2015). A similar approach worked with other professionals such as plumbers. *Id.*

40 David Halpern, *INSIDE THE NUDGE UNIT, HOW SMALL CHANGES CAN MAKE A BIG DIFFERENCE* 74 n.10 (2015) (citing an increase from 19.2 to 23.4 percent); BIT, *EAST, Four Simple Ways to Apply Behavioural Insights* 12 (July 2015), http://www.behaviouralinsights.co.uk/wp-content/uploads/2015/07/BIT-Publication-EAST_FA_WEB.pdf.

41 Fact Sheet: President Obama Signs Executive Order; White House Announces New Steps to Improve Federal Programs by Leveraging Research Insights (Sept. 15, 2015), <https://www.whitehouse.gov/the-press-office/2015/09/15/fact-sheet-president-obama-signs-executive-order-white-house-announces>. In 2014, the White House Office of Science and Technology Policy (OSTP) established the Social and Behavioral Sciences Team (SBST), a cross-agency team organized under the National Science and Technology Council to identify how behavioral insights could help U.S. agencies. Nat’l Sci. & Tech. Council, Exec. Off. of the President, Soc. & Behav. Sci. Team (SBST), *2015 Annual Report* (Sept. 2015), https://www.whitehouse.gov/sites/default/files/microsites/ostp/sbst_2015_annual_report_final_9_14_15.pdf. SBST worked with Treasury on this project.

- The National Tax Agency of Colombia (DIAN) increased the probability of payment by eight percentage points with a letter, 17 points with an email, and about 87 points with a personal visit, which in each case delivered the same deterrence and moral suasion messages.⁴²
- The Guatemalan tax authority tested social norms and deliberate choice messages in its delinquency letters. These messages increased the average amount paid per taxpayer by 210 percent and 269 percent, respectively, relative to no letter.⁴³ The deliberate choice message stated: “Previously we have considered your failure to declare an oversight. However, if you don’t declare now we will consider it an active choice and you may therefore be audited and could face the procedure established by law.” The ROI for the social norms and deliberate choice letters was about 35 to 1.⁴⁴ They also increased the likelihood that taxpayers would both declare and pay the following year with no further reminder.

Although reporting compliance may be more difficult to measure, both norms- and deterrence-based messages can also increase reporting compliance by measurable amounts, particularly if carefully tailored. For example, a 2007 study found that letters with normative appeals (“most people in this country pay ... [and mistakes mean] less money available for public spending on things like hospitals, schools and pensions”) and deterrence messages (the agency is increasing inquiries and “your return may be one of those chosen”) both prompted small businesses in the U.K. to increase reported sales (above the simplified reporting threshold) and net profits.⁴⁵

42 Daniel Ortega and Carlos Scartascini, *Don’t Blame the Messenger: A Field Experiment on Delivery Methods For Increasing Tax Compliance* 31 (CAF, Development Bank of Latin America, Working Paper No. 2015/09, 2015), <http://scioteca.caf.com/handle/123456789/821>. The authors suggest email may have been superior to letters because “[T]he agency had been moving many of its transactions online, so the email may have had a relatively higher salience, which may not export easily to other places. Additionally, given the fact that payments can be made online, the act of paying may have been more spontaneous than after receiving a letter (the person was already sitting at the computer).” *Id.* at 27 n31. Another study by the same researchers found that phone calls have an intermediate effect between the impersonal methods and in-person visits. *Id.* at 3 (citing Daniel Ortega & Carlos Scartascini, Inter-American Development Bank, *Who’s Calling? The Effect of Phone Calls as a Deterrence Mechanism* (2015)).

43 Stewart Kettle *et al.*, *Behavioural Interventions in Tax Compliance: Evidence from Guatemala*, IRS Research Conference (2015), <https://www.irs.gov/pub/irs-soi/15resconhemandez.pdf>. The authors explain the deliberate choice message “aims to eliminate omission as an excuse for noncompliance now ... The wording also gives the taxpayer an exemption for not previously declaring, which introduces an element of reciprocity, as the taxpayer is given the sense that he has been granted a favor. The text is also worded to give the impression that the behaviour of the taxpayer is being closely monitored and serves to increase the perception of punishment for noncompliance.” *Id.* at 148.

44 *Id.* at 157-58.

45 See John Hasseldine *et al.*, *Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors*, 24 CONTEMP. ACCOUNTING RES. 171-94 (Spring 2007), <http://onlinelibrary.wiley.com/doi/10.1506/P207-004L-4205-7NX0/abstract>. These findings are generally consistent with prior research. See Joel Slemrod *et al.*, *Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Field Experiment in Minnesota*, 79 J. PUB. ECON. 455-83 (2000) (finding a letter emphasizing “increased audit” probability increased reporting compliance for low income Schedule C or F filers, but reduced it for high income taxpayers), and Richard Schwartz & Sonya Orleans, *On Legal Sanctions*, 34 UNIV. CHICAGO L. REV. 274, 299 (1967) (finding taxpayers who had been asked survey questions that either appealed to conscience or that highlighted sanctions both increased their reporting compliance, though the effect of the sanction discussion was weaker). *But see*, Marsha Blumenthal *et al.*, *Do Normative Appeals Affect Tax Compliance? Evidence From a Controlled Experiment in Minnesota*, 54 NAT. TAX J. 125-36 (2001) (finding a generic letter which said “[a]udits ... [show people] pay voluntarily 93 percent” of what they owe (a normative appeal) did not improve reporting compliance by Schedule C or F filers; however, the letter stated that “many Minnesotans believe other people routinely cheat” and recipients may not have believed that audits detected all noncompliance).

Improving the timing and salience of existing messages can also improve reporting compliance.⁴⁶ For example, the General Services Administration (GSA) improved the accuracy of government contractors' self-reported sales by moving an online signature box from the bottom to the top of the form, enabling GSA to collect an additional \$1.59 million in fees in a single quarter.⁴⁷

Alternative Treatments That Ignore Behavioral Science Insights Can Be Ineffective

In February 2009, Wage and Investment's (W&I) Stakeholder Partnerships, Education and Communication function (SPEC) sent a brochure of "common errors" to elderly taxpayers who had a math error on their 2007 returns.⁴⁸ The brochures generally did not improve compliance.⁴⁹ However, seniors are less responsive than others to impersonal forms of communication.⁵⁰ More importantly, the brochure did not remind the recipient that he or she had made an error, which would have increased its salience. For those who read the brochure, its reference to "common errors" reinforced the view that making errors is the norm for seniors — a message that is, potentially, more likely to reduce compliance than improve it. Moreover, it may be particularly difficult to avoid repeating inadvertent errors.

Of course, it would be inaccurate to conclude that all alternative treatments are ineffective because one did not provoke the desired behavior in a specific context with a specific population. Rather, the IRS needs to measure and report on the effectiveness of specific alternative treatments with different populations on a regular basis so that it can better understand why some are more effective than others for a particular segment. If one IRS function identifies an effective alternative treatment, it should publish and index the results so that other functions and stakeholders can benefit.

The IRS Is Testing Alternative Treatments That Use Behavioral Insights

Preliminary data suggests the W&I Division has improved reporting compliance by sending "soft" notices to taxpayers who appeared (based on third-party reporting) to have violated the Individual Retirement Account (IRA) contribution and distribution rules during 2013-2015.⁵¹ These notices appear to have educated taxpayers, making compliance easier and noncompliance more salient and visible. In some cases, W&I did not use a randomly selected control group.⁵² However, its (non-projectable) results indicate that "approximately 91 percent of notice recipients and 85 percent of non-notice recipients stopped contributing in excess ..." and "roughly 10 percent of notice recipients self-assessed the excise tax [penalty] in comparison to non-notice recipients whose correction rate remained at 1 percent."⁵³

46 See, e.g., Lisa L. Shu et al., *Signing at the Beginning Makes Ethics Salient and Decreases Dishonest Self-Reports in Comparison to Signing at the End*, 109 PROC. NAT'L ACAD. SCI. 15197 (2012), <http://www.ncbi.nlm.nih.gov/pmc/articles/PMC3458378/> (finding that signing before — rather than after — the opportunity to cheat makes ethics salient at the right time, and significantly reduces dishonesty).

47 Nat'l Sci. & Tech. Council, Exec. Off. of the President, *SBST, 2015 Annual Report* (Sept. 2015), <https://sbst.gov/>.

48 WIRA, Project No: 4-09-01-S-006, *SPEC's Senior Math Error Direct Mail Marketing Campaign* (Jan. 2010).

49 *Id.*

50 IRS, Pub. 4579, *Taxpayer Assistance Blueprint Phase II 65* (2007), <http://www.irs.gov/pub/irs-pdf/p4579.pdf> (Figure 3-7). Further, the study does not indicate that the IRS removed taxpayers from the analysis if their brochures were returned as undeliverable. WIRA, Project No: 4-09-01-S-006, *SPEC's Senior Math Error Direct Mail Marketing Campaign* (Jan. 2010).

51 Wage and Investment (W&I) response to TAS information request (June 22, 2016). Both GAO and TIGTA had identified IRA compliance as a problem. See TIGTA, Ref. No. 2008-40-087, *Individual Retirement Account Contributions and Distributions Are Not Adequately Monitored to Ensure Tax Compliance* (Mar. 28, 2008); GAO, GAO-08-654, *Individual Retirement Accounts: Additional IRS Actions Could Help Taxpayers Facing Challenges in Complying with Key Tax Rules* (Aug. 14, 2008); TIGTA, 2010-40-043, *A Service-wide Strategy Is Needed to Address Growing Noncompliance With Individual Retirement Account Contribution and Distribution Requirements* (Mar. 29, 2010).

52 W&I response to TAS information request (June 22, 2016).

53 W&I Strategies and Solutions Group 3, Project Num. 4-15-03-S-616, *Excess Contributions to Individual Retirement Accounts: 2014 Mail-Out Analysis 3* (June 2016).

In July 2016, the IRS reported on several ongoing EITC studies mandated by Congress.⁵⁴ In one, the IRS reduced the EITC errors that preparers made on returns, by visiting, calling, and sending notices.⁵⁵ Mode of communication mattered. In-person visits were more effective, but also more costly. Salience and relevance mattered. Notices that specified the types of errors the IRS was seeing were more effective than generic notices. Timing also mattered. The IRS had more success when it sent notices immediately before the filing season than during the filing season.

In a second study, the IRS improved EITC reporting compliance by working with tax software companies to clarify eligibility questions, and require taxpayers to affirm key facts. This made eligibility easier to determine. It probably also made it harder for taxpayers to justify noncompliance while retaining a positive self-image (*e.g.*, on the basis that the rules were complicated and they did not understand).

In a third study, the IRS sent letters to those with apparent discrepancies, explaining the discrepancy, and asking them to self-correct, if necessary. These letters should also make it easier for taxpayers to comply and harder for them to justify noncompliance.

In fiscal years (FYs) 2013 to 2015, the IRS sent reminders to low income taxpayers who appeared eligible for the EITC, but had not filed a return.⁵⁶ The reminders reduced nonfiling for the year in question (and prior years) for both taxpayers with a balance due and those due a refund (*i.e.*, addressing inattentiveness).⁵⁷ They also increased voluntary compliance in subsequent years, at least for those who had received a refund. The reminders might have been even more effective if they had explained why the IRS believed the taxpayer should have filed (increasing salience). Researchers projected that an expansion of the effort could bring in an additional 53,000 filers, pay out \$180 million in additional refunds, and bring in an additional \$27 million in unpaid taxes.⁵⁸ However, the IRS did not report any of the foregoing “service” revenues to stakeholders in its routine reports.⁵⁹

Similarly, in January 2016, TAS sent letters to taxpayers who claimed the EITC on 2014 returns that were not audited even though the returns appeared to have the same problems as those that were. The letter was salient, highlighting that the purpose was “so that you can avoid an error in the future,” explaining the requirements for claiming the EITC in easy to understand language, identifying the exact requirement that the taxpayer did not appear to meet and why, and suggesting sources of additional information and

54 U.S. Department of the Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis 16* (July 5, 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-EITC-Data-Driven-Compliance-2016.pdf>.

55 For additional information, see, Karen Masken, *IRS Preparer-Level Treatment Tests* (Dec. 2014), <https://www.irs.gov/pub/irs-soi/15resconmasken.pdf>.

56 IRS response to fact check (Dec. 7, 2016); IRS Management’s Discussion & Analysis (MD&A) 5-6 (FY 2015), reproduced in, GAO, GAO-16-146, *Financial Audit: IRS’s Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015), www.gao.gov/assets/680/673614.pdf; RAAS response to TAS information request (July 7, 2016).

57 Researchers found no difference when the reminder was framed to harness loss aversion (*i.e.*, “avoid losing valuable tax benefits”). RAAS response to TAS information request (July 7, 2016).

58 *Id.*

59 Compare IRS MD&A FY 2015, *supra* 5-6 (not referencing service revenue estimates), with U.S. Department of the Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis 16* (July 5, 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-EITC-Data-Driven-Compliance-2016.pdf> (indicating the study would quantify the results in October 2016) and John Guyton *et al.*, *Reminders & Recidivism: Evidence From Tax Filing & EITC Participation Among Low-Income Nonfilers* § IV(b)(2) (NBER Working Paper 21904, 2016), <http://www.nber.org/papers/w21904.pdf> (reporting that “roughly 52% of individuals who had a balance due on the 2013 return recidivated into nonfiling, but the treatment reduced this recidivism to about 42%”).

assistance, including TAS.⁶⁰ TAS also considered timing, mailing the letters in the second or third week of January when taxpayers might expect to get tax-related notices, such as W-2's, and noted on the outside of the envelope "important tax information enclosed." These letters improved compliance for some types of recipients as compared to the control group that did not receive a letter, as discussed in volume 2 of this report.⁶¹

Small Business/Self-Employed (SB/SE) is also working to improve the "alerts" it provides to taxpayers at risk of falling behind on their federal tax deposits (called FTD alerts).⁶² It is using BIs related to (1) timing – triggering them earlier, sometimes before a deposit is due; (2) salience and visibility – better targeting taxpayers most likely to fall behind, and explaining why they are receiving a reminder; (3) social norms – including statements like "nine out of ten businesses deposit on time each quarter;" (4) rational appeals or deterrence – disclosing the penalties and interest that could apply, and (5) segmentation – using different modes of communication (*e.g.*, letters, calls, and visits) for different segments.⁶³

In addition, SB/SE is sending notices to taxpayers who appear to be under withheld.⁶⁴ The notices include rational appeals about the potential consequences of being under withheld (*i.e.*, deterrence), but do not explain why the IRS believes there is a problem.⁶⁵ Similarly, the IRS is testing the extent to which sending additional letters to non-filers before it makes substitute for return (SFR) assessments triggers self-correction.⁶⁶ While these letters may improve voluntary compliance, the IRS should incorporate BIs to improve the results and report the resulting revenue and compliance gains.

Finally, TAS is investigating the effectiveness of letters that use BIs to improve payment compliance.⁶⁷ These letters may include: (1) rational appeals – information on the composition of the outstanding amount and the accrual of interest and penalties; (2) social norms appeals – information about the high rate of on-time tax payments in the taxpayers' area; (3) reciprocity appeals – information on how payments are used for services that benefit taxpayers; (4) threats of enforcement – information on potential penalties and the IRS's capacity to enforce noncompliant behavior; and (5) "extra help" offers – the telephone number of a hotline staffed with TAS employees who will assist with the filing and payment process (including payment alternatives). TAS will also compare the impact of different letter formats, such as those using a typical IRS format and those formatted using cognitive and visual learning concepts. TAS plans to quantify and report the overall and relative effectiveness of each communication. However, it is unclear whether or how the IRS will report any "service" revenues that result from these letters or its other BI projects (discussed above) to stakeholders.

60 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 184 (TAS Research Initiatives: *Impact of Education and Outreach on Earned Income Tax Credit (EITC) Taxpayer Compliance*).

61 Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter from the National Taxpayer Advocate*, vol. 2, *supra*.

62 SB/SE response to TAS information request (June 22, 2016).

63 *Id.* Through FY 16 (April), over 85 percent of FTD Alerts were worked in the field, and Field Time overall (all cases in Field Collection), increased by nearly 12 percent compared to last year. SB/SE response to fact check (Dec. 8, 2016). This could improve the salience of the message. The IRS also found that letters increase payments for certain taxpayer segments. *Id.* Although personal contacts are likely superior, letters can nearly always be improved.

64 *Id.* Letter 2802C, *Withholding Compliance Letter*. SB/SE is also working to modify delinquency notices, such as CP 14, and to measure taxpayer responses to different versions using RCTs. SB/SE response to TAS information request (Oct. 19, 2016).

65 *Id.*

66 SB/SE response to TAS information request (June 22, 2016).

67 National Taxpayer Advocate 2017 Objectives Report to Congress 184.

The IRS Reports “Enforcement” Revenues to Stakeholders More Routinely Than “Service” Revenue From Alternative Treatments, Potentially Biasing Policy Decisions

The IRS reports the revenues from alternative treatments on an *ad hoc* basis (*e.g.*, in connection with studies that it decides to publish), but routinely reports its “enforcement revenue” to stakeholders.⁶⁸

“Enforcement” revenue generally include any payments received after a case is assigned to an “enforcement” function (*i.e.*, Exam, Appeals, Chief Counsel, Collection, Information Reporter Program (IRP), and the Automated Underreporter (AUR) Program), even if the taxpayers made them as a result of alternative treatments (*e.g.*, a letter) rather than an enforcement action (*e.g.*, an assessment or levy).⁶⁹ The IRS’s expansive definition of “enforcement” revenue exaggerates the effectiveness of coercive treatments, and seems to ignore “service” revenue.

More importantly, the IRS is working to quantify the ratio of direct “enforcement” revenue to cost for each of its “enforcement” programs so that it can allocate more resources to those with the greatest marginal ROI.⁷⁰ Similarly, the IRS routinely estimates “enforcement” ROIs to justify additional investments by “enforcement” functions, but not to justify additional investment by service functions.⁷¹ Moreover, its “enforcement” revenue computations ignore the indirect effects of enforcement on voluntary compliance (*e.g.*, effects on future compliance or compliance by others).⁷² The IRS plans to add

... indirect effects whenever we have reasonable estimates. There is no timeline established at this time. In the meantime, the resource allocation will continue to account for indirect effects by imposing minimum coverage constraints in each Exam category.⁷³

- 68 See, *e.g.*, IRS, *Fiscal Year 2015 Enforcement and Service Results* (Mar. 8, 2016), <https://www.irs.gov/uac/newsroom/fiscal-year-2015-enforcement-and-service-results>. As noted above, the IRS recently collaborated with outside researchers on four studies addressing various ways to improve EITC compliance, and quantified some of its results. See U.S. Department of Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis* 16 (July 5, 2016). However, the IRS mixed the results of alternative treatments with “enforcement revenue” in its routine reports. See IRS MD&A FY 2015, 44.
- 69 LB&I, Operations Planning & Support (OPS), *What Exactly Do We Mean by “Enforcement Revenue”?* (2016); Bill Gammon & Peter Rose, IRS, *Tracking and Estimating the Direct Revenue Effects of IRS Enforcement Actions* (Apr. 25, 2005). For a historic discussion of this problem, see IRS, Pub. 1501, *Evaluation of the IRS System of Projecting Enforcement Revenue* (Oct. 1990). Although the criminal investigation (CI) division is the only function that conducts true law enforcement, it is not considered an enforcement function for this purpose. *Id.*
- 70 The IRS is implementing a recommendation by GAO, which suggested the IRS should compute the direct marginal “enforcement” revenue ROI for its reporting compliance programs (*i.e.*, automated substitute for return, AUR, correspondence exam, and field exam) by broad taxpayer segments and allocate compliance resources on that basis. GAO, GAO-13-151, *IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* (Dec. 2012), <http://www.gao.gov/assets/660/650521.pdf>; RAAS, *Business Performance Review* (2014), <http://ras.web.irs.gov/AboutRAS/BPR/RASBPRJulSep2014.pdf>.
- 71 See, *e.g.*, IRS, *Budget in Brief 10-15* (FY 2017), https://www.treasury.gov/about/budget-performance/budget-in-brief/Pages/index_17.aspx.
- 72 Ronald H. Hodge II *et al.*, *Estimating Marginal Revenue/Cost Curves for Correspondence Audits*, IRS Research Conference 1 n.5 (2015), <https://www.irs.gov/pub/irs-soi/15resconplumley.pdf> (“If we had estimates of the associated changes in voluntary compliance that are induced indirectly by that program [some of the major discretionary categories of correspondence audits] throughout the entire population, those estimates could be added to the direct revenue estimates to represent the full benefit of the program.”); Alan H. Plumley & C. Eugene Steuerle, *Ultimate Objectives for the IRS: Balancing Revenue and Service*, in *THE CRISIS IN TAX ADMINISTRATION* 311, 329 (Henry J. Aaron & Joel Slemrod, eds., 2004), http://webarchive.urban.org/UploadedPDF/1000636_IRS_objectives.pdf (“The appeal of direct revenue maximization is that, for the most part, it is measurable, and it provides a basis for making resource allocation decisions ... To the extent that IRS activities — whether enforcement or nonenforcement — indirectly affect the voluntary compliance of the general population, it is the combination of direct and indirect revenue that is important.”); IRS, *Budget in Brief 15* (FY 2017) (“[T]he ROI estimate does not include the revenue effect of the indirect deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.” [On average]).
- 73 RAAS response to TAS information request (July 7, 2016).

If the IRS could collect one percent more revenue through an unresponsive automated enforcement strategy that causes taxpayers to lose faith in the IRS and reduces voluntary compliance by one percent, voluntary compliance revenue would decline by about 60 times as much as “enforcement” revenue increased.

The IRS’s minimum coverage strategy is based on the implicit assumption that indirect effects are always positive and driven primarily by deterrence. However, research (discussed above) suggests the indirect effects could be negative, especially when coercion is misapplied to certain taxpayer segments.

If the IRS could collect one percent more revenue through an unresponsive automated enforcement strategy that causes taxpayers to lose faith in the IRS and reduces voluntary compliance by one percent, voluntary compliance revenue would decline by about 60 times as much as “enforcement” revenue increased.⁷⁴ Thus, if the IRS allocates resources to increase marginal “enforcement” revenue without regard to indirect effects, it risks making costly and ill-informed resource allocation decisions.⁷⁵ Alternative treatments are less likely to have negative indirect effects on voluntary compliance than enforcement treatments, as discussed above. Yet, the IRS does not routinely measure and report the direct (or indirect) revenue from alternative treatments.

CONCLUSION

Alternative treatments can be a cost effective way to improve tax compliance while minimizing taxpayer burden, particularly if they use BIs. They also support taxpayer rights.⁷⁶ They help alert taxpayers when they may not have complied, promoting the *right to be informed*. They are less intrusive than coercive treatments, furthering the taxpayers’ *right to privacy*. They help taxpayers comply more quickly, promoting the taxpayers’ *right to finality*. Because coercing those who would respond to nudges seems unfair, they also support the taxpayer’s right to a *fair and just tax system*. Because the IRS can over-reach when using coercive tools, they also further the taxpayer right to *pay no more than the correct amount of tax*.

Unless the IRS identifies the best alternative treatments, such as those that leverage BIs, it is more likely to conclude that alternative treatments are ineffective. It should continue to test the effectiveness of different levers with different taxpayer segments using RCTs. Even if the IRS identifies effective alternative treatments, it may underutilize them unless it routinely quantifies and reports the resulting service revenues and compliance gains.

74 See GAO, GAO-16-146, *Financial Audit: IRS’s Fiscal Years 2015 and 2014 Financial Statements* 25 (Nov. 2015), www.gao.gov/assets/680/673614.pdf (reflecting direct “enforcement” revenue of \$54.2 billion out of \$3.3 trillion). The indirect effect of IRS activities on compliance far exceeds the direct effects, with the indirect effect of an audit exceeding six times the proposed assessment, according to some IRS estimates. See, e.g., Alan H. Plumley, *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results*, National Tax Association, 95th Annual Conference on Taxation 12-13 (2002), <http://www.irs.gov/pub/irs-soi/irsvtc.pdf>; Jeffrey A. Dubin et al., *The Effect of Audit Rates on the Federal Individual Income Tax, 1977-1986*, 43 Nat. Tax J. 395, 405 (1990), <http://www.ntanet.org/NTJ/43/4/ntj-v43n04p395-409-effect-audit-rates-federal.pdf>. Without effective and timely measures of voluntary compliance, any negative indirect effects from more “efficient” exams will go unnoticed.

75 See, e.g., Treasury Department, *Congressional Justification* 112 (FY 2017), <http://www.treasury.gov/about/budget-performance/Pages/cj-index.aspx>. (“Net revenue is maximized only when resources are allocated according to marginal *direct and indirect* return on investment, but those ratios are much more challenging to estimate than the average ROI shown here.”).

76 See IRC § 7803(a); TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt procedures for routinely testing BIs using RCTs to identify which ones are most effective for various compliance problems and taxpayer segments.
2. Adopt procedures to timely disclose the results of IRS studies and RCTs so that all internal and external stakeholders can benefit from them.
3. Routinely measure and report the “service” revenue and compliance gains from alternative treatments to internal and external stakeholders.
4. Discontinue or modify reports that highlight “enforcement” revenue (as currently defined), which is misleading because it includes “service” revenue and does not include the (potentially negative) indirect effects of unnecessary coercion.
5. Incorporate behavioral response metrics (*e.g.*, response rates and future compliance) into all IRS programs to help avoid over-emphasizing the importance of direct revenue.

MSP #2 **WORLDWIDE TAXPAYER SERVICE: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges As Other Tax Administrations**

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Operating Division
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 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Jeffrey Tribiano, Deputy Commissioner, Operations Support

TAXPAYER RIGHT IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*

DEFINITION OF PROBLEM²

The IRS, like tax administrations elsewhere, has reacted to budgetary constraints in recent years by shifting taxpayer services to online channels.³ “Best practices” in taxpayer service begin with considering taxpayers’, as opposed to the tax administration’s, needs and preferences, but the IRS bases its approach on information and surveys that are not designed to elicit diverse taxpayer perspectives and do not distinguish between simple tasks and highly emotional, complex transactions. The IRS’s vision of how taxpayers will interact with it through their online accounts may be unrealistic, conveying to taxpayers a lack of interest in engaging with them.

ANALYSIS OF PROBLEM

Background

In the light of a budget cut of about 19 percent from fiscal year (FY) 2010 to FY 2016, the IRS, as an integral part of its “Future State” design, plans significant shifts to online channels, particularly online taxpayer accounts, to deliver taxpayer service.⁴ The IRS is not the only tax administration confronted with a shrinking budget in recent years. According to the Organisation for Economic Co-operation and

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Taxpayer Service in Other Countries*, vol. 3, *infra*.
- 3 National Taxpayer Advocate 2015 Annual Report to Congress 3 (Most Serious Problem: *The IRS Has Developed a Comprehensive “Future State” Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*); Organisation for Economic Co-operation and Development (OECD), *Managing Service Demand: A Practical Guide to Help Revenue Bodies Better Meet Taxpayers’ Service Expectations* 9 (2013).
- 4 “Future State” refers to the IRS’s description of how it intends to operate in coming years. For a full discussion of the IRS’s “Future State,” see National Taxpayer Advocate 2015 Annual Report to Congress 3 (Most Serious Problem: *The IRS Has Developed a Comprehensive “Future State” Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*); Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.

Applying these insights to tax administration, if a taxpayer prefers telephone or in-person communication and that channel is not available, the taxpayer may feel alienated, frustrated, and disengaged from the tax system. He may make an emotional decision that he will regret later, such as ignoring the IRS's messages or agreeing to the IRS's adjustments to his return even though he believes the IRS is wrong.

Development (OECD), out of 56 countries surveyed, 21 reported that specific reductions in their tax administrations had been required.⁵

In response to financial pressures, many tax administrations, like the IRS, adopted the objective of shifting taxpayer service to self-service and online channels.⁶ As of 2011, however, efforts for managing service demand were “immature — fragmented, incomplete, and/or lacking co-ordination” and revenue bodies were not effectively determining the root cause of demand for various services and service channels.⁷

This situation has persisted, with revenue bodies seeking to increase the use of online channels but not collecting enough data to understand what services taxpayers seek via online channels and the reasons taxpayers choose to use online services.⁸ The IRS, for example, has appeared to view online accounts as a substitute for, rather than a complement to, other service channels such as telephone or in-person assistance.⁹ This approach is inconsistent with at least one non-IRS survey showing that people who interacted with various federal government administrations had a slightly higher level of satisfaction with their in-person interactions than with digital interactions through mobile applications, federal websites, and email.¹⁰

Taxpayers Overall Prefer a Mix of Channels, and the Delivery Channel an Individual Taxpayer Prefers May Depend on the Services Being Sought and Whether the Transaction Is Emotionally Charged

Experience elsewhere in the world demonstrates that, as in the United States, when citizens interact with their governments they prefer different service channels depending on the task they hope to accomplish.¹¹ For example, a case study of how 500 job seekers would prefer to use the services of the German Federal Employment Agency showed they usually preferred online services to search for a job, telephone services for making appointments and contacting employers, and in-person contact for signing up for employment, unemployment benefits, or counseling.¹² Even the 215 citizens in the study who were daily internet users did not prefer digital delivery for all services — these users also preferred multiple channels,

5 OECD, *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies* 171-72, Table 5.1 (2015). These countries are: Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Mexico, Netherlands, New Zealand, Portugal, Slovenia, Spain, United Kingdom, and United States (OECD countries); Cyprus, Romania, and Russia (non-OECD countries).

6 See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*, *infra*.

7 OECD, *Managing Service Demand: A Practical Guide to Help Revenue Bodies Better Meet Taxpayers' Service Expectations* 9 (2013).

8 OECD, *Increasing Taxpayers' Use of Self-Service Channels* 28-32, 65 (2014).

9 National Taxpayer Advocate 2015 Annual Report to Congress 7 (Most Serious Problem: *The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*) (noting that “[b]ased on our internal discussions with IRS officials, TAS has been left with the distinct impression that the IRS's ultimate goal is ‘to get out of the business of talking with taxpayers.’”).

10 See Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience* 2 (Feb. 18, 2016).

11 National Taxpayer Advocate 2015 Annual Report to Congress 7-8 (Most Serious Problem: *The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*) (noting that “[o]nline accounts work well for ‘cookie cutter’ transactions. ... When dealing with the IRS, little is ‘cookie cutter’ and much is case-specific.”).

12 Julia Klier, Regina Pflieger, & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, *Wirtschaftsinformatik Proceedings Paper* 13, 186-7 (2015).

which varied depending on the service they needed.¹³ Moreover, a mix of channels for each service was usually needed to accommodate all preferences.¹⁴

Analysis of customer preference in the banking sector yields similar insights. Some transactions, such as opening or closing an account, applying for a loan, or seeking financial advice, lie at one end of the human-to-digital continuum.¹⁵ For these complex or emotionally charged transactions, most customers prefer in-person interaction at a branch. At the other end of the continuum, most customers preferred to receive statements by mail or online.¹⁶ Customers' satisfaction and engagement with the bank declined when they could not or did not use their preferred delivery channel, and the decline was greater when they did not use the channel they preferred for the highly emotional, complex transactions.¹⁷

Even investment banks offering “robo-advisor” services (in which computer programs provide investment advice online, typically for less than half the fees of traditional brokerages) report similar experiences.¹⁸ Customers may not seek advice from an actual person when markets are rising, but as markets fluctuate, customers want the option to speak with someone. As one professional noted, “[t]here are times when people just want to talk — even if it’s just to reinforce that they’re doing the right thing. Without access to a professional when the market gets choppy, there’s a risk that some investors might make emotional decisions that they’ll regret later.”¹⁹

Applying these insights to tax administration, if a taxpayer prefers telephone or in-person communication and that channel is not available, the taxpayer may feel alienated, frustrated, and disengaged from the tax system. He may make an emotional decision that he will regret later, such as ignoring the IRS’s messages or agreeing to the IRS’s adjustments to his return even though he believes the IRS is wrong.

The Information and Surveys the IRS Has Relied on in Developing the “Future State” Have Important Limitations

The IRS has used various methodologies to conduct surveys relating to taxpayer services:

- Contacting taxpayers on their landline telephones or cellphones;
- Delivering a paper survey to taxpayers in person and collecting the completed survey; and
- Using “online panels” — groups of participants who, in response to an invitation, take part in a survey by completing it online.²⁰

13 Julia Klier, Regina Pflieger, & Lea Thiel, *Just Digital or Multi-Channel? The Preferences of E-Government Service Adoption by Citizens and Business Users*, *Wirtschaftsinformatik Proceedings Paper 13*, 187 (2015).

14 *Id.*

15 Daniela Yu & John H. Fleming, *How Customers Interact With Their Banks*, *GALLUP BUSINESS JOURNAL* (May 2013), <http://www.gallup.com/businessjournal/162107/customers-interact-banks.aspx?version=print>.

16 *Id.*

17 *Id.*

18 Hugh Son & Margaret Collins, *The Rich Are Already Using Robo-Advisers, and That Scares Banks*, *BLOOMBERG BUSINESS* (Feb. 5, 2016).

19 Ben McLannahan, *‘Robo-advisers’ Try to Calm Investor Nerves*, *FINANCIAL TIMES* (Feb. 1, 2016) (quoting Tobin McDaniel, San Francisco-based president of Schwab Wealth Investment Advisory).

20 For a summary of various IRS surveys relating to taxpayer services, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

In developing online taxpayer accounts, the IRS has placed particular reliance on an online panel survey, the *W&I Web-First Conjoint Study* (Conjoint Study).²¹

As an online panel survey, the Conjoint Study may provide insights about the needs and preferences of taxpayers who are already online. However, a sizeable portion of U.S. households, 33 percent, do not have access to broadband internet at home.²² Their needs and preferences are not reflected in the Conjoint Study, and they may not be able to rely on an online account. Moreover, according to Pew Research, a drawback of panel surveys is that panelists who are members of racial and ethnic minority groups may not be representative of these groups more broadly.²³

Significantly, the survey instrument used in the Conjoint Study is not designed to elicit taxpayers' preferences, but requires respondents to select from among a limited number of specified alternatives. For example, one survey question is:

Question: People need help with many issues related to taxes. For each of the service needs listed, indicate if you have ever needed to complete the task:

1. Make a payment;
2. Obtain a copy of a tax transcript;
3. Obtain tax account information;
4. Have identity authenticated for tax-related purposes.²⁴

The respondent cannot indicate that he or she needed another type of service or needed to complete a different task, such as responding to an IRS adjustment to a return or entering into an installment agreement.²⁵ The survey then explores taxpayers' preferred delivery channels, but only with respect to those four services.

In contrast, the ongoing TAS Service Priorities Survey, conducted by calls to land lines and cellphones, includes open-ended questions. For example, one question is:

Question: You mentioned that you have contacted the IRS in the past 12 months. Did you contact the IRS for any of the following reasons? Please say yes or no to each one.

The taxpayer can indicate whether he or she used any of ten specified services, such as "Get a form or publication," or "Get answers to your tax law question." The 11th option is "Or did you contact the IRS for some other reason — specify."

21 IRS, *Facilitating Access to Convenient & Efficient IRS Service: W&I Web-First Conjoint Study* (Sept. 30, 2016). A conjoint study, often used to evaluate tangible products, uses a tradeoff approach that provides a series of different scenarios and asks participants which option they prefer for each. Participants must choose from among the offered options. This approach assumes participants have complete knowledge, preferably based on experience, of the topic that is the subject of the survey — in this instance, all different IRS service tasks and delivery options.

22 John B. Horrigan & Maeve Duggan, Pew Research Center, *Home Broadband 2015*, 2 (Dec. 21, 2015).

23 Courtney Kennedy, Andrew Mercer, Scott Keeter, Nick Hatley, Kiley McGeeney, & Alejandra Gimenez, Pew Research Center, *Evaluating Online Nonprobability Surveys; Vendor Choice Matters; Widespread Errors Found for Estimates Based on Blacks and Hispanics* (May 2, 2016).

24 Question 6, IRS, *Web-First Conjoint Study Survey Instrument*.

25 For a discussion of the TAS Service Priorities Survey, see Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

In another survey, the IRS asked taxpayers seeking face-to-face assistance at Taxpayer Assistance Centers (TACs) to complete a paper questionnaire.²⁶ The questionnaires were distributed to taxpayers already at the doors of the TACs.²⁷ Taxpayers who were turned away after waiting outside the TAC in hopes of being seen by an assistor were never surveyed.²⁸ For many TACs during filing season, the number of taxpayers needing assistance and waiting outside the TAC was far greater than the number granted appointments and admitted to the TAC. Thus, the IRS has no information about the services and assistance needed by taxpayers who were unserved by the TAC or who did not make an appointment.

Similarly, in the Conjoint Study, the IRS asked respondents whether they had visited a local IRS office in the last two years. If so, the respondent was asked “For the most recent interaction, did you:”

- Walk in for face-to-face service with a representative;
- Make an appointment for face-to-face service with a representative; or
- Serve yourself with no live assistance provided by a representative.²⁹

There is no menu option for the respondent to report that he or she visited a TAC but did not receive *any* assistance. Thus, the IRS does not know what these taxpayers’ needs were or if they were ever met.

The IRS’s Vision of How Taxpayers Will Perceive or Use Online Accounts May Not Reflect Taxpayers’ View of Reality

The IRS uses detailed scenarios, or “vignettes,” as the most detailed illustrations of how it perceives the IRS “Future State” will operate. The vignettes, now posted to the IRS website, describe how various types of taxpayers might interact with the agency through online accounts, which became available on November 16, 2016.³⁰ One vignette describes Jane, an individual taxpayer who electronically files a return on which she claims the Earned Income Tax Credit (EITC).³¹ When the IRS proposes to disallow the claimed EITC, Jane ultimately (and seamlessly) uses her online account to “resubmit” her return.³²

26 IRS, *Taxpayer Assistance Center Customer Expectations Survey* (2013). The survey is carried out every three years; the survey for 2016 has been completed and the results are being compiled. At most TACs, taxpayers are required to make appointments for assistance, although managers have discretion to provide service to taxpayers without appointments. Internal Revenue Manual 21.3.4.2.4.2, *TAC Appointment Exception Procedures* (Oct. 21, 2016).

27 According to the IRS, “[t]he survey administrators position themselves at the door of the TAC and everyone who comes to the TAC is invited to take the survey.” IRS response to TAS fact check (Dec. 19, 2016).

28 There were long lines at some TACS and some TACs had to advise taxpayers as early as 9:30 in the morning that the office would not be able to serve additional taxpayers that day. See Treasury Inspector General for Tax Administration (TIGTA), Rep. No. 2016-IE-R010, *Selected Taxpayer Assistance Centers Were Professional and Organized, and Sensitive Information and Equipment Were Properly Secured* (Sept. 13, 2016), which includes photographs of long lines of taxpayers waiting outside TACs.

29 Question 5, IRS, *Web-First Conjoint Study Survey Instrument*.

30 *Future State and IRS Activities*, <https://www.irs.gov/uac/newsroom/future-state-and-irs-activities>. There are vignettes featuring an accountant employed by a state government (<https://www.irs.gov/pub/newsroom/irs-government-entity-vignette-version-a.pdf>); an individual taxpayer (<https://www.irs.gov/pub/newsroom/irs-individual-vignette-version-a.pdf>); a small business taxpayer (<https://www.irs.gov/pub/newsroom/irs-small-business-vignette-version-a.pdf>); and a large business taxpayer (<https://www.irs.gov/pub/newsroom/irs-large-business-vignette-version-a.pdf>). Features of the first release of the online account technology are described below.

31 *Individual Taxpayer Experience of the Future*, <https://www.irs.gov/pub/newsroom/irs-individual-vignette-version-a.pdf>. The EITC is an anti-poverty program consisting of a refundable tax credit available to certain low income working taxpayers and their families. See IRC § 32. For a full discussion of this vignette, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

32 This type of self-correction raises additional concerns. See National Taxpayer Advocate 2015 Annual Report to Congress 56, 62 (Most Serious Problem: *As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).

The online account in its present form does not give Jane this option. Currently, Jane could only view her balance due and make a payment.³³ When the first release of the technology is complete, Jane would still be able to do only four things via her online account:

- View her balance due;
- Make a payment;
- See payments that have been made; and
- Obtain a transcript of her account.³⁴

There is no option for Jane to indicate she doesn't believe she owes the tax. There are no buttons she could click to learn, for example, how to file a protest, how to seek audit reconsideration or penalty abatement, how to file a refund claim, or how to file for "innocent spouse" relief. The National Taxpayer Advocate has urged the IRS to add these features to the online account pages.

The vignette also does not capture taxpayers' actual experience when the IRS audits their EITC return. According to a 2007 TAS survey of taxpayers whose EITC returns were audited:

- More than one-quarter of taxpayers receiving an EITC audit notice did not understand that the IRS was auditing their return;
- Almost 40 percent of the survey respondents did not understand what the IRS was questioning about their EITC claim;
- Only about half of the survey respondents felt that they knew what they needed to do in response to the audit letter;
- Even though slightly over half of the respondents indicated that they understood what was being questioned and knew what they needed to do, overall, more than 90 percent contacted the IRS;
- Seventy-two percent of the respondents said that they either called or visited the IRS in response to the letter;
- More than 75 percent of those taxpayers contacting the IRS about their audit letter did so by telephone; and
- Overall, 46 percent of respondents would have *preferred* to communicate about their audit with the IRS by telephone, and another 23 percent would have *preferred* to communicate in person.³⁵

It is difficult to see how an online account, even one that allowed taxpayers to "interact" through drop down menus, could encompass the complexity of the American family unit.³⁶ As the "Future State" vignette illustrates, the IRS expects online accounts to be used by a large population (for Tax Year 2014, over 28 million taxpayers claimed the EITC) and with respect to issues for which online accounts may

33 The online account is accessed from the payments page on [irs.gov](https://www.irs.gov/payments/finding-out-how-much-you-owe). See *Finding How Much You Owe*, <https://www.irs.gov/payments/finding-out-how-much-you-owe>.

34 IRS, *View Your Tax Account Online* (Nov. 21, 2016), <http://win.web.irs.gov/articles/2016/View-your-tax-account-online.htm>.

35 See National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 93-116 (*IRS Earned Income Credit Audits — A Challenge to Taxpayers*) (describing surveys returned by 754 different taxpayers whose 2004 return claimed EITC and had been audited).

36 See Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra* (noting that the facts in an EITC case are often complex and fluid, since they involve the personal lives of taxpayers and thus are not suitable for resolution via a one-stop online experience); Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *infra*.

be singularly inappropriate.³⁷ The IRS has actual knowledge and data (from TAS studies) about what “audited” taxpayers prefer — and need — and yet its sole illustration shows it ignores that knowledge and imposes its own worldview.³⁸ Thus, the online account is not designed as a vehicle for engaging and educating taxpayers. On the contrary, it may communicate to taxpayers the IRS’s lack of interest in engaging with them.

Best Practices Start With Looking at Taxpayers’, As Opposed to the Tax Administration’s, View of Reality

The OECD, having identified shortcomings in the way in which tax administrations measured and managed demand for taxpayer services, provided practical advice on how to address those shortcomings.³⁹ The first step is simply to know the tax administration’s “clients” — taxpayers.⁴⁰

The Swedish Tax Agency’s guiding principle is that “[w]hat we think is efficient, may turn out not to be, and what we think is good service is not necessarily so from the taxpayer’s perspective. We have understood the importance of not building our service based on our own internal view of reality.”

The Swedish tax agency, lacking any agenda to “force taxpayers to certain channels,” exemplifies success in providing taxpayer service.⁴¹ The agency surveys taxpayers about their experiences with various service channels, usually four times a year, and follows up with more qualitative surveys to understand the underlying reason for the quality of the experience. Its guiding principle is that “[w]hat we think is efficient, may turn out not to be, and what we think is good service is not necessarily so from the taxpayer’s perspective. We have understood the importance of not building our service based on our own internal view of reality.”⁴² Put another way, “best-in-class tax administrations are taking a different approach to digitization. Going digital is no longer about making digital channel usage mandatory for 100 percent of citizens — it is about improving the taxpayer experience one segment or service at a time.”⁴³

37 IRS, *EITC — A Big Tax Break for Working People Who Qualify*, http://win.web.irs.gov/articles/2015/EITC_Spread_the_word.htm (Jan. 26, 2015).

38 For a description of the TAS Service Priorities Survey, which uses an online panel and telephone contact to explore taxpayers’ service delivery preferences, behavior patterns, and knowledge of Affordable Care Act requirements, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

39 OECD *Managing Service Demand: A Practical Guide to Help Revenue Bodies Better Meet Taxpayers’ Service Expectations*, 3 (2013). The guide, prepared by the Australian Taxation Office, was supported by a task group of 12 countries: Canada, Chile, Finland, Ireland, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey, and the United Kingdom.

40 *Id.* at 24. The report includes concrete, detailed suggestions of how this might be done, such as seeking direct feedback, using online communities, and mining external social media sites. *Id.* at 24-25, Table 4.1.

41 According to one study of Swedish government agencies, “the Tax Administration was in an absolute top position and won convincingly over the other agencies. In fact, the service score for the agency was so high that they ended up in the summary clearly ahead of most public companies regardless of line of business.” Vilhelm Andersson, *Mechanisms for Measuring the Quality of Service Provided to the Taxpayer and Results Achieved*, Inter-American Center of Tax Administrations – CIAT, 46th CIAT General Assembly, *Improving the Performance of the Tax Administration: Evasion Control and Taxpayer Assistance*, 171 (Apr. 2012).

42 *Id.* at 169.

43 Aurélie Barnay, Thomas Dohrmann, Wopke Hoekstra, Jose Nogueira, Fiyifolu Oladiran, & Kristine Romano, *Tax Myths-Dispelling Myths About Tax Transformation in Rapidly Growing Economies* McKinsey & Company, 5 (Sept. 2015).

Some Tax Administrations and Local Governments Reap Benefits From Providing In-Person Service That Digital Channels Do Not Provide

Tax administrations generally recognize the need to accommodate taxpayer preferences for in-person assistance where the taxpayer is remote. For example, New Zealand’s Inland Revenue sends an employee each year to the Chatham Islands (located more than 800 kilometers from New Zealand) to assist the 609 residents with tax matters.⁴⁴ Inland Revenue’s regular presence in this close and private community “has had a huge impact, not only for reducing debt but also in terms of their acceptance of Inland Revenue.”

Just as important is recognizing that the category of “remote” users of a government service may include not only those in rural areas but also those in an urban environment who are nevertheless isolated because of personal circumstances or due to other causes such as a natural disaster.⁴⁵

CONCLUSION

As other tax administrations and the private sectors in other parts of the world have found, taxpayers and other customers usually prefer a mix of service channels. Moreover, a user’s preferred service channel depends on the service being sought and whether it involves an emotionally charged transaction. Thus, research into taxpayers’ preferences — what they prefer and why — is essential before planning any initiatives that affect taxpayer service. World-class tax administrations consider taxpayer service from the taxpayers’ perspective and commit to honoring taxpayers’ preferences, not just because it is the right thing to do but because it makes good business sense and promotes compliance. The IRS, by relying on information and surveys that are not designed to elicit *taxpayers’* preferences, is falling short of that standard and may be impeding taxpayers from engaging with it.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct any taxpayer service surveys by calling taxpayers’ land line telephones or cellphones, or by sending taxpayers the survey by mail.
2. In surveys of TACs, include taxpayers who attempted to use TAC services but were turned away.
3. In taxpayer service surveys, include menu options (such as “other”) that allow respondents to indicate that the given alternatives do not describe their experience or preference.
4. In developing taxpayer service surveys, use focus groups and pre-testing with real taxpayers to ensure the surveys reflect all the potential preferences of taxpayers.
5. In implementing taxpayer service programs, place highest priority on meeting the preferences of taxpayers and stakeholders.
6. Implement procedures to safeguard against adopting service methods that have as their implicit or explicit objective forcing taxpayers to online channels.

44 *Mechanism Implemented for Assisting Taxpayers in Remote Geographical Areas*, Inter-American Center of Tax Administrations – CIAT, 46th CIAT General Assembly, Tax Administration New Zealand 186 (Apr. 2012).

45 For a discussion of the benefits of having a local presence, see Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*, *infra*.

MSP
#3**IRS STRUCTURE: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Debra Holland, Commissioner, Wage and Investment Division
 Sunita Lough, Commissioner, Tax Exempt and Government Entities Division
 Douglas W. O'Donnell, Commissioner, Large Business and International Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to give organizational units end-to-end responsibility for providing service to specific taxpayer population segments.² After RRA 98, the IRS created national operating divisions (ODs) named after four segments: Small Business/Self-Employed (SB/SE), Wage and Investment (W&I), Tax Exempt and Government Entities (TE/GE), and Large Business and International (LB&I).

However, taxpayers generally do not receive end-to-end service from a single OD. SB/SE, LB&I, and TE/GE allocate only about one percent, zero percent, and four percent, respectively, to service, whereas W&I allocates 82 percent to it.³ For example, SB/SE's only service function is Communications and Stakeholder Outreach, which primarily focuses on providing information to stakeholders rather than taxpayers.⁴ By contrast, W&I's only "enforcement" function is Return Integrity and Compliance Services

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998); JCT, General Explanation of RRA 98, JCS-6-98, 17 (1998).

3 IRS Chief Financial Officer (CFO) response to TAS information request (Oct. 12, 2016).

4 SB/SE has the following top-level organizations: Collection, Exam, and Operations Support (OS). OS includes: Technology Solutions, Communications and Stakeholder Outreach (CSO), Human Capital, Finance, Research and Strategy, Servicewide Operations, and Leadership Development. SB/SE, *Operating Unit Org Charts* (Nov. 16, 2016). According to SB/SE, its service appropriation is allocated to Stakeholder Liaison Field (SLF) employees. SB/SE response to TAS fact check (Nov. 22, 2016). SLF is a component of CSO, which focuses "on the needs of the taxpayers with the expectation that all information provided [to stakeholders] reaches the taxpayer." *Id.*

(RICS), which focuses on preventing improper refunds.⁵ As a result, no single unit is responsible for either SB/SE or W&I taxpayers. These taxpayers receive most services from W&I, but SB/SE audits and collects delinquencies from them. The IRS's functional structure presents the following challenges:

- No unit below the Deputy Commissioner for Services and Enforcement (DCSE) has the authority to ensure functions collaborate.⁶
- Each function focuses on completing tasks quickly without sufficient regard for the downstream consequences to other functions or taxpayers.⁷
- IRS “enforcement” functions waste resources and create problems when they use enforcement tools before working with service functions to address the root causes of compliance problems using the most effective and least burdensome alternative treatment(s) (e.g., educating taxpayers, alerting them to apparent discrepancies and improving guidance, and improving forms, communications, and outreach).⁸

If the IRS has not tried alternatives before resorting to enforcement, then the enforcement may be unnecessary. The use of unnecessary coercion violates the *rights to quality service, to a fair and just tax system, to privacy*, and in some cases *to pay no more than the correct amount of tax*. Moreover, when the IRS violates taxpayer rights, it likely reduces voluntary compliance by eroding trust for the IRS and promoting the view that noncompliance is justified.⁹ In addition, the IRS's service functions may waste resources if they do not use information from enforcement functions to identify the services taxpayers need to help them comply.

5 Internal Revenue Manual (IRM) 1.1.13.6 (Oct. 7, 2013); IRS, *Wage & Investment Division At-a-Glance* (May 6, 2016), <https://www.irs.gov/uac/wage-investment-division-at-a-glance>. According to W&I, its Identity Theft Victims Assistance organization is also funded from “enforcement” dollars. W&I response to TAS fact check (Nov. 21, 2016). When we use the term “enforcement” in quotes, we are referring to the IRS's overly-broad definition (e.g., any action by a so-called IRS “enforcement” function); when we use it without quotes, we are referring to its more natural meaning — the IRS's use of coercive power to compel action (e.g., assessment, summons, lien, levy, and the withholding of refunds). See THE OXFORD ENGLISH DICTIONARY, http://www.oxforddictionaries.com/us/definition/american_english/enforcement (“The act of compelling ...”). For further discussion of this issue, see Nina E. Olson, *The Future of Tax Administration*, 2016 TNT 49-11 (Mar. 10, 2016) and Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

6 See, e.g., IRS, *IRS to Realign Compliance Operations* (Nov. 3, 2014), <https://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (“The goal of the realignment is to primarily focus SB/SE on post-filing compliance and W&I on pre-refund compliance.”).

7 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*).

8 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*); National Taxpayer Advocate 2014 Annual Report to Congress 31-39 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

9 See, e.g., Tom Tyler, *Legitimacy and Criminal Justice: The Benefits of Self-Regulation*, 7 OHIO ST. J. CRIM. L. 307-359 (2009); Erich Kirchler, *The Economic Psychology of Tax Behaviour* 203-205 (2007); Most Serious Problem: *The IRS Can Increase Voluntary Compliance Using Behavioral Science Insights, But Is Overly Focused on So-Called “Enforcement” Revenue and Productivity*, *supra*.

ANALYSIS OF PROBLEM

Before 1998, Local Managers Who Engaged the Community Had the Authority to Require Local Service and “Enforcement” Functions to Work Together

Before 1998, the IRS served every taxpayer at one of ten centralized IRS service centers and 33 local district offices.¹⁰ Each district director assigned taxpayer education programs to the examination or collection functions within their districts.¹¹ This structure reportedly developed creative and technically-savvy managers accustomed to addressing local compliance problems using more than one function and communicating with and being accountable to the public.¹²

However, because district employees had to serve every type of taxpayer, they could not focus on a segment’s needs or maintain the technical expertise to address all of the issues that might arise.¹³ Serving each taxpayer from both a district office and a service center also raised concerns about consistency and accountability.¹⁴ In addition, competition on enforcement productivity measures (*i.e.*, records of tax enforcement results, or ROTERS) led to abuses that eroded public confidence.¹⁵ Moreover, IRS “enforcement” functions focused on short-term processing efficiencies (*e.g.*, closures) rather than identifying the root causes of noncompliance.¹⁶

The IRS Restructuring and Reform Act of 1998 (RRA 98) Required the IRS to Give Units End-To-End Responsibility for Serving Specific Taxpayer Segments, But the IRS Has Interpreted It Narrowly

RRA 98 contemplated that the IRS would improve service and accountability by assigning one employee to handle a taxpayer’s matter until it was closed,¹⁷ including the employee’s name and telephone number

10 S. Rep. No. 105-174, at 9 (1998); Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 16-17 (1998); IRS Pub. 3349, *Modernizing America’s Tax Agency* 1-10 (Apr. 2000), <https://www.irs.gov/pub/irs-utl/27877d00.pdf>.

11 IRM 22.30.1.1.2 (Jan. 1, 2002).

12 See Frank Wolpe, *A White Paper on Executive Action to Restore Trust in the Internal Revenue Service by Rebuilding Field Operations*, American Bar Association (ABA), Section of Taxation, News Quarterly 17 (2014), http://www.tnorrislaw.com/pdf/FW_WhitePaper.pdf. Similarly, traditional police enforcement strategies are not as effective in reducing crime as working with community partners to address the underlying problems (called problem-oriented policing, or POP) at the local level. See, *e.g.*, David Weisburd *et al.*, *Is Problem-Oriented Policing Effective in Reducing Crime and Disorder? Findings From a Campbell Systematic Review*, 9 *CRIMINOLOGY & PUB. POL.* 139, 141, 162 (2010), http://www.smartpolicinginitiative.com/sites/all/files/POP%20Weisburd_et_al.pdf.

13 See, *e.g.*, *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. 12, 14 (1998) (testimony of Charles Rossotti, Commissioner of Internal Revenue), <https://www.irs.gov/pub/irs-news/ir-98-3.pdf> (“The IRS organizational structure no longer enables its managers to be knowledgeable....Since each [new] unit will be fully responsible for serving a set of taxpayers with like needs, the management teams responsible for each of these units will be able to become knowledgeable about the needs and problems of their customers, and be held fully accountable for achieving specific goals in serving them.”).

14 See, *e.g.*, *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. 12 (1998) (testimony of Charles Rossotti, Commissioner of Internal Revenue). Although consistency issues can be minimized through transparent procedures, some problems may be inevitable, as even campuses can have inconsistent procedures. See, *e.g.*, National Taxpayer Advocate 2004 Annual Report to Congress 132-42 (Most Serious Problem: *Inconsistent Campus Procedures*).

15 See Douglas M. Browning *et al.*, *Special Review Panel Report for Charles O. Rossotti, Commissioner, IRS* (Aug. 1998). Similarly, among local police organizations an excessive focus on efficiency statistics including reported crime statistics and revenue from tickets, rather than on the means used, can lead to misreporting of crime, abuse of power, and a dysfunctional organizational culture. See, *e.g.*, Malcolm Sparrow, *HANDCUFFED, WHAT HOLDS POLICING BACK, AND THE KEYS TO REFORM* 20-22 (2016).

16 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 20 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>. (“Employees believe that [performance metrics] do not measure long-term quality performance accurately. Consequently, employees put an emphasis on short-term performance and meeting goals of efficiency ... One of the most significant efforts that the IRS must undertake is to redesign its internal measurement system to encourage behavior which makes it easy for taxpayers to interact with the IRS.”).

17 RRA 98, Pub. L. No. 105-206, § 3705(b), 112 Stat. 685, 777 (1998).

on any “manually generated correspondence,”¹⁸ providing callers with the option to talk to an employee who could help,¹⁹ and placing the addresses and telephone numbers for local offices in phone directories across the country.²⁰ RRA 98 also directed the IRS to: (1) establish “organizational units serving particular groups of taxpayers with similar needs;”²¹ (2) “restate its mission to place a greater emphasis on serving the public and meeting taxpayers’ needs;”²² and (3) adopt “balanced measures,” including customer and employee satisfaction, to counter “efficiency and productivity” metrics.²³ Legislators believed that increasing the IRS’s focus on customer service would improve voluntary compliance by promoting public confidence in the IRS.²⁴

The IRS could have responded to RRA 98 by assigning units and individual IRS employees with more responsibility for providing end-to-end service to specific taxpayers or taxpayer segments, potentially increasing their communications with and accountability to taxpayers. However, the IRS has interpreted these directives narrowly.²⁵ Its interpretation has enabled it to shift more work from highly-trained field employees to lower-graded campus employees who have less authority and are assigned narrower issues and mechanical tasks.²⁶

18 RRA 98, Pub. L. No. 105-206, § 3705(a), 112 Stat. 685, 777 (1998).

19 RRA 98, Pub. L. No. 105-206, § 3705(d), 112 Stat. 685, 777 (1998).

20 RRA 98, Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998). At recent public forums, stakeholders reiterated their preference for personal service. See, e.g., Oral Statement of Jennifer MacMillan, Chair, Internal Revenue Service Advisory Committee (IRSAC), National Taxpayer Advocate Public Forum 93 (Feb. 23, 2016), <http://taxpayeradvocate.irs.gov/public-forums> (“[T]he number one issue that I think builds trust among taxpayers and practitioners with the IRS is to have a person that they can deal with either by phone or face-to-face. I think that is the most crucial thing required. And I don’t see that going away even with advances in the digital tools.”); Oral Statement of Robert Wall, Esq. Attorney, Member, Spilman Thomas & Battle, PLC, National Taxpayer Advocate Public Forum 59 (Apr. 4, 2016) (“The golden ticket, when dealing with the IRS, as everyone will back me up, is when you get a letter with someone’s name and phone number on it. And when that happens, I would say nine times out of ten you can get an answer within 15 minutes.”).

21 RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998). For further discussion of the restructuring, see, e.g., IRS Pub. 3349, *Modernizing America’s Tax Agency* (Apr. 2000).

22 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998). See also National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 20 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf> (“Reorganizing into specialized units focused on taxpayer needs, rather than IRS internal needs, should better serve the American public.”).

23 See RRA 98, Pub. L. No. 105-206, Title I, §§ 1204, 112 Stat. 722, 9508(a)(2) (1998); J. Comm. on Tax’n, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998* 47-50 (1998); T.D. 8830, 64 Fed. Reg. ¶ 42,834 (Aug. 6, 1999) (explaining “[t]he presence of measures that evaluate the quality of the work done by the unit, the satisfaction of customers served by the unit (including taxpayers), and the satisfaction of employees working in the unit will obviate the risk that managers place undue emphasis upon the quantity of work completed.”).

24 See, e.g., JCT, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (1998) (“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.”).

25 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 134-44 (Most Serious Problem: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*); National Taxpayer Advocate 2014 Annual Report to Congress 145-53 (Most Serious Problem: *The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*); National Taxpayer Advocate 2014 Annual Report to Congress 123-33 (Most Serious Problem: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*).

26 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45.

IRS Employees Need Sufficient Authority, Technical Expertise, and Communication With Taxpayers to Improve Service and Compliance

Stakeholders have recently complained that IRS employees sometimes do not have sufficient expertise,²⁷ or authority to resolve problems.²⁸ Stakeholders have also observed that employees need to communicate with taxpayers enough to understand the reason(s) for apparent discrepancies, and resolve cases correctly.²⁹

Similarly, employees will not be able to identify appropriate alternative treatment(s) to address the root causes of noncompliance if they do not have enough personal communications with taxpayers. RRA 98 contemplated that these communications would occur. It provided that “front-line technical experts” with an understanding of taxpayer problems would report back to the tax writing committees with respect to the “administrability” of pending amendments to the tax code,³⁰ and that the IRS would report to Congress each year on the sources of complexity in tax administration and on ways to reduce it.³¹

It may be easier for the IRS to manage campus employees charged with narrow tasks. However, their geographic isolation, narrow knowledge base, and limited authority likely make it more difficult for them to understand and communicate with taxpayers and resolve their problems.³² An organizational design textbook elaborates on some these concerns as follows:

[A] service firm[’s] ... greatest economies are achieved through disaggregation into small units that can be located close to customers. Stockbrokers, doctors’ clinics, consulting firms, and banks disperse their facilities into regional and local offices ... These employees need enough knowledge and awareness to handle customer problems rather than just enough to perform mechanical tasks. Employees need social and interpersonal skills as well as technical skills. Because of higher skills and structural dispersion, decision making often tends to be

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- 27 See, e.g., Oral Statement of Rollin Groseclose, CPA, Johnson, Price, Sprinkle, PA, National Taxpayer Advocate Public Forum 64-65 (Apr. 4, 2016) (“... we use practitioner priority ...and they can’t always find the answer, or they will give a recommendation and it doesn’t quite line up with the documentation we received. So they seem to have limited, either training in some instances, or access to information within the databases that the IRS has.”); Oral Statement of Audience Member, National Taxpayer Advocate Public Forum 47-48 (May 5, 2016) (“...you’re still dealing with fairly uneducated people on those lines. If it’s not on their checklist, and I can literally hear them going down the — okay, what are you talking about, okay, let me get my — I hear pages flipping or something or the computer system is slowing down. I cannot imagine how another taxpayer without some basis of knowledge would be able to get satisfaction or resolution to the question.”).
- 28 See, e.g., Coalition for Effective and Efficient Tax Administration, *CEETA Addresses Changes Under Way in LB&I Division*, 2016 TNT 140-13 (July 21, 2016) (“taxpayers typically want a single point of contact ... Under the new structure, the first point of convergence of the nine practice areas, i.e., so-called tie-breaking authority, is the Deputy Commissioner Taking issues all the way to the Deputy Commissioner level for resolution will be a long, frustrating process for both taxpayers and IRS personnel and will add to the potential for conflict in the examination process.”); Oral Statement of Elizabeth Atkinson, Esq., LeClairRyan, PC, National Taxpayer Advocate Public Forum 82-83 (May 13, 2016) (“... when I worked at the IRS, there were a lot of really good IRS employees who want to do the right thing for the taxpayer. Often, they are unable to do that because there is a gap in authority.”).
- 29 See, e.g., Oral Statement of Warren Hudak, EA, President, Hudak & Company, National Taxpayer Advocate Public Forum 24-25 (Apr. 8, 2016) (“Oftentimes, during the course of an audit, the taxpayer is — has taken a position on an issue that is perfectly fine, but because they don’t understand the language of the law, they don’t understand the language of regulations, they inaccurately communicate their point, their perspective, their position. And it isn’t because they’re taking an improper position, but because they don’t know how to communicate it properly.”).
- 30 RRA 98, Pub. L. No. 105-206, Title IV, § 4021, 112 Stat. 685, 785 (1998). The IRS does not facilitate such communications. See National Taxpayer Advocate 2014 Annual Report to Congress 108-11 (Most Serious Problem: *The IRS Has No Process to Ensure Front-line Technical Experts Discuss Legislation with the Tax-writing Committees as Requested by Congress*).
- 31 RRA 98, Pub. L. No. 105-206, Title IV, § 4022(a), 112 Stat. 785 (1998). The IRS no longer produces a complexity report. See National Taxpayer Advocate 2014 Annual Report to Congress 102-07 (Most Serious Problem: *The IRS Does Not Report on Tax Complexity As Required by Law*).
- 32 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

decentralized in service firms, and formalization tends to be low. Although some service organizations, such as many fast-food chains, have set rules and procedures for customer service, employees in service organizations typically have more freedom and discretion on the job ... The concept of separating complex tasks into a series of small jobs and exploiting economies of scale is a cornerstone of traditional manufacturing, but researchers have found that applying it to service organizations often does not work so well ...³³

Moreover, between 1970 and 2014, financial institutions, whose business models the IRS initially emulated, were opening local branches at a rate nearly twice as fast as U.S. population growth.³⁴ Immediately after RRA 98, the IRS planned to address many of these issues by forming units responsible for narrower taxpayer segments, as shown for W&I in Figure 1.3.1.

33 Richard Daft, *ORGANIZATION THEORY AND DESIGN* 270-71 (10th ed., 2010).

34 See Federal Deposit Insurance Corporation (FDIC), Press Release, *Branch Banking Remains Prevalent Despite the Growth of Online and Mobile Banking* (Feb. 19, 2015), <https://www.fdic.gov/news/news/press/2015/pr15018.html>. Similarly, problem- and community-oriented policing is deemed so effective that the Department of Justice (DOJ) Office of Community Oriented Policing Services (COPS) provides grants to facilitate its adoption. DOJ, *Congressional Justification, FY 2017 Performance Budget* (Feb. 9, 2016), <https://www.justice.gov/jmd/file/821491/download>.

FIGURE 1.3.1³⁵

W&I TAXPAYER CHARACTERISTICS Examples of Special Needs of Individual Taxpayer Market Segments			
SEGMENT	PROFILE	KEY NEEDS	PROPOSED STRATEGY TO ADDRESS NEEDS
Segment I	<ul style="list-style-type: none"> Simple returns; low income (<\$30K); low tax understanding; language assistance; urban; possible dependents; possible compliance issues 	<ul style="list-style-type: none"> Face-to-face contact required; tax education; needs hand-holding; language assistance 	<ul style="list-style-type: none"> Focus on education about taxes; reach through walk-in centers; bi-lingual assistance
Segment II	<ul style="list-style-type: none"> Simple returns; low to middle income; educated and computer proficient; understands taxes; prepare own returns; compliant 	<ul style="list-style-type: none"> Need for accurate and fast access to IRS (through Internet); answers to specific questions 	<ul style="list-style-type: none"> Aggressive marketing of e-commerce products; education on forms to file and taxation issues pertaining to them; greater access to electronic sites (e.g., through schools and universities)
Segment III	<ul style="list-style-type: none"> Middle income families; average return complexity; familiar with taxation; typically paper filers; prepare own returns; compliant 	<ul style="list-style-type: none"> Reliable information on tax law changes, new forms and procedures; prompt and accurate response to queries 	<ul style="list-style-type: none"> Provide information on tax laws through direct mail; marketing of e-commerce products—migrating them toward e-commerce; provide more accessibility through new channels
Segment IV	<ul style="list-style-type: none"> Complex returns, investment and schedules; high income; professionals and wealthy retirees; paid preparers; compliant 	<ul style="list-style-type: none"> Customized assistance through preparers; need help with complex problems; easy access to tax information through preparers 	<ul style="list-style-type: none"> No direct assistance required from IRS; focus on providing high-quality assistance to practitioners; leverage partnerships with practitioners to provide better service
Segment V	<ul style="list-style-type: none"> Divorced/separated individuals; simple/average complexity of returns; low/middle income; low understanding of taxation; possible compliance problems 	<ul style="list-style-type: none"> Increased understanding of tax system; recognition of their circumstances—possible hardship assistance; accessibility to someone who will solve their problems; clear explanation of child support test 	<ul style="list-style-type: none"> Basic tax education (e.g., seminars on return preparation); hardship programs; outreach through divorce courts, single parent associations
Segment VI	<ul style="list-style-type: none"> Balance due and non-filers; some understanding of taxes; possible fear of the tax system; low understanding of collection options; financial problems; withholding (W-4) problems; frequently ignoring notices, contact attempts; prepare own returns 	<ul style="list-style-type: none"> Understanding of the collection process, options and implications; understanding of withholding; accessibility to tax help; reduction of penalties for honest mistakes 	<ul style="list-style-type: none"> Aggressive marketing/clinics on collection options (installment agreements, offers in compromise and credit card settlement); information on reasonable cause incentives; providing specific help on the phone; quicker response to non-filing situations
Segment VII	<ul style="list-style-type: none"> Elderly/retired; low to middle income; Social Security/pension-based incomes; simple/middle complexity returns; prepare own returns; not computer literate; value face-to-face contact; easy to reach through retirement communities 	<ul style="list-style-type: none"> Face-to-face assistance/education; information on Social Security/pension changes; desire to volunteer; increased awareness of investment tax law changes; assistance on return preparation 	<ul style="list-style-type: none"> Increased coordination with AARP and other relevant stakeholders; seminars and assistance on filing through community organizations; reach through VITA and TCE; joint ventures with Social Security, investment firms, banks, etc.

35 This table appears as Exhibit A in IRS Pub. 3349, *Modernizing America's Tax Agency* 22 (1999).

IRS units responsible for smaller segments could better understand these segments, and use this specialized knowledge to improve service and compliance.³⁶

No IRS Unit Has End-To-End Responsibility or Accountability

The IRS continues to move away from the end-to-end service concept. In 2014, SB/SE and W&I realigned operations.³⁷ The goal was to improve processing efficiencies and to ensure a single executive has “end-to-end accountability for Collection and a single executive has end-to-end accountability for Examination.”³⁸ However, as noted above, exploiting economies of scale is more suited to manufacturing than service industries. The IRS solicited comments about the realignment from employees,³⁹ but not from its customers or external stakeholders.

No unit was assigned end-to-end accountability for specific segments.⁴⁰ Because SB/SE took responsibility for most post-refund compliance work for individuals,⁴¹ even the W&I Commissioner does not have end-to-end responsibility for compliance by most individual taxpayers. Similarly, SB/SE, LB&I, and TE/GE devote a small fraction of their resources to assist the taxpayers they are named after.⁴² As shown in Figure 1.3.2, for fiscal year (FY) 2016 only about one percent, zero percent, and four percent of their respective budgets were devoted to service.⁴³ By contrast, 82 percent of W&I’s FY 2016 budget was devoted to service.⁴⁴

36 See, e.g., IRS Pub. 3349, *Modernizing America’s Tax Agency* 34 (1999) (“since the taxpayers served [by each unit] are reasonably homogeneous in their needs, it will be possible and expected for the managers at all levels to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their division.”); GAO, GAO/T-GGD-91-54 *Identifying Options for Organizational and Business Changes at IRS* (July 9, 1991), <http://www.gao.gov/assets/110/103988.pdf> (recommending the IRS consider: “assigning a single staff to perform both auditing of tax returns and collecting taxes due. Reinforcing accountability ... [and reorganize them] to focus on types of taxpayers with common noncompliance problems, thereby enhancing the expertise of the agency in dealing with industries with special or complex tax situations.”). The IRS briefly established units of examination and collection employees who would report to multi-functional managers. See IRS Pub. 3349, *Modernizing America’s Tax Agency* 1-15 (Apr. 2000).

37 Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014). The IRS did not document a business case for these changes. See, e.g., Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-IE-R005, *Several Changes Sought by the Internal Revenue Service Restructuring and Reform Act of 1998 Remain a Challenge* 6 (Mar. 28, 2016), <https://www.treasury.gov/tigta/iereports/2016reports/2016ier005fr.pdf>.

38 Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014); SB/SE, *General questions about the realignment* (Nov. 13, 2014). Even though the Examination and Collection functions are both lodged within SB/SE, they generally do not work together. See, e.g., TIGTA, Ref. No. 2016-30-070, *Examination Collectibility Procedures Need to Be Clarified and Applied Consistently* (Sept. 7, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630070fr.pdf>.

39 The IRS held 31 employee focus groups and town hall sessions at all ten campuses and considered more than 1,600 emails from employees before finalizing its realignment plans for SB/SE and W&I. Email from W&I and SB/SE Commissioners to all W&I Employees, *An Update on the Realignment Process* (July 17, 2014). The current IRS Commissioner is careful to consult employees before making organizational changes. See, e.g., *Prepared Remarks of Commissioner of Internal Revenue Service John Koskinen before the National Press Club*, IR-2014-42 (Apr. 2, 2014).

40 Taxpayers who claimed the Earned Income Tax Credit (EITC) or who had been the victim of identity theft would generally be assigned to specific units, however. Email from W&I and SB/SE Commissioners to all W&I Employees, *Organizational Realignment Announcement* (Oct. 8, 2014) (referencing the EITC).

41 IRS, *IRS to Realign Compliance Operations* (Nov. 3, 2014), <https://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (“this plan would move pre-filing compliance work to W&I and post-filing compliance work for individuals and small businesses to SB/SE”).

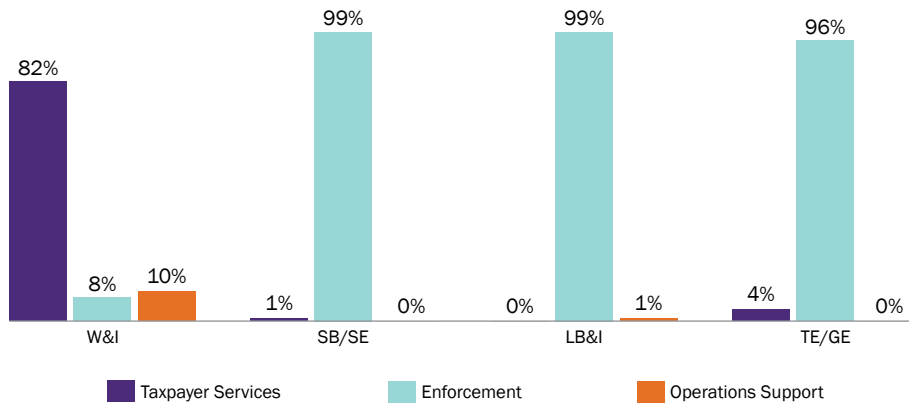
42 *Id.*

43 CFO response to TAS information request (Oct. 12, 2016).

44 *Id.*

FIGURE 1.3.2⁴⁵

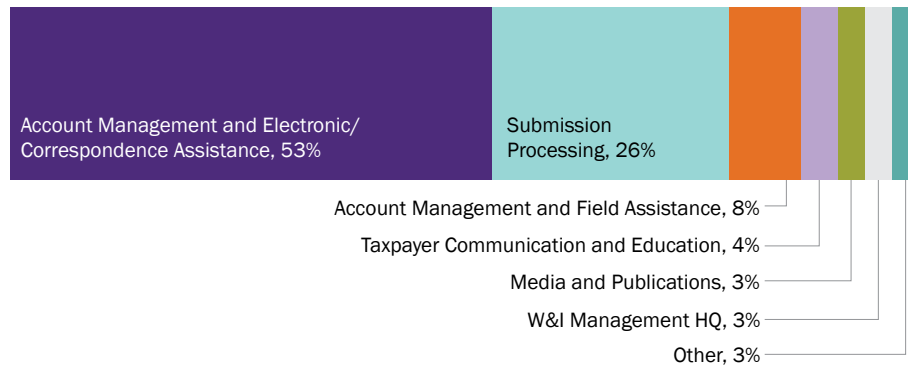
Budget Allocation by Operating Division for FY 2016



The vast majority of W&I's service budget is allocated to agency-wide services such as processing correspondence and returns, answering calls, staffing assistance centers, and maintaining IRS-wide Internal Revenue Manuals (IRMs) and publications, as shown in Figure 1.3.3.

FIGURE 1.3.3⁴⁶

W&I's Service Budget for FY 2016



Even before the recent realignment, most of W&I's budget was devoted to agency-wide services.⁴⁷ Thus, the IRS is even more organized around internal functions than it was before RRA 98. The National

45 CFO response to TAS information request (Oct. 12, 2016). These figures do not include user fees.

46 TAS analysis of W&I budget data (Oct. 13, 2016). These figures do not include user fees.

47 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*).

Taxpayer Advocate has recommended placing W&I's agency-wide back-office support functions into a separate organization so that W&I could focus on wage earners and investors.⁴⁸

In a Functional Organization, Each Function Needs to Be Accountable for Coordinating with Others

The IRS's Functions Sometimes Focus on Narrow Productivity Measures Rather Than Broader Agency Goals

To prevent errors, IRS "enforcement" functions need to identify the causes of noncompliance and communicate them to taxpayers, service functions, and other stakeholders so that the agency and its stakeholders can address them.⁴⁹ Instead, IRS "enforcement" functions generally focus on processing efficiency, perhaps because efficiency statistics are more readily available than information about root causes.⁵⁰ IRS examiners are no longer required to identify and record the reasons for misreporting, and the IRS no longer tracks the laws that trip up its own employees or reports on the sources of complexity.⁵¹ LB&I has problems accurately tracking its audit adjustments by issue so that it knows where taxpayers are making the most significant errors.⁵² Similarly, collection employees do not accurately record what actions prompt taxpayers to make payments.⁵³

As another example, without doing any research that could help avoid burdening taxpayers unnecessarily, IRS "enforcement" functions allow computers to make inaccurate assessments or unnecessarily delay

48 See 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*).

49 See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS 20* (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>. ("In a stovepipe operation, functional units such as taxpayer services, exam, collection, appeals, and counsel set and implement their own priorities and objectives, which often are disconnected from the other functions and the organization as a whole. This is why a taxpayer may receive a notice from the IRS, but when the taxpayer calls the toll-free number, the customer service representative is unable to help. ... The new IRS leadership team should establish performance measures that encourage functions within the IRS to cooperate. Additionally, the IRS should continue on the course begun in Compliance 2000, in which cross functional teams work together to solve problems. Finally, the Commission considered more far reaching reforms to break down functional stovepipes, including reorganizing the entire organization into four divisions ...").

50 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*). For example, LB&I's "Key Stats" report contains 14 substantive worksheets. LB&I response to TAS information request (June 23, 2016). The first 12 contain detailed enforcement productivity statistics (e.g., closures, dollars per hour, yield, hours per return, cycle time, no change rates, etc.) broken out by type of taxpayer, income level and issue (i.e., activity code). *Id.* Only the last two worksheets are devoted to quality, and customer and employee satisfaction data are not broken out by activity code, and for the last few years have not been broken out by industry. *Id.* LB&I's lack of disaggregated satisfaction data is due to IRS-wide changes to its survey process.

51 See National Taxpayer Advocate 2013 Annual Report to Congress 102 n.5 (Most Serious Problem: *The IRS Does Not Report on Tax Complexity As Required by Law*) (describing how the IRS is required to identify the areas of the tax code where taxpayers and revenue agents make frequent errors, but the IRS no longer tracks tax law errors by code section); National Taxpayer Advocate 2007 Annual Report to Congress 35, 57 (Most Serious Problem: *The Cash Economy*) (recommending that when the IRS's national research program examinations identify an error on a return, the IRS should determine the reasons why the taxpayer made the error).

52 See TIGTA, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 14, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630089fr.pdf>.

53 National Taxpayer Advocate 2014 Annual Report to Congress 221-26 (Most Serious Problem: *The IRS's Failure to Accurately Input Designated Payment Codes for All Payments Compromises Its Ability to Evaluate Which Actions Are Most Effective in Generating Payments*).

refunds.⁵⁴ These and similarly automated enforcement tools prompt communications to which the IRS cannot timely respond.⁵⁵ Automated IRS “enforcement” functions create these types of problems far too often.⁵⁶

Procedural Requirements, Multi-Functional Compliance Projects, Teams, and Campaigns Could Help Ensure Functions Work Together

Procedural safeguards could help mitigate problems caused by the IRS’s functional structure. For example, the IRS could require all “enforcement” functions to document the reasons for any noncompliance, communicate them to service functions, and implement alternative treatments before resorting to coercive ones.

The IRS could also establish more effective local and national multi-functional groups (*e.g.*, councils, program management offices, and cross-functional groups and initiatives). To be effective, these groups should have the responsibility and authority to identify compliance problems and implement alternative treatments to address them. The IRS has long known that multi-functional Compliance Initiative Projects (CIPs) could prevent noncompliance by identifying and delivering what a segment needs to comply.⁵⁷ In theory, an examination function could use CIP procedures to collaborate with other

54 See, *e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 114, 119-20 (Research Study: *Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*); National Taxpayer Advocate FY 2017 Objectives Report to Congress 80, 82 (Area of Focus: *IRS Implementation and Enforcement of Withholding on Certain Payments to Foreign Persons Is Burdensome, Error-Ridden, and Fails to Protect the Rights of Affected Taxpayers*) (discussing how the IRS improperly denied or delayed tens of thousands of refunds to international students because of transcription errors and poor IRS data quality, rather than first investigating the reason(s) for apparent mismatches).

55 See, *e.g.*, Oral Statement of Troy K. Lewis, Chair, Tax Executive Committee, AICPA, National Taxpayer Advocate Public Forum 72–73 (May 17, 2016) (“The income, which was reported to the IRS on a Form 1099-B, was properly reported on my client’s tax return, and the appropriate amount of income tax had actually been paid. There was no error on the return. However, due to requirements in its matching system, the IRS needed additional information to verify the income was indeed properly reported. The notice was a mere case of matching the third party information reported to the IRS with information reported on the return. However, it took me two letters and four months to resolve this notice. It was a highly inefficient experience and an example of where change is clearly needed.”).

56 See, *e.g.*, National Taxpayer Advocate 2015 Annual Report to Congress 188-95 (Most Serious Problem: *Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*); National Taxpayer Advocate 2015 Annual Report to Congress 112-22 (Most Serious Problem: *The IRS Files Most NFTLs Based on Arbitrary Dollar Thresholds Rather Than on a Thorough Analysis of a Taxpayer’s Financial Circumstances and the Impact on Future Compliance and Overall Revenue Collection*). TIGTA, *Actions Can Be Taken to Better Address Potential Noncompliance for Roth Individual Retirement Arrangement Conversions*, Ref. No. 2016-10-054 (Aug. 30, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201610054fr.pdf> (“Our review found that 97 (25 percent) of the 383 sampled cases had information that could have been researched on IRS systems that would have enabled AUR Program personnel to correctly conclude that minimal or no taxes were due on discrepancies resulting from Traditional IRAs being converted to Roth IRAs. In each of the 97 discrepancies, taxpayers received CP 2000 Notices. However, after correspondence with the taxpayer, little or no additional tax was assessed.”). As another example, the LB&I Commissioner had to ask W&I to stop its automated assessment of penalties for failure to file Forms 3520 and 3520-A due to concerns that these assessments were inaccurate. Memorandum from LB&I Commissioner to W&I Commissioner, *Direction to Close All Current Inventory Related to Forms 3520 & 3520A* (Mar. 20, 2013).

57 Multi-functional CIPs are similar to the Compliance 2000 projects endorsed by the IRS and its stakeholders in the late 1990s. See, *e.g.*, National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 23, 27 (June 25, 1997).

functions to implement alternative treatments,⁵⁸ but “enforcement” functions use them primarily to identify returns to examine.⁵⁹

The IRS provided TAS a list of 114 teams and highlighted several that it believes address compliance problems using a multi-functional approach.⁶⁰ For example, multi-functional issue management teams (IMTs) seem promising because they can address compliance problems using CIPs, proposed legislation, settlement offers, or guidance to the field, provided they coordinate with the Servicewide Compliance Strategy (SCS) Executive Steering Committee (ESC).⁶¹ However, IMTs focus on abusive transactions rather than common transactions or local compliance issues.⁶² In most cases, the development of a service-wide strategy must also be approved by high level executives on the SCS ESC. Moreover, W&I is not on the SCS ESC, potentially making it less likely to consider alternative treatments.

The Right Operational Measures Could Help Ensure Functions Work Together

Functional managers are naturally interested in whether their employees are following procedures and working efficiently.⁶³ It may be more natural for them to focus on productivity than on the effect of their employees on taxpayers’ views of the agency and voluntary compliance. For example, collection employees may seem to have little ability to influence voluntary compliance or a taxpayer’s view of the agency. To counter this without making radical changes, the IRS could measure factors that likely affect voluntary compliance (*e.g.*, multi-functional collaboration on alternative treatments) and public perception of the agency (*e.g.*, respect for taxpayer rights), as recommended by the National Taxpayer Advocate.⁶⁴ IRS employees should be able to affect taxpayer behavior and attitudes by measurable amounts if the taxpayer segment is small enough.

58 IRM 4.17.1.4 (Feb. 25, 2010); IRM 4.17.4.4.1 (Feb. 25, 2010); Form 13498, *Compliance Initiative Project Authorization - Part Two* (Apr. 2009).

59 There may have been a few multifunctional CIPs, but they are not the norm. IRS response to TAS information request (June 22, 2016) (“SBSE Exam is not aware of any non-enforcement function working Compliance Initiative Projects.”); SB/SE response to TAS information request (Oct. 22, 2016) (“SBSE is still not aware of any non-enforcement functions working Compliance Initiative Projects.”); SB/SE response to TAS fact check (Nov. 21, 2016) (“During a cursory review of CIPs for this fact check request response, SB found two examples of multi-Functional CIPs We also have [six] examples where our Communication and Stakeholder Outreach function (CSO) [formerly known as Communication, Liaison, and disclosure (CLD)] has worked with our Examination function on a CIP and signed off on the CIP”). Alternative treatments could be used in most CIPs. For example, the IRS could send soft notices and educational materials to all of the taxpayers with apparent discrepancies to give them an opportunity to self-correct so that an examination would not be necessary.

60 IRS response to TAS information request (July 13, 2016).

61 See IRM 4.32.1 (June 5, 2014). The SCS ECC reports to the Enforcement Committee, which is chaired by the DCSE. *Id.* LB&I’s new “campaigns” could also use alternative treatments to address compliance problems. However, without direct access to any significant resources for service, it is not clear how LB&I will ensure that alternative treatments are actually implemented.

62 IRM 4.32.1 (June 5, 2014); IRS response to TAS information request (July 13, 2016).

63 See National Taxpayer Advocate 2010 Annual Report to Congress 28-48 (Most Serious Problem: *IRS Performance Measures Provide Incentives That May Undermine the IRS Mission*).

64 In her 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that “... provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance,” which she has updated in subsequent reports. See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface); National Taxpayer Advocate 2015 Annual Report to Congress xvii-xxiii (Taxpayer Rights Assessment: *IRS Performance Measures and Data Relating to Taxpayer Rights*).

The IRS could routinely estimate the effect of alternative treatments on “service revenues,” voluntary compliance, and the views of narrow taxpayer segments.⁶⁵ Some proxies for measuring the effect of alternative treatments on voluntary compliance are:

- On-time filing and payment rates;
- The percentage of returns with unexplained discrepancies (*e.g.*, mismatches and math errors);
- The IRS’s estimate (as measured by the Discriminant Index Function or other screens) of the amount of underreporting it would find if it audited the segment’s returns;
- Changes to income or deductions actually reported on subsequent returns as compared to appropriate benchmarks or control groups; and
- Satisfaction with and trust for the agency.⁶⁶

Standard examinations (and compliance checks) could be used, in large part, to educate specific taxpayers and identify areas of noncompliance that need to be addressed more broadly and systemically through coordination with the IRS’s other functions, including through education and outreach.

CONCLUSION

The IRS’s functional organization does not empower employees or business units to find creative ways to prevent noncompliance by collaborating with other functions or using alternative treatments, even if doing so would be more efficient and effective. However, one premise of the IRS’s Future State plan is “to provide [taxpayers] the services they need in the way that works for them.”⁶⁷ This presents an opportunity for the IRS to increase the links between functions and embrace the end-to-end service concept.

Luckily, some of the initial benefits of centralization — efficiency in processing calls and correspondence — can now be achieved by leveraging technology instead. Today, calls can be routed anywhere, 88.2 percent of the individual returns received during the 2016 filing season were filed electronically, and the IRS’s Future State plan is to establish more digital communication with taxpayers.⁶⁸ As a result, the IRS has more freedom to decentralize and empower highly skilled multi-functional groups of employees in local offices to better understand their customers where they work and live. The IRS should give them more autonomy, discretion, and incentives to cut across functional lines to identify systemic solutions and help customers, rather than asking them to be uncreative cogs in a centralized processing and enforcement machine.

65 See Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*.

66 Voluntary compliance is correlated with trust for the IRS. See, *e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

67 IRS, *Future State Initiative* (Feb. 22, 2016), <https://www.irs.gov/uac/Newsroom/Future-State-Initiative>.

68 IRS, *Filing Season Statistics for Week Ending May 13, 2016* (May 19, 2016), <https://www.irs.gov/uac/newsroom/filing-season-statistics-for-week-ending-may-13-2016> (reporting individual filings received); Pub. 3415, *The Electronic Tax Administration Advisory Committee’s June 2016 Annual Report to Congress* 4 (June 2016) (Table 2) (discussing the future state plan and projecting 152,825,688 out of 195,931,400 returns would be e-filed for calendar year 2016), <https://www.irs.gov/pub/irs-pdf/p3415.pdf>. It could achieve consistency by increasing the transparency of its procedures by incorporating them into the IRM.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Remove service-wide functions from W&I by establishing a new unit that handles service wide functions (*e.g.*, submission processing, media and publications, etc.) so that W&I can focus on providing end-to-end service to W&I taxpayers, as previously recommended.⁶⁹
2. Establish cross-functional units that have true end-to-end responsibility and accountability for voluntary compliance (*e.g.*, on-time filing and payment rates), satisfaction with, and trust for the agency by narrow taxpayer segments that they can affect, such as those shown in Figure 1.3.1.
3. Establish procedures that require the ODs to implement alternative treatments to address the root causes of noncompliance for a segment or issue (*e.g.*, using multi-functional CIPs, campaigns, or similar programs) before applying coercive treatments, except when it is clear that alternative treatments would be ineffective.

⁶⁹ See 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*).

MSP
#4**GEOGRAPHIC FOCUS: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Debra Holland, Commissioner, Wage and Investment Division
 Sunita Lough, Commissioner, Tax Exempt and Government Entities Division
 Douglas W. O'Donnell, Commissioner, Large Business and International Division
 Donna C. Hansberry, Chief, Appeals

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM²

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) required the IRS to replace its geographic-based structure with organizational units serving specific groups of taxpayers.³ In doing so, the importance of having a local, engaged presence in taxpaying communities was minimized. Instead of communicating with IRS employees who understand the needs and conditions of a specific geographic economy or community, taxpayers often interact with IRS employees who lack this knowledge.

The National Taxpayer Advocate has long emphasized the importance of the IRS maintaining a local presence in both service and compliance operations.⁴ Voluntary tax compliance relies heavily on taxpayer

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.

3 Internal Revenue and Restructuring Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998) (codified at IRC § 7801). For more information and a detailed discussion of IRS Structure, see Most Serious Problem: *IRS Structure: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *supra*.

4 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 31-45; National Taxpayer Advocate 2014 Annual Report to Congress 46-54; National Taxpayer Advocate 2014 Annual Report to Congress 311-14; National Taxpayer Advocate 2012 Annual Report to Congress 302-18; National Taxpayer Advocate 2010 Annual Report to Congress 267-77; National Taxpayer Advocate 2008 Annual Report to Congress 95-113; National Taxpayer Advocate 2007 Annual Report to Congress 162-82; National Taxpayer Advocate 2005 Annual Report to Congress 2-24; National Taxpayer Advocate 2004 Annual Report to Congress 8-25.

discretion, integrity, and honesty.⁵ A local presence in the community better equips the IRS to improve tax morale by encouraging voluntary compliance, creating a culture of compliance, and influencing prevailing social views in a geographic region.

The National Taxpayer Advocate is concerned that:⁶

- A lack of geographic presence can have a negative effect on taxpayer morale, which in turn may decrease voluntary compliance and increase taxpayer burden;
- The absence of a geographic footprint deprives the IRS and taxpayers of local knowledge which may result in missed opportunities to meet taxpayers' unique needs, and to identify and address noncompliance specific to a geographic region; and
- The IRS is slow to find innovative ways to maintain and create local presence in communities.

The overriding purpose of tax administration is to enable voluntary compliance which can be significantly furthered by providing service, creating a culture of trust, and promoting an understanding of the role taxes play “in a civilized society.”⁷ Failing to maintain a robust geographic presence hinders the IRS's ability to achieve its mission.⁸

ANALYSIS OF PROBLEM

Background

Prior to 1998, the IRS served every taxpayer at one of ten centralized IRS service centers and 33 local district offices.⁹ Each district director assigned taxpayer education programs to the examination or collection functions within their districts.¹⁰ RRA 98 required the IRS to give organizational units end-to-end responsibility for providing service to specific taxpayer population segments.¹¹ After RRA 98, the IRS created national operating divisions (ODs) named after four taxpayer segments: Wage and Investment (W&I), Small Business/Self-Employed (SB/SE), Tax Exempt and Government Entities (TE/GE), and Large and Mid-Sized Business (LMSB), later renamed Large Business and International (LB&I).¹²

5 For a detailed discussion on behavioral research, see Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra* and Literature Review: *Behavioral Science Lessons for Taxpayer Compliance*, *infra*. See also Maria Sigala, Carole B. Burgoyne & Paul Webley, *Tax Communication and Social Influence: Evidence from a British Sample*, 9 J. OF CMTY. & APPLIED SOC. PSYCHOL. 237, no. 3 (1999). See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-55 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*). A recent TAS Research study on compliance factors identified a link between salient relationships, *i.e.*, one's membership in a group, and one's own attitudes and behaviors towards tax and compliance.

6 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.

7 *Compania General De Tabacos De Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

8 See, e.g., IRS Pub. 3349, *Modernizing America's Tax Agency* (Feb. 1999).

9 S. REP. No. 105-174, at 9 (1998); J. Comm. on Tax'n (JCT), *General Explanation of Tax Legislation Enacted in 1998*, JCS-6-98 16-17 (1998); IRS Pub. 3349, *Modernizing America's Tax Agency* 1-10 (Apr. 2000), <https://www.irs.gov/pub/irs-utl/27877d00.pdf>.

10 Internal Revenue Manual (IRM) 22.30.1.1.2 (Jan. 1, 2002).

11 RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998); JCT, *General Explanation of RRA 98*, JCS-6-98, 17 (1998).

12 For a more detailed discussion of the lack of IRS cross-functional cooperation and end-to-end service, see Most Serious Problem: *IRS Structure: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *supra*.

Legislators believed that increasing the IRS's focus on customer service would improve voluntary compliance by promoting public confidence in the IRS.¹³ However, the IRS has interpreted congressional directives narrowly by shifting more work from highly-trained field employees to lower-graded campus employees who have less authority and are assigned narrower issues and mechanical tasks.¹⁴

FIGURE 1.4.1, Locations With Specified Employees in the Last Pay Period of the Fiscal Year¹⁵

Number of Locations, Employees, or Visitors	2011	2012	2013	2014	2015	2016
IRS Offices (Cities)	541	523	510	499	479	470
Appeals Officers (AOs)	1,129	1,058	958	881	795	739
Revenue Officers (ROs)	4,402	4,035	3,703	3,441	3,191	3,072
Revenue Agents (RAs)	11,959	11,258	10,502	9,776	9,090	8,871
Stakeholder Liaison Outreach Employees	137	123	119	110	105	98
Stakeholder Partnerships, Education and Communication Outreach Employees	522	475	444	405	386	365
Taxpayer Assistance Centers (TACs)	401	401	398	382	378	376
TAC Service Reps	1,639	1,515	1,484	1,520	1,423	1,267

At the same time, taxpayer returns filed increased between tax year (TY) 2011 and TY 2015. Overall, filings grew nearly four percent from nearly 235 million in TY 2011 to over 243 million in TY 2015.¹⁶

13 See, e.g., JCT, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (1998) (“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.”).

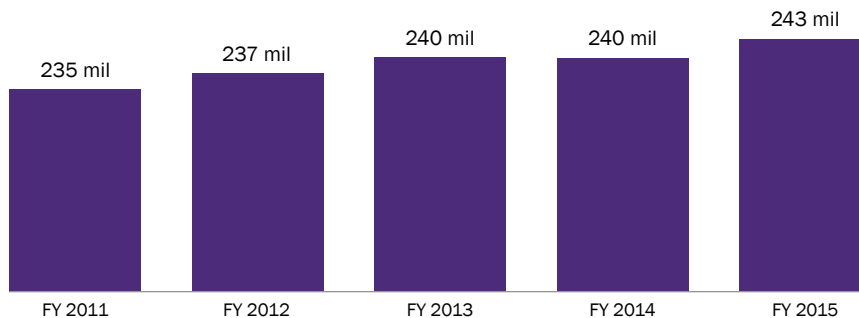
14 See, e.g., National Taxpayer Advocate 2014 Annual Report to Congress 134-44; National Taxpayer Advocate 2014 Annual Report to Congress 145-53; National Taxpayer Advocate 2014 Annual Report to Congress 123-33.

15 Figures for Appeals Officers, Revenue Officers, Revenue Agents, Stakeholder Liaison Outreach, Stakeholder Partnerships, Education and Communication Outreach, and Taxpayer Assistance Center (TAC) Service Representatives are from the IRS response to TAS Fact Check (Dec. 16, 2016). TAC customer service representative figures are from the IRS Human Resources Reporting Center *Position Report by Employee Listing for the ending pay period for FY 2011 to 2016*, <https://persinfo.web.irs.gov/>. The IRS response to TAS Fact Check (Dec. 16, 2016) showed the following counts for TAC customer service representative: Fiscal Year (FY) 2011 – 1,977, FY 2012 – 1,839, FY 2013 – 1,775, FY 2014 – 1,803, FY 2015 – 1,678, and FY 2016 – 1,477. TAS was unable to replicate the IRS TAC employee figures, and information was not provided by TAC employee location (city) to update the Figure 1.4.3, *Assistance Centers With Employees in 2011 But Without Employees by 2016*. TAC Office figures for FYs 2011-2014 from IRS response to TAS Fact Check (Dec. 23, 2014). TAC Office figures for FY 2015 from W&I analyst (Dec. 13, 2016). TAC Office figures for FY 2016 from the IRS response to TAS Fact Check (Dec. 20, 2016).

16 IRS, *Databook Returns Filed Tax Year (TYs) 2011-2015*, Nov. 30, 2016.

FIGURE 1.4.2¹⁷

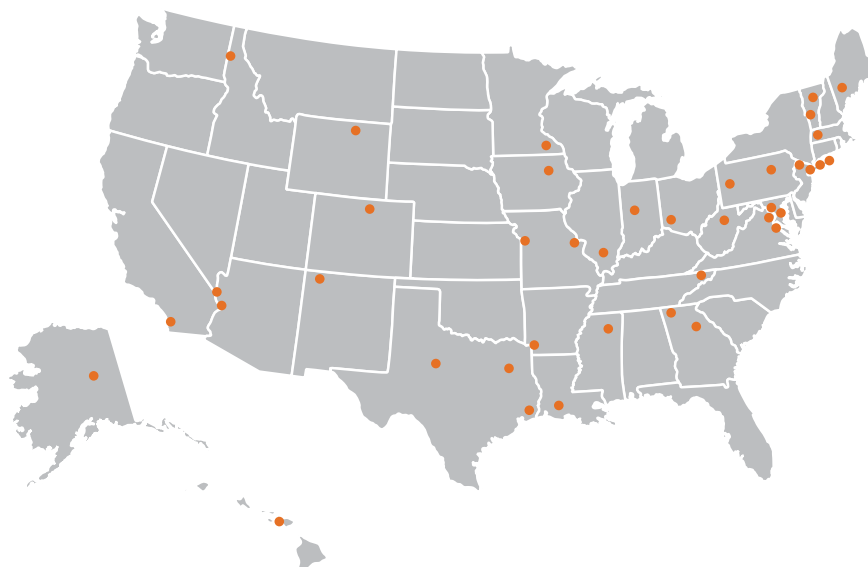
U.S. Tax Returns Filed, FYs 2011-2015



Not only has the IRS moved employees from local offices to campuses, it has also decreased the number of Taxpayer Assistance Centers (TACs) (also known as walk in sites) from 401 to 376 (six percent) since 2011.¹⁸ Additionally, 22 TACs have no staff and 95 have only one employee.¹⁹ TAS review of IRS human resources reports found that at least 40 TAC locations that had customer service representatives in 2011 did not have these employees by 2016, as illustrated in Figure 1.4.3.

FIGURE 1.4.3²⁰

Taxpayer Assistance Centers With Employees in 2011 But Without Employees by 2016



17 IRS, *Databook Returns Filed Tax Year (TYs) 2011-2015*, Nov. 30, 2016.
 18 In 2011, the IRS operated 401 TACs. IRS response to TAS information request (Dec. 23, 2014). Today the IRS operates 376 TACs, a reduction of six percent. IRS response to TAS Fact Check (Dec. 20, 2016).
 19 IRS response to TAS Fact Check (Dec. 20, 2016).
 20 IRS Human Resources Reporting Center, Nov. 29, 2016.

A Lack of Geographic Presence Can Have a Chilling Effect on Taxpayer Morale, Which Decreases Voluntary Compliance and Increases Taxpayer Burden

A growing body of research on the concept of “tax morale” and an individual’s inherent motivation to pay taxes continues to focus on the psychological factors that drive compliance.²¹ 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 within the group.²² Each of these factors interacts with and is influenced by the others.²³

In 2012 and 2013, TAS developed and administered a survey to a national sample of sole proprietors to determine the factors that influence compliance behavior in this population.²⁴ TAS also identified geographic communities where a disproportionate number of taxpayers were deemed to be either high or low compliant taxpayers. 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 dispersed. The low-compliance group also reported more participation in local institutions. The research identified a link between the salient relationships, *i.e.*, one’s membership in a group, and one’s own attitudes and behaviors towards tax and compliance. Local norms were the most influential factors of tax compliance.²⁵ The research suggests the IRS should retain a local presence and conduct targeted outreach and education events, particularly in low-compliance communities.

A lack of geographic presence may have a chilling effect on taxpayer morale, which in turn may decrease voluntary compliance contributing to the growth of the “shadow economy.”²⁶ Without access to local IRS employees, taxpayers may turn to both legitimate and illegitimate internet resources for tax information, where anonymity provides cover for behavior people might not normally consider. Psychological research has shown that “anonymity increases unethical behavior” and that “in the online world, which can offer total anonymity, the effect is even more pronounced” with “[p]eople — even ordinary, good

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- 21 Eva Hofmann, Erik Hoelzl, & Erich Kirchler, *Preconditions of Voluntary Tax Compliance: Knowledge and Evaluation of Taxation, Norms, Fairness, and Motivation to Cooperate*, 216 Z PSYCHOL. No. 4, 209–17, (2008). For a detailed discussion on behavioral research, see Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra* and Literature Review: *The IRS Is Missing Opportunities to Leverage Behavioral Science Insights and Measure Service Revenues*, *infra*. See The Netherlands Tax and Custom Administration, *Horizontal Monitoring Within the Medium to Very Large Business Segment*, (Nov. 30, 2010) for an example of a tax agency incorporating the concepts of mutual trust and transparency to build rapport with the taxpayers it serves.
- 22 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*).
- 23 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 1-14 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*) (finding small businesses subject to an accuracy-related penalty had lower subsequent compliance if the penalty was assessed by default, was abated, or was appealed, potentially suggesting that penalties perceived as unfair reduce future compliance); Norman Gemmill and Marisa Ratto, *Behavioral Responses to Taxpayer Audits: Evidence From Random Taxpayer Inquiries*, 65 NAT. TAX J. No. 1, 33–58, (Mar. 2012) (suggesting that audits of compliant taxpayers may reduce voluntary compliance); National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 67-100 (*Audit Impact Study*) (finding taxpayers who were audited but did not receive an additional assessment reduced their reported income following an audit).
- 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 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 33-55 (*Small Business Compliance: Further Analysis of Influential Factors*).
- 26 Also called the underground, informal or parallel economy, the shadow economy includes not only illegal activities but also unreported income from the production of legal goods and services, either from monetary or barter transactions. See Friedrich Schneider with Dominik Enste, *Hiding in the Shadows: The Growth of the Underground Economy*, Economic Issues No. 30 (Int’l Monetary Fund, Mar. 2002), <http://www.imf.org/external/pubs/ft/issues/issues30/>.

people — often chang[ing] their behavior in radical ways.”²⁷ Taxpayers may become convinced that avoiding taxes is the social norm and may act accordingly in regards to their obligations.

The Absence of a Proper Geographic Footprint Deprives the IRS and Taxpayers of Local Knowledge Which May Result in Missed Opportunities to Meet Taxpayer Service Needs and to Identify and Address Noncompliance Specific to a Geographic Region

Post-RRA 98, the IRS shifted its community based resources to campuses relying on national “one-size-fits-all” service and compliance policies for each category of taxpayer. This centralization has resulted in the IRS not addressing the particular attributes of local taxpayer populations and disregarding their *rights to quality service and to a fair and just tax system*. Additionally, service and compliance initiatives designed at the national level may vary in effectiveness across geographic lines.

Research identified a link between the salient relationships, *i.e.*, one’s membership in a group, and one’s own attitudes and behaviors towards tax and compliance. Local norms were the most influential factors of tax compliance. The research suggests the IRS should retain a local presence and conduct targeted outreach and education events, particularly in low-compliance communities.

Reductions in IRS geographic presence permeate the entire organization. Twelve states and the territory of Puerto Rico lack a permanent Appeals presence, leaving taxpayers in these states to either wait for a circuit riding employee to visit their area or to travel to the nearest state with an Appeals presence to obtain an in-person hearing.²⁸ Additionally, 16 states and Puerto Rico lack a Settlement Officer, who hears collection appeals.²⁹ The IRS consolidated 33 geographically dispersed lien units into a single centralized unit in 2005, virtually eliminating taxpayers’ ability to walk in and obtain an immediate release of a lien.³⁰ Localized outreach and education have all but disappeared. For example, SB/SE, which serves approximately 62 million taxpayers, has no outreach and education employees in 14 states, plus the District of Columbia.³¹

The Uniqueness and Complexity of a Tax Experience Suggests a Continuing Need for Face-to-Face Interaction

The National Taxpayer Advocate has long advocated that the IRS should provide service that meets taxpayer needs and provide

27 Julie Zhuo, *Where Anonymity Breeds Contempt*, N.Y. TIMES, Nov. 29, 2010, http://www.nytimes.com/2010/11/30/opinion/30zhuo.html?_r=0.

28 Appeals response to TAS information request (June 6, 2016). The states that lack a permanent Appeals Officer are Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont, and Wyoming. There is no permanent Appeals office in the territory of Puerto Rico. For a detailed discussion of the Appeals Future State plans, see Most Serious Problem: *Appeals: The Office of Appeals’ Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its “Future Vision” Should Incorporate Those Values, infra*. IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

29 Appeals response to TAS information request (June 6, 2016). IRS did not provide information to confirm or disprove the figures during the TAS Fact Check process.

30 Government Accountability Office (GAO), GAO 05-26R, *Opportunities to Improve Timeliness of IRS Lien Releases* (Jan. 10, 2005).

31 IRS response to TAS Fact Check (Dec. 15, 2016). IRS Human Resources Reporting Center, *Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees as of the week ending October 1, 2016* (Dec. 1, 2016) (14 states include Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, Wisconsin, and Wyoming).

taxpayers with the necessary tools to comply with their tax obligations.³² A taxpayer's willingness and ability to use a certain service, such as the internet, mobile applications, phone, or face-to-face services will influence the service a taxpayer actually uses.³³ When it is clear a taxpayer cannot use a particular service, the IRS must ensure the taxpayer is provided alternative channels. In particular, it must continue to provide service to taxpayers who do not use the internet.³⁴ The IRS cannot ignore the 13 percent of the population that does not use the internet while it moves forward with offering more services online and fewer face-to-face services.³⁵ Service delivery — the provision of assistance to taxpayers in the manner they require in order for them to comply with their tax obligations — should be the primary tenet of tax administration around which all functions are organized.

The IRS Can Look to the Financial Industry for Models of Presence in Local Communities and Should Seek Local Community Partners

Individuals “feel more at ease when speaking with local representatives who fully understand their language and idiomatic expressions.”³⁶ Local management provides “leaders who are completely familiar with the local business environment, culture, and legal climate.”³⁷ As “one of the world's largest financial institutions”³⁸ that touches the lives of millions every year, the IRS should study and learn from literature on effects of geographic expansion on bank efficiency.³⁹ For example, “making relationship loans to borrowers that do not qualify for credit scoring because of a relatively weak financial statements and collateral of questionable value requires local knowledge that is difficult to quantify and transmit to a distant headquarter,” and this “local knowledge” does not only include financial information, but information about “managers, its local environment, and its relationship with customers, suppliers, and local competition.”⁴⁰

One good example of community involvement is the Department of Justice (DOJ) community policing program that involves public-private partnerships between law enforcement and the communities it serves to collaboratively resolve problems and build community trust.⁴¹ The IRS can and should be able to build partnerships with local organizations. It already has a network of Volunteer Income Tax

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- 32 See National Taxpayer Advocate 2006 Annual Report to Congress vol. 2, at 114; National Taxpayer Advocate 2005 Annual Report to Congress 13-15; National Taxpayer Advocate 2004 Annual Report to Congress 49. See also *Internal Revenue Service FY 2008 Budget Request: Hearing Before the S. Comm. on Appropriations Subcomm. on Financial Services and General Government*, 110th Cong., 7-10 (2007) (statement of Nina E. Olson, National Taxpayer Advocate).
- 33 See National Taxpayer Advocate 2007 Annual Report to Congress 162-82 (Most Serious Problem: *Service At Taxpayer Assistance Centers*).
- 34 Pew Research, *Americans' Internet Access: 2000-2015* (June 2015) <http://www.pewinternet.org/2015/12/21/home-broadband-2015/>. For an analysis of taxpayer ability and willingness to use certain service channels, see Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol.2, *infra*.
- 35 Pew Research, *13% of Americans don't use the internet. Who are they?* (Sept. 2016) <http://www.pewresearch.org/fact-tank/2016/09/07/some-americans-dont-use-the-internet-who-are-they/>. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 56-63
- 36 David Ingram, *The Advantages of Geographical Organizational Structure*, HOUSTON CHRONICLE, <http://smallbusiness.chron.com/advantages-geographical-organizational-structure-717.html> (last visited Oct. 1, 2016).
- 37 *Id.* For an extended literature review related to this topic see Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.
- 38 IRS, *Resources Home*, <https://jobs.irs.gov/resources> (last visited Dec. 4, 2016).
- 39 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.
- 40 See Allen N. Berger, *The Effects of Geographic Expansion on Bank Efficiency* (2000).
- 41 See, e.g., U.S. Department of Justice (DOJ), FY 2017 Performance Budget, Office of Community Oriented Policing Services (COPS Office), Congressional Justification (Feb. 9, 2016) (discussing the concept of community policing or building partnerships between law enforcement and local communities).

Assistance (VITA) sites, Tax Counseling for the Elderly sites, and Low Income Taxpayer Clinic sites with relationships with local communities. The IRS could expand these partnerships to increase its grassroots outreach and education as well as its involvement in local communities.

The IRS Is Slow in Finding Innovative Ways to Foster Local Presence in Communities

The IRS Should Consider Partnering With Private and Non-Profit Service Organizations to Increase Its Grassroots Presence and Improve Service to Remote Populations

It is not always physically or financially feasible to permanently assign employees to the most remote parts of the United States. In these instances, the IRS can partner with private and non-profit organizations to visit these most remote regions and provide tax education and preparation to its taxpayers, many of whom are small businesses or self-employed, or are individuals who rely on tax refunds to provide for their families by claiming credits such as the Earned Income Tax Credit, Child Tax Credit, and other refundable credits.⁴²

One example of a successful IRS non-profit partnership is The Alaska Business Development Center, Inc. (ABDC)⁴³ Volunteer Tax and Loan Program (VTLP). In Alaska, there are more than 100 small remote villages each with fewer than 1,000 residents.⁴⁴ There are no TACs or VITA programs in these areas and the geographic location and financial wherewithal of these resident taxpayers make it virtually impossible to visit the closest location for assistance. The ABDC's volunteers travel directly to rural Alaskan communities to provide hands on assistance to those in need.⁴⁵ All volunteers complete IRS VITA training "as well as additional ABDC designed training, which details program and Alaska-specific issues."⁴⁶ Services are brought to the villages during the tax season to provide free one-on-one assistance and education on taxpayer rights and responsibilities.⁴⁷ The IRS should expand this type of partnership to more remote communities throughout the country.

TACs and VITA Programs Provide a Human Element and Help Evoke a Cooperative Relationship Between Taxpayers and the IRS

TACs provide more than just information to taxpayers. For many taxpayers, the filing of a tax return is the largest monetary transaction they complete each year. It is a complex transaction where mistakes can be financially disastrous for taxpayers. If a taxpayer does not have the proper tools or wherewithal to file a return, that could be the difference between filing (and filing correctly with assistance), or not filing and triggering IRS assessment and collection proceedings.

42 Chuck Marr, Chye-Ching Huang, Arloc Sherman, and Brandon DeBot, *EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development, Research Finds, Center for Budget and Policy Priorities* (Oct. 1, 2015), <http://www.cbpp.org/research/federal-tax/eitc-and-child-tax-credit-promote-work-reduce-poverty-and-support-childrens>.

43 Alaska Business Development Center (ABDC) is a 501(c)(3) nonprofit corporation that provides business consulting and tax-related services to rural Alaskan residents. Founded in 1978, ABDC provides assistance to individuals who do not have access to professional services due to their income, language barriers or isolated geographic location.

44 *Alaska Very Small Towns and Villages (fewer than 1000 residents)*, <http://www.city-data.com/city/Alaska3.html#ixzz4GwkU5eqy>, <http://www.city-data.com/city/Alaska3.html>.

45 ABDC, <http://www.abdc.org/>.

46 Manny Boitz, *Volunteer Tax & Loan Program Celebrates 20 Years Alaska Business Development Center Helps Bring Millions Back to Rural Communities*, ALASKA BUSINESS MONTHLY, (Feb. 2015), <http://www.akbizmag.com/Alaska-Business-Monthly/February-2015/Volunteer-Tax-Loan-Program-Celebrates-20-Years/>.

47 *Id.* In TY 2014, VTLP teams traveled to 80 rural villages and assisted an additional 49 more through the Anchorage Mail-in Site; assisted over 9,100 taxpayers to include more than 1,000 elders aged 60 years or older and over 1,000 commercial fishing captains, crew members, and industry workers; prepared in excess of 4,800 tax returns and delivered nearly 1,400 education presentations; generated over \$6.9 million in tax refunds for rural Alaskan residents; and captured nearly \$2.7 million in the EITC.

... The IRS shifted its community based resources to campuses relying on national “one-size-fits-all” service and compliance policies for each category of taxpayer. This centralization has resulted in the IRS not addressing the particular attributes of local taxpayer populations and disregarding their *rights to quality service and to a fair and just tax system*.

TACs play an important role in meeting the needs of underserved taxpayers, including rural, elderly, disabled, English as a second language, American Indian, and low income taxpayers. The National Taxpayer Advocate is concerned that the IRS’s focus on online services will leave these vulnerable populations behind.⁴⁸

As part of its service changes for fiscal year (FY) 2014, the IRS eliminated return preparation at all TACs and redirected taxpayers to volunteer sites and Free File.⁴⁹ Despite unprecedented service reductions, taxpayer demand for face-to-face service at the IRS’s walk-in sites has remained high — above 2.5 million visits by June 2016.⁵⁰ That same period, 95 TACs were staffed by only one employee.⁵¹ The IRS has now converted all TACs to appointment only services.⁵² The IRS justifies the closure of TACs and reduction in other services by the lack of need, as based on taxpayer responses to surveys, some of which are conducted entirely online, which may exclude those taxpayers most in need of the services due to lack of internet access.⁵³ Failing to accurately survey the taxpayers who actually use the TACs, and are in greatest need of these services, creates a self-fulfilling justification that taxpayers do not need or want TACs and therefore the IRS can close them due to decreased demand. Shifting to “by appointment only,” the IRS ignores the way many taxpayers take care of their tax responsibilities.

TAS and W&I have collaborated on the development of a ranking methodology, the Service Priorities Project (SPP), for the major taxpayer service activities offered by W&I. The methodology will take taxpayer needs and preferences into account while balancing them against the IRS’s need to conserve limited resources. TAS has been conducting a phone survey on taxpayer needs and preferences to fill in the available data to make the tool as effective as possible in representing the varying needs of taxpayer populations while addressing the gaps created by data collected only online.⁵⁴

The National Taxpayer Advocate is pleased with the IRS’s initiative to co-locate IRS offices with Social Security Administration offices.⁵⁵ Continued expansion of this program, coupled with the creation of virtual service terminals hosted by community partners, will help the IRS reach taxpayers in remote and other underserved communities in a cost-effective manner. The National Taxpayer Advocate encourages

48 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 56-63.

49 National Taxpayer Advocate 2014 Annual Report to Congress 11.

50 IRS response to TAS Fact Check (Dec. 20, 2016).

51 *Id.*

52 IRS, *Contact Your Local IRS Office*, <https://www.irs.gov/help-resources/contact-your-local-irs-office> (last visited Nov. 30, 2016).

53 See IRS, *Taxpayer Assistance Center Customer Expectations Survey* (2013). The survey is carried out every three years; the survey for 2016 has been completed and the results are being compiled. See also IRS, *Web-First Conjoint Study Survey Instrument*. For a discussion of these surveys see Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*.

54 For a discussion of understanding taxpayer needs and preferences, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*; for a discussion of the TAS Service Priorities Survey and a report of initial findings, see Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

55 As part of “Customer Assistance, Relationships and Education (CARE) FS 2017 Priorities,” the IRS is “continu[ing] to develop and implement plans that will ensure face-to-face service is available to those taxpayers whose tax compliance issues cannot be resolved through alternative methods.”

the IRS to partner with local government organizations such as departments of motor vehicles and Native American governments to bring service to additional communities.

Other Tax Administrations' Experiences Suggest That Using Mobile Advisors or Mobile Stations and Vans May Improve IRS Connection With the Communities It Serves

Tax agencies around the world are researching the ways to improve tax morale and inner motivation to improve compliance and perceptions of the agency.⁵⁶ 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 taxpayers on a local level.⁵⁷ The HMRC approach 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.⁵⁸ Chile also uses mobile taxpayer assistance stations to deliver services to remote communities, especially those where taxpayers have no or limited internet access.⁵⁹ The National Taxpayer Advocate has recommended on numerous occasions that IRS use mobile vans to reach underserved taxpayer populations.⁶⁰

56 See, e.g., Anders Stridh, Compliance Strategist Swedish Tax Agency (Sweden), *The Strategic Plans and Tax Morale*, 45th Inter-American Center of Tax Administrations (CIAT) General Assembly (2011).

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

58 HMRC News, *HMRC Comes Out of the Office to Support Customers Who Need Extra Help* (Feb. 12, 2014), <https://www.gov.uk/government/news/hmrc-comes-out-of-the-office-to-support-customers-who-need-extra-help>.

59 Chilean Tax Agency, *¿Qué Es SII Móvil?*, http://www.sii.cl/portales/sii_movil/que_es.html (last visited Nov. 28, 2016).

60 See National Taxpayer Advocate 2014 Annual Report to Congress 31-45. See also National Taxpayer Advocate 2010 Annual Report to Congress 267-77. In this Most Serious Problem, that IRS reported that it had tested a mobile van program in 2008, 2009, and 2010 despite previously responding to research requests that it did not have mobile vans. Additionally, the IRS never shared the parameters of this program with the National Taxpayer Advocate so TAS was unable to evaluate the efficacy of the program design. See also National Taxpayer Advocate 2008 Annual Report to Congress 95-113. In this Most Serious Problem, the IRS did not respond at all to the National Taxpayer Advocate's recommendation that the IRS begin a mobile van program.

FIGURE 1.4.4, Chilean Servicio de Impuestos Internos (Chilean Tax Agency) Mobile Van⁶¹



CONCLUSION

A primary way to build taxpayer trust and confidence, provide taxpayer specific service, and to promote understanding of the tax system is to be a part of the community and to display a desire to work with and educate local taxpayers. Local presence entails developing partnerships between the IRS and the communities it serves to collaboratively resolve problems and build community trust.⁶² By maintaining and increasing its community presence, the IRS will be better able to:

- Serve taxpayers on a local level through outreach and education;
- Address compliance problems tied to a specific region or group by developing partnerships with the communities and working collaboratively to resolve problems and build community trust;⁶³
- Provide local managers and higher level employees with additional exposure to specific trends that drive compliance in a positive or negative way and enable them to relay those trends to executives for consideration on a national level; and
- Alleviate taxpayer mistrust by providing a human aspect to the agency as a whole where employees either live amongst or interact with taxpayers in their communities on a regular basis.

61 Chilean Tax Agency, *¿Qué Es Sii Móvil?*, http://www.sii.cl/portales/sii_movil/que_es.html (last visited Nov. 28, 2016).

62 See, e.g., U.S. DOJ, FY 2017 Performance Budget, COPS Office, Congressional Justification (Feb. 9, 2016) (discussing the concept of community policing or building partnerships between law enforcement and local communities).

63 DOJ has developed a “community policing” program since 1994, which provides promising results in reducing crime rates and building trust between the police and local communities. See U.S. DOJ, FY 2017 Performance Budget, COPS Office, Congressional Justification (Feb. 9, 2016) (citing a study that showed that the crime problems targeted by COPS Office grantees “led to a statistically precise drop in crime in subsequent years for four of the seven index crimes.”).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Expand partnerships with private and non-profit organizations, similar to the Alaska Volunteer Tax and Loan Program, to visit most remote and underserved regions and provide tax education and preparation to taxpayers within their communities.
2. Use the SPP model to make decisions on taxpayer services, including the location of TACs.
3. Work with community partners to host virtual service delivery terminals for taxpayers located in remote and otherwise underserved communities.
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 taxpayer assistance stations (vans) in each state.

MSP
#5**TAXPAYER BILL OF RIGHTS (TBOR): The IRS Must Do More to Incorporate the Taxpayer Bill of Rights into Its Operations****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Sunita Lough, Commissioner, Tax Exempt/Government Entities Division
 Douglas O'Donnell, Commissioner, Large Business and International Division
 Donna C. Hansberry, Chief, Appeals
 Dan Riordan, IRS Human Capital Officer

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM²

The National Taxpayer Advocate had long called for the IRS to adopt a Taxpayer Bill of Rights (TBOR) to be used as a framework for effective tax administration and for Congress to add the list of fundamental rights comprising the TBOR to the Internal Revenue Code (IRC).³ The IRS officially adopted the TBOR in 2014, and Congress followed in late 2015 by adding the list of fundamental rights to the IRC.⁴ IRC § 7803(a)(3) now states:

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.
- 3 See, e.g., National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration; Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (2013), <https://taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf>.
- 4 IRS, IR-2014-72, *IRS Adopts "Taxpayer Bill of Rights;" 10 Provisions to be Highlighted on IRS.gov*, in *Publication 1*, <https://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights%3B-10-Provisions-to-be-Highlighted-on-IRSGov-in-Publication-1> (June 10, 2014). Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

In discharging his duties, the Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title, including—

This section then goes on to list the ten fundamental rights originally proposed by the National Taxpayer Advocate.

Following the adoption of the TBOR, the IRS embarked on an extensive public outreach campaign. In conjunction with the National Taxpayer Advocate, it revised Publication 1, *Your Rights as a Taxpayer*, to explain the ten rights in plain language.⁵ During the 2015 and 2016 filing seasons, the IRS published Special Edition Tax Tips and a series of weekly fact sheets covering each of the ten fundamental rights. The IRS mailed TBOR fact sheets to tax professional organizations and partners, and placed articles in online newsletters.

Although the IRS has commendably done much to make the public aware of the TBOR, it is not fulfilling Congress's mandate in IRC § 7803(a)(3) in a comprehensive or strategic manner.⁶ The IRS has declined to incorporate the TBOR into many areas of its operations, maintaining that its materials already include taxpayer rights. Despite being mandated by Congress to ensure that IRS employees are familiar with and abide by taxpayer rights,⁷ the following areas represent missed opportunities for the IRS to incorporate the TBOR into its operations:

- Employee training and messaging;
- Employee guidance such as the Internal Revenue Manual (IRM);
- Employee recognition and awards;
- Performance measures, quality measures, and customer satisfaction surveys;
- Mechanisms for holding itself accountable such as the Business Performance Review (BPR) process; and
- Policy decisions and strategic plans for serving taxpayers, including its Future State plans.

The IRS's failure to fully incorporate the TBOR into these areas creates a risk that taxpayer rights will not be fully observed during interactions with taxpayers. For example, appeal rights may be lost or the IRS may fail to consider a taxpayer's unique facts and circumstances. When the TBOR is not fully observed, taxpayers may be harmed and voluntary compliance may decline. This Most Serious Problem will gauge the IRS's progress in operationalizing the TBOR and draw on the lessons learned from other countries' experiences with implementing and adhering to a taxpayer charter.⁸

⁵ See IRS Publication 1, *Your Rights as a Taxpayer* (Dec. 2014).

⁶ In 2013, the National Taxpayer Advocate issued a report to the Principal Deputy Commissioner of the IRS, outlining how it could use the TBOR as a framework for effective tax administration. This report contained almost two dozen action items for the Taxpayer Advocate Service (TAS) as well as almost two dozen recommendations for the Commissioner of the IRS. While TAS has followed through with what it committed to doing in this report, the IRS has not fulfilled its part. National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration; Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (2013), <https://taxpayeradvocate.irs.gov/userfiles/file/2013FullReport/Toward-a-More-Perfect-Tax-System-A-Taxpayer-Bill-of-Rights-as-a-Framework-for-Effective-Tax-Administration.pdf>.

⁷ Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

⁸ Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

ANALYSIS OF PROBLEM

Employee Training and Messaging Needs to Meaningfully Incorporate the Taxpayer Bill of Rights (TBOR)

Without Guidance From Leadership, Training Materials Incorporate the TBOR Inconsistently and Insufficiently

In 2015, Congress mandated that the IRS Commissioner “In discharging his duties . . . shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title.”⁹ This training obligation can be met in several ways — technical training, annual mandatory training, IRM instructions, messages to employees, etc. Although the IRS has incorporated taxpayer rights into some of its training courses,¹⁰ and has disseminated messages to IRS employees emphasizing the importance of observing TBOR, it has not issued any kind of operating division-wide or servicewide guidance specifically on how to incorporate the TBOR into training materials.¹¹ The Human Capital Office (HCO) reported it would be open to working with TAS to include a preliminary page about TBOR in the training materials for each leadership training course.¹² While helpful, this effort falls short of what is critically needed — to provide consistent and comprehensive directions to all employees who create training on how to incorporate the TBOR throughout their training materials, as required by IRC § 7803(a).

This lack of strategic leadership results in taxpayer rights information being inserted in IRS course materials in a piecemeal and boilerplate manner, with some courses covering taxpayer rights topics with no reference to the fundamental rights adopted by the IRS,¹³ other courses sending mixed messages about the TBOR,¹⁴ and still other courses failing to explain taxpayer rights at all.¹⁵ Notwithstanding this lack of

9 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

10 See, e.g., Automated Collection System (ACS) Basic Taxpayer Appeal Rights, Item 18755 (draft version provided to TAS on July 13, 2016); CPE Lesson 6, Taxpayer Rights and Automated Underreporter (AUR) (undated training document provided to TAS on July 13, 2016).

11 The Human Capital Office (HCO) reported that it is working on content for annual ethics discussions and plans to add TBOR information into the New Manager Orientation Program, but the IRS has not provided TAS with any evidence of guidance issued that specifically addresses how to incorporate the TBOR into all training materials. The Small Business/Self Employed (SB/SE) Operating Division stated “SBSE was asked to incorporate TBOR into training in 2014, but we cannot locate that guidance/communication.” IRS response to TAS information request (July 13, 2016).

12 IRS response to TAS information request (July 13, 2016); IRS response to TAS fact check (Dec. 16, 2016).

13 The current ACS course, *Basic Taxpayer Appeal Rights*, never mentions the TBOR by name nor does it cite any of the ten fundamental rights. It references “appeal rights” but never articulates that taxpayers have the *right to appeal an IRS decision in an independent forum*, thus overlooking a key part of this right — the independence of the Office of Appeals or the U.S. Tax Court. IRS, *ACS Basic Taxpayer Appeal Rights*, Item 18755 (draft version provided to TAS on July 13, 2016). The IRS states it is currently updating this training, which will become *ACS New Recruit Course 18755 - Taxpayer Appeal Rights*, and will incorporate the TBOR, the Freedom of Information Act, and other information related to taxpayer rights. IRS response to TAS fact check (Dec. 16, 2016). Another example provided by the IRS references the legislation, TBOR 2, but makes no reference to the TBOR adopted by the IRS and Congress, reflecting a lack of awareness about the difference between prior legislation granting specific rights and the statement of principles adopted by the IRS. IRS response to TAS information request (July, 13, 2016).

14 See Return Integrity & Compliance Services (RICS) Integrity & Verification Operations (IVO), Training 29048-102 (Dec. 2014). This training states, “As an IVO employee, it is also your responsibility to protect the rights of the *good taxpayer*” (emphasis added), implying that only “good” taxpayers have rights. Leaving aside the definitional issues of what, precisely, a “good” taxpayer is, this statement is a false and dangerous generalization because the TBOR rights are guaranteed to *all* taxpayers. They are foundational to the structure of effective tax administration.

15 For example, the Examination Toll-Free Telephone Assistor Training covers topics related to taxpayer rights, such as taxpayer authentication and power of attorney, without discussing the rights and their significance. Exam Toll-Free Telephone Assistor Training Course 12256-102 (Rev. June 2013). This course has not been updated since 2013, despite a prior discussion of its inadequate coverage of taxpayer rights. See National Taxpayer Advocate’s 2013 Annual Report to Congress 53.

direction at a servicewide level, Examination prepared an excellent course on taxpayer rights that could be a model for other IRS courses.¹⁶ This training discusses what the fundamental rights mean and provides examples of how the rights apply in specific situations with references to IRC provisions, Treasury Regulations, Revenue Procedures, and Internal Revenue Manuals (IRMs).¹⁷ Such training should be shared with other IRS functions with guidance to prepare similar training.

Employee Messaging About the Taxpayer Bill of Rights (TBOR) Should Motivate Employees to Improve the Protection of Taxpayer Rights and Should Be Ongoing

Employee messaging can communicate TBOR information and help create a shared mindset among employees.¹⁸ During the 2015 filing season, the Small Business/Self Employed (SB/SE) Division sent out a series of six employee emails from the Directors of Collection and Examination.¹⁹ Each email focused on one or two fundamental rights and gave examples of what employees already do each day to recognize these rights. While helpful, this messaging would have been even more beneficial if used to improve the protection of taxpayer rights, as opposed to recognizing what has always been done, and thus merely upholding the status quo.²⁰

An email to employees from the Director of Field Collection provides a great example of effective TBOR messaging:²¹

Two important rights in the Taxpayers' Bill of Rights (TBOR) are the Right to be Informed and the Right to Quality Service. These are also closely related to vital "customer satisfaction" measures we monitor. This fiscal year we want to continue to stress the criticality of making sure our customers are aware of the status of their case. Generally, interaction with a field Revenue Officer of the Internal Revenue Service has the potential for adding uncertainty and anxiety in the lives of those we serve. While we must do our best to bring them into voluntary compliance with the tax laws, treating each taxpayer with dignity, respect, and courtesy go a long way in instilling trust in the system. Likewise, periodically letting the taxpayer know where we are in the process of resolving their case gives the customer knowledge about the process and a sense they have a role in the outcome — peace of mind. Please continue to make this effort for the public you serve. This year, Field Collection saw improvement in the Customer Satisfaction measure, "Keeping the Taxpayer up to date on the Collection Process" from 54% satisfied (1st Quarter 2016) to 57% satisfied (2nd Quarter 2016). We also saw improvement in "Courtesy and professionalism of the assigned RO" from 72% to 77% satisfied! However, we still need to improve in "Notifying the TP of case closure" (where we saw a decline from 56% to 55% satisfied). Imagine how you would want to be treated by the IRS, or how you would want your friends and family members treated?

This message focuses on two fundamental rights, connects those rights to specific customer satisfaction measures where results have increased recently, and nudges employees to try to improve other related measures where results have declined.²² TAS is unaware of similar communications from other IRS

16 IRS, *Taxpayer Rights Self Study Guide*, Fiscal Year (FY) 2014 Exam CPE Training 57089 (undated document provided to TAS on July 13, 2016). This training will be part of the curriculum for new hire revenue agents and tax compliance officers in 2016.

17 *Id.*

18 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

19 IRS response to TAS information request (July 13, 2016) (emails on file with TAS).

20 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

21 IRS response to TAS information request (July 13, 2016).

22 IRS response to TAS information request (July 13, 2016) (email on file with TAS).

managers.²³ Messaging must be ongoing and delivered in a variety of ways, not only in the filing season following the adoption of the TBOR or in a single message from one director. TBOR annual refreshers similar to mandatory briefings currently available on the Enterprise Learning Management System can become yet another example of ongoing messaging.²⁴ TAS will undertake the development of a TBOR annual training, and work with the IRS Operating Divisions and functions to develop content that is relevant to their work.

The IRS Has Not Adequately Incorporated the Taxpayer Bill of Rights (TBOR) Into Its Guidance and Written Materials

The IRS Has Provided Little Direction to Employees on How to Incorporate the Taxpayer Bill of Rights (TBOR) into Internal Revenue Manual (IRM) Guidance, Letters, and Notices

The IRS has provided little guidance to employees responsible for drafting IRMs and taxpayer correspondence that focuses on how to incorporate the TBOR into these materials.²⁵ In 2016, the National Taxpayer Advocate spoke at the Internal Management Document (IMD) Virtual Conference²⁶ on how to incorporate taxpayer rights into IRM drafts and reviews.²⁷ In addition, the Servicewide Policy,

Directives and Electronic Research office sent an email to be distributed to all IRM authors that included boilerplate language advising authors to review and update their content related to the TBOR, without further explanation.²⁸ More comprehensive training is needed for all employees drafting IRMs and taxpayer correspondence, similar to the training the National Taxpayer Advocate provided to TAS employees.²⁹ This training used examples of IRM sections negotiated by TAS as well as those with potential for adding TBOR information. The training included best practices and tips for how to identify which fundamental rights apply, how to explain what they mean, and how to apply them to the particular situation.

Until the IRS provides this training or a similar training to its employees, TBOR information will continue to be added inconsistently, if at all. Some IRM sections include a proper discussion of TBOR or a fundamental

This lack of strategic leadership results in taxpayer rights information being inserted in IRS course materials in a piecemeal and boilerplate manner, with some courses covering taxpayer rights topics with no reference to the fundamental rights adopted by the IRS.

23 Other examples of TBOR messaging provided by the IRS include a short description of the TBOR in the FY 2016 Exam Program Letter and a token reference to TBOR in the document, SB/SE Examination Operating Unit FY 2015 Priorities. IRS response to TAS information request (July 13, 2016).

24 Annual mandatory briefings for all employees include courses on ethics, physical security, information systems security, privacy and disclosure, records management, and section 1204 of the Restructuring and Reform Act of 1998 (RRA 98), which relates to the use of enforcement statistics to evaluate employees and the fair and equitable treatment retention standard. IRS, Mandatory Briefing Timeframes, Mandates & Certification Requirement, <http://e-learning.web.irs.gov/Briefings/docs/Briefings/2016/Mandatory%20Briefing%20Timeframes.pdf> (Nov. 25, 2016). IRM 1.5.2.7, *Restructuring and Reform Act of 1998 (RRA 98) Section 1204* (Jan. 1, 2015).

25 See IRS response to TAS information request (July 13, 2016).

26 This conference was conducted by the Servicewide Policy, Directives, and Electronic Research Office on May 3, 2016, and this session was intended for all IRM authors and managers.

27 TAS representatives also spoke at an Internal Management Document (IMD) Oversight Council meeting in 2015 and requested IRM authors go through their IRMs to see if they needed new or updated references. IMD Oversight Council Meeting Minutes (May 20, 2015).

28 Email from Servicewide Policy, Directives and Electronic Research to IMD Coordinators (May 26, 2015) (on file with TAS).

29 TAS continues to focus on ensuring employees receive ongoing education in protecting taxpayer rights, tax law and procedures, and on how to advocate effectively for taxpayers. To meet this objective, the National Taxpayer Advocate conducted a webinar training on how to incorporate the TBOR into the IRM, which was viewed by all TAS employees. TAS, *Taxpayer Bill of Rights: Persuasive Writing and Research for IRM Reviews*, https://www.irsvideos.gov/Presentation?post_id=1445 (Aug. 2015).

right, including how it specifically applies in a situation,³⁰ but others merely include token references to the fundamental rights³¹ or fail to articulate the connection to the TBOR or the fundamental rights at all.³² In one example provided by the IRS, the IRM states “Taxpayers should receive quality customer service.”³³ This phrasing, instead of a clear “Taxpayers have the right to quality service,” weakens the meaning of the TBOR. Further, even when the IRM does point out a specific action that should be taken by the IRS to properly observe one of the specific rights, the IRM fails to provide any remedy for taxpayers if such action is not taken.

The IRS Has Declined to Accept Many of TAS’s Suggestions to Add Taxpayer Bill of Rights (TBOR) References into Its Guidance, Correspondence, and Publications

Between October 1, 2015 and November 2, 2016, TAS has made 402 recommendations to the IRS, seeking to change guidance, correspondence, or publications to better observe a TBOR right or add a reference to a particular right. The IRS has only adopted 136 (or about 49 percent) of the 280 recommendations that are not currently in process, being monitored, or being negotiated.³⁴

An example of one such recommendation not adopted is IRM 25.13.1.3, *Erroneous Correspondence Procedures – Report Erroneous Correspondence Process*, which provides IRS employees with the procedures for reporting any correspondence (*i.e.*, notices, letters, transcripts, faxes, etc.) that was improperly sent to a taxpayer or correspondence that contains errors. This IRM states “All IRS employees are responsible for reporting any case of erroneous taxpayer correspondence (or potential case) to the Office of Taxpayer Correspondence, Data Metrics & Error Resolution (DMER) office through the Report Erroneous Correspondence process.”³⁵ TAS submitted the following recommended language to help employees understand how this responsibility relates to the TBOR:

Taxpayers have the Right to Confidentiality, which means they can trust that the information they provide to the IRS will not be disclosed unless authorized by the taxpayer or the law. Employees can support this right by reporting erroneous taxpayer correspondence, which may prevent future unauthorized disclosures and build taxpayer trust.

The IRS refused to add this language, or alternative TBOR language, stating:

Not necessary. We have already outlined OTC [Office of Taxpayer Correspondence] areas of responsibility.

30 See, e.g., IRM 4.46.1.4, *Principles of Collaboration* (Mar. 9, 2016).

31 See, e.g., IRM 25.23.1.4, *Identity Theft and the IRS* (Sept. 22, 2016) (stating the TBOR “grants all taxpayers important rights” without more detail). This IRM section was provided as an example from the IRS in response to TAS’s information request.

32 See, e.g., IRM 4.46.3.5.6, *Opening Conference (Meeting) Participants* (Mar. 14, 2016) (discussing who may receive confidential information and warning examiners to be wary of who is in the room, but failing to make the connection to the *right to confidentiality* included in the TBOR). This IRM section was provided as an example from the IRS in response to TAS’s information request.

33 IRM 4.46.1.1, *Introduction* (Mar. 9, 2016). This IRM was provided as an example from the IRS in response to TAS’s information request.

34 The 280 recommendations include recommendations that have been adopted, recommendations that have not been adopted, and recommendations that have been elevated to the TAS Technical Liaison after negotiations between the author and the TAS reviewer were unsuccessful. The remaining recommendations of the 402 are currently in process, being monitored, or being negotiated.

35 IRM 25.13.1.3, *Erroneous Correspondence Procedures – Report Erroneous Correspondence Process* (Oct. 14, 2015).

However, the OTC areas of responsibility in the IRM say nothing about taxpayer rights, and the refusal to include this reminder represents a missed opportunity for the IRS to make taxpayer rights a part of its daily operations, and fails to fulfill the mandate of IRC § 7803(a).³⁶

Including the Taxpayer Bill of Rights (TBOR) in Employee Recognition and Awards Would Reinforce the TBOR As Part of the IRS's Culture

The IRS has multiple award systems for recognizing employee accomplishments. There are various monetary as well as nonmonetary awards presented by managers, heads of office, and the Commissioner of Internal Revenue.³⁷ The awards vary among their focus — employees can be recognized for exceptional contributions, for “going the extra mile,” for demonstrating a sustained, strong commitment to achieving the strategic objectives, for outstanding strategic thinking and leadership, and for distinguished service, including military, public, and community service.³⁸ The IRS should create a special award at the Commissioner's level to encourage employees to protect and support the TBOR, to demonstrate the leadership's commitment to the TBOR principles, and to ingrain those principles in the IRS's culture.

The Taxpayer Bill of Rights (TBOR) Could Be Better Applied In Developing and Reviewing Quality Measures, Performance Standards, and Customer Satisfaction Surveys

The IRS can use the TBOR as a lens through which to view IRS metrics.³⁹ In response to TAS's information request, two IRS operating divisions took their quality measurement standards and grouped them according to the relevant TBOR right.⁴⁰ While this is a good start, the exercise of assigning different standards to the different rights is not effective unless the results are reported in a similar way so that employees can see which rights are being supported and which require improvement. TAS does this in its “Taxpayer Rights Assessment,” which takes various IRS performance indicators, such as the cycle time to correspond in an identity theft case, and links them to fundamental rights, such as the *right to be informed*.⁴¹ Other IRS offices could similarly use the TBOR to organize their metrics and report success. In addition, TBOR should be used to help create new quality measurements to ensure the IRS is meaningfully measuring adherence to taxpayer rights.

While some IRS offices are effectively incorporating the TBOR into quality and customer satisfaction measures, one area where the IRS seems deficient across the board is in measuring employee performance. The IRS evaluates its employees on a number of critical job elements (CJEs). To TAS's knowledge, the IRS has provided no guidance to employees on how to incorporate the TBOR into CJEs. Instead, the IRS maintains that several of the CJE components already relate to taxpayer rights, including customer satisfaction and quality of business results.⁴² CJE components may include questions that

36 IRM 25.13.1.1, *Overview of Taxpayer Correspondence Services* (Oct. 14, 2015).

37 See, e.g., IRM 6.451.1.9, *Performance Awards* (May 20, 2011); IRM 6.451.1.15, *IRS Employee Recognition Program* (May 20, 2011).

38 IRS internal webpage, <http://hco.web.irs.gov/erp/awards.html> (Nov. 9, 2016).

39 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

40 Both the Large Business & International Division (LB&I) and the Wage & Investment Division (W&I) provided documents to TAS demonstrating how their quality standards reflect the different TBOR rights. IRS response to TAS information request (July 13, 2016). In response to TAS's fact check, the IRS stated that because TAS did not request a crosswalk of the quality standards and TBOR rights, TAS should “not infer from the IRS response provided that the other IRS BODs [Business Operating Divisions] do not have quality standards that reflect the different TBOR rights.” IRS response to TAS fact check (Dec. 16, 2016).

41 See *Taxpayer Rights Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights*, *supra*. The National Taxpayer Advocate started publishing the Taxpayer Rights Assessment annually in 2014.

42 IRS response to TAS information request (July 13, 2016).

Based on the IRS response [regarding Future State], the IRS appears to believe the Taxpayer Bill of Rights (TBOR) is not relevant to what capabilities will be required for the Future State (such as the capability for a person to speak with an IRS employee), but is only relevant in prioritizing how to deliver the capabilities it has decided on and in making a post-hoc justification for funding. The IRS disregards taxpayer rights by not considering the TBOR upfront.

relate to taxpayer rights, such as “Did we provide meaningful outreach to all customers?”⁴³ However, to truly incorporate the TBOR, the CJEs should make the connection between the component and the relevant TBOR rights — the *right to be informed* and the *right to a fair and just tax system*. Linking the desired employee action to a particular right would increase employee awareness of the TBOR and make the employee accountable for observing the TBOR when interacting with taxpayers or working on a taxpayer’s case. The IRS can also use the TBOR as impetus to update and expand existing CJEs in order to better evaluate how an employee’s performance supports the TBOR.

Similar to its position regarding CJEs, the IRS maintains that existing customer satisfaction survey questions relate to the TBOR, while declining to use the TBOR to inform the creation of additional questions.⁴⁴ An Appeals customer satisfaction survey included multiple questions regarding the Alternative Dispute Resolution (ADR) process, asking about general satisfaction, savings in time, savings in money, and whether the taxpayer thought the ADR process and the arbitrator or mediator was impartial.⁴⁵ Appeals could use the TBOR to create additional questions, asking not just if the ADR process was impartial, but whether taxpayers felt the ADR mediator was independent from the IRS, part of the *right to appeal an IRS decision in an independent forum*. There may be situations where customers answered affirmatively to certain questions that implicate taxpayer rights, but did not feel that all of their rights were observed. This information could be captured by adding additional questions, such as “Do you feel the IRS observed your right to [insert relevant right]?”, a question that has been posed by other countries in their customer surveys.⁴⁶

The IRS Should Hold Itself Accountable Through Reporting in the Business Performance Review (BPR)

To make the TBOR more concrete and hold itself accountable, the IRS could implement a program to periodically report on what actions it has taken to further the principles of the TBOR.⁴⁷ This could be easily accomplished through the Business Performance Review (BPR) process, which is a quarterly report used to measure and evaluate a division’s performance against established strategic plans, and to share significant accomplishments as well as evolving concerns with the IRS senior leadership.⁴⁸ Some BPRs already do report on efforts that advance taxpayer rights. For example, Appeals reported in a recent BPR that it has taken actions to mitigate the risk of negative perceptions of Appeals’ independence.⁴⁹ This

43 IRS response to TAS information request (July 13, 2016).

44 In response to TAS’s information request, LB&I and W&I provided documents to TAS grouping the questions in their customer satisfaction surveys by the TBOR right that is implicated. *Id.*

45 IRS, *FY 2015 Appeals Final Survey Instrument* (2015). For a discussion of the National Taxpayer Advocate’s concerns about Appeals’ ADR program, see Most Serious Problem: *Alternative Dispute Resolution (ADR): The IRS is Failing to Effectively Use ADR As a Means of Achieving Mutually Beneficial Outcomes for Taxpayers and the Government*, *infra*.

46 See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

47 See Finance Act 2009, c 10, § 92 (Eng.) (requiring annual reporting on the Her Majesty’s Revenue and Customs (HMRC) charter); HMRC, *Your Charter Annual Report: April 2014 to March 2015* (2016), <https://www.gov.uk/government/publications/your-charter-annual-report-2014-to-2015>. See Literature Review: *Incorporating Taxpayer Rights into Tax Administration*, vol. 3, *infra*.

48 IRM 4.46.2.8 *Headquarters Reports* (July 22, 2011).

49 IRS, Appeals Business Performance Review (BPR), Third Quarter – FY 2016 (Aug. 4, 2016).

reporting would be more effective if the BPR grouped together actions and successes that further the TBOR so a function or operating division can clearly see how it is making progress on implementing the TBOR and areas where improvement is needed.

The IRS Does Not Provide Evidence That It Considers the Taxpayer Bill of Rights (TBOR) When Making Policy Decisions or Creating Strategic Plans

Recent Changes to IRS Policy Fail to Adequately Consider TBOR

The IRS has provided no evidence that it considers the TBOR when creating policies and plans. For example, the Office of Appeals has moved towards a policy of providing appeal conferences by telephone as the default, and only offering in-person conferences under limited circumstances.⁵⁰ It appears that Appeals considered some taxpayer rights in coming up with exceptions to this policy. For example, the Appeals employee should consider whether there are numerous conference participants, such that there's a risk of unauthorized disclosure, which relates to the *right to confidentiality*. However, it is not clear Appeals considered how this policy would impact other rights, such as the *right to quality service*. By not providing taxpayers with a method to challenge the denial of a face-to-face conference, the IRS is also infringing on a taxpayer's *right to challenge the IRS and be heard*.

The IRS Does Not Adequately Consider the TBOR in Its Long-Term Plans

The TBOR is noticeably absent from some of the IRS's long term strategic plans, including its Future State vision.⁵¹ The IRS's Future State webpage includes a passage at the bottom, stating "The Taxpayer Bill of Rights is a foundational component underlying the future vision of the IRS and reflects the agency's ongoing commitment to respecting taxpayer rights. For example, the right to quality service is a central part of these efforts."⁵² However, in response to TAS's question regarding how TBOR is being considered and how Future State teams have been instructed to consider TBOR, the IRS acknowledges:

Specific guidance has not been provided to the Groups related to specific requisites, as the groups are currently developing plans on "what" capabilities and functionalities will be needed to attain the envisioned Future State. The "how" to deliver them will be considered once the plans are completed, compiled, and analyzed for their interdependencies, prioritization, and sequencing.⁵³

Not including the TBOR in deciding "what" a taxpayer needs will lead to infringements of taxpayer rights. As an example, the IRS has decided that one such need is greater access to taxpayer accounts for third parties like tax return preparers and tax software companies. Such access is intended to compensate for taxpayers for whom online accounts are insufficient. By not considering key taxpayer rights, such as the rights *to be informed*, *to quality service*, *to confidentiality*, and *to a fair and just tax system*, the IRS does not adequately consider that "what" some taxpayers may need is not greater preparer access — which leads

50 See IRM 8.6.1.4.1, Conference Practice (Oct. 1, 2016). For further discussion on Appeals' decision to limit taxpayer's access to face-to-face hearings, see Most Serious Problem: *Appeals: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values*, *infra*.

51 See Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *infra*.

52 IRS, *IRS Future State*, <https://www.irs.gov/uac/newsroom/irs-future-state> (last updated Mar. 4, 2016).

53 IRS response to TAS information request (July 13, 2016).

to increased compliance costs for taxpayers who may prefer to handle their own accounts — but instead alternatives for communicating with the IRS.⁵⁴

The IRS's response regarding the Future State goes on to state that the TBOR will be a requisite to consider when developing business cases for investments.⁵⁵ Such post-hoc consideration of the TBOR is clearly inadequate. Based on the IRS response, the IRS appears to believe the TBOR is not relevant to what capabilities will be required for the Future State (such as the capability for a person to speak with an IRS employee), but is only relevant in prioritizing how to deliver the capabilities it has decided on and in making a post-hoc justification for funding. The IRS disregards taxpayer rights by not considering the TBOR upfront.

CONCLUSION

Congress mandated that the IRS Commissioner “In discharging his duties . . . shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title.”⁵⁶ In order for the IRS to operationalize the TBOR, it must incorporate it into the daily actions and interactions IRS employees take every day. By not instructing employees to consider and include the TBOR in training, guidance, correspondence, measures, performance appraisals, policy decisions, and strategic plans, the IRS misses opportunities for reinforcing the TBOR as an important part of the IRS's way of doing things. Furthermore, by insisting that the IRS's preexisting practices and materials already recognize taxpayer rights, the IRS avoids using the TBOR as a way to improve the treatment of taxpayers and the protection of their rights.

54 See Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *infra*; Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*.

55 IRS response to TAS information request (July 13, 2016).

56 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Issue guidance at a servicewide level and an operating division-wide level to employees who author training materials, internal guidance, and correspondence with detailed instructions regarding how to incorporate the TBOR into those materials.
2. Collaborate with TAS to create an annual mandatory briefing on the TBOR, which should be designated as mandatory for all employees by the IRS's Human Capital Office.
3. Create an award to be given by the Commissioner of Internal Revenue to recognize special achievements in supporting taxpayer rights and the TBOR.
4. Require operating divisions and functions to report the results of their performance measurements and quality measurements according to the relevant TBOR rights associated with each measure.
5. Update the IRS's guidance for developing CJE's to instruct employees to incorporate the TBOR into the CJE's for all positions.
6. Provide instructions from senior leadership to all Future State teams to consider the TBOR in developing Future State plans and to document how Future State plans affect taxpayer rights.

**MSP
#6****ENTERPRISE CASE MANAGEMENT (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project****RESPONSIBLE OFFICIALS**

Karen M. Schiller, Assistant Deputy Commissioner for Services and Enforcement
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
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TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

As the IRS moves forward with its “Future State” planning,² a critical component of this effort will be how it improves its information technology (IT) systems in order to achieve its mission.³ The IRS's IT challenges are significant and include:⁴

- The two oldest IT systems (each 56 years old) in the entire federal government,⁵ and

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 TAS is unable to provide its usual comprehensive background data for this Most Serious Problem because in an unprecedented move, the IRS declined to respond to the ECM-related information requested by TAS as part of the Annual Report to Congress process, taking the position that ECM is internal to the IRS and “cannot be categorized as a most serious problem ‘encountered by taxpayers.’” IRS response to TAS research request (Nov. 3, 2016).

3 See, e.g., Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-053, *Taxpayer Online Account Access is Contingent on the Completion of Key Information Technology Projects* (May 2015) (noting that while the IRS has made progress in providing taxpayers with online customer service options, it needs to prioritize the completion of key IT projects that are necessary to provide the electronic platform for developing future projects that will provide taxpayers with dynamic online access capabilities).

4 For an excellent discussion of the IRS's IT challenges, see Zach Noble, *The Taxman's Tech Troubles*, FEDERAL COMPUTER WEEK (FCW) (Apr. 15, 2016), <https://fcw.com/articles/2016/04/08/taxman-tech-troubles.aspx>.

5 See Government Accountability Office (GAO), GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS's Individual Master File (IMF) and Business Master File (BMF) as the two oldest investments or systems at 56 years old each).

- Disparate case management systems ranging between 60 and approximately 200 based on different estimates.⁶

The age, number, and lack of integration across IRS case management systems as well as the lack of digital communication and record keeping cause waste, delay, and make it difficult for IRS employees, including those in TAS, to perform their jobs efficiently. They also create a burden on taxpayers, who must contend with IRS customer service representatives who may not be able to access the records they need to assist taxpayers or must do so on multiple systems. This infringes upon the taxpayers' *right to quality service*.

As a part of its "Future State" vision, the IRS is currently pursuing an IT solution to unify these disparate case management systems through an enterprise case management (ECM) project intended to deal with the issues of automation, records management, and integration. ECM requires a significant investment of both time and money to promote productivity and efficiency gains, and to improve taxpayer service.

Two of the IRS's systems, according to a recent Government Accountability Office report, are the oldest IT systems (at 56 years old) in the entire federal government.

TAS understands these challenges, as it is operating with a 1980s legacy system known as the Taxpayer Advocate Management Information System (TAMIS), a system that is largely obsolete and requires case advocates to manually perform many tasks that can and should be automated.⁷ For several years TAS worked with the IRS's IT function and a contractor to develop the requirements for an integrated replacement system known as the Taxpayer Advocate Service Integrated System (TASIS), completing around 70 percent of the system programming and spending approximately \$20 million out of a total estimated cost of about \$32 million.⁸ However, in March 2014, the IRS halted TASIS citing a lack of funding.⁹ This decision impacts taxpayers' *right to a fair and just tax system*, which includes the right to receive assistance from TAS. TAS advocates for taxpayers who are experiencing *significant* hardship and therefore the risk of harm from delay or inefficiency is markedly greater.

The National Taxpayer Advocate is concerned that:

- The IRS is failing to design the ECM project from the ground up to comprehensively engage its employees and seek their suggestions as to how to make processes and procedures more efficient and maximize employee productivity. Without this critical foundational step, the ECM system

⁶ See *IRS Legacy Information Technology Systems: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. (2016) (written testimony of Terence Milholland, Chief Technology Officer, IRS) (noting that there are more than 60 aging IRS case management systems), <https://oversight.house.gov/wp-content/uploads/2016/05/2016-05-25-Milholland-Testimony-IRS.pdf>; TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program 22* (Sep. 2016) (noting that the IRS maintains approximately 90 case management systems); Email from Director, Enterprise Case Management (ECM) to all designated ECM Business Unit Point of Contacts, which included the TAS Executive Director, Business Modernization (Mar. 11, 2016) (listing 198 case management systems). IRS response to TAS fact check request (Dec. 16, 2016). See also TIGTA, Ref. No. 2014-20-071, *Information Technology: Improvements Are Needed to Successfully Plan and Deliver the New Taxpayer Advocate Service Integrated System* (Sept. 2014); TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* (Sept. 2014) (both TIGTA reports note "there are more than 200 case management applications in operation across the IRS enterprise").

⁷ A legacy system can be defined as an obsolete computer system that may still be in use because its data cannot be changed to newer or standard formats, or its application programs cannot be upgraded, <http://www.businessdictionary.com/definition/legacy-system.html> (last visited Dec. 22, 2016).

⁸ *Internal Revenue Service Fiscal Year (FY) 2017 Budget Request: Hearing Before S. Subcomm. on Financial Services and S. General Government Comm. on Appropriations*, 114th Cong. 27 (2016) (statement of Nina E. Olson, National Taxpayer Advocate).

⁹ *Id.*

ultimately designed may work well for IT but will not be employee centric and will ultimately adversely impact taxpayers. If the IRS is unable to successfully integrate its 60 to 200 case management systems, then it is unlikely that it will be able to create robust online services to serve taxpayers, thus jeopardizing its “Future State” goals;¹⁰

- The IRS’s current ECM strategy appears to be inefficient and does not reflect lessons learned from its past case management project failures that, to date, have resulted in abandoned, wasteful, and incomplete initiatives costing tens of millions of dollars; and
- The IRS is failing to leverage the extensive investment of time, money, and effort expended on TASIS in order to incorporate the largely completed elements of TASIS as building blocks for the servicewide ECM solution.

ANALYSIS OF PROBLEM

Background

Enterprise Case Management (ECM) in General

The IRS is currently undertaking an assessment of its case management systems as part of a comprehensive project to create a servicewide ECM solution. The term “case management” is used in a comprehensive sense to refer to electronic recordkeeping systems the IRS uses to track information about interactions with respect to taxpayers’ tax returns or other tax-related matters.¹¹ These systems include audit and collection case records for individuals and large, medium, and small businesses, exempt organization determinations, whistleblower claims, automated substitutes for returns, the Automated Underreporter Program, criminal investigations, and TAMIS, the TAS case management system.

ECM offers a future vision for consolidated case management that will address the need to modernize, upgrade, and consolidate multiple aging IRS systems. The IRS now supports many of these systems, and although it is unclear precisely how many systems the IRS has, estimates range from more than 60 to approximately 200 systems.¹² As stated above, two of the IRS’s systems, according to a recent Government Accountability Office report, are the oldest IT systems (at 56 years old) in the entire federal government.¹³ Few of these systems communicate with one another and none provides an electronic substitute for the paper case file (*i.e.*, there are reams of paper supplementing whatever records

10 See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.

11 Case management can also be referred to as “the process that addresses the resolution of tax administration issues through the management of case creation, execution, maintenance, and closure.” See TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program 22* (Sept. 2016).

12 See *IRS Legacy Information Technology Systems: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. (2016) (written testimony of Terence Milholland, Chief Technology Officer, IRS) (noting that there are more than 60 aging IRS case management systems), <https://oversight.house.gov/wp-content/uploads/2016/05/2016-05-25-Milholland-Testimony-IRS.pdf>; TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program 22* (Sep. 2016) (noting that the IRS maintains approximately 90 case management systems); Email from Director, Enterprise Case Management (ECM) to all designated ECM Business Unit Point of Contacts, which included the TAS Executive Director, Business Modernization (Mar. 11, 2016) (listing 198 case management systems). IRS response to TAS fact check request (Dec. 16, 2016). See also TIGTA, Ref. No. 2014-20-071, *Information Technology: Improvements Are Needed to Successfully Plan and Deliver the New Taxpayer Advocate Service Integrated System* (Sep. 2014); TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* (Sept. 2014) (both TIGTA reports note “there are more than 200 case management applications in operation across the IRS enterprise”).

13 See GAO, GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS’s IMF and BMF as the top two oldest investments or systems at 56 years old each).

are included in the electronic system). The IRS's current case management system structure requires employees to retrieve data from many systems manually, which requires maintaining both paper and electronic records. They must transcribe or otherwise import information from paper and other systems into their own case management systems, and ship, mail, or fax an estimated hundreds of thousands, if not millions, of case management files and supporting documents annually for management approval, quality review, and responses to Appeals and Counsel.¹⁴

The IRS's former Chief Technology Officer discussed the IRS's ECM goal in recent congressional testimony. He noted:

The IRS intends to further improve compliance programs through investment in an Enterprise Case Management (ECM) system, which is intended to modernize, upgrade, and consolidate more than 60 aging IRS case management systems. This common case management environment will yield efficiencies by implementing standard case management functions, providing the ability to transfer cases between IRS organizations and creating centralized case data accessibility and usability.¹⁵

ECM Is Fundamentally Connected to the "Future State"

The IRS recognizes the critical importance of ECM to its "Future State," stating:

The nexus of ECM to Future State is as an enabler of a more flexible workplace whereby an all-electronic case file will be a complete record of a selected case from its inception to closure, including all the tax histories, contacts, communications, actions, etc. The cases could be reassigned if necessary simply by transferring the electronic file, regardless of function or geography — this enables workload balancing and workforce alignment, in addition to enabling a more flexible work environment and more efficient work assignment. It also enables more complete communications with taxpayers and those they authorize to serve them to more readily resolve issues based on the entire tax and case history and all related interactions, so both the taxpayer and employee are working from complete information, including interactions between them from secure messaging and file uploads and downloads for openness and transparency.¹⁶

In addition, the Commissioner of Internal Revenue has noted "If we can pull off Enterprise Case Management, it would impact so many IRS employees positively and would allow us to make a significant step toward our dealings with taxpayers and the future state."¹⁷

ECM Is a Taxpayer Issue

In an unprecedented move, the IRS declined to respond to the ECM-related information requested by TAS as part of the Annual Report to Congress process, taking the position that ECM is internal to the

14 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 196.

15 *IRS Legacy Information Technology Systems: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 114th Cong. (2016) (written testimony of Terence Milholland, Chief Technology Officer, Internal Revenue Service).

16 IRS response to TAS research request (Nov. 3, 2016).

17 IRS, *Enterprise Case Management Day 4* (Aug. 3, 2016).

The IRS's current case management system structure requires employees to retrieve data from many systems manually, which requires maintaining both paper and electronic records. They must transcribe or otherwise import information from paper and other systems into their own case management systems, and ship, mail, or fax an estimated hundreds of thousands, if not millions, of case management files and supporting documents annually for management approval, quality review, and responses to Appeals and Counsel.

IRS and “cannot be categorized as a most serious problem ‘encountered by taxpayers.’”¹⁸ This is contrary to the Commissioner of Internal Revenue’s remarks above and his statement that ECM’s ultimate goal is “better taxpayer service.”¹⁹

Fortunately for all of us, the IRS isn’t the arbiter of what constitutes a most serious problem for taxpayers — Congress granted that authority to the National Taxpayer Advocate.²⁰ The National Taxpayer Advocate is disappointed that the IRS refused to provide information about its ECM strategy to TAS and, through the National Taxpayer Advocate’s Annual Report to Congress, to members of Congress. ECM is not internal to the IRS. ECM ties directly into the “Future State” and has an impact on the quality of taxpayer interaction with the IRS, which is essential to voluntary compliance and taxpayer morale.²¹ Finally, and more fundamentally, ECM implicates *taxpayer rights*, specifically taxpayers’ *right to quality service*.²²

The IRS Has Not Laid the Foundation It Needs for ECM to Succeed

As mentioned above, the IRS’s ECM solution is intended to modernize, upgrade, and consolidate somewhere between 60 and approximately 200 aging IRS case management systems and develop a servicewide solution for performing case management functions using a common infrastructure platform for multiple projects to share across all business units. However, in order to accomplish this mammoth undertaking, it is critical that the IRS undertake the necessary foundational work and build the ECM project from the ground up. Specifically, the National Taxpayer Advocate believes that the IRS should actively and comprehensively engage its employees at the outset of the ECM project, which, as will be described below, is what TAS did when it developed TESIS. IRS employees are the ones that use IRS systems, and understanding their

18 IRS response to TAS research request (Nov. 3, 2016). As such, TAS was unable to obtain the bulk of the information it sought to prepare this Most Serious Problem. TAS obtained the information used in this Most Serious Problem from external sources and from IRS information outside of the formal Most Serious Problem process.

19 Enterprise Case Management Day 2016, Commissioner Koskinen’s remarks, IRS Newsletter (Oct. 4, 2016), <http://irweb.irs.gov/AboutIRS/Nwsctr/OtherNws/51951.aspx>.

20 See IRC § 7803(c)(2)(B)(ii)(III). With respect to the IRS’s unlawful refusal to provide data and other information required by the National Taxpayer Advocate in furtherance of her tax administration duties, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

21 See Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*. Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.

22 See TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

interaction with those systems and how to make current processes and procedures more efficient is crucial to having a more functional and polished ECM product that will maximize employee productivity. Without this critical foundational step, the ECM system ultimately designed may work well for IT but will not be employee centric and will ultimately adversely impact taxpayers.

However, it appears that the IRS has not reached out to its employees in its current ECM effort. The IRS stated that it asked its employees for work process improvement suggestions during a 2014 realignment between its Small Business/Self-Employed (SB/SE) and Wage and Investment (W&I) divisions.²³ The IRS indicated that it received several employee suggestions noting the need for creating a common case history and providing access to all systems.²⁴ Soliciting these type of suggestions, particularly from front-line employees and on a larger scale across all business units, is critical to building a solid foundation for ECM.

The National Taxpayer Advocate is supportive of the IRS's efforts to develop a comprehensive ECM solution and believes that proper funding from Congress is needed for this effort to succeed.²⁵ However, she is concerned about the IRS's ECM planning, particularly its failure to comprehensively engage its employees. The IRS will also benefit from engaging taxpayers and tax professionals to gauge their needs in obtaining quality service from IRS employees. Because ECM will ultimately feed into online accounts, taxpayers and their representatives are important end users.²⁶ Further, as the IRS is not alone in its need for a large-scale ECM solution, it might benefit from consulting with other federal agencies and international tax agencies about their ECM experiences.²⁷ However, TAS is unaware of the IRS's attempts to engage taxpayers, tax professionals, or even the majority of future ECM users within the IRS. The National Taxpayer Advocate is concerned that without seeking suggestions from users and intended beneficiaries (*i.e.*, taxpayers), the ECM system developed will likely be rudimentary, cumbersome, and one that falls far short of what the IRS needs to accomplish its "Future State" vision.²⁸

23 IRS response to TAS research request (Nov. 3, 2016).

24 *Id.*

25 See Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

26 *Id.* Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *infra*.

27 For example, in a recent article the Chief Information Officer (CIO) of the Social Security Administration (SSA) stated that incremental migration may not be an effective solution to the problem of outdated legacy systems. Instead, he believes that agencies need to understand the business rules and processes that went into the programming of these systems and rewrite the programming from scratch for the modern IT environment. The SSA CIO also believes that these modernization builds can be broken down into several \$25 or \$50 million dollar modules, instead of projects that run hundreds of million dollars or more. See Zach Noble, *It's Time to Trash Your Legacy System and Rewrite From Scratch*, FCW (June 8, 2016), <https://fcw.com/articles/2016/06/08/modernization-acquire-noble.aspx>. In addition, an Australian National Audit Office audit report of the Australian Taxation Office (ATO) describes the ATO's Change Program to develop a cost effective and integrated system of tax administration. As part of this program, the ATO implemented the Client Contact – Work Management – Case Management System (CWC), an enterprise-level system used to manage cases and work items as well as manage telephone calls and correspondence. The audit report notes "The implementation of the CWC has changed the way customer service representatives (CSR) and other Tax Office staff interact with clients. Previously staff were required to refer to several computer systems to obtain enough information to verify a caller's identity, resulting in time-consuming processes for even basic client interactions. Staff only had access to specific items of information on the taxpayer. This meant that advice and information given to the taxpayer was general and could not be tailored to the individual taxpayer's circumstances." See Australian National Audit Office, Audit Report No.6 2010-11, *The Tax Office's Implementation of the Client Contact – Work Management – Case Management System* 17 (Sept. 2010).

28 For an overview of the IRS's "Future State" plans, see IRS, *Future State Initiative* (Feb. 22, 2016), <https://www.irs.gov/uac/newsroom/future-state-initiative>.

The IRS's Current ECM Strategy Appears to Be Inefficient and Does Not Reflect Lessons Learned From Past Mistakes

The IRS's Current ECM Efforts Do Not Appear to Be Successful

The current ECM effort began in September 2014 with a presentation to IRS senior leadership and, in January 2015, the IRS Commissioner approved a plan for an ECM system that can be used IRS-wide.²⁹ The IRS's top priority in ECM is ECM fraud case management (EFCM), specifically the retirement and replacement of the Electronic Fraud Detection System (EFDS) program.³⁰ The IRS has stated that EFCM "will set the technology foundation for Enterprise Case Management."³¹ However, this transition has been fraught with issues and it appears that the IRS will need multiple case management systems, including a new system outside of ECM, to replace EFDS.³² Thus, instead of creating a "technology foundation" for ECM, it appears that the IRS is creating patchwork and new case systems that will need to be integrated into ECM at a later date.

Because the IRS would not respond to TAS's ECM-related questions, TAS does not have information about how much the IRS has spent on ECM efforts so far, other than the fact that more than \$566 million of the IRS's 2016 Fiscal Year (FY) \$2.5 billion IT budget was available for business systems modernization funding.³³ Additionally, it appears that the IRS has more than \$35 million in ECM commitments, obligations, expenditures, and disbursements (COED) for FY 2016 alone.³⁴

In Developing Its ECM Solution the IRS Should Learn From Its Previous Unsuccessful Case Management Projects

It is also important that in developing its ECM solution the IRS look to its own unsuccessful case management efforts to avoid repeating the same mistakes. As noted in a Treasury Inspector General for Tax Administration (TIGTA) report from September 2014, the IRS spent \$8.6 million from FYs 2009 through 2013 developing a failed information reporting and document matching case management (IRDMCM) system.³⁵ The report indicates that the IRDMCM system requirements were not sufficient, user testing of the system generated a high number of problem tickets, and the system "could not effectively process business cases containing underreported income and could not be deployed into the IRS production environment."³⁶ The report also pointed out that the IRS potentially relinquished \$54.9 million in taxes in 2011 alone from unprocessed cases due to the IRDMCM failure.³⁷ A

29 IRS, *Enterprise Case Management Day, Journey to the Future State 10* (Aug. 3, 2016). See also TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program 22* (Sept. 2016).

30 IRS, *Enterprise Case Management Day, Journey to the Future State 45* (Aug. 3, 2016). For a detailed discussion of the high false positive rates within IRS fraud detection programs, see Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*.

31 IRS, *Enterprise Case Management Day, Journey to the Future State 45* (Aug. 3, 2016).

32 IRS, *Enterprise Case Management Point of Contact Briefing 4, 11* (Oct. 3, 2016).

33 TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program 4* (Sept. 2016).

34 IRS, *Enterprise Case Management Governance Board 14* (Oct. 27, 2016).

35 TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* (Sept. 2014). As stated in this TIGTA report, the purpose of the IRDMCM case management system was "to assimilate and correlate data submitted on filed business tax returns to information returns and select individual sole proprietor and business returns for examination."

36 *Id.*

37 *Id.*

subsequent United States GAO report, from February 2015, put the IRDMCM project cost at \$16.2 million, nearly double the figure mentioned in the TIGTA report.³⁸

As noted in a Treasury Inspector General for Tax Administration report from September 2014, the IRS spent \$8.6 million from fiscal years 2009 through 2013 developing a failed information reporting and document matching case management system ... A subsequent United States Government Accountability Office report put the project cost at \$16.2 million.

In addition, a recent TIGTA report has pointed out issues with three other IRS case management system projects.³⁹ First, after approximately a year and a half of work and an unspecified amount of money spent on an Affordable Care Act (ACA) case management system, the IRS decided in June 2016 to stop the project in order to free up resources.⁴⁰ In addition, the report notes that the IRS developed and spent \$15 million on a Foreign Account Tax Compliance Act (FATCA) database that although built to requirements, “has not provided the intended business results.”⁴¹ However, the semi-automated tool the IRS developed to screen returns for potential irregularities harms thousands of taxpayers, including many international students.⁴² Finally, the report describes the IRS’s development of the Return Review Program (RRP), one of the systems that will replace the EFDS. Even though the IRS has been developing RRP since 2009, it does not have an estimated date for its full implementation.⁴³

It is also vitally important that the IRS ensure that Entellitrak, the case management platform that it will use for ECM, has the requisite functionality to handle the task of large-scale ECM and the integration of between 60 and 200 separate case management systems. In audit reports of prior IRS individual case management projects, TIGTA recommended that the IRS verify and assess whether Entellitrak’s case management capabilities could meet those project needs.⁴⁴ The IRS has a significant investment in Entellitrak, as it entered into a \$50 million contract for its use in 2015, and needs to ensure that it is spending money on an ECM system that will meet its business needs.⁴⁵

The IRS Is Overlooking the Largely Completed TASIS Project As a Quick Deliverable and Building Block for the Larger ECM Project

The IRS Should Take Lessons From the Development of TASIS

The IRS does not need to look far for assistance with its ECM efforts, as TAS has performed a significant amount of the necessary legwork in developing its TASIS case management system. TAS worked for several years with the IRS’s IT function and a contractor to develop the requirements for TASIS, an

38 GAO, GAO-15-297, *Information Technology: Management Needs to Address Reporting of IRS Investments’ Cost, Schedule, and Scope Information* (Feb. 2015).

39 TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* (Sept. 2016).

40 *Id.* at 22.

41 *Id.* at 24.

42 See Most Serious Problem: *Foreign Account Tax Compliance Act (FATCA): The IRS’s Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *infra*.

43 TIGTA, Ref. No. 2016-20-094, *Annual Assessment of the Internal Revenue Service Information Technology Program* 25 (Sept. 2016).

44 TIGTA, Ref. No. 2014-20-071, *Information Technology: Improvements Are Needed to Successfully Plan and Deliver the New Taxpayer Advocate Service Integrated System* 11 (Sept. 2014); TIGTA, Ref. No. 2014-20-088, *The Information Reporting and Document Matching Case Management System Could Not Be Deployed* 15 (Sept. 2014).

45 See *U.S. Internal Revenue Service Signs \$50 Million Deal with MicroPact*, PR Newswire (Mar. 11, 2015), <http://www.prnewswire.com/news-releases/us-internal-revenue-service-signs-50-million-deal-with-micropact-300048249.html>.

integrated replacement system for its current antiquated TAMIS system. The IRS should pay heed to the process that TAS undertook in developing TESIS. Beginning in 2011, TAS started TESIS development by focusing on processes first (intake strategy, guidance, Operations Assistance Requests (OARs), case-weighting and assignments rules) and only then did the analysis of what the case management program needed to do.

By holding workgroup meetings dedicated to employee technology needs, TAS asked *all* of its employees what they needed to perform their jobs efficiently, recorded their proposals and “wish lists” for capabilities, and tracked them in the development of the business requirements. In other words, TAS built TESIS from the ground up. In addition, unlike the IRS, TAS did not pay a single consultant for the work it did until it started actually writing the computer-based business rules. The initial thinking and planning was done directly by TAS, saving taxpayers significant dollars.

TESIS Is a Versatile Case Management System That Can Benefit the IRS As a Whole

As the National Taxpayer Advocate has discussed in previous Objectives Reports to Congress and congressional testimony, TESIS is a versatile case management system that would replace TAMIS, TAS’s current antiquated system.⁴⁶ While ECM focuses on case selection and work assignment capabilities, among other things, TESIS focuses on case intake and case-building functions, creating virtual case files with data auto-populated from other IRS systems and information transmitted electronically between functions for review and action, resulting in a complete picture of the taxpayer’s case and both the IRS and TAS’s actions with respect to that matter. Once TESIS is completed, the IRS can incorporate elements or modules of TESIS into core ECM for use by other IRS business units, including the Exempt Organization function, Appeals, Whistleblower Office, Office of Professional Responsibility, and the Innocent Spouse, Identity Theft, and Offer in Compromise units.

When TAS learned that TAMIS was slated for retirement, it capitalized on the opportunity to integrate all of its systems and business processes into a single state-of-the-art application. TAS developed over 4,500 business requirements⁴⁷ for the case management system aspect of TESIS functionality, including:

- Fully virtual case files;
- Electronic access to other IRS case-management systems and automatic retrieval of taxpayer information;
- Electronic submission and tracking of Operations Assistance Requests (OARs);⁴⁸
- Electronic transmission and tracking of Taxpayer Assistance Orders (TAOs);
- Full access to all virtual case information for purposes of management and quality review;
- TAS and taxpayer (and representative) ability to communicate digitally;
- Taxpayer (and representative) ability to electronically check the status of a case in TAS; and
- An electronic case assignment system.

These are just some of the capabilities contained within the TESIS Business System Requirements Report, which collectively illustrates that TESIS’s case management component will not just replace TAMIS but

46 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 195; National Taxpayer Advocate FY 2016 Objectives Report to Congress 98.

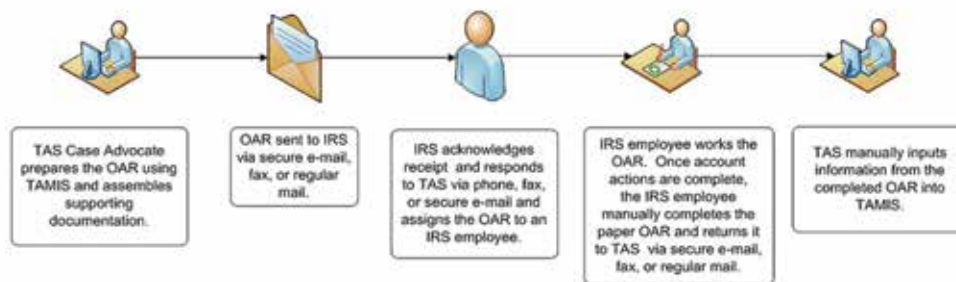
47 TAS, *TESIS Business System Requirements Report* (Nov. 14, 2011).

48 IRS Form 12412, *Operations Assistance Request*, is the form TAS uses when it lacks the statutory or delegated authority to perform an action on a case and must request the IRS to perform that action.

will significantly increase the productivity of TAS case advocates because they will no longer spend their valuable time tracking down paper documents or inputting information into multiple systems. Moreover, taxpayers will be able to communicate efficiently with TAS and electronically send key case information and documents. This functionality will enable TAS's case advocates to spend their time advocating for taxpayers, rather than performing administrative tasks such as manually inputting and tracking documents and IRS actions, thereby upholding taxpayers' *right to quality service*. In short, TESIS reflects the complexity and interaction of cases in the IRS.

The following figure illustrates the current, labor-intensive OAR process, which is representative of many of the challenges of the current manual processes facing both TAS and the larger IRS.

FIGURE 1.6.1, Operations Assistance Request (OAR) Process



Without an electronic OAR process:

- Getting an OAR to the right IRS unit may be complicated. There are over 100 options for TAS to choose from, and an incorrect selection can lead to rework, delaying resolution of the taxpayer's problem;
- Very limited data is available for analyzing OAR process performance, such as tracking the reasonable performance expectations in the Service Level Agreements between TAS and IRS operating divisions (ODs);
- Both TAS and the responding OD manually track OAR progress. TAS cannot look up the status, but must call, fax, or email a status request and wait for a response; and
- Supporting documents are not stored electronically, and must sometimes be shared by mail, with related packaging and shipping costs, including expedited handling when the taxpayer's need is urgent.

Implementation of a solution to electronically submit and track OARs, whether in TESIS or ECM, would benefit both TAS and the IRS by reducing delays in case resolution and providing resource savings by eliminating much of the current costs, including shipping, time spent by employees manually inputting and tracking OARs; and physically printing and scanning OARs into other IRS tracking systems. TAS has proposed a separate electronic OAR process since 2015, and to date this request has been denied despite the clear benefits to taxpayers, the IRS, and TAS.⁴⁹

⁴⁹ See IRS, *Enterprise Case Management (ECM) Governance Board Meeting Minutes 5* (Aug. 5, 2016); see also IRS response to TAS research request (Nov. 3, 2016).

The IRS's Commitment to Completion of TASIS Is Critical for TAS

At the time the project was halted after the IRS spent \$20 million on it, it was estimated that six months and \$12 million would be needed to complete Release 1 programming, testing, and launch.⁵⁰ Despite the demonstrated savings of TASIS and its benefits for all of the IRS, no funding is presently allocated for TASIS. Moreover, the IRS has stated that TASIS has not been identified as a legacy system for the ECM program because it was not placed into production and has therefore not been prioritized for ECM.⁵¹ Yet since 2013, Congress has identified TASIS as a major IT system and requires the IRS to provide quarterly reports on it.⁵² The IRS's position appears to contradict a statement made by the IRS nearly two years ago in a required quarterly report to Congress on TASIS. In that report, the IRS stated that if it does not receive ECM funding, it will impact TASIS, which is part of the ECM initiative and uses the same Entellitrak platform.⁵³ It is also disturbing that despite apparent benefits for both the IRS and TAS, as well as the taxpayers we serve, electronic OARs are not being prioritized as an ECM early delivery.⁵⁴

TAS is ready to begin final TASIS programming as soon as funds are available. If TASIS is not funded to completion, the \$20 million the IRS has spent on it will be wasted and TAS will be forced to invest time and funds in upgrading TAMIS, an obsolete legacy system. This would be an extreme waste of limited resources, and fails to provide TAS's case advocates with the tools they need to effectively and promptly assist taxpayers who are *experiencing significant hardship* in resolving their problems with the IRS. It would also infringe upon taxpayers' *right to a fair and just tax system*.

CONCLUSION

The IRS's current ECM project has been in existence for nearly two years, has not produced a single ECM product, and appears to lack the planning and focus necessary to succeed. It is critical that ECM not follow the path of prior IRS case management projects, which have resulted in abandoned, wasteful, and incomplete initiatives that have cost taxpayers tens of millions of dollars. Without engaging with its employees and other stakeholders in ECM development, learning from past case management mistakes, and using the TASIS development process and system as a building block for ECM, the end case management product will inevitably be mediocre, have usability issues, and the IRS will likely not realize genuine productivity increases. The National Taxpayer Advocate is concerned that IRS will develop an ECM solution with the lowest common denominator and will not push technology to meet taxpayer needs. This will also have an adverse effect on the IRS's ability to carry out its "Future State" vision. Therefore, both congressional funding and oversight of ECM are needed.

50 *Internal Revenue Service FY 2017 Budget Request: Hearing Before S. Subcomm. on Financial Services and S. General Government Comm. on Appropriations*, 114th Cong. 27 (2016) (statement of Nina E. Olson, National Taxpayer Advocate). In a required quarterly report to Congress, the IRS stated "Once funding is secured, vendor contracts are in place, and the project resumes, TASIS is expected to deploy in approximately 14 months." IRS Report of Chief Technology Officer, *FY 2015 1st Quarter IT Investment Report DRAFT V. 4.1* (Jan. 2015), provided in IRS response to TAS research request (Nov. 3, 2016).

51 IRS response to TAS research request (Nov. 3, 2016).

52 The Senate Appropriations Subcommittee on Financial Services and General Government has repeatedly included TASIS on a list of six "major information technology project activities" about which it has directed the IRS to submit quarterly reports. See S. REP. No. 114-280, at 40 (2016); S. REP. No. 114-97, at 39 (2015); S. REP. No. 113-80, at 34 (2013). In 2014, a similar provision was included in the Senate Appropriations Committee's draft report, but the draft report was not adopted for that year.

53 IRS Report of Chief Technology Officer, *FY 2015 1st Quarter IT Investment Report DRAFT V. 4.1* (Jan. 2015), provided in IRS response to TAS research request (Nov. 3, 2016).

54 IRS response to TAS research request (Nov. 3, 2016).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop its ECM solution from the ground up by actively and comprehensively engaging all its employees and seeking their specific suggestions as to how to make processes and procedures more efficient and maximize employee productivity in order to provide quality customer service to taxpayers.
2. Use TESIS and its foundational work as part of the ECM effort, for example by using TESIS modules that are adaptable for ECM.
3. Provide the funding necessary to complete TESIS Release 1.
4. Prioritize and fund the development of an electronic OAR process.

**MSP
#7****ONLINE ACCOUNTS: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Operating Division
 Paul Mamo, Director, Office of Online Services
 Benjamin Herndon, Director, Research, Applied Analytics & Statistics

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

A main component of the IRS's Future State vision is the development of an online taxpayer account.² The National Taxpayer Advocate has proposed for years that the IRS develop an online account system for taxpayers.³ An online account system will benefit those taxpayers who are able to access the digital system and who have the background, knowledge, and experience to navigate through various complex transactions. In order for taxpayers and the government to realize the benefits of an online taxpayer account application, the IRS must address the following:

- Develop an overarching online strategy that focuses on taxpayer service needs and preferences rather than merely business or budget demands;
- Incorporate existing third-party and TAS research on service needs and preferences into its Future State vision;
- “Do Digital Right” by ensuring the online account provides taxpayers with a service they need in the format they need; otherwise taxpayers may lose interest and not return to the site;

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 For more details on the IRS Future State Initiative, see <http://irweb.irs.gov/future/default.aspx> (last visited Nov. 30, 2016).

3 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

- Acknowledge the real consequences of strong and necessary e-authentication standards. With about one-third of users passing the multi-factor e-authentication security measures, getting taxpayers through the “front gate” is half the battle;⁴ and
- Prioritize practitioner access, authority, and preferences for the online account.

ANALYSIS OF PROBLEM

Background

A key initiative to attain the IRS’s envisioned Future State is the development of a taxpayer online account. According to the IRS, the online account will enable taxpayers and eventually authorized third-parties to “securely obtain taxpayer information, make payments, resolve compliance issues, share documentation, and self-correct issues in an individualized, online account.”⁵

The IRS has shared with TAS its bare bones plans to roll out the application. The IRS conducted a soft launch of the first phase of the online account on November 16, 2016, and announced the launch to the public on December 1, 2016.⁶ Individual taxpayers currently access the online account through the payments tab of the IRS official website. Once individual taxpayers pass the multi-factor e-authentication standards, as discussed in more detail below, they can view the account balance and select payment options such as IRS Direct Pay, debit or credit card, or apply for an installment agreement.⁷

Despite efforts by TAS, the first phase of the online account does not provide taxpayers with any information on how to dispute the account balance provided.⁸ The National Taxpayer Advocate has suggested that the IRS provide a button indicating “I don’t think I owe this amount.” Once the taxpayer clicks on that button, the site should provide links for different options, including: amending a return, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability for offer in compromise. To date, the IRS has not agreed with this recommendation.

By mid-2017, the IRS tentatively plans for the application to enable taxpayers to see up to 18 months of payment history and a transcript summary screen. The National Taxpayer Advocate has encouraged the IRS to increase the 18-month payment history to at least 24 months in order to provide useful information for refund claims.⁹ Finally, by the end of 2017, the IRS tentatively plans to add more payment features as well as a fully integrated transcript with search capabilities.¹⁰

4 National Taxpayer Advocate Notes from Services and Enforcement Executive Steering Committee (S&E ESC) Meeting (Nov. 17, 2016). The pass rate was 28 percent on Nov. 16, 2016, 29 percent on Nov. 17, 2016, and increased to 34 percent as of Dec. 18, 2016. IRS 10-day response to MSP fact check (Dec. 20, 2016).

5 IRS, *Draft IRS Future State: Overview, The Path Traveled and the Road Ahead* 11 (Feb. 2016), https://www.irs.gov/PUP/newsroom/IRS%20Future%20State%20Journey_R.pdf (Oct. 14, 2016).

6 IRS News Release 2016-155, *IRS Launches New Online Tool to Assist Taxpayers with Basic Account Information* (Dec. 1, 2016).

7 IRS S&E ESC, *Online Account Status Briefing* 4, 5 (Nov. 17, 2016); TAS Employee Testing of the Online Account (Nov. 26, 2016).

8 The online account can be accessed from the following IRS payments page: <https://www.irs.gov/payments/finding-out-how-much-you-owe> (last visited Nov. 27, 2016).

9 IRS response to TAS fact check (Dec. 20, 2016). Under IRC § 6511(a), a taxpayer must file a claim for credit or refund of an overpayment within: 1) three years from the time the return was filed, or 2) two years from the time the tax was paid, whichever is later. If no return was ever filed by the taxpayer then the claim must be filed within two years of payment of the tax.

10 Wage and Investment (W&I) response to TAS information request (Sept. 1, 2016); S&E ESC, *Online Account Status Briefing* 5 (Nov. 17, 2016); IRS response to TAS fact check (Dec. 20, 2016).

Develop an Overarching Online Strategy That Is Driven by Taxpayer Needs and Preferences for Taxpayer Service

The IRS has not developed an overarching online strategy or design for the online account that is based on an understanding of taxpayer skills and abilities, as well as their needs and preferences for the various modes of receiving taxpayer service. To its credit, the IRS conducted the 2014 Taxpayer Choice Model (TCM) study; however, this survey was conducted solely online. Based on the TCM findings, the IRS concluded that it needed “to introduce more online self-service options to help today’s taxpayers meet their tax obligations.” Specifically, the IRS interpreted the results to show that the service channel most used to contact the IRS is the IRS website (28 percent). In addition, the survey indicated that 48 percent of taxpayers chose the online tool as their preferred service channel to obtain the status of a case or transaction. As a result, the IRS developed the “Web Apps Program,” including online account capabilities, “as a direct solution to how today’s taxpayers prefer to interact with the IRS.”¹¹

About one-third of those taxpayers interested in using the online service channel can access the service. While the strict authentication measures are important to safeguard taxpayer data, the initial pass rates show that the online account cannot be the main service channel.

While the 2014 TCM study demonstrated some interest in online tools by taxpayers who already had internet access, the IRS never conducted more in depth research to determine exactly how taxpayers would prefer to use this tool. While the TCM findings indicate that almost half of already-online taxpayers prefer to get status updates through an online tool, the IRS never conducted a survey to determine if taxpayers would prefer to “self-correct” a return by agreeing to an addition to tax using an online account, or would they prefer to first speak with an assistor about the basis of that adjustment. The focus on online-only surveys, the general vagueness of the survey questions, and the absence of more detailed scenarios and choices means the IRS’s claim that the online account is “a direct solution to how today’s taxpayers prefer to interact with the IRS” is based more on IRS wishing than in reality. The TCM is *some evidence* of how *already-online taxpayers* would like to interact with the IRS about *some activities*. It is not a comprehensive analysis of the online or taxpayer service needs of the U.S. taxpayer population, and to pretend it is undermines the positive aspects of the online account.

Further, the IRS Future State vision focuses primarily on the IRS’s own operating preferences.¹² Accordingly, the IRS is shifting resources away from the more expensive service delivery channels, such as face-to-face and phone service, towards self-service channels that are seemingly less costly. The rationale for this strategy is to free up resources for those taxpayers who still require more personal service.¹³ While the IRS’s stated rationale is commendable, it is not supported by sufficient research. A leading best practice supported by research is that organizations in general must understand the needs of the customer

11 IRS Service & Enforcement Executive Steering Committee Briefing: Online Account Status Update 3 (Oct. 17, 2016); Courtney Rasey and Mackenzie Wiley, Wage & Investment Research and Analysis, IRS, *2014 Taxpayer Choice Model (TCM): Designing Digital Communication Products to Reduce Phone and Mail Inventory*, <https://www.irs.gov/pub/irs-soi/15resconwiley.pdf> 172 (last visited Dec. 9, 2016).

12 See Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*. The Swedish Tax Agency, which has received top rank for service among government agencies, has the following guiding principle: “What we think is efficient, may turn out not to be, and what we think is good service is not necessarily so from the taxpayer’s perspective. We have understood the importance of not building our service based on our own internal view of reality.” Vilhelm Andersson, *Mechanisms for Measuring the Quality of Service Provided to the Taxpayer and Results Achieved*, Inter-American Center of Tax Administrations – CIAT, 46th CIAT General Assembly, *Improving the Performance of the Tax Administration: Evasion Control and Taxpayer Assistance*, 169 (2012).

13 National Taxpayer Advocate Public Forum 12 (Feb. 23, 2016).

and let those needs drive the change, rather than business or budget demands.¹⁴ Before the IRS invests too many resources into an online-centric Future State vision, it must conduct extensive research on taxpayer preferences for service delivery channels, based on demographics as well as the type of interaction with the government.¹⁵

As pointed out by Professor Leslie Book at the February 23, 2016, National Taxpayer Advocate Public Forum on Taxpayer Service Needs and Preferences in Washington, D.C.:

[A] fundamental starting point in thinking about service is that the IRS needs to know whom it is serving and the characteristics and challenges associated with a particular group of taxpayer[s] or parties it is regulating An agency fixated on efficiency and delivering services at lowest possible short term costs without knowing the impact and burdens of its actions may find itself pushing more serious problems down the road while at the same time jeopardizing taxpayer rights.¹⁶

Without extensive research into taxpayer preferences, the IRS may be surprised by the adoption rate of the online account or its impact on call volume. For example, the California Franchise Tax Board did not expect call volumes to increase by 20 percent when it initially launched its online account, MyFTB. Only five percent of taxpayers created an account in the first year and many of the MyFTB users called when they experienced difficulties.¹⁷

The IRS Future State Vision Does Not Incorporate Existing Third-Party and TAS Research on Service Needs and Preferences

As noted above, the IRS began developing the online account after the 2014 Taxpayer Choice Model (TCM) study found some interest in online services by taxpayers who already have access to the internet. In addition to the TCM, it conducted the Web-First Strategy Conjoint Study (Conjoint), another online survey. Wage and Investment (W&I) has stated that “the objective of the study was to identify opportunities to increase taxpayer awareness and utilization of web-based customer service delivery options that are convenient, effective, and cost effective for the customer and IRS.” The survey includes information about current and future service options for four service tasks: (1) make a payment, (2) obtain a transcript, (3) obtain tax account information, and (4) authenticate your identity. The IRS interpreted the results of the 2015 Conjoint to indicate a high preference for online services, even for taxpayer assistance center (TAC) users, and predict that triage through appointment-based, walk-in service will facilitate access to online and phone channels.¹⁸ The IRS interpreted the results to show that “[a]ll service needs in this study show a similar pattern with the majority of taxpayers preferring Online

14 See, e.g., Knowledge@Wharton, *Becoming Digital: Strategies for Business and Personal Transformation* (2016); Accenture, Partnership for Public Service, *Government for the People: The Road to Customer-Centered Services* (Feb. 2016).

15 Knowledge@Wharton, *Becoming Digital: Strategies for Business and Personal Transformation* (2016); Accenture, Partnership for Public Service, *Government for the People: The Road to Customer-Centered Services* (Feb. 2016); Organisation for Economic Co-operation and Development (OECD), *Forum on Tax Administration: SME Compliance Sub-Group, Information Note, Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012) (Her Majesty’s Revenue and Customs (HMRC) breaks down the taxpayers into segments and retains face-to-face assistance specifically targeted for the “needs help” segment).

16 Oral Statement of Professor Leslie Book, Villanova University Charles Widger School of Law, National Taxpayer Advocate Public Forum 27 (Feb. 23, 2016).

17 Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers’ Rights Advocate, National Taxpayer Advocate Public Forum (Aug. 22, 2016); Oral Statement of Susan Maples, California Franchise Tax Board, Taxpayers’ Rights Advocate, National Taxpayer Advocate Public Forum 26-27 (Aug. 22, 2016).

18 W&I, *Business Performance Review* 37 (May 10, 2016).

Account in the Future State. In addition, most taxpayers like their Future State better than the options available to them now.”¹⁹

While we acknowledge that the IRS did attempt to learn taxpayer needs by conducting these studies, we have several serious concerns:

1. **Online Study:** Both the TCM and Conjoint surveys were conducted entirely online and, therefore, left out that portion of the population with no online access. Not only do 33 percent of American adults not have broadband access, and therefore are unlikely to participate in online surveys, but Pew Research has also found that online surveys are biased against the African American and Hispanic American populations.²⁰ Rather than acknowledge the limitations of the online surveys, the IRS applied these narrow research findings to all taxpayers.
2. **Design of Survey Questions.** For both studies, respondents were presented a finite set of service channel options with predetermined values for attributes such as “time to access service.” An example question from the 2014 TCM is set forth in Figure 1.7.1 below:²¹

FIGURE 1.7.1, Sample Question from 2014 Taxpayer Choice Model Survey

“If you wanted to obtain an answer to your tax question, and these were your only options, which would you choose?”

	Option 1	Option 2	Option 3	Option 4
Service Channel	Toll-Free, CSR	Website, Online Interactive Tool	Smartphone	Toll-Free, Automated
Time Required	20 minutes	10 minutes	5 minutes	10 minutes
Progress Toward Resolution	Completely Resolved	Get Specific Information	Completely Resolved	Get General Information
Social Security Number Required	No	No	No	No
Personal Info Required	Yes	Yes	Yes	No
Tax Info Required	No	No	No	No

The Conjoint survey questions were similar in format. Both surveys allowed the respondent to choose only one option. If given several options, it is rational for the respondent to choose the service with the lower access times. Most importantly, the survey question shows that the IRS has pre-determined the

19 For a detailed discussion of the research conducted by the IRS to support its shift to online services, see Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*; IRS Wage & Investment (W&I) Research, *Facilitating Access to Convenient & Efficient IRS Service: W&I Web-First Conjoint Study 11, 13* (Sept. 30, 2016).

20 John B. Horrigan and Maeve Duggan, Pew Research Center, *Home Broadband 2015 2-9* (Dec. 21, 2015); Pew Research Center, *Evaluating Online Nonprobability Surveys: Vendor choice matters; widespread Errors Found for Estimates Based on Blacks and Hispanics* (May 2, 2016).

21 W&I Research & Analysis, *Taxpayer Choice Model: Presentation for Excellence through Productivity Improvements and Quality (EPIQ) 8* (Dec. 2014). The IRS has described the Conjoint survey format as follows: “In a conjoint survey, respondents are given service channel options for completing a task and asked to choose which option he/she prefers. This occurs ten times for each service task with the service channel features changing each time. From this data, researchers perform analysis to determine the impact of each service feature to build a predictive model that allows researchers to predict taxpayer preference with perfect awareness within the confines of the service channels and service channel features included in the study.” IRS response to TAS fact check (Dec. 20, 2016).

service options that the taxpayer may express an opinion about (“these were your only options”), rather than providing a broad range of options, including “other”, from which the taxpayer can choose.

Moreover, the question above is actually very misleading. It seems to imply that a taxpayer will spend 20 minutes to achieve complete resolution by calling the toll-free line and talking to a live assistor, but that same taxpayer could achieve complete resolution in five minutes by using a smartphone. However, the question does not make clear what happens in those five minutes with the smartphone — will the taxpayer only get automated prompts (which indicates the taxpayer will receive only general information, as with the automated phone service); or will the taxpayer get through to a live assistor, only faster than the toll-free line? If the latter, it is unclear why a smartphone user should receive faster access to an assistor than a taxpayer who calls on the toll-free line. At any rate, the question is completely muddled and not much use as a basis for strategic decisions, much less service design.

TAS Performed Research, Held a Dozen Public Forums Across the Country, and Conducted Practitioner Focus Groups, All of Which Produced a Wealth of Information for the IRS As It Develops Its Future Vision

TAS has conducted research, nationwide Public Forums, and focus groups which produced a wealth of information that is valuable in developing a Future State vision that meets the needs and preferences of taxpayers and practitioners. Specifically, TAS has conducted the following:

1. **Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups.** A nationwide survey of U.S. taxpayers about their needs, preferences, and experiences with IRS taxpayer service conducted entirely by telephone (landline and cell phone). Most importantly, taxpayers were able to choose from a detailed list of reasons why they interacted with the IRS during the past 12 months, including an open-ended “other option.” For their particular service need (*e.g.*, obtain a transcript, tax law question, assistance with an IRS notice, and make a payment), taxpayers were asked to identify the first choice in service channel (*i.e.*, IRS website, TAC, and phone) as well as any additional information sources used. This will enable us to track preferred service channel by service need or task. In addition, participants were asked about their internet access and use. TAS is still in the process of evaluating the results of the survey. Preliminary results show that elderly and low income taxpayers are less likely to have online access, and those who do have online access use it in a very limited manner. The preliminary results also indicate that a large percentage of all taxpayer groups — low income (43.5 percent), not low income (37.2 percent), elderly (60.7 percent), and disabled (44.0 percent) — do not feel secure sharing personal information with a government agency or sharing personal financial information over the internet (56.9 percent, 43.8 percent, 66.2 percent, and 65.1 percent, respectively).²²
2. **National Taxpayer Advocate Public Forums on Taxpayer Service Needs and Preferences.** During 2016, the National Taxpayer Advocate held 12 Public Forums around the country, most in conjunction with Members of Congress who serve on committees actively engaged in IRS oversight. Each Public Forum heard from a panel of witnesses representative of the community visited. Most panels included a representative from a Volunteer Income Tax Assistance (VITA) site and a Low Income Taxpayer Clinic (LITC); an attorney, Certified Public Accountant, or Enrolled Agent active in representing individuals and small businesses; and witnesses who focused on

22 See Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*; Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

challenges faced by particular taxpayer groups, including English as a Second Language (ESL) and immigrant taxpayers, elderly taxpayers, farmers, U.S. taxpayers living abroad, disabled taxpayers, victims of identity theft, and small businesses hurt by payroll service provider fraud.²³

- 3. TAS Focus Groups During IRS Nationwide Tax Forums.** During the IRS Nationwide Tax Forums, TAS conducted focus groups, one of which specifically addressed the IRS Future State Initiative. The 58 participants were asked for their thoughts on the online account, including features that they believe are most and least useful, practitioner access and authorizations, and restricting access to Circular 230 practitioners.²⁴

Throughout this discussion, we will cite recommendations generated from participants of the above-discussed Public Forums and focus groups.

A Plethora of Third-Party Research Is Available to Guide the IRS in Its Strategy

Existing third party research indicates that a significant percentage of the taxpayer population will not use taxpayer accounts in the way envisioned by the Future State initiative. The National Taxpayer Advocate's 2015 Annual Report cites various studies showing the digital divide in this country and the preference for multiple service delivery channels.²⁵ Multi-channel service options are considered a best practice in tax administration. A 2015 McKinsey Center for Government report stated that “best-in-class tax administrations are taking a different approach to digitization. Going digital is no longer about making digital channel usage mandatory for 100 percent of citizens — it is about improving the taxpayer experience one segment or service at a time.”²⁶ In addition, there is a clear trend in private industry and tax administration worldwide to provide multi-channel service options.²⁷ Finally, as a panelist representing the Electronic Tax Administration Advisory Committee (ETAAC) stated at the February 23, 2016, National Taxpayer Advocate Public Forum: “[W]hether it is online, phone, chat, taxpayer assistance center, VITA site, or through a tax professional, the IRS should provide all of these options to meet the variety of taxpayer preferences.”²⁸

In a 2015 nationwide survey of American adults, Pew Research Center found that home broadband adoption has plateaued. Approximately 67 percent of adults had broadband at home in 2015, as compared to approximately 70 percent in 2013. That means 33 percent of U.S. adults did not have home broadband access. This leveling-off of broadband use coincides with an increase in “smartphone-only” adults. Smartphone adoption has reached a similar rate as that of broadband. Specifically, 68 percent of American adults own a smartphone and 13 percent are “smartphone-only.” The most significant rates of

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- 23 For details on the National Taxpayer Advocate Public Forums on Taxpayer Service Needs and Preferences, including submitted written statements from panelists as well as full transcripts of the forums, see <https://taxpayeradvocate.irs.gov/public-forums> (last visited Nov. 30, 2016).
- 24 TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State* 6, 11 (Oct. 2016).
- 25 National Taxpayer Advocate 2015 Annual Report to Congress 56-63 (Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).
- 26 Aurélie Barnay, Thomas Dohrmann, Wopke Hoekstra, Jose Nogueira, Fiyinfolu Oladiran, Kristine Romano, McKinsey Center for Government, *Tax Myths-Dispelling Myths About Tax Transformation in Rapidly Growing Economies* 5 (Sept. 2015).
- 27 Knowledge@Wharton, *Becoming Digital: Strategies for Business and Personal Transformation* (2016); OECD, *Forum on Tax Administration: SME Compliance Sub-Group, Information Note, Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012); Deloitte, *Navigating the New Digital Divide: Capitalizing on Digital Influence in Retail* (2015).
- 28 Oral statement of Jim Buttanow, National Taxpayer Advocate Public Forum 83 (Feb. 23, 2016).

increase in the smartphone-only populations can be found among African Americans, individuals whose household income is at or below \$75,000, adults living in rural areas, parents, and those with a high school degree or less.²⁹

FIGURE 1.7.2, Pew Research Center Survey Results Showing Shift From Broadband to Smartphones Between 2013 and 2015³⁰

Several groups are shifting their home internet connectivity away from broadband and toward smartphones

% of each group who have ...

	Broadband at home			Smartphone, but no broadband at home		
	2013	2015	CHANGE	2013	2015	CHANGE
All adults	70%	67%	-3%	8%	13%	+5%
African Americans	62	54	-8	10	19	+9
Rural residents	60	55	-5	9	15	+6
Household income < \$20K	46	41	-5	13	21	+8
\$20K-\$50K	67	63	-4	10	16	+6
\$50K-\$75K	85	80	-5	5	10	+5
Parents	77	73	-4	10	17	+7
High school degree or less	50	47	-3	11	18	+7

Source: Pew Research Center surveys

PEW RESEARCH CENTER

The approximately 33 percent of adults without home broadband access are at a major disadvantage when it comes to various complex tasks, such as accessing government services, getting health information, and applying for jobs.³¹ Many without broadband access have to reroute their lives in order to get to a library, school, or coffee shop to access the internet. This presents cybersecurity challenges to those who have to access confidential information from public computers or networks in public locations, potentially carrying documents with confidential information. At a National Taxpayer Advocate Public Forum, a panelist from Pew Research Center noted that 27 percent of Americans have used a computer or Wi-Fi at a public library in the last year.³² Accordingly, taxpayers attempting to access the online account application in such public locations are not only inconvenienced, but are at greater risk for identity theft.

29 John B. Horrigan and Maeve Duggan, Pew Research Center, *Home Broadband 2015* 2-9 (Dec. 21, 2015).

30 *Id.* at 6.

31 *Id.* Oral Statement of Aaron Smith, Pew Research Center; National Taxpayer Advocate Public Forum 143 (Feb. 23, 2016).

32 Oral Statement of Aaron W. Smith, Pew Research Center, National Taxpayer Advocate Public Forum 176 (Feb. 23, 2016).

The IRS Strives to Provide Service Offerings Comparable to the Financial Industry, But Ignores Those Offerings When They Do Not Comport with the Direction the IRS Wants to Follow

In justifying the Future State vision towards online accounts, the Commissioner of Internal Revenue has stated that taxpayers “should expect the same level of service when dealing with the IRS in the future as they have now from their financial institution, whether it’s a bank, brokerage, or mortgage company.”³³ However, the IRS’s approach to Future State is not consistent with the research performed specifically for the financial sector. Research commissioned by the Federal Reserve found that even tech-savvy mobile phone users prefer multiple service channels. Over the past several years, the Federal Reserve has surveyed banking preferences among mobile phone users. According to the most recent report, more mobile phone users who have a bank account reported visiting a branch than using any other channel in the last 12 months.³⁴

The existing research findings highlight that online services should supplement rather than replace more personal services. At the National Taxpayer Advocate February 23, 2016 Public Forum, a panelist from the Federal Reserve noted that 80 percent of banking consumers surveyed in 2015 use four or five of the service channels available and only two percent used only one or two channels.³⁵

Doing Digital Right: Just Because the IRS Builds It, Doesn’t Mean Taxpayers Will Use It

An online account application can be an extremely useful tool for those with the ability to access the application and who can navigate complex transactions with minimal personal assistance. However, without crucial research into taxpayer and practitioner service needs and preferences, there is a significant risk the IRS will build something few people need or use. For example, as raised in the National Taxpayer Advocate Public Forums, the online account must be more than just a digital version of the guidance and correspondence already in existence in paper form. Unless the IRS improves its current quality of taxpayer assistance and correspondence, the text and explanations contained within the digital account will be no less confusing than what taxpayers currently receive. Many taxpayers will still require additional personal assistance and reassurance to understand how the rules and procedures apply to their particular facts and circumstance.³⁶

In a 2015 survey conducted by Forrester Research, respondents indicated a slightly higher level of satisfaction with their in-person interactions with various federal government administrations, compared to their digital interactions through mobile

Unless the IRS improves its current quality of taxpayer assistance and correspondence, the text and explanations contained within the digital account will be no less confusing than what taxpayers currently receive.

33 Prepared Remarks of Commissioner John A. Koskinen Before the Tax Policy Center (Aug. 1, 2016), <https://www.irs.gov/uac/newsroom/commissioner-koskinen-remarks-to-the-tax-policy-center> (last visited Nov. 26, 2016).

34 Although more respondents report visiting a branch in the past 12 months, other channels may have been used more frequently during that same period. “Among those who had used each of the channels in the past month, the median number of uses in the past month was five for each of the online and mobile channels, three for ATM, and two for each of the branch and telephone channels.” Board of Governors of the Federal Reserve, *Consumer and Mobile Financial Services 2016* 14 (March 2016); Board of Governors of the Federal Reserve, *Consumer and Mobile Financial Services 2015* 9 (March 2015).

35 Oral Statement of Arturo Gonzales, Board of Governors of the Federal Reserve, National Taxpayer Advocate Public Forum 157 (Feb. 23, 2016); Board of Governors of the Federal Reserve, *Consumer and Mobile Financial Services 2015* 9 (March 2015).

36 See, e.g., Oral Statement of Aaron Smith, Pew Research Center, National Taxpayer Advocate Public Forum 156 (Feb. 23, 2016).

applications, federal websites, and email.³⁷ More importantly, the survey found that only 39 percent of respondents believe that the federal government should focus on offering more digital services, down from 41 percent the previous year.³⁸ This clearly indicates a downward trend.³⁹ When asked if they had the choice between trying to find the answer to a government question online or by picking up the phone and calling somebody, approximately 60 percent of respondents to the nationwide Forrester Research survey said they prefer the phone. Based on the research findings, a panelist from Forrester Research at the National Taxpayer Advocate Public Forums provided four general recommendations on how the government can do digital right:

1. Find the right channel for each service;
2. Design mobile services more strategically;
3. Market the digital services by explaining the benefits of digital channels; and
4. Ensure that those customers who do not interact digitally are still able to interact as easily, conveniently, and effectively as possible.⁴⁰

In addition, the panelist from Forrester Research recommended the IRS add wizard tools to the online account to walk users through the various steps in complex rules and procedures in a straightforward and somewhat customized manner.⁴¹

When asked if they had the choice between trying to find the answer to a government question online or by picking up the phone and calling somebody, approximately 60 percent of respondents to the nationwide Forrester Research survey said they prefer the phone.

Given the reluctance of individuals to use government digital services, as illustrated by the above-mentioned Forrester study, it is incumbent on the IRS to “do digital right” when launching the online account. The first phase of the IRS online account provides the first installment of a minimum viable product which includes account balances and payment options. These services that will be useful to those lucky taxpayers able to pass the IRS three-factor authentication (discussed below); it also will provide a useful tool to assist taxpayers who receive IRS scam calls, since they could go online to verify the existence of a tax debt.

However, the IRS is not promoting the account as a fraud prevention tool. In addition, taxpayers who are able to access the account are not given the option or information on how to dispute the account balance provided. The National Taxpayer Advocate has urged the IRS to provide a link on the page to give the taxpayer an option, other than paying the tax, to dispute the balance. When the taxpayer clicks on a button indicating “I don’t think I owe this amount,” as illustrated in Figure 1.7.3, the IRS should provide links for different options, including: amending a return, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability offer in compromise. With such limited options that may not even address the taxpayer’s needs, the taxpayer may lose trust in the online account and never return, even for

37 Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience 2* (Feb. 18, 2016). This report is based on Forrester’s North American Consumer Technographics® Healthcare and Government Survey, 2015. Specifically, respondents had a 72 percent satisfaction rate for in person interaction in the past 12 months with such administrations as the U.S. Post Offices, Social Security Administration (SSA) locations, and Veterans Affairs regional benefits offices. The satisfaction rates were 70 percent for federal mobile applications and 69 percent for federal websites or email.

38 Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience 4-5* (Feb. 18, 2016).

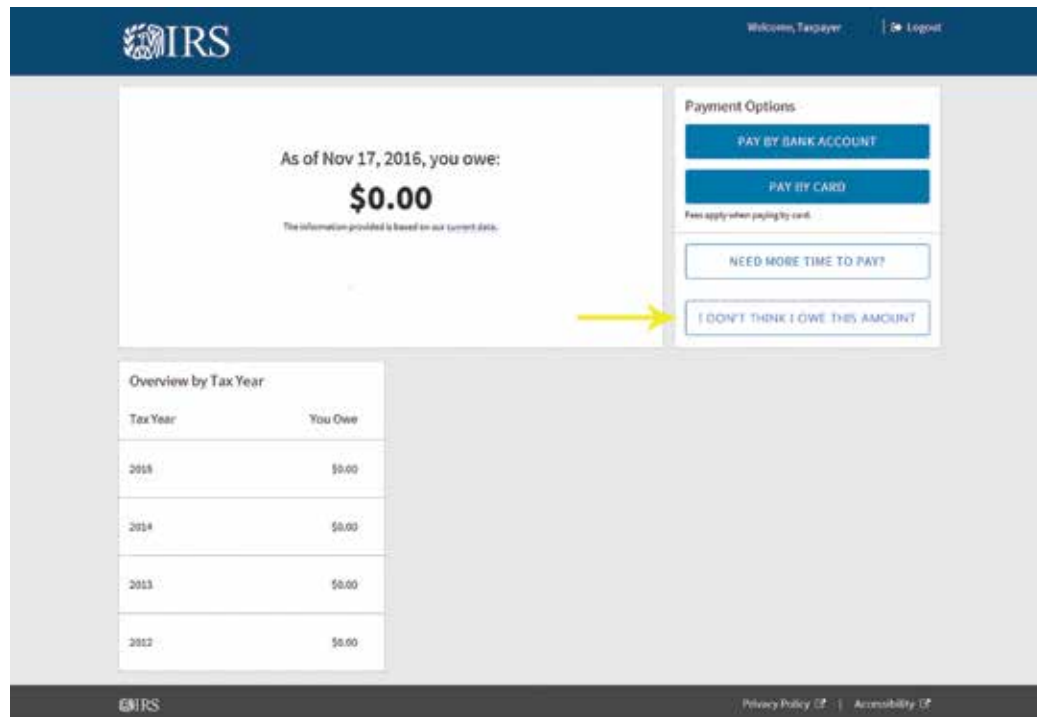
39 Oral Statement of Rick Parrish, Forrester Research, National Taxpayer Advocate Public Forum 114-15 (May 17, 2016).

40 *Id.* at 116-21.

41 *Id.* at 163-65.

future releases. As Rick Parrish of Forrester Research stated: “One of the best things the IRS can do is provide a much better experience when people do have to deal with it, and they will be much more likely to come back when they don’t have to.”⁴²

FIGURE 1.7.3, TAS Proposed Prototype of Online Account Payments Page With the Recommended “I Don’t Think I Owe This Amount” Button



E-Authentication: Getting Taxpayers Through the “Front Gate” Is Half the Battle

Authentication is perhaps the most important feature of the online account. While we are not experts on what is the required level of security for an online account, TAS does have expertise on the consequences of heightened security, in terms of limits on taxpayer access and usability, and the downstream consequences of those limitations if the IRS focuses resources on digital channels. For the application to be effective, taxpayers need to feel confident that their data is protected.⁴³ In a recent Forrester Research survey, only 32 percent of respondents agreed with the statement “I am confident that the federal government keeps secure any personal information it has on its citizens.”⁴⁴

To achieve a high level of security, however, e-authentication measures can become a barrier to entry for a significant portion of the taxpayer public. The National Taxpayer Advocate is not suggesting that the IRS relax its digital security protections. The IRS should acknowledge that strict e-authentication blocks

42 Oral Statement of Rick Parrish, Forrester Research, National Taxpayer Advocate Public Forum 159 (May 17, 2016).

43 Treasury Inspector General for Tax Administration (TIGTA), *Improved Tax Return Filing and Tax Account Access Authentication Processes and Procedures Are Needed*, Ref. No. 2016-40-007 (Nov. 19, 2015).

44 Rick Parrish, Forrester Research, *The Public is Still Skeptical of Federal Digital Customer Experience* 6 (Feb. 18, 2016).

access, and design its service strategy accordingly so that the blocked taxpayers have other suitable service channels available, including person-to-person assistance.⁴⁵

The IRS Adopted Strict E-Authentication Standards for Get Transcript Online, Which Will Limit Access

A concrete example of how e-authentication can act as a barrier to entry is the 2016 launch of the “Get Transcript Online” application.⁴⁶ The e-authentication procedures, called Secure Access, used for Get Transcript Online, were later used for the online account application, which was soft launched on November 16, 2016, and publicly announced on December 1, 2016.⁴⁷ Therefore, in order to gain access to both online applications, taxpayers need to pass a multi-factor authentication process by providing the following:⁴⁸

1. **Identity proofing authentication:** Provide a name, email address, birthdate, Social Security number, and filing status and address from the most recent tax return;
2. **Financial verification authentication:** Provide an account number from one of the following:
 - Credit card (not debit card or American Express);
 - Automobile loan;
 - Principal home mortgage;
 - Home equity line of credit; and
3. **Phone verification authentication:** Provide a readily available mobile phone. Only U.S.-based mobile phones may be used. The taxpayer’s name must be associated with the mobile phone account. Landlines, Skype, Google Voice or similar virtual phones as well as phones associated with pay-as-you-go plans cannot be used.⁴⁹

Before the initial testing of the Get Transcript Online application, it should have been clear that a significant portion of the taxpayer population could, by definition, not pass e-authentication to gain access. For example, taxpayers who do not have a credit card and do not own either a home or automobile are by default excluded from the application. Thus, a significant portion of taxpayers renting apartments in big cities where residents rely on mass transit can only gain access if they have a credit card in their own name.

45 *Cybersecurity and Protecting Taxpayer Information: Hearing Before the S. Comm. on Finance, 114th Cong. (Apr. 12, 2016)* (written statement of John Koskinen, Commissioner, Internal Revenue Service); National Taxpayer Advocate 2015 Annual Report to Congress 56-63 (Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).

46 IRS, *IRS Launches More Rigorous e-Authentication Process and Get Transcript Online*, IR-2016-85 (June 7, 2016).

47 IRS News Release 2016-155, *IRS Launches New Online Tool to Assist Taxpayers with Basic Account Information* (Dec. 1, 2016); Luca Gattoni-Celli, *Olson Details IRS Online Account Requirements, Remains Skeptical* TAX NOTES TODAY, Tax Analysts (May 18, 2016).

48 IRS, *How to Register for Get Transcript Online Using New Authentication Process*, FS 2016-20 (June 2016); IRS, *Welcome to Get Transcript*, <https://www.irs.gov/individuals/get-transcript-beta> (last visited October 14, 2016); IRS, *Get Transcript Frequently Asked Questions (FAQs)*, <https://www.irs.gov/individuals/get-transcript-faqs> (last visited October 14, 2016). The IRS verifies the financial account and mobile phone information with an external vendor.

49 IRS response to TAS fact check (Dec. 20, 2016). As discussed below, in August 2016, the IRS modified the phone verification requirement to provide that those who do not have a text-enable mobile phone can choose the “PIN in Mail” option. This enables the user to request the IRS to physically mail a Personal Identification Number (PIN) to the taxpayer’s address of record via U.S. mail instead of receiving the PIN via SMS text.

A leading best practice supported by research is that organizations in general must understand the needs of the customer and let those needs drive the change, rather than business or budget demands.

The phone requirements impact a significant population of taxpayers. From the outset, it was clear that international taxpayers could not gain access to the online application due to the U.S.-based mobile phone requirements of e-authentication. These taxpayers would possibly stand to benefit the most from online access because they already experience difficulty trying to access personal services.⁵⁰

In addition, the phone requirements exclude those taxpayers who do not have a contract mobile phone plan or whose mailing address does not match the billing address. Therefore, anyone on a family mobile phone plan who does not live in the same household as the contract holder would be excluded. As the IRS developed these authentication measures, the Social Security Administration (SSA) struggled with these same issues. SSA recently eliminated a mandatory text-based authentication measure from its my Social Security online account program, due to congressional and other stakeholder concerns raised about the burden it imposes on the elderly and disabled populations.⁵¹

In August 2016, the IRS attempted to expand coverage for users who are unable to register because they could not satisfy the previous authentication requirement to have a text-enabled mobile phone of record. The IRS implemented the “PIN in Mail” option to enable the user to request the IRS to physically mail a Personal Identification Number (PIN) to the taxpayer’s address of record via U.S. mail instead of receiving the PIN via SMS text to a text-enabled mobile phone.⁵² This resolution may prolong the account registration process, but it does provide a viable option to those who could not otherwise satisfy the phone verification authentication step.⁵³

Once the IRS Launched Applications With Necessary Multi-Factor E-Authentication Standards, It Experienced Low Pass Rates

As anticipated, both the Get Transcript Online and online account applications had low overall pass rates. Once the IRS launched the Get Transcript Online application on June 7, 2016, Secure Access authentication users experienced an overall pass rate ranging from 27 to 29 percent.⁵⁴ Likewise, early data after the soft launch of the online account application on November 16, 2016 showed a 28 percent pass rate. The rate increased to 29 percent on November 17, 2016 and steadily increased to 34 percent as of

50 Oral Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 51 (May 17, 2016); (“[T]hat poses a huge obstacle for our community. It virtually blocks them completely out of being able to use online. And you know obviously, ... online and more automated would certainly help our community.”); Written Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 3 (May 17, 2016); National Taxpayer Advocate 2015 Annual Report to Congress 72-81 (Most Serious Problem: *International Taxpayer Service: The IRS’s Strategy for Service on Demand Fails to Compensate for the Closure of International Tax Attaché Offices and Does Not Sufficiently Address the Unique Needs of International Taxpayers*).

51 Office of the Inspector General, SSA, *SSA Rolls Back Multifactor Authentication on My Social Security* (Aug. 23, 2016).

52 Email on August 2016 Secure Access – Monthly Status (Aug. 19, 2016). The California Franchise Tax Board incorporated a physical mailing of a Personal Identification Number (PIN) to the address of record into its authentication procedures for MyFTB. While this introduces a delay into the process, it is a necessary safeguard. Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers’ Rights Advocate, National Taxpayer Advocate Public Forum (Aug. 22, 2016).

53 Oral Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 24 (May 17, 2016); Written Statement of Marylouise Serrato, Executive Director, American Citizens Abroad, National Taxpayer Advocate Public Forums 3 (May 17, 2016).

54 Email briefing on Secure Access - Authentication - Weekly Status Report, June 13 -17, 2016 (June 19, 2016); Email on August 2016 Secure Access – Monthly Status (Aug. 19, 2016); IRS response to TAS fact check (Dec. 20, 2016) (“The rate fluctuates and reflects the user-base of various applications as they come online.”).

IRS should acknowledge that strict e-authentication blocks access, and design its service strategy accordingly so that the blocked taxpayers have other suitable service channels available, including person-to-person assistance.

December 18, 2016.⁵⁵ While the strict authentication measures are important to safeguard taxpayer data, the initial pass rates show that the online account cannot be the main service channel. About one-third of those taxpayers interested in using the online service channel can access the service. If the IRS is promoting this application as a main component of its Future State vision, yet approximately two-thirds of taxpayers who want to use the application cannot access it, the IRS is overvaluing the application's reach.

The California Franchise Tax Board (FTB) faced similar issues addressing security and access concerns for its MyFTB online account. The FTB had to incorporate a delay into the account registration and practitioner access procedures to increase security measures. The FTB now sends a PIN to the taxpayer's or practitioner's address of record during account registration to verify the user's identity.⁵⁶ It also instituted a delay into the practitioner authorization process to provide time to the taxpayer to acknowledge the client/representative relationship. As a result, practitioners complained that the online account is less useable in their business if they need quick access to the client's tax information such as when there is a short deadline to respond to a notice, meaning practitioners will continue to rely on telephone service channels, if not face-to-face contacts.⁵⁷

Cybersecurity Is a Top Priority for Any Online Strategy

Because cybersecurity is of top concern and any breach can have significant impact on taxpayer's trust in the agency, not to mention use of online services overall, the IRS must stay abreast of the latest updates and best practices used throughout the government and private industry, both domestic and international. In 2015, the Treasury Inspector General for Tax Administration (TIGTA) found that in some of the security breaches that the IRS failed to comply with government information security standards provided by the Office of Management and Budget (OMB) and the National Institute of Standards and Technology (NIST). This failure allowed unscrupulous individuals to gain unauthorized access to tax information in the Get Transcript and IP PIN applications. The IRS agreed to conduct a review of the e-authentication risk assessment process to ensure that all current and future online applications comply with the standards.⁵⁸ The IRS created a cross-functional team to consistently apply risk-based authentication measures across all channels of taxpayer service, not just online services. Through our briefings with this team, we have learned that NIST is in the process of updating its standards, in a way that may require updates to the two-step Secure Access authentication IRS launched in June 2016. Specifically, the new standards discourage the use of SMS texts and encourage in-person authentication

55 National Taxpayer Advocate Notes from S&E ESC Meeting (Nov. 17, 2016). The pass rate was 28 percent on Nov. 16, 2016, 29 percent on Nov. 17, 2016 and increased to 34 percent as of Dec. 18, 2016. IRS response to TAS fact check (Dec. 20, 2016).

56 Tax preparers create their own MyFTB account and access their client's information through their own account. The account will automatically populate a client list for all active Power of Attorney declarations on file with the FTB. The FTB will mail the account registration PIN to the preparer's address on the PTIN record. See State of California Franchise Tax Board, *MyFTB for Tax Preparers*, https://www.ftb.ca.gov/online/myacct/tax_preparers.asp?WT.mc_id=Professionals_Online_MyFTBAccount&WT.svl=PPr2 (last visited Dec. 10, 2016); State of California Franchise Tax Board, *Tax Preparer: How to Register for a MyFTB Account*, <https://www.ftb.ca.gov/online/myacct/help/register-tax-preparer.shtml> (last visited Dec. 10, 2016).

57 Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers' Rights Advocate, National Taxpayer Advocate Public Forum 1-2 (Aug. 22, 2016).

58 TIGTA, *Improved Tax Return Filing and Tax Account Access Authentication Processes and Procedures Are Needed*, Ref. No. 2016-40-007, 13-19 (Nov. 19, 2015).

measures for high risk applications.⁵⁹ As discussed above, the IRS recently launched multi-factor authentication measures to include SMS texts. Furthermore, the IRS is evaluating many different authentication measures across the agency's service channels and considering a way to leverage in-person authentications that already occur within the IRS as well as other federal agencies and private financial institutions.⁶⁰

Practitioners Have Expressed a Real Interest in Using the Online Account But Practitioner Access, Authority, and Preferences Seem to Be an After-Thought

During the National Taxpayer Advocate Public Forums, as well as focus groups conducted by TAS during the 2016 IRS Tax Forums, practitioners have expressed a real interest in using the online account. This group of users promises to have significant downstream savings for IRS resources. However, the IRS has not shared any detailed plans about practitioner access to the account, the procedures to authorize such access, or planned account features and capabilities geared toward practitioners.⁶¹ If the IRS fails to engage with practitioners during the design phase and fails to provide details on how practitioner access fits into the Future State vision, it will result in an online account that does not work for the taxpayer or practitioner community.

As background, the National Taxpayer Advocate has recommended that the IRS restrict third party access to taxpayer data available on the online account. First, only practitioners who are subject to Circular 230 oversight should be able to access an online account and take actions on behalf of the taxpayer.⁶² Second, for both practitioners and any other authorized third-parties, the taxpayer should maintain strict control over which detailed actions the preparer or third party can take on behalf of the taxpayer.⁶³

The IRS has indicated that only the taxpayer can create the taxpayer's online account. The National Taxpayer Advocate agrees with this approach. However, the IRS has not provided information as to how the practitioner will access the taxpayer information through the online account. Does the IRS have plans to update Form 2848, *Power of Attorney and Declaration of Representative*, to provide online account access? Will the account have safeguards to limit access as specified by the taxpayer? All of these questions remain unanswered.

The IRS has also not addressed how a practitioner can utilize the online account if the taxpayer has no online access or fails to pass the e-authentication requirements. The California Franchise Tax Board has addressed this issue by providing that taxpayers and preparers each create their own account. The preparer's account will automatically populate with a client list of those taxpayers for which the preparer

59 TAS Briefing by W&I Identity Risk Assurance (July 12, 2016); NIST, Draft NIST Special Publication 800-63B: Digital Authentication Guideline 34 (July 13, 2016).

60 The NIST guidance will not deprecate the use of SMS texts until the issuance of NIST SP 800-63-4. In the interim, the IRS will work to comply with NIST guidance. IRS response to TAS fact check (Dec. 20, 2016); IRS, *IRS Identity Assurance – Authentication Strategy Executive Summary* (June 20, 2016); TAS Briefing by W&I Identity Risk Assurance (July 12, 2016). For example, certified acceptance agents conduct in-person authentication for domestic and international taxpayers in need of an Individual Taxpayer Identification Number (ITIN). In addition, many banks conduct similar authentication for domestic and international taxpayers opening up bank accounts.

61 W&I response to TAS information request (Sept. 1, 2016).

62 The National Taxpayer Advocate supports providing access to certain preparers, but only if they have satisfied robust minimum competency standards, which include a one-time "entrance" examination to ensure basic competency in return preparation and continuing education courses to ensure preparers keep up to date with the many frequent tax-law changes. The current voluntary Annual Filing Season Program does not satisfy this threshold.

63 For a detailed description of these recommendations, see National Taxpayer Advocate 2015 Annual Report to Congress 64-70 (Most Serious Problem: *Preparer Access to Online Accounts: Granting Uncredentialed Preparers Access to an Online Taxpayer Account System Could Create Security Risks and Harm Taxpayers*).

has a power of attorney on file. The preparer will only have authority to access data and act on behalf of the taxpayer as detailed in the power of attorney.⁶⁴ This way, a taxpayer does not necessarily need to have an online account to authorize a preparer to take actions through an online account service channel. The IRS could create a similar process with built-in safeguards, such as providing notifications to the taxpayer, either digitally or by mail, as designated by the taxpayer on a revised Form 2848.⁶⁵

In addition to access issues, practitioners at the various Public Forums and focus groups provided useful information about the information they would like to see available on the online account. Many expressed interest in the following types of information and services:⁶⁶

- Images of tax returns;
- Images of notices and correspondence;
- Images of documents in the administrative file;
- Ability to submit documents and with a return receipt acknowledgement;
- Taxpayer's transcript, written in plain language, to clearly set forth the status of filings, payments, correspondences, and compliance activities;
- A means to communicate quickly with the IRS and document such communications and correspondence; and⁶⁷
- Access to information from all IRS systems necessary to resolve a question or issue.

However, what the IRS plans to deliver may be quite different than what practitioners have indicated they need at the National Taxpayer Advocate's Public Forums. Practitioners at the TAS focus groups indicated that a balance due breakdown and payment options are among the least useful capabilities for the online account. Yet, this is exactly what the IRS has provided in its initial release of the application.⁶⁸

64 See State of California Franchise Tax Board, *MyFTB for Tax Preparers*, https://www.ftb.ca.gov/online/myacct/tax_preparers.asp?WT.mc_id=Professionals_Online_MyFTBAccount&WT.svl=PPr2 (last visited Dec. 10, 2016); State of California Franchise Tax Board, *Tax Preparer: How to Register for a MyFTB Account*, <https://www.ftb.ca.gov/online/myacct/help/register-tax-preparer.shtml> (last visited Dec. 10, 2016).

65 Taxpayer Advocate Service Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State 10-11* (Oct. 2016) (Participants unanimously agreed that taxpayers should receive notification of preparer access on the account).

66 See, e.g., Oral Statement of Robert Hamilton, Managing Attorney MidPenn Legal Services LITC, National Taxpayer Advocate Public Forum 10-12 (April 8, 2016). Written Statement of Erik Schryver, Qualified Tax Expert, National Taxpayer Advocate Public Forum (March 18, 2016); Written Statement of Michael L. Such, Research Assistant, Lewis & Clark LITC, Lewis & Clark Law School, National Taxpayer Advocate Public Forum (Aug. 18, 2016); TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State 6, 7, 11* (Oct. 2016). For an example of an online account with comprehensive features, see California Franchise Tax Board, *MyFTB*, <https://www.ftb.ca.gov/online/myacct/> (last visited October 14, 2016); Written Statement of Susan Maples, California Franchise Tax Board, Taxpayers' Rights Advocate, National Taxpayer Advocate Public Forum (Aug. 22, 2016).

67 As an example, the French Tax Administration requires the government to respond to email questions within 48 hours. OECD, *Forum on Tax Administration: SME Compliance Sub-Group, Information Note, Right from the Start: Influencing the Compliance Environment for Small and Medium Enterprises* (Jan. 2012).

68 TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers' Thoughts about IRS's Proposed Future State 9* (Oct. 2016).

CONCLUSION

In order to build an online account system that taxpayers actually use, the IRS must develop an overarching online strategy that incorporates comprehensive research through a variety of media to determine taxpayer and practitioner preferences for different service channels. In designing new research and interpreting existing research, the IRS should recognize that many taxpayers will require multiple channels, including person-to-person assistance, to resolve their issues. TAS has conducted research and held focus groups and Public Forums around the country over the past year, and has received valuable suggestions and comments from a variety of researchers, practitioners, taxpayers, consumer advocates, and government officials. We encourage the IRS, in conjunction with the National Taxpayer Advocate, to review the findings of TAS's *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups* study as well as written statements, transcripts, and reports from the Public Forums and focus groups. Finally, while robust e-authentication measures are crucial, the launch of the Get Transcript Online and online account application has proven that such measures act as a barrier to entry for most potential users. Accordingly, the IRS may be overselling the impact the online account will have in reducing taxpayer usage of other service channels.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. By mid-2017, make available at least 24 months of payment history, rather than only 18 months, on the online account in order to provide information necessary for refund claims.
2. By mid-2017, provide a link on the payments page of the online account to give the taxpayer an option, other than paying the tax, to dispute the balance due shown. The IRS should provide a button on the payment page indicating "I don't think I owe this amount." Once the taxpayer selects this option, the IRS should provide links for different options, including: amending a return, audit reconsideration, refund claims, penalty abatement, innocent spouse, injured spouse, identity theft, return preparer fraud, and doubt as to liability offer in compromise.
3. Work collaboratively with the National Taxpayer Advocate to review the recommendations of participants in the 2016 National Taxpayer Advocate Public Forums, the 2016 IRS Nationwide Tax Forum TAS Focus Groups, as well as the findings of TAS and third party research, and address the public's recommendations in the plans for the online account.
4. Conduct research, in consultation with the National Taxpayer Advocate, using a variety of methods (online, landline and cell phone) into taxpayer and practitioner service needs and preferences for the various existing and proposed service channels by type of transaction, with acknowledgement that the taxpayer may choose multiple service channels to resolve a single issue.
5. Incorporate into the Future State vision realistic expectations for access to and use of the online account application given robust e-authentication measures.
6. Limit access to the online account to only those practitioners who are subject to Circular 230 oversight.

MSP
#8**EARNED INCOME TAX CREDIT (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

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

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) was enacted as a work incentive in the Tax Reduction Act of 1975.² It has become one of the government's largest means-tested anti-poverty programs.³ In tax year (TY) 2014, 27.5 million taxpayers received about \$66.7 billion in EITC benefits.⁴ Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy "application" process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of case workers and local agencies to make eligibility determinations. However, the easy application process of the EITC is also associated with a high improper payment rate, which must be considered in any efforts to improve the EITC.⁵

The IRS recently announced its intention to pursue a "Future State" plan.⁶ Major goals of the plan are to improve tax processing systems, increase electronic filing and payment options, and expand services available on irs.gov.⁷ The IRS's Future State plans, which emphasize a reliance on technology and

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975).

3 Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

4 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc> (last visited Dec. 31, 2016).

5 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, § 2(e) (2010) amending Improper Payments Information Act of 2002, Pub. L. No. 107-300 (2002) by striking § 2(f) and adding (f)(2). The IRS estimates that the 2015 Earned Income Tax Credit (EITC) improper payment rate is about 24 percent (which accounts for an estimated \$15.6 billion in improper payments). *Projected Improper Payments for Earned Income Tax Credit (EITC)*, <https://paymentaccuracy.gov/tabular-data/projected-by-program/420> (last visited Dec. 31, 2016).

6 IRS, *Future State Initiative*, <https://www.irs.gov/uac/newsroom/future-state-initiative> (last visited Dec. 31, 2016).

7 *Id.*

taxpayer self-help, as opposed to communication with the taxpayer, will do a disservice for many low income taxpayers by compounding existing obstacles facing this population.

The National Taxpayer Advocate has the following concerns with the Future State's reliance on online tools for EITC taxpayers:

- The Future State is not reflective of low income taxpayers' experiences;
- Recent legislative changes make unintentional EITC errors very harmful to taxpayers; and
- The IRS has proceeded with Future State plans without researching or addressing how it will affect low income taxpayers.

ANALYSIS OF THE PROBLEM

Background

The EITC is a complex area of law and most low income taxpayers require specialized assistance in order to claim the credit successfully.⁸ However, the IRS primarily relies on the correspondence audit process in order to address questionable claims *after* a return has been filed. EITC audits make up approximately 36 percent of all IRS audits despite the fact that EITC returns account for only about 19 percent of all individual income tax returns filed.⁹ Thus, the EITC involves a large segment of the individual taxpayer population and comprises a significant portion of the IRS workload.

The Future State Is Not Reflective of Low Income Taxpayers' Experiences

To illustrate its plans for the Future State, the IRS has published “vignettes” of different taxpayers' experiences interacting with the IRS of the future. These vignettes are the most detailed representations to date of the IRS vision of its Future State.” One vignette sets forth an example of what a taxpayer may experience when he or she claims the EITC.¹⁰ The example tells the story of Jane, a taxpayer who has a 19 year-old son and who has recently returned to the workforce. The example illustrates that Jane created an online IRS account and filed her tax return claiming her son. After filing, the IRS sent Jane a digital message saying that she may not qualify for the EITC because it did not have information to show that Jane's son is a full-time student. At this point, Jane talked to her son and determined that, in fact, he was not a full-time student. Jane then logged into her account to resubmit her return, this time without claiming the EITC. The vignette is reproduced in Figures 1.8.1 and 1.8.2.

8 National Taxpayer 2015 Annual Report to Congress 240-47.

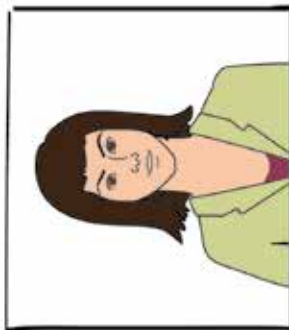
9 IRS, *2015 Data Book*, table 9a (comparing the number of EITC returns filed and the number of EITC audits in footnote 5 of the same table). There were a total of 146,861,217 individual returns filed, of which 28,308,931 claimed the EITC (this number differs from the data referenced in footnote 4, *supra*, because it reports on EITC returns in calendar year 2014 (primarily tax year 2013) and includes all EITC claims, not just recipients). There were 445,594 EITC audits and 1,228,117 total individual audits. In footnote 4, *supra*, it is reported that 27.5 million taxpayers received the EITC in 2014.

10 IRS, *Individual Taxpayer Experience of the Future*, <https://www.irs.gov/pub/newsroom/irs-individual-vignette-version-a.pdf>.

FIGURE 1.8.1

INDIVIDUAL

Taxpayer Experience of the Future



JANE
TEACHER,
LOCAL MIDDLE SCHOOL

BACKGROUND

Jane just rejoined the work force as a middle school math teacher. Having no previous teaching experience, Jane's income is low. Jane's son turned 19 years old this tax year and lives with her part-time.

Jane has historically used a tax preparer to file her taxes, but this year she is switching to a third-party web application that her new neighbor recommended. Since Jane is filing her own taxes for the first time, she is unfamiliar with many tax laws.

EXPERIENCE EXPECTATIONS

Secure Consistent Transparent
Easily Accessible Fast

TAXPAYER JOURNEY

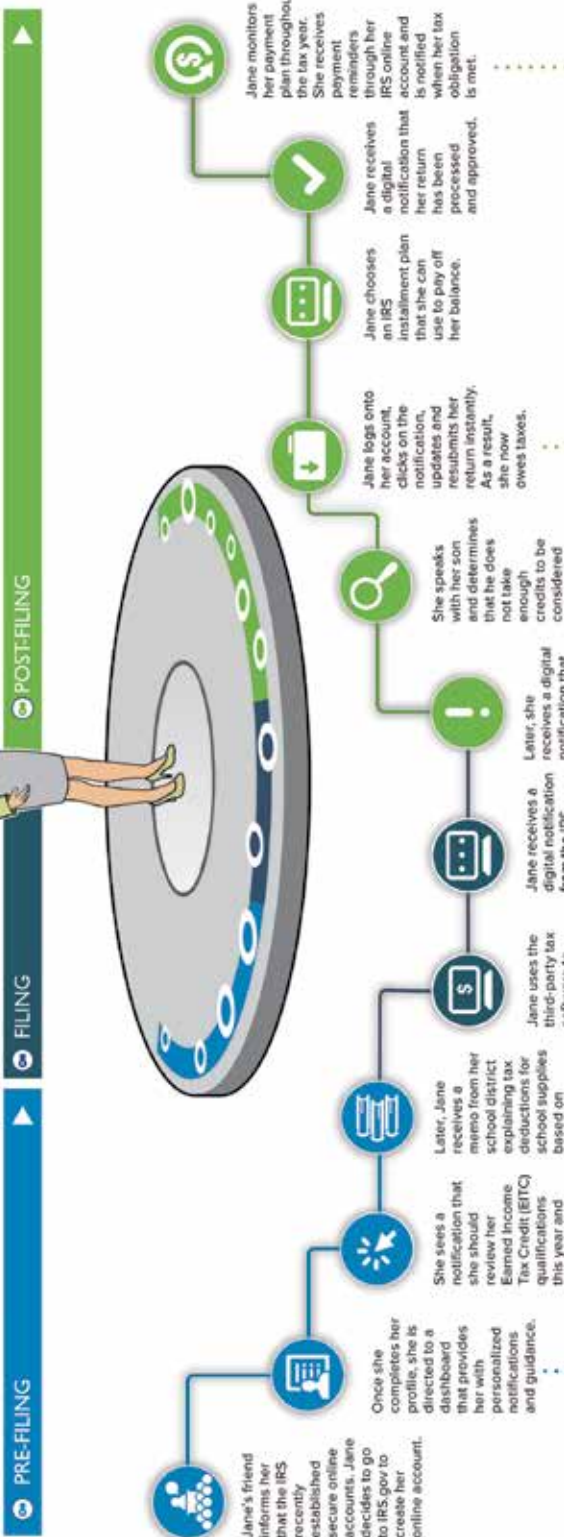
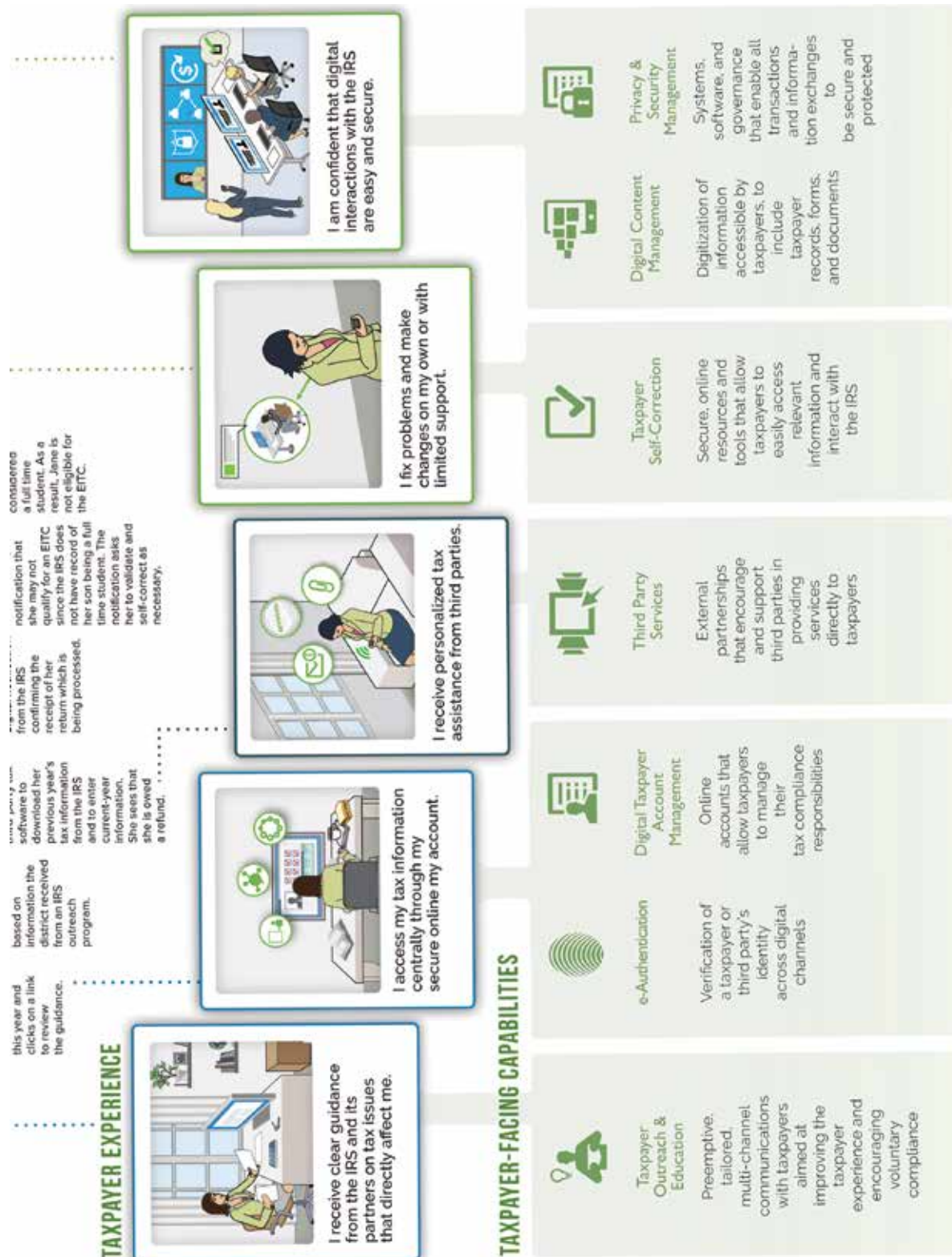


FIGURE 1.8.2



The facts in an Earned Income Tax Credit case are often complex and fluid, since they involve the personal lives of taxpayers. These are not the kind of cases that can be resolved with a one-stop online experience.

The National Taxpayer Advocate does not believe the vignette is illustrative of the normal experience for EITC taxpayers but instead assumes an idealized EITC taxpayer that is far-divorced from reality.¹¹ As for all taxpayers, the extent to which Jane would be entitled to EITC depends, among other things, on the amount of her adjusted gross income (AGI), whether she filed a joint return, and how many “qualifying children” she has.¹² The vignette describes Jane as a middle school math teacher with no previous teaching experience and with one qualifying child. The vignette notes that “Jane’s income is low.”

Figure 1.8.3 shows the entry-level salaries for middle school math teachers in the 11 cities in which a National Taxpayer Advocate Public Forum was held. The figure also shows the income limitations for claiming EITC in 2014-2016 for taxpayers with one qualifying child who did not file a joint return.¹³

11 National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress, vol. 2, 150.

12 IRC § 32. A “qualifying child” is a person who among other things meets age requirements, bears a specified relationship to the taxpayer, and has the same principal residence as the taxpayer for more than half the year. IRC §§ 32(c)(3), 152(c). Married taxpayers can claim EITC only if they file a joint return. IRC § 32(d).

13 For taxpayers with one qualifying child who do not file a joint return, the income limitations for claiming EITC that applied in 2014, 2015, and 2016 were \$38,511, \$39,131, and \$39,296, respectively. Internal Revenue Manual (IRM) 21.6.3.4.2.7.6, *Adjusted Gross Income* (Oct. 1, 2016). Sources for salary data: *North Carolina Public School Salary Schedules*, www.ncpublicschools.org/fbs/finance/salary/; *Teacher Elementary School Salaries in San Antonio, Texas*, <http://www1.salary.com/TX/San-Antonio/Teacher-Elementary-School-Salary.html>; National Council on Teacher Quality, *District Policy: Portland Public Schools, OR, Oregon*, <http://www.nctq.org/districtPolicy/contractDatabase/district.do?id=89>; *Red Oak Independent School District 2016-2017 Salary Schedules*, http://images.pcmac.org/Uploads/RedOakISD/RedOakISD/SubDepartments/DocumentsCategories/Documents/2016-17_Teacher_Step_Pay-n-Salary_Structure-071916.pdf; *Public School Teacher Salaries in Harrisburg, Pennsylvania*, <http://www1.salary.com/PA/Harrisburg/Public-School-Teacher-salary.html>; *Parma City Average Teacher Salary & How to Become a Teacher*, <http://www.teachersalaryinfo.com/ohio/teacher-salary-in-parma-city/>; 2012-2016 Teachers’ Agreement Between Glen Ellyn School District 41 Board of Education and Glen Ellyn Education Association, http://www.d41.org/cms/lib010/IL01904672/Centricity/Domain/429/2012-2016_teacher_agreement.pdf; National Council on Teacher Quality, *District Policy: Baltimore City Public School System, Maryland*, <http://www.nctq.org/districtPolicy/contractDatabase/district.do?id=34>; New York Office of Salary Services, <http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=0ahUKEwjEg4n4-oLRAhVlbSYKHfAsB1lQFgghMAE&url=http%3A%2F%2Fschools.nyc.gov%2Fnr%2Frdonlyres%2Ffeddb658c-be7f-4314-85c0-03f5a00b8a0b%2F0%2Fsalary.pdf&usg=AFQjCNEKJwoPeoWQIIzYX5WbiGudAIMdmw&bvm=bv.142059868,d.eWE>; Los Angeles Unified School District Board of Education, *2015-2016 Salaries for Teachers with Regular Credentials (T) C Basis (2%)*; District of Columbia Public Schools, *Compensation and Benefits for Teachers*, <http://dcps.dc.gov/page/compensation-and-benefits-teachers>.

FIGURE 1.8.3, Entry-Level Salaries for Middle School Teachers in Selected Cities Compared to Income Limitations for Claiming EITC in 2014-2016 for Taxpayers With One Qualifying Child Who Did Not File a Joint Return¹⁴

Forum Location	Year	Entry-Level Salary, Middle School Teacher
Parma, OH	2016-2017	\$33,290
Hendersonville, SC	2015-2016	\$35,000
Portland, OR	2015-2016	\$38,921
Earned income must be below		\$38,511 (2014) \$39,131 (2015) \$39,296 (2016)
Red Oak, IA	2016-2017	\$44,000
Harrisburg, PA	2016-2017	\$45,997
Glen Ellyn, IL	2014-2015	\$47,262
Baltimore, MD	2016-2017	\$48,430
San Antonio, TX	2016-2017	\$50,000
Los Angeles, CA	2016-2017	\$50,368
Washington, DC	2016-2017	\$51,359
Bronx, NY	2016-2017	\$51,650

Thus, in eight of the 11 National Taxpayer Advocate Public Forum venues, a middle school teacher earning an entry level salary like Jane would not be eligible to claim the EITC. In the three venues in which entry level salaries for middle school teachers like Jane did not exceed the income limitations for claiming EITC, the teacher would be eligible for EITC, but the most she could receive would be less than \$1,000 — far below the \$3,400 maximum amount of credit available in 2016.¹⁵ For 2014, the most recent year for which data is available, the average amount of EITC paid out was more than \$2,400.¹⁶ Thus, neither actual middle school math teachers nor actual average EITC claimants would be likely to recognize themselves in this vignette.

The vignette goes on to describe how the IRS notifies Jane, via her online account, that she may not qualify for EITC. The reason for the proposed adjustment is not because Jane's income disqualifies her for claiming the EITC, but because Jane's 19-year old son does not appear to be a full-time student, and this, according to the IRS, prevents him from being her qualifying child. Nothing in the vignette allows for the possibility that additional information would change the analysis of whether Jane is entitled to EITC. For example, Jane *would* be eligible for the EITC if her son is permanently disabled, no matter how old he is, and whether or not he is a full-time student.¹⁷

14 The cities in Figure 1.8.3 were selected because they each served as a venue for the National Taxpayer Advocate Public Forums in 2016.

15 See IRS Form 1040A Instructions *Earned Income Credit (EIC) Table* (assuming Jane's salary as a middle school teacher was her only source of income). The maximum amount of EITC available to taxpayers with one qualifying child who did not file a joint return was \$3,359 in 2015 and \$3,373 in 2016. IRS, *2016 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates*, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts> (last visited Dec. 31, 2016).

16 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc> (last visited Dec. 31, 2016).

17 See IRC §§ 32(a)(3)(C); 152(c)(3)(B).

Nevertheless, in the vignette, Jane ultimately (and seamlessly) uses her online account to “resubmit” her return.¹⁸ The online account in its present form does not give Jane this option. Currently, Jane could only view her balance due and make a payment.¹⁹ When the first release of the technology is complete, Jane would still be able to do only four things via her online account:

- View her balance due;
- Make a payment;
- See payments that have been made; and
- Obtain a transcript of her account.²⁰

There is no option for Jane to indicate she does not believe she owes the tax. There are no buttons Jane could click to learn, for example, how to file a protest, how to seek audit reconsideration or penalty abatement, how to file a refund claim, or how to file for “innocent spouse” relief. The National Taxpayer Advocate has urged the IRS to add these features to the online account pages.²¹

The facts in an EITC case are often complex and fluid, since they involve the personal lives of taxpayers. These are not the kind of cases that can be resolved with a one-stop online experience. In fact, the National Taxpayer Advocate has argued consistently that low income taxpayers need the opposite of what the Future State offers, which are customer service approaches fine-tuned to their specific needs and preferences, with an emphasis on communication and education.²² This is because low income taxpayers, generally speaking, often share a unique set of attributes that may prevent them from navigating the audit process successfully on their own. These attributes include having lower levels of education, being more likely to speak English as a second language, being less likely to have a bank account, and having a higher rate of relocation.²³ The vignette also does not capture taxpayers’ actual experiences when the IRS audits their EITC return.²⁴

The National Taxpayer Advocate’s concerns with the vignette were backed up time and time again by practitioners at the recent Public Forums held by the National Taxpayer Advocate. For instance, a tax controversy attorney commented that perhaps Jane’s problem could have been avoided altogether if there

18 This type of self-correction raises additional concerns. See National Taxpayer Advocate 2015 Annual Report to Congress 56, 62 (Most Serious Problem: *As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).

19 The online account is accessed from the payments page on IRS.gov. See *Finding How Much You Owe*, <https://www.irs.gov/payments/finding-out-how-much-you-owe> (last visited Dec. 31, 2016).

20 IRS, *View Your Tax Account Online* (Nov. 21, 2016), <http://win.web.irs.gov/articles/2016/View-your-tax-account-online.htm>.

21 See Most Serious Problem: *Online Accounts: Research Into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *supra*.

22 National Taxpayer Advocate 2015 Annual Report to Congress 245; National Taxpayer Advocate 2012 Annual Report to Congress 103-15; National Taxpayer Advocate 2011 Annual Report to Congress 296-312 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*); National Taxpayer Advocate 2008 Annual Report to Congress 227-42 (Most Serious Problem: *Suitability of the Examination Process*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress, vol. 2, 8-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

23 National Taxpayer Advocate 2015 Annual Report to Congress 235-39.

24 For a full discussion of how the Future State does not reflect taxpayers’ EITC audit experiences, see Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations*, *supra*.

had been more interactive contact either by person-to-person or telephone contact.²⁵ An attorney from a Low Income Taxpayer Clinic surmised that the IRS's Future State is “more idealized fantasy than accurate portrayal” because it “envisions a simple, self-explanatory experience, where the taxpayer is both informed and up-to-date about tax rules and regulations, and is tech-savvy enough to navigate a revised online interface.”²⁶

Recent Legislative Changes Make Unintentional EITC Errors Very Harmful to Taxpayers

The Future State plans are not designed to accommodate a legally and factually complex law like the EITC, particularly when any error, whether understood by the taxpayer or not, can affect subsequent years. For instance, Internal Revenue Code (IRC) § 32(k) authorizes the IRS to ban a taxpayer from claiming the EITC for two years if the IRS determines the taxpayer claimed the credit improperly due to reckless or intentional disregard of rules and regulations.²⁷ Previously, the National Taxpayer Advocate drew attention to the harmful IRS practice of imposing the ban even when the IRS had no interaction with the taxpayer. In particular, a TAS review of the IRC § 32(k) ban showed that the IRS imposed the ban on taxpayers with whom it had had no interaction 49 percent of the time in 2009, 44 percent of the time in 2010, and 39 percent in 2011.²⁸

However, when the audit process does not meet taxpayer needs, any EITC denied to the taxpayer (and subsequent bans on future claims) may reflect the taxpayer's inability to navigate the audit process rather than an improper payment.²⁹ The National Taxpayer Advocate has repeatedly recommended that the IRS hire employees with social work skillsets in order to meet the needs of taxpayers claiming the EITC.³⁰ At the very least, the IRS can train existing employees in these very skillsets, which will increase their effectiveness in communicating with and assisting this taxpayer population. Poor communication has significant consequences for taxpayers. For example, if a taxpayer who is not eligible for the EITC in the year of audit does not receive a clear explanation as to why she is ineligible, she will likely repeat the same error on her next return. This repetition of the mistake would trigger the two-year ban under IRC § 32(k), even if she becomes eligible in future years. In the Future State plans, the IRS may see more EITC errors as taxpayers are not able to navigate the online tools for self-help on top of an already confusing audit process; alternatively, eligible taxpayers may defer to IRS online tools and thus not receive the EITC benefits to which they are entitled.

The ramifications for taxpayers who make mistakes claiming the EITC are even higher since Congress recently granted IRS the ability to use math error authority in situations where the taxpayer has claimed the EITC during a time that he or she is barred from doing so under IRC §32(k).³¹ Math error authority allows the IRS to correct mathematical errors and inconsistencies on a return which may result in a tax

25 Oral Statement of Elizabeth Atkinson, Attorney, National Taxpayer Advocate Public Forum 27 (May 13, 2016).

26 Oral Statement of Robert Hamilton, Attorney, National Taxpayer Advocate Public Forum 13 (Apr. 8, 2016).

27 IRC § 32(k)(1)(B)(ii) provides for a two-year “disallowance period” of “two taxable years after the most recent taxable year for which there was a final determination that the taxpayer’s claim of credit under this section was due to reckless or intentional disregard of rules and regulations.”

28 National Taxpayer Advocate 2013 Annual Report to Congress 105.

29 National Taxpayer Advocate 2011 Annual Report to Congress 301.

30 Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*; National Taxpayer Advocate 2015 Annual Report to Congress 261; National Taxpayer Advocate 2010 Annual Report to Congress 15-27.

31 Protecting Americans from Tax Hikes (PATH Act) of 2015, Pub. L. No. 114-113, div. Q, title 2, § 208, 129 Stat. 3083.

increase or a tax decrease.³² It is now possible that a taxpayer who made an error claiming the EITC but is eligible for it in the future, will be denied the credit in subsequent years by math error authority. With the EITC vignette described above, a taxpayer who continues to pursue his or her EITC claim despite the electronic notification from the IRS may be deemed to be exhibiting reckless behavior under IRC § 32(k).

Taxpayers who make mistakes claiming the EITC will also incur costs from penalty assessments. Prior to December 18, 2015, the Tax Court ruling in *Rand v. Commissioner* held that refundable credits (such as the EITC) could not reduce below zero the amount shown as tax by the taxpayer on a return.³³ The amount of tax shown by the taxpayer on a return is an important element in calculating an underpayment of tax, which in turn serves as the basis for the accuracy-related penalty under IRC § 6662.³⁴

However, recently enacted law reversed the Tax Court's decision in *Rand v. Commissioner*, and amended IRC § 6664(a) to be consistent with the rule of IRC § 6211(b)(4), which will allow the IRS to calculate negative tax in computing the amount of underpayment for accuracy-related penalty purposes.³⁵ Thus, for returns filed after December 18, 2015, or for returns filed before that date for which the period of limitations on assessment under IRC § 6501 has not expired, a taxpayer can be subject to an underpayment penalty in IRC § 6662 based on an EITC claim which reduces tax below zero.

The IRS Has Proceeded With the Future State Plans Without Researching or Addressing How It Will Affect Low Income Taxpayers

Given the harms that can befall a taxpayer claiming the EITC, this is a time when taxpayers need to have sufficient, one-on-one assistance with their initial EITC claims. The IRS needs to speak with and engage these taxpayers because EITC cases are complex. This is not a time to reduce assistance to low income taxpayers in the name of efficiency, especially since the IRS does not know what impact the Future State will have on low income taxpayers.

TAS is conducting a study to evaluate the compliance impact of education and outreach on potentially noncompliant EITC taxpayers.³⁶ TAS Research identified EITC taxpayers who were audited in 2015 and others who were not, but who had similar risk scores to the taxpayers who were audited. TAS then developed three representative samples from this population:

- Audit Group: This group was comprised of taxpayers who were audited in 2015.
- Test Group: This group was comprised of taxpayers who were not audited in 2015, but with similar risk scores to the taxpayers who were audited. The National Taxpayer Advocate sent letters highlighting potential errors to this group at the beginning of the 2016 filing season.

32 Generally, IRC § 6212 requires that prior to assessment of a liability the IRS must send a notice of deficiency to the taxpayer via certified mail. This notice provides the taxpayer with the right to petition the U.S. Tax Court, the only opportunity for judicial review without first paying the tax. IRC § 6213. However, IRC § 6213, in subsections (b) and (g), authorizes the IRS to use its math error authority to summarily assess tax and bypass normal deficiency procedures. Summary assessments made under these provisions can be abated if the taxpayer timely requests abatement. IRC § 6213(b)(2)(A). The IRS will then work the case through normal deficiency procedures. IRC § 6213(b)(2)(A).

33 *Rand v. Comm'r*, 141 T.C. 376 (2013). See also National Taxpayer Advocate 2014 Annual Report to Congress 449.

34 IRC § 6664(a).

35 Pub. L. No. 114-113, Consolidated Appropriations Act, 2016 (Division Q, PATH Act of 2015), § 209, 114th Cong. (Dec. 18, 2015).

36 See Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*, vol. 2, *infra*; National Taxpayer Advocate FY 2017 Objectives Report to Congress, vol. 2, 185.

- Control Group: This group was also comprised of taxpayers not audited in 2015, but with similar risk scores to the taxpayers who were audited or sent a TAS letter.

In January 2015, the National Taxpayer Advocate sent about 7,100 letters to the taxpayers who were not audited but appeared to have erroneously claimed EITC on their 2014 returns.³⁷ The letters were specifically designed to inform and educate taxpayers with targeted and specific information about EITC eligibility rules, geared to the error the IRS identified. The letters explained their purely educational purpose, and clearly stated that this contact was not an audit. For those taxpayers who received Title IV benefits (Temporary Assistance for Needy Families, *etc.*), the letter included a sentence reminding them that the eligibility rules for EITC were different from the rules for Title IV benefits, so a taxpayer could receive Title IV benefits for a child and yet not be eligible for the EITC with respect to that same child. TAS then compared the level of compliance shown on taxpayers' 2016 returns among three groups:

- Taxpayers who were not audited but were sent the TAS letter;
- A representative sample of taxpayers whose 2014 returns were audited; and
- A representative sample of taxpayers whose 2015 returns appeared to erroneously claim the EITC but who were not audited and did not receive the TAS letter.³⁸

The TAS letter, intended to educate taxpayers about the requirements for claiming EITC, appeared to help taxpayers avoid repeating their mistakes.³⁹ Taxpayers who were sent a TAS letter were less likely to file a 2015 return that repeated the apparent error of not meeting the relationship test, compared to unaudited taxpayers who were not sent a TAS letter.

TAS is planning to repeat the letter test in the 2017 filing season. TAS will add an additional sample of taxpayers who will be offered, in the letter, the availability of a dedicated "Extra Help" line staffed by trained TAS employees who can answer taxpayer questions about the letter and the EITC eligibility rules. TAS will be tracking the compliance behavior of that cohort as well, and report on that in the 2017 Annual Report to Congress.

While the IRS has not collected any data to show the impact of the Future State on low income taxpayers, there is some data to suggest it will be harmful to many in the low income taxpayer population. As the IRS moves away from traditional in-person services such as live telephone assistance or face-to face, the transition will impact some groups of taxpayers more than others.⁴⁰ Research conducted by the Pew Research Center (Pew) confirms that internet use varies across different groups.

- In 2013, a Pew survey revealed that 44 percent of adults with no high school diploma reported not going online whereas only seven percent of adults with some college reported not going online.⁴¹
- In 2014, Pew found that only 77 percent of adults with household income less than \$30,000 per year went online but 99 percent of adults with household income of \$75,000 or more went online.⁴²

37 See Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*, vol. 2, *infra*.

38 *Id.*

39 *Id.*

40 National Taxpayer Advocate 2014 Annual Report to Congress 11.

41 Pew Research Center (Pew), *Offline Adults* (2013), <http://www.pewinternet.org/data-trend/internet-use/offline-adults/> (last visited Dec. 31, 2016).

42 Pew, *Internet User Demographics* (2014), <http://www.pewinternet.org/data-trend/internet-use/latest-stats/> (last visited Dec. 31, 2016).

- Over 90 percent of Americans under the age of 50 report going online whereas less than half of Americans over the age of 80 use the internet.⁴³

Even when a taxpayer can access the internet, it does not mean that access is adequate. In 2015, only 67 percent of all adults reported having broadband access in the home.⁴⁴ A lack of broadband in the home was identified as a disadvantage to getting tasks done.⁴⁵ According to Pew surveys, 43 percent of non-broadband adopters say that cost is the primary reason why they do not currently have broadband.⁴⁶ Instead, “many of those non-broadband adopters are now turning to their smart phones and other mobile devices to bridge those gaps.”⁴⁷ Having to rely on a smart phone or similar device for complex tasks can be difficult because of the small screen and the requirement that the user find a public space providing service, such as a coffee shop.⁴⁸

In 2015, the United Kingdom’s tax authority, Her Majesty’s Revenue and Customs (HMRC), announced “the end of the tax return” as it set out to modernize its tax system.⁴⁹ By 2020, HMRC plans to have a fully digital system where taxpayers will have their own accounts to register, file, pay, and update their information at any time.⁵⁰ The initiative made a commitment to have “good customer service at its heart.”⁵¹ HMRC acknowledges that even with the convenience of digital services, some taxpayers need additional support. As a result, HMRC plans to offer alternative options for assistance, including over the phone, face-to-face visits, and partners in the community.⁵² Most significantly, unlike in the United States, 89 percent of households in Great Britain have an internet connection and 93 percent of those households have broadband.⁵³

TAXPAYER DIGITAL COMMUNICATION

It is important that the IRS understands the needs and preferences of the taxpayers who will be using the digital features of the Future State.⁵⁴ Taxpayer Digital Communication (TDC) is a pilot project, slated to begin in the first quarter of FY 2017, which TAS continues to develop in conjunction with IRS Online Services.⁵⁵ Under this initiative, taxpayers will have the ability to communicate with their assigned

43 Oral statement of Aaron Smith, Associate Director, Pew Research Centers, National Taxpayer Advocate Public Forum 153 (Feb. 23, 2016).

44 Pew, *Home Broadband 2015* (Dec. 21, 2015), <http://www.pewinternet.org/2015/12/21/home-broadband-2015/> (last visited Dec. 31, 2016).

45 Oral statement of Aaron Smith, Associate Director, Pew Research Centers, National Taxpayer Advocate Public Forum 155 (Feb. 23, 2016). The Federal Communications Commission (FCC) demonstrates the difference between broadband access and the alternative, dial-up access, by offering this explanation: “Every page, image and video on the web comes to your home device as small pieces of data, or packets. How fast these packets move on the network is measured in Megabits per second, abbreviated Mbps. Broadband technology can move those packets to and from your home much more quickly than dial-up access using a modem and telephone line.” FCC, *Broadband Service for the Home: A Consumer’s Guide*, <https://www.fcc.gov/research-reports/guides/broadband-service-home-consumers-guide> (last visited Dec. 31, 2016).

46 Oral statement of Aaron Smith, Associate Director, Pew, National Taxpayer Advocate Public Forum 155 (Feb. 23, 2016).

47 *Id.*

48 *Id.* at 158.

49 Her Majesty’s Revenue and Customs (HMRC), *Making Tax Easier: the End of the Tax Return* 1 (Mar. 2015).

50 HMRC, *Making Tax Digital* 4 (Dec. 2015).

51 HMRC, *Making Tax Easier: the End of the Tax Return* 1 (Mar. 2015).

52 HMRC, *Making Tax Digital* 6 (Dec. 2015).

53 Office for National Statistics, *Internet Access: Households and Individuals: 2016* 25-29 (Aug. 4, 2016). Internet access in Great Britain is tied to age. Only 53 percent of households with one adult aged 65 or older has internet access. Office for National Statistics, *Internet Access: Households and Individuals: 2016* 29 (Aug. 4, 2016).

54 See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*, *supra*.

55 See National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 198.

TAS case advocate using a secure web-based portal that allows one-way and two-way communication, including live text chat, voice chat, video chat, and screen sharing. TDC also plans to deliver notifications and alerts by text message and feature smart phone interactivity. The pilot is designed to test whether TDC enhances communication and information sharing between TAS employees and taxpayers. TAS plans to pilot the portal to process EITC cases in four TAS offices.

The goal of testing EITC cases is to see if taxpayers can create online accounts and get through the three-factor verification process. Currently, the “pass rate” for taxpayers attempting to create an online IRS account is 28 percent.⁵⁶ The pass rate for low income taxpayers will most assuredly be lower, because they do not possess many of the financial attributes the verification process requires. Of those taxpayers who can create an online account, TAS will gather more details about their experience. For instance, TAS will attempt to answer these questions:

- Were taxpayers able to access their accounts in a timely manner;
- Were taxpayers able to use their accounts as intended;
- Did taxpayers communicate well via email and were they more responsive than regular mail;
- Did taxpayers respond and provide documentation more quickly via email than through regular mail;
- Did taxpayers understand what the IRS and TAS sent to them;
- Were taxpayers unwilling to use the online account (instead relying on telephone contact with the IRS); and
- Did taxpayers have a higher relief rate using the online account versus traditional contacts?

The National Taxpayer Advocate anticipates having this data by the end of 2017, which will shed light on the ability of over 27 million EITC taxpayers to participate in the IRS Future State. Given all of the concerns discussed above, the IRS should postpone its planning of any EITC Future State technology until the TDC data is available. Instead, the IRS should invest its resources into person-to-person communication for EITC taxpayers, including an “Extra Help” line.

CONCLUSION

The National Taxpayer Advocate is concerned that the IRS may make the EITC out of reach for taxpayers with its Future State plans. Since the Future State relies on online services and self-help capabilities, the IRS may be creating a situation where many low income taxpayers who require personalized assistance are left to fend for themselves or pay for assistance from unregulated preparers. This may prevent eligible taxpayers from receiving the credit and will do nothing to improve the improper payment rate. This is happening at a time when unintentional errors claiming the EITC will have drastic consequences for taxpayers, including a future ban that can be imposed with more ease, and penalties that up until now have not been considered. The IRS has not collected sufficient data to determine if the Future State will be compatible with the needs of low income taxpayers, and what data is available clearly indicates it is not compatible. Given that the Future State could be negatively impacting one of the largest anti-poverty programs, the IRS should postpone its implementation for EITC purposes until it understands how this will affect low income taxpayers.

56 National Taxpayer Advocate Notes from Services and Enforcement Executive Steering Committee Meeting (Nov. 17, 2016).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Amend Internal Revenue Manual 4.19.14.5.4, *EITC Qualifying Child*, to allow an IRS employee to use a state agency's determination that a taxpayer has qualified for Temporary Assistance for Needy Families, Section 8 or comparable benefits, as substantiation for EITC with a qualifying child.
2. Hire or train employees with social work skillsets in order to meet the needs of taxpayers claiming the EITC.
3. Postpone its planning of any EITC Future State technology until the TDC data is available. Instead, the IRS should invest its resources into person-to-person communication for EITC taxpayers, including a dedicated "Extra Help" line for EITC taxpayers.

**MSP
#9****FRAUD DETECTION: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM²

Over the past decade, fraud and identity theft have increasingly plagued consumers, businesses, and financial institutions.³ The IRS has also been impacted. A 2015 Treasury Inspector General for Tax Administration (TIGTA) report found that the IRS processed approximately 1.5 million returns for tax year (TY) 2010 with characteristics of identity theft, issuing potentially fraudulent refunds totaling \$5.2 billion.⁴

To detect and prevent identity theft and other tax refund fraud, the IRS has established a complicated screening process.⁵ When a return is flagged by one of the multiple IRS systems that scrutinize returns for characteristics of refund fraud or identity theft, the refund is held until the taxpayer can authenticate

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Reducing "False Positive" Determinations in Fraud Detection*, vol. 3, *infra*.

3 See also American Bankers Association (ABA), *Banks Stop \$11 Billion in Fraud Attempts in 2014* (Jan. 27, 2016), <http://www.aba.com/press/pages/012716depositsurvey.aspx>. While attempted fraud against bank deposit accounts reached \$13 billion, banks' prevention measures stopped \$11 billion in fraudulent transactions. Bureau of Justice Statistics (Sept. 27, 2015), www.bjs.gov. An estimated 17.6 million persons, or about seven percent of U.S. residents age 16 or older, were victims of at least one incident of identity theft in 2014.

4 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft* (Apr. 24, 2015).

5 The IRS Return Integrity & Compliance Services (RICS) uses three independent systems to identify returns when it suspects identity theft has occurred or that the return is fraudulent — the Dependent Database (DDb), the Return Review Program (RRP), and the Electronic Fraud Detection System (EFDS).

his or her identity, or until the information on the return can be verified.⁶ Although these systems do identify improper returns and prevent improper refunds from being issued, they also have a high degree of inaccuracy, which results in unnecessary refund delays and reduced taxpayer morale.⁷

Over the past 13 years, the National Taxpayer Advocate has consistently advocated for taxpayers whose legitimate refunds have been unreasonably delayed by the IRS and recommended improvements to reduce taxpayer burden while preventing identity theft and refund fraud.⁸

The National Taxpayer Advocate remains concerned that:

- IRS fraud detection systems have a high false positive rate (FPR).⁹ For calendar year (CY) 2016 through September, IRS filters and business rules used for detecting fraudulent returns and identity theft had many FPRs over 50 percent. These improper selections delayed approximately 1.2 million tax returns associated with about \$9 billion in legitimate refunds for more than an additional 30 days on average. Notably, one IRS process for reviewing returns for identity theft had an FPR of roughly 91 percent.¹⁰
- The issuance of refunds that were improperly identified by IRS systems as being returns likely resulting from identity theft or fraud was significantly delayed. On average, these refunds were delayed an additional 36 days, meaning it took taxpayers nearly two months to receive their refunds.¹¹

6 The IRS has distinct screening processes for identity theft and refund fraud. For purposes of this report, we will refer to refund fraud in its broadest sense, to include identity theft as a subset of refund fraud. See also National Taxpayer Advocate 2015 Annual Report to Congress 45-55 (Most Serious Problem: *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of “False Positives” Within the IRS’s Pre-Refund Wage Verification Program*). The IRS uses identity theft filters to select and suspend the processing of tax returns it suspects were filed by identity thieves. When the IRS stops a return, it will send the taxpayer a letter asking him or her to either call the Taxpayer Protection Program (TPP) phone number, visit the ID verify website, or appear in person at a Taxpayer Assistance Center (TAC) to verify his or her identity. Internal Revenue Manual (IRM) 25.25.6.1, *Taxpayer Protection Program* (May 26, 2015).

7 Gregg S. Henzel et al., *Using Model Calibration and Optimization to Reduce Fraud Risk: How Financial Institutions Can Identify Fraud More Effectively While Reducing Costs* 3-4 (Crowe Horwath 2015), <https://www.crowehorwath.com/folio-pdf/Using-Model-Calibration-and-Optimization-to-Reduce-Fraud-Risk-Article-RISK-16007-008A.pdf>. See also Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *supra*.

8 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress, 45-55, 180-87; National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67, 95-110; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-17; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 25-54, 180-91; National Taxpayer Advocate 2004 Annual Report to Congress 133-36; and National Taxpayer Advocate 2003 Annual Report to Congress 175-81.

9 A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. IRS response to TAS information request (Nov. 3, 2016).

10 *Id.* The returns reviewed by this process include taxpayers who have previously been victimized by identity theft, and therefore these filters are more stringent, which may account in part for this high false positive rate (FPR).

11 *Id.* The normal timeframe for processing a refund is 21 days. These refunds were delayed 36 days beyond that normal processing time, meaning that the average processing time for these refunds was 57 days. See IRS Newswire, *As Holidays Approach, IRS Reminds Taxpayers of Refund Delays in 2017*, IR-2016-152 (Nov. 22, 2016). “As the IRS steps up its efforts to combat identity theft and tax refund fraud through its many processing filters, legitimate refund returns sometimes get delayed during the review process.”

- IRS fraud detection systems are antiquated and the IRS's ability to adjust the systems in real time is limited, placing them outside the industry standard for fraud detection systems.¹²

IRS systems that improperly flag legitimate tax returns and delay refund issuance can create a financial hardship for taxpayers, expend unnecessary IRS resources to resolve the issues, and negatively impact taxpayers' voluntary compliance. Thus, as literature has shown, in order to reduce FPRs, it is extremely important that the IRS identify the necessary elements to establish a robust fraud detection system.¹³ This objective can be met by regularly consulting with other government entities and private industry about best practices for effectively designing systems to accurately detect fraud. Through this process, the IRS should establish aspirational goals for reducing FPRs. This goal is within reach after Congress passed legislation moving the deadline for third-party information reporting up from the end of February (and the end of March for electronic filers) to January 31, providing the IRS more time to match the wage and tax information reported on the taxpayer's return against the information submitted by third parties.¹⁴

ANALYSIS OF PROBLEM

Background

The return integrity program, a process critical to the IRS's strategy to address identity theft and detect and prevent improper fraudulent refunds, is complex and multifaceted.¹⁵ The Return Integrity & Compliance Services (RICS) Integrity and Verification Operation (IVO) — a part of the Wage & Investment (W&I) Division — uses filters, rules, data mining models, and manual reviews to identify potentially false returns, usually through wages or withholding reported on the returns, to stop fraudulent refunds before the IRS issues them.¹⁶

The IRS electronically screens tax returns using three independent systems: the Dependent Database (DDb), the Return Review Program (RRP), and the Electronic Fraud Detection System (EFDS).¹⁷ If one of these systems flags a return as potentially fraudulent, the return goes to the Taxpayer Protection Program (TPP) or the Income Wage Verification (IWV) program for further scrutiny.

In addition to the RICS programs, the IRS began employing additional filters known as the Identity Theft business rules in January 2009. The business rules are applied to any return filed with a Social Security number (SSN) associated with an identity theft indicator. These returns are not allowed to post

12 "The heart of an efficient fraud prevention solution is a strong analytics engine, which can use the available data intelligently, recognize and identify patterns, provide real time visibility into threats, and signal discrepancies. It should enable the solution to detect and respond swiftly to suspicious or fraudulent transactions." Vasudevan Easwaran, *The Combination to a Safe Future for Banking Using Technology in the Banking Industry to Prevent Fraud*, WIPRO (2015).

13 See Literature Review: *Reducing "False Positive" Determinations in Fraud Detection*, vol. 3, *infra*.

14 Section 201 of the Protecting Americans From Tax Hikes (PATH) Act amended IRC § 6071 to require that certain information returns be filed by January 31, generally the same date as the due date for employee and payee statements, and are no longer eligible for the extended filing date for electronically filed returns under section 6071(b). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015). This legislative change is consistent with prior National Taxpayer Advocate recommendations. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 45-55; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-88; National Taxpayer Advocate 2012 Annual Report to Congress 180-91; National Taxpayer Advocate 2011 Annual Report to Congress 284-95; National Taxpayer Advocate 2009 Annual Report to Congress 338-45.

15 Internal Revenue Manual (IRM) 25.25.1.1 (Feb. 19, 2015).

16 IRM 25.25.2.1(1) (Aug. 20, 2015).

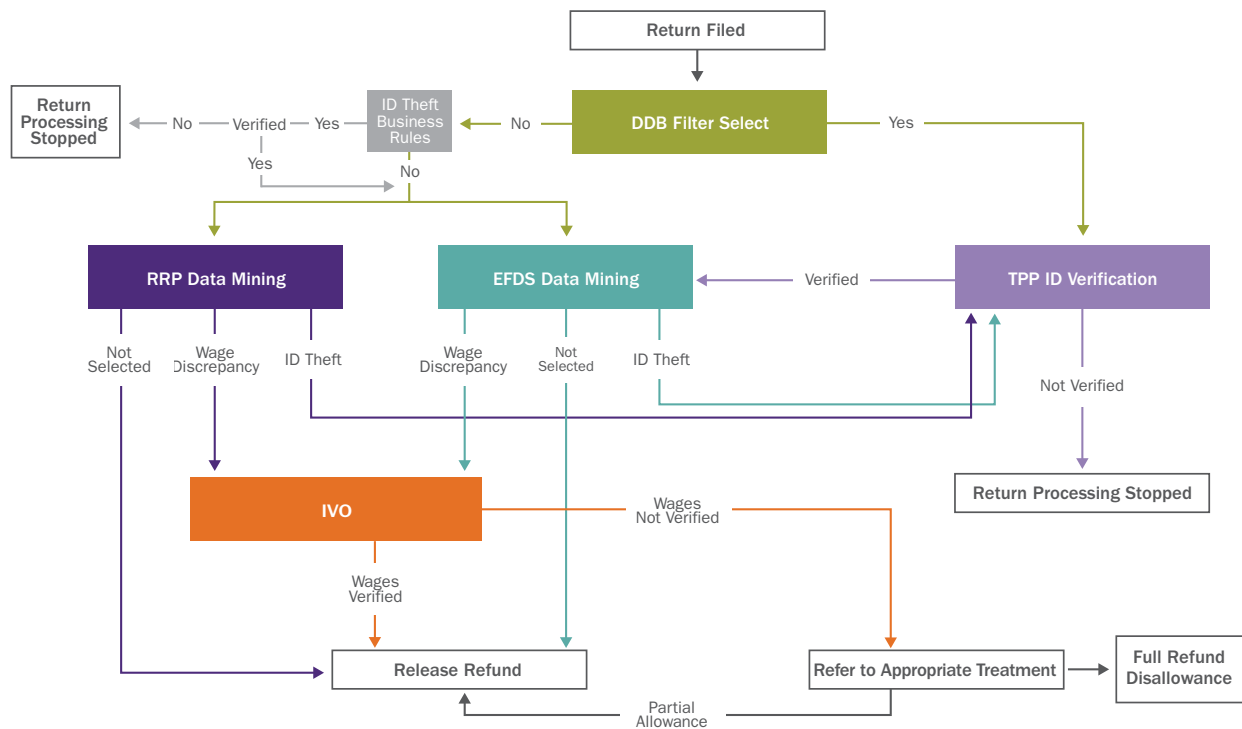
17 IRM 25.25.6.1 (Aug. 26, 2016).

to taxpayers' accounts (these are called "unpostable" returns) until the IRS can review the returns and accounts, and determine that they belong to the valid SSN owners.¹⁸

Figure 1.9.1 provides a simplified flow chart of the complicated processes the IRS uses to screen returns claiming refunds for identity theft and fraud.

FIGURE 1.9.1

Flow Chart of Refund Return Screening for Identity Theft and Fraud



As illustrated above, when a refund return is subject to the TPP, it will first be analyzed by the DDb system which will look for identity theft characteristics. As of CY 2016 through September, the DDb system has selected 1,184,976 returns with an FPR of 49 percent, and the affected returns took an average of 57 days to be processed.¹⁹

The RRP will select returns for both the TPP and the IWV programs. RRP then generates scores that relate to the predictive value of possible identity theft or fraud, or both.²⁰ For CY 2016 through

¹⁸ National Taxpayer Advocate 2009 Annual Report to Congress 307-17.

¹⁹ IRS response to TAS information request (Nov. 3, 2016). The IRS generally allows 21 days for a return to be processed. The processing of these returns took about 36 days beyond the normal 21 day processing time, meaning that the total return processing time for these returns was about 57 days. After the return is scrutinized by the DDb system, returns filed with an Social Security number associated with the identity theft indicators are subjected to a separate set of business rules. For calendar year (CY) 2016 through September, the IRS suspended the processing of 736,111 returns that did not pass the business rules with an FPR of 91 percent and an average processing delay of 30 days. The IRS has committed to eliminating the business rules that are outside of the TPP in CY 2017.

²⁰ See TIGTA, Ref. No. 2015-20-060, *The Return Review Program Enhances the Identification of Fraud; However, System Security Needs Improvement* (July 2, 2015).

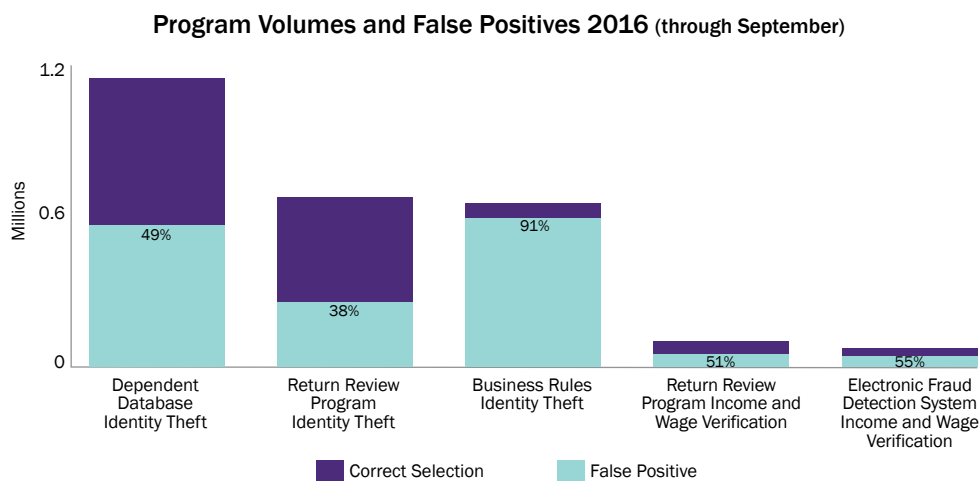
IRS fraud detection systems have a high false positive rate (FPR). For calendar year 2016 through September, IRS filters and business rules used for detecting fraudulent returns and identity theft had many FPRs over 50 percent. These improper selections delayed approximately 1.2 million tax returns associated with about \$9 billion in legitimate refunds for more than an additional 30 days on average. Notably, one IRS process for reviewing returns for identity theft had an FPR of roughly 91 percent.

September, RRP has selected 698,960 returns for potential identity theft with an FPR of 37.9 percent, and the affected returns took an average of 57 days to be processed (*i.e.*, this system scrutinizes returns for both identity theft or fraud).²¹ Likewise, RRP selected 103,520 returns for potential refund fraud during the same period. The FPR for improperly selected refund fraud returns was 50.6 percent.²²

The EFDS program will run simultaneously with the RRP program. EFDS uses data mining models to score each Form W-2 and 1099 on refund returns for fraud potential based on business rules that consider return and filing characteristics.²³ For CY 2016 through September, EFDS has selected 77,810 returns with an FPR of 54.5 percent, and the affected returns took an average of 55 days to be processed.²⁴

Figure 1.9.2 shows the volume and false positive rates for the above-mentioned IRS identity theft and fraud detection systems.²⁵

FIGURE 1.9.2



21 IRS response to TAS information request (Nov. 3, 2016).

22 *Id.*

23 IRS response to TAS information request (Aug. 20, 2015). IRM 25.25.2.1 (Aug. 20, 2015).

24 IRS response to TAS information request (Nov. 3, 2016).

25 *Id.*

It appears that the IRS has accepted these FPRs as a necessary byproduct of risk detection, viewing the harm to legitimate taxpayers as a minor inconvenience. However, other government agencies, such as the U.S. Citizenship and Immigration Service (USCIS), are making efforts to improve error rates to as little as three percent.²⁶ The National Taxpayer Advocate realizes that identifying fraud and identity theft in tax administration is likely much different from the processes established by USCIS, but it illustrates the point that other government agencies are interested and motivated to reduce FPRs.

IRS Systems Are Antiquated and Lack the Nimbleness Necessary to Function in an Ever Changing World of Fraud and Identity Theft

The high false positive rates set out above result in thousands of taxpayers with legitimate returns being subjected to a frustrating and often elusive process. If the IRS is scrutinizing the return for possible identity theft, the taxpayer will likely be instructed to contact the IRS's dedicated Taxpayer Protection Program line, which had a Level of Service of 31.7 percent for fiscal year 2016 and a wait time of almost 11 minutes.

The IRS's EFDS system is incapable of having its filters adjusted regularly.²⁷ However, the DDb and RRP systems are capable of having their filters adjusted.²⁸ DDb filters are able to be changed, if needed, on a weekly basis, and RRP has set aside programming dates to make that kind of change during the filing season.²⁹ Despite the systems' abilities to have their filters changed to address emerging circumstances, the IRS has established a cumbersome and laborious process for such changes to occur. For instance, any changes to the RRP must receive approval from the Business Rules and Requirements Management (BRRM) office, and any changes to the DDb are subject to a different process.³⁰ BRRM does not meet regularly; therefore, any change request that needs immediate attention must go through a time-consuming approval process resulting in more refund delays. Creating a sub-approval group authorized to implement real-time modifications to screening rules and filters would allow for faster resolution of systemic issues and minimization of taxpayer harm. Such an approach would better align the IRS with accepted private industry practices to detect and prevent fraud. Specifically, experts in this area advise that designing an organizational structure that allows sharing of information in real time enables all necessary stakeholders to evaluate and adjust an organization's fraud detection systems and filters based on this information.³¹ In fact, for identity theft and fraud detection systems to be effective, the organization's leaders must accept that some traditional implementation and support processes are too slow to react to actions of fraud groups.³²

Furthermore, having a large number of stakeholders involved in the decision-making process runs a "risk of over-governance resulting in duplication, inefficiencies, and uncertainty relating to ownership of fraud

26 *E-Verify Progressing, but Still Needs Work*, GAO Finds, CQ HOMELAND SECURITY (CONGRESSIONAL QUARTERLY, Washington, DC) (Jan. 20, 2011).

27 TIGTA, Ref. No. 2015-20-093, *Review of the Electronic Fraud Detection System* (Sept. 2015) (stating that EFDS is modified annually).

28 IRS response to TAS information request (Nov. 3, 2016).

29 *Id.*

30 IRM 1.1.13.6.3.4 (Oct. 7, 2013). The office is responsible for the coordination and execution of the activities required to define, develop, maintain, and control business requirements and rules.

31 Deloitte, *The Latest Tools and Tactics for Battling Bank Fraud* 3 (May 1, 2014), <http://deloitte.wsj.com/cio/2014/05/01/the-latest-tools-tactics-for-battling-bank-fraud/> (Dec. 31, 2016).

32 *Id.*

detection issues needing resolution.”³³ The heart of an efficient fraud prevention solution is a strong analytics engine, which can use the available data intelligently, recognize and identify patterns, provide real time visibility into threats, and signal discrepancies.³⁴ It should enable the solution to detect and respond swiftly to suspicious or fraudulent transactions.³⁵ It appears that while the IRS’s DDb and RRP systems have the analytic capabilities necessary for a successful fraud and identity theft detection system, the IRS is not taking full advantage of these capabilities. Instead, the IRS adheres to a cumbersome process for changing system filters, thereby limiting the system abilities to respond to changing circumstances in real time.

In addition to IRS systems lacking the capability to adjust in real-time, another significant drawback is system limitations towards analyzing information simultaneously. As described above, IRS systems work independently from one another, thereby extending the time for a return to be analyzed, resulting in additional refund delays and frustrated taxpayers.

Continuing and Enhancing Collaboration in the Form of Public-Private Partnerships Can Leverage the IRS’s Ability to Fight Identity Theft and Refund Fraud

The literature³⁶ has shown that in the financial sector, a system developed to detect fraud normally contains the following four elements:

- Detect: predict fraud before it happens;
- Respond: apply new fraud insights;
- Investigate: turn fraud intelligence into action; and
- Discover: leverage existing historical data.³⁷

Any successful fraud detection system should also contain a combination of the following types of analytics:

- *Advanced Analytics*: Critical data drawn from across the enterprise can be centralized in a flexible framework that, unlike more limiting relational databases, can accommodate multiple data formats in a production environment.³⁸
- *Behavioral Analytics*: Behavioral analytics solutions are designed to understand the normal behavior of each individual consisting of a detailed, multi-faceted combination of timing, sequence, devices, locations, channels, and the financial and non-financial activities performed via those channels.³⁹

33 Australian Government, Inspector-General of Taxation, *Review into the Australian Taxation Office’s Compliance Approach to Individual Taxpayers Income Tax Refund Integrity Program* 13 (Sept. 2013), <http://igt.gov.au/files/2014/11/income-tax-refund-integrity-program.pdf>.

34 Vasudevan Easwaran, *The Combination to a Safe Future for Banking Using Technology in the Banking Industry to Prevent Fraud*, WIPRO (2015).

35 *Id.*

36 See, e.g. IBM Software, *Fighting Fraud in Banking with Big Data and Analytics* (Oct. 2014), discussed in Literature Review: *Reducing “False Positive” Determinations in Fraud Detection*, vol. 3, *infra*.

37 IBM Software, *Fighting Fraud in Banking with Big Data and Analytics* (Oct. 2014).

38 Deloitte, Chief Information Officer (CIO) News, CIO Insight and Analysis, WALL STREET JOURNAL, *The Latest Tools and Tactics for Battling Bank Fraud* 2 (May 1, 2014), <http://deloitte.wsj.com/cio/2014/05/01/the-latest-tools-tactics-for-battling-bank-fraud/>.

39 Craig Priess, *Behavioral Analytics for Detecting Fraud* 2 (Mar. 18, 2015), <https://www.bai.org/banking-strategies/article-detail/behavioral-analytics-for-detecting-fraud>.

- *Transaction Analytics*: This technique allows financial institutions to analyze their customers' detailed transaction data over time to gain an understanding of purchasing patterns and behaviors.⁴⁰
- *Anomaly Analytics*: This analytical technique is focused on detecting inconsistencies with previously demonstrated “normal” patterns of behavior.⁴¹

Although the IRS uses some of these analytic techniques in its fraud detection systems, its systems still have limitations, such as their inability to share information with one another, essentially only allowing these systems to operate in a vacuum. Therefore, the IRS should continue and enhance its collaboration with experts in the financial industry, including the Federal Financial Institutions Examination Council (FFIEC),⁴² to identify necessary elements of a robust fraud detection system and learn from private sector and other tax administration experiences to establish best practices for its fraud detection programs. A good example of IRS's collaboration with states and industry partners is the IRS Security Summit.⁴³

The National Taxpayer Advocate commends the IRS for its involvement in the Security Summit, but encourages the IRS to leverage private partnerships to a greater extent, to identify industry standards for designing and implementing fraud detection systems that are modern and effective. Additionally, the IRS should establish partnerships with other government agencies, such as the Defense Intelligence Agency, that use data mining and risk detection in an effort to learn more about successful government systems and processes.

IRS's Outdated Systems That Generate High FPRs Result in a High Price for Both Taxpayers and the IRS

IRS Systems with High FPRs Harm Legitimate Taxpayers by Significantly Delaying Their Refunds and Entangling Them in an IRS System That Is Challenging to Navigate

The high FPRs set out above result in thousands of taxpayers with legitimate returns being subjected to a frustrating and often elusive process. If the IRS is scrutinizing the return for possible identity theft, the taxpayer will likely be instructed to contact the IRS's dedicated TPP line, which had a Level of Service (LOS) of 31.7 percent for fiscal year (FY) 2016 and a wait time of almost 11 minutes.⁴⁴ If the taxpayer's return was being scrutinized for refund fraud, the taxpayer would call into Accounts Management, which had a LOS of 53.4 percent for FY 2016 and a wait time of almost 18 minutes.⁴⁵ If a taxpayer tries to get

40 Dean Nolan, *Combating Fraud with Transaction Analytics* (Apr. 2, 2014), <https://www.bai.org/banking-strategies/article-detail/combating-fraud-with-transaction-analytics>.

41 The power of anomaly detection lies in the fact that it doesn't matter how the account is compromised - whether it's a Trojan or other malware, stolen credentials, or social engineering through customer service — the suspicious behavior relative to established norms is what provides a clue or signals that something is amiss. Guardian Analytics, *Best Practices for Detecting Banking Fraud*, 2013, http://www.cbai.com/news/Best_Practices_for_Detecting_Fraud_white_paper.pdf. For a more in depth discussion about how private industry has leveraged modern technology to detect and prevent identity theft and fraud, see Literature Review: *Reducing “False Positive” Determinations in Fraud Detection*, vol. 3, *infra*.

42 The Federal Financial Institutions Examination Council, <https://www.ffiec.gov/>.

43 See IRS, *Security Summit Partners Update Identity Theft Initiatives for 2017*, FS-2016-21, June 2016, <https://www.irs.gov/uac/security-summit-partners-update-identity-theft-initiatives-for-2017> (last visited Dec. 31, 2016). The IRS Security Summit allows partners to identify possible identity theft (IDT) schemes and report them to the IRS and state partners to help them stay on top of emerging schemes; increases public awareness about the need for computer security and to provide people with tips on how to protect their personal information; and it also established seven workgroups for 2017, including authentication, financial services, lead reporting & information sharing, supporting the filing season 2017, tax professional, Strategic Threat Assessment & Response, and Communications subgroups.

44 IRS, Joint Operations Center (JOC), *TPP Snapshot Reports* (FY 2016).

45 IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016; report generated Nov. 30, 2016).

Private sector research shows customers who are subjected to false positives are likely to take their business and go elsewhere ... Unlike customers making a purchase, taxpayers have little choice other than interacting with the IRS. However, taxpayers may be discouraged by the experience of having their returns improperly delayed, increasing the likelihood that they will disengage from their dealings with the IRS in the future.

information from the “Where’s My Refund” application, he or she will receive a generic message prompting a call to the IRS.

Even if the taxpayer does reach a customer service representative (CSR), he or she will find the CSR does not have access to the EFDS histories and cannot give specific responses to taxpayer inquiries.⁴⁶ CSRs take down information and refer it to the IWV group in IVO. IVO, however, does not call back or correspond with a taxpayer based on the referral from a CSR. If the information forwarded by the CSR is not verifiable, IVO will simply close out the referral on an Account Management Services application, without contacting the taxpayer.⁴⁷

Not only can scrutinizing a legitimate return unnecessarily subject taxpayers to a frustrating process, but it may also create a significant financial strain. For example, a delay of more than a month could pose severe consequences for a taxpayer who was relying on the refund to assist with medical expenses, rent, heating, or other necessary living expenses.

High FPRs Also Increase Direct and Indirect Costs for the IRS

High FPRs also come at a cost to the IRS and are a drain on the IRS’s limited resources.⁴⁸ Commentators believe that in the private sector false positives cost businesses more than the actual fraud.⁴⁹ For example, when a taxpayer’s return is incorrectly identified by one of its fraud detection or identity theft systems, the IRS may have to send letters and notices to the taxpayer, have IRS employees authenticate a taxpayer’s identity at a Taxpayer Assistance Center, or consider taxpayer correspondence. Additionally, when a taxpayer’s issue still cannot be resolved, the taxpayer may decide to come to TAS, incurring yet another downstream cost that could be mitigated by reducing FPRs.⁵⁰

High FPRs not only come with a significant monetary cost, but they also have a detrimental impact on employee engagement. For example, research shows that the second problem with high FPRs is how it

46 IRM 21.5.6.4.35.3 (Oct. 1, 2016).

47 Integrity and Verification Operation (IVO) does not correspond with a taxpayer based on a referral from a customer service representative. To the contrary, if it is just a refund status inquiry not associated with any verifiable information, IVO employees will just close out the referral on Account Management Services. IRM 25.25.5.2 (July 15, 2016); IRM 25.25.5.4 (Dec. 10, 2015); IRM 25.25.5.4.1 (May 17, 2016).

48 Financial industry experts see a direct correlation between high FPRs and the increased cost of fraud prevention. “As rates rise, fraud prevention requires more labor and becomes more expensive. Indeed, at very high rates, prevention becomes so costly that — from a purely economic view — it could be cheaper simply to let fraud occur.” See Gregg S. Henzel *et al.*, *Using Model Calibration and Optimization to Reduce Fraud Risk: How Financial Institutions Can Identify Fraud More Effectively While Reducing Costs* 3-4 (Crowe Horwath 2015), <https://www.crowehorwath.com/folio-pdf/Using-Model-Calibration-and-Optimization-to-Reduce-Fraud-Risk-Article-RISK-16007-008A.pdf>.

49 See, e.g., Steven Overly, *Artificial Intelligence in Credit Cards Saves You From Faux-Fraud Stupidity*, WASH. POST, A9, Dec. 12, 2016 (“MasterCard estimates that \$118 billion in sales were declined due to falsely identified fraud in the United States in 2014 — well more than the \$9 billion lost to actual instances of fraud.”); SecuredTouch, *Fraud Losses and False Positives: The Numbers* 7 (Dec. 2015), <http://securedtouch.com/fraud-losses-and-false-positives-the-numbers>. (“For example, sales that were blocked by the credit card companies’ fraud detection systems amounted to \$118 billion in 2014, while the cost of real card fraud only amounted to \$9 billion for the same year.”).

50 For FY 2016, TAS received 7,160 cases with TPP issues which had a relief rate of 78.7 percent; 41,819 cases with identity theft issues which had a relief rate of 69 percent; and 29,174 cases with Pre-Refund Wage Verification issues with a relief rate of 80.8 percent. Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2016).

affects the engagement level of those analyzing the company's data for evidence of fraud. Research has shown that when FPRs start to climb above the ratio 25:1, employees know their next alert is unlikely to reveal fraud. Employee incentive to stay engaged lessens and morale erodes. In contrast, when false positives run 5:1, employees know that they are likely to potentially uncover another instance of fraud, thereby encouraging an engaged, focused, and efficient workforce.⁵¹

In addition to increased costs and eroding employee morale, high FPRs also threaten to negatively impact voluntary compliance. In fact, private sector research shows customers who are subjected to false positives are likely to take their business and go elsewhere. For instance, two-thirds of cardholders who were declined during an e-commerce (electronic) transaction or m-commerce (mobile) transaction reduced or stopped their patronage of the merchant following a false-positive decline, versus 54 percent for all declined cardholders.⁵² Unlike customers making a purchase, taxpayers have little choice other than interacting with the IRS. However, taxpayers may be discouraged by the experience of having their returns improperly delayed, increasing the likelihood that they will disengage from their dealings with the IRS in the future. A choice to stop engaging could be met with penalties, but it also means a loss of a compliant taxpayer for the IRS.

CONCLUSION

The National Taxpayer Advocate recognizes the need to detect and prevent refunds resulting from fraud or identity theft from being issued. However, this objective must be accomplished while respecting and protecting the taxpayer's *right to a fair and just tax system*, meaning the IRS is obligated to design and implement systems that impact as few legitimate taxpayers as possible. Currently, the IRS systems and processes are largely out of step with private industry's accepted fraud and identity theft detection, and prevention systems and processes because real time adjustments to IRS systems are bogged down by established processes. This creates high FPRs, which compromises a taxpayer's *right to be informed*, and *to finality*, and also drains IRS resources, erodes employee morale, while damaging voluntary compliance.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Establish aspirational FPR goals and a schedule to meet them.
2. Continue to build, maintain, and improve private-public partnerships to implement techniques to fight fraud.
3. Establish relationships with other government agencies that use data mining and risk detection systems to learn better techniques for lowering false positive rates.
4. Create a real time governance board to adjust filters and include TAS on this board.

51 Gregg S. Henzel et al., *Using Model Calibration and Optimization to Reduce Fraud Risk: How Financial Institutions Can Identify Fraud More Effectively While Reducing Costs* 3-4 (Crowe Horwath 2015), <https://www.crowehorwath.com/folio-pdf/Using-Model-Calibration-and-Optimization-to-Reduce-Fraud-Risk-Article-RISK-16007-008A.pdf>.

52 Riskified and Javelin, *Overcoming False Positives: Saving the Sale and the Customer Relationship* 4 (Sept. 2015).

**MSP
#10****TIMING OF REFUNDS: The Speedy Issuance of Tax Refunds Drives Refund Fraud and Identity Theft, As More Research Is Needed on the Costs and Benefits of Holding Refunds Until the End of the Filing Season****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*

DEFINITION OF PROBLEM

The IRS processes in excess of 150 million tax returns each year and issues refunds to taxpayers in about 70 percent of the returns received.² Although the IRS prides itself in delivering 90 percent of refunds in less than 21 days,³ many countries deliver tax refunds more quickly than the IRS is able to do. For example, the Organisation for Economic Co-operation and Development (OECD) found that Estonia processed 100 percent of its tax returns with refunds within five working days and Canada delivered 100 percent of its e-filed refunds within 1.6 weeks.⁴

With the average refund amount being nearly \$2,800,⁵ delays in processing the refund can cause significant hardship to taxpayers who rely on this refund. The IRS states that this lag time is needed to fully verify the validity of the items reported on the income tax return against the information returns submitted by employers and other third parties. Even with this 21-day delay, the IRS is still susceptible to identity theft and other refund fraud. In a 2015 report issued by the Treasury Inspector General for Tax Administration (TIGTA), TIGTA found that although the IRS's fraud detection efforts were able to stop between \$22 billion and \$24 billion of false refunds from being issued, identity thieves were still able to successfully defraud the government — and taxpayers, collectively — out of approximately \$5.75 billion in the 2013 filing season.⁶

The speed with which a tax agency issues refunds requires the balancing of two compelling interests. That is, there is an inherent tension between the need to get refunds out to taxpayers quickly and the need to protect against refund fraud. Whether the delay should be a couple of weeks, or whether the IRS should not issue refunds until the filing season officially ends, requires careful consideration.

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>.

3 <https://www.irs.gov/Refunds/What-to-Expect-for-Refunds-This-Year>.

4 Organisation for Economic Co-operation and Development (OECD), *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*.

5 <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>.

6 Treasury Inspector General for Tax Administration, Ref. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2* (Apr. 24, 2015).

ANALYSIS OF PROBLEM

Because Congress has chosen to deliver many social benefit programs through the tax system, and because the IRS has done a good enough job of delivering the resulting tax refunds timely, a cultural phenomenon has developed — many U.S. taxpayers now have an expectation that they will receive a sizable refund shortly after the beginning of each tax filing season. The IRS expects more than 70 percent of taxpayers to get a tax refund after they file.⁷

FIGURE 1.10.1⁸

Taxpayers Receiving Refunds by Income Level

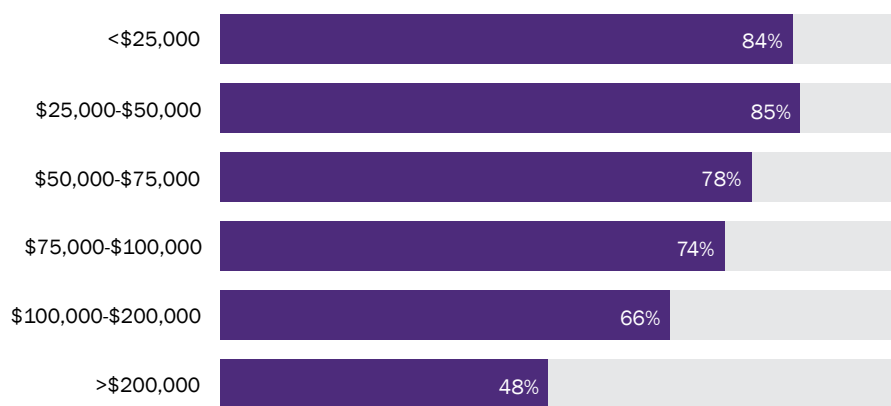


FIGURE 1.10.2, Average Refund Issued by Income Level⁹

	<\$25,000	\$25,000-\$50,000	\$50,000-\$75,000	\$75,000-\$100,000	\$100,000-\$200,000	>\$200,000
Average Refund (of Those Who Got a Refund)	\$2,056	\$2,618	\$2,722	\$3,246	\$4,310	\$15,437
Average Refund/Average Total Positive Income	16%	7%	4%	4%	3%	4%

There are various reasons why one would, in essence, give the government an interest-free loan by choosing to be owed a refund. Some taxpayers have a strong desire to avoid uncertainty or to avoid any chance of underpayment of taxes; others may simply enjoy the psychological benefits of looking forward to getting a large refund each year.¹⁰ One thought is that taxpayers “perceive emotional benefits

7 <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-Ause-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>.

8 Total positive income data from tax year (TY) 2015 Forms 1040 was used to create this chart (data compiled Nov. 10, 2016).

9 *Id.*

10 See Donna D. Bobek and Kristin Wentzel, *An Investigation of Why Taxpayers Prefer Refunds: A Theory of Planned Behavior Approach*, JOURNAL OF THE AMERICAN TAXATION ASSOCIATION (Mar. 2008).

(e.g., enjoyment of refund check, reduced anxiety) from over-withholding that equal or offset the financial costs.”¹¹

Some taxpayers seem to view the tax system as a “forced savings” mechanism, preferring to overfund their tax withholding to ensure that they receive a lump sum refund when they file their tax return.¹² Researchers have found that as refund timing changes, savings and spending patterns change. In one study, respondents receiving a hypothetical lump-sum tax refund saved more (spent less) than those receiving the same amount, but on a monthly basis.¹³

Other taxpayers receive a significant refund as a result of being eligible for refundable credits, such as the Earned Income Tax Credit (EITC), which are payable only through a lump sum after filing. These taxpayers might not have the opportunity to adjust their withholding enough to eliminate their tax refund.

The Protecting Americans from Tax Hikes Act (PATH Act) Will Delay Refunds for Certain Taxpayers Starting in 2016

Section 201 of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) that was enacted December 18, 2015, requires the IRS to hold all refunds that include EITC or the Additional Child Tax Credit (ACTC) until February 15 for calendar year filers to allow the IRS more time to verify the validity of the refunds and detect fraud. This will delay the issuance of refunds to early filers who have EITC and ACTC claims, causing a significant burden on households that rely on tax refunds to pay bills. Delaying the issuance of the EITC or ACTC until February 15 will significantly impact taxpayers whose refunds represent a significant portion of their yearly income (see Figure 1.10.2, above).

The PATH Act also changes the due date for employers and payors to submit wage information (Form W-2) and non-employee compensation (Form 1099-MISC) to the Social Security Administration. The deadline to file these information returns has been moved up to January 31 from the end of February (if filing on paper) or the end of March (if filing electronically). The new accelerated deadline will make it easier for the IRS to spot errors on returns and verify the legitimacy of tax returns before issuing refunds.

States and Foreign Countries Are Combating Refund Fraud by Delaying Refund Issuance or Accelerating Information Reporting

Some states (including Illinois, Louisiana, and Utah) are beginning to push back the date they issue tax refunds.¹⁴ By delaying the issuance of refunds, these states can enhance their efforts to prevent tax-related refund fraud.

In the United Kingdom, Her Majesty’s Revenue and Customs (HMRC) engaged extensively with employers, software developers, agents, and other interested parties to design a Real Time Information

11 When paid in a lump sum annually, \$243 (81 percent) of the \$300 refund and \$487 (also 81 percent) of \$600 would be saved, vs. \$108 (36 percent) and \$180 (30 percent) saved, respectively, with monthly refunds. See Donna D. Bobek and Kristin Wentzel, An Investigation of Why Taxpayers Prefer Refunds: A Theory of Planned Behavior Approach, *JOURNAL OF THE AMERICAN TAXATION ASSOCIATION* (Mar. 2008).

12 Valerie Chambers & Marilyn Spencer, Does Changing the Timing of a Yearly Individual Tax Refund Change the Amount Spent vs. Saved?, *JOURNAL OF ECONOMIC PSYCHOLOGY* 29 (2008) 856-62.

13 *Id.*

14 See <http://www.dontmesswithtaxes.com/2016/01/state-tax-refunds-to-be-delayed-in-illinois-louisiana-utah-because-of-tax-identity-theft-procedures.html> (last visited Nov. 18, 2016); Ann Carrns, *State Tax Refunds May Be Delayed by Security Precautions*, *N.Y. TIMES* (Jan. 15, 2016), http://www.nytimes.com/2016/01/16/your-money/state-tax-refunds-may-be-delayed-by-security-precautions.html?_r=0.

reporting of income tax information from employers, starting in 2013.¹⁵ Such an arrangement gives HMRC an early start in examining “Pay-As-You-Earn”¹⁶ income tax information in real time, well ahead of the filing season.

Do the Benefits of Reducing Improper Payments Outweigh the Costs of Delaying Refunds?

With tax refund fraud becoming a significant problem, costing taxpayers billions of dollars each year, it may make sense for the IRS to delay the issuance of tax refunds while it verifies taxpayer-reported data. If the IRS held off issuing refunds until the end of the filing season, it would have an opportunity to validate return information using Form W-2 data, check for duplicate dependency exemption claims, reconcile child support and alimony reporting, and conduct Automated Underreporter matching, enabling it to process error-free returns and deliver accurate refunds.¹⁷ The IRS should quantify the compliance impact of administering these programs in real time. Once it does, the IRS would be much better positioned to determine whether delaying the issuance of refunds by a couple of months will be justified, after balancing it against the very real financial impact of the delay on taxpayers, particularly low income taxpayers.

Participants in the 2016 IRS Nationwide Tax Forum focus groups cautioned that changing their clients’ mindsets and expectations about the timing of refund delivery would be difficult.¹⁸ Focus group participants reported that taxpayers who claim EITC often depend on their tax refunds for utility bill payments, car repair expenses, property taxes, tuition, and other bills they may have been holding off paying until the tax filing season. With their clients’ urgent need for the refunds, practitioners felt it would take quite a bit of time to change behavior. Thus, in conducting its study of the implications of delayed refunds, the IRS should consider a staged approach, rolled out over several years. In that regard, the February 15 refund date for EITC and ACTC returns will provide the IRS valuable information about the effect of delayed refunds on the most vulnerable taxpayer population.

CONCLUSION

The OECD reminds us that tax refunds “represent a cost to taxpayers in terms of ‘the time value of money’... Any delays in refunding legitimately overpaid taxes may therefore result in significant ‘costs’ to taxpayers, particularly where there are inadequate provisions in tax laws for the payment of interest to taxpayers with respect to delayed refunds.”¹⁹ Accordingly, the IRS should carefully weigh the cost of delaying the issuance of refunds to taxpayers who may have grown reliant on such refunds being issued a few weeks after tax filing.

15 Her Majesty’s Revenue and Customs, *Real Time Information (RTI): Improving the Operation of Pay As You Earn* (Dec. 17, 2014), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388103/RTI-TIIN.pdf.

16 Under a Pay-As-You-Earn (PAYE) system, such as the one widely used in the United Kingdom, a country collects taxes on items including wages, dividends, and other earnings directly from the payor of that income at the time the income is earned. For more discussion about PAYE systems, see Research Study: *A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems as a Mechanism for Simplifying and Improving U.S. Tax Administration*, vol. 2, *infra*.

17 These procedures, however, raise significant taxpayer rights concerns if not properly administered. See Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical As the IRS Develops an Online Taxpayer Account System*, *supra*, for more detailed discussion.

18 TAS, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Timing of Refunds* (Nov. 2016).

19 Organisation for Economic Cooperation and Development (OECD), *Tax Administration 2015: Comparative Information on OECD and Other Advanced and Emerging Economies*, http://www.keepeek.com/Digital-Asset-Management/oced/taxation/tax-administration-2015_tax_admin-2015-en#.V8iLK7DVzIU#page1.

RECOMMENDATION

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, initiate a research study on the potential savings to the government from reducing improper payments and the potential impact to taxpayers, particularly low income taxpayers, if refund issuance is delayed until after the filing season.

MSP #11 PAYMENT CARDS: Payment Cards Are Viable Options for Refund Delivery to the Unbanked and Underbanked, But Security Concerns Need to Be Addressed

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*

DEFINITION OF PROBLEM

As the nation's tax administrator, the IRS is responsible for processing approximately 150 million tax returns each year, issuing refunds to taxpayers in about 70 percent of the returns received.² According to IRS estimates, it costs more than \$1 per refund check issued compared to only ten cents for each direct deposit made.³ In addition to the cost savings, the use of direct deposit saves time — taxpayers who use direct deposit should be able to access their refund within one to five days after their return is processed, compared with waiting several weeks for paper checks to arrive in the mail.⁴

Even those without bank accounts can elect to receive their refunds via direct deposit. With over 68 million adults in the U.S. either unbanked⁵ or “underbanked,”⁶ taxpayers can request that the IRS load their tax refund onto a reloadable debit card, rather than to a conventional bank account.

However, the convenience offered by the IRS delivering refunds via such payment cards (which we will refer to as “prepaid debit cards”) comes at a cost — in the form of refund fraud. Because the IRS receives little information about the owner of the prepaid debit card (compared to a traditional savings or checking account), identity thieves and perpetrators of refund schemes may opt to avoid detection by

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 IRS, *IRS Ready to Start 2016 Tax Season; Encourages Use of IRS.gov and e-File; Works with States, Industry on Identity Theft Refund Fraud*, <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>.
- 3 IRS, *Direct Deposit Your Refund*, www.irs.gov/individuals/get-your-refund-faster-tell-irs-to-direct-deposit-your-refund-to-one-two-or-three-accounts (last visited Sept. 15, 2016).
- 4 IRS, *IRS Ready to Start 2016 Tax Season; Encourages Use of IRS.gov and e-File; Works with States, Industry on Identity Theft Refund Fraud*, <https://www.irs.gov/uac/Newsroom/IRS-Ready-to-Start-2016-Tax-Season-Encourages-use-of-IRS-gov-and-e-File-Works-with-States,-Industry-on-Identity-Theft-Refund-Fraud>; IRS, *2016 Tax Season Refund Frequently Asked Questions*, <https://www.irs.gov/refunds/tax-season-refund-frequently-asked-questions>.
- 5 50.9 million “unbanked” households do not have an account at an insured institution. Federal Deposit Insurance Corporation (FDIC), *2013 FDIC National Survey of Unbanked and Underbanked Households* 4 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.
- 6 16.7 million “underbanked” households have used at least one of the following alternative financial services from non-bank providers in the last 12 months: money orders, check cashing, remittances, payday loans, refund anticipation loans, rent-to-own services, pawn shop loans, or auto title loans. FDIC, *2013 FDIC National Survey of Unbanked and Underbanked Households* 4 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.

requesting refunds via prepaid debit cards. By the time the IRS learns of the refund fraud, the money is already loaded onto prepaid debit cards, leaving the IRS with little chance of recouping those funds.

We will explore the advantages and disadvantages of the IRS issuing tax refunds to taxpayers via prepaid debit cards.

ANALYSIS OF THE PROBLEM

The IRS Allows Taxpayers to Load Refunds onto Prepaid Debit Cards

As noted above, a large segment of the U.S. population is unbanked or underbanked. For those without bank accounts, a prepaid debit card is a faster, more secure way to get a tax refund than to request a paper check (which may get lost or stolen). Prepaid debit cards have become disproportionately used by the unbanked and underbanked communities and can be used to pay bills, withdraw cash at ATMs, make purchases, deposit checks, and receive direct deposits. A recent study published by the Federal Deposit Insurance Corporation (FDIC) found that while only eight percent of all households used prepaid debit cards in the last 12 months, unbanked households had the highest rate of use (22.3 percent), compared with underbanked households (13.1 percent) and fully-banked households (5.3 percent).⁷

In 2011, the Department of Treasury conducted a pilot program in which it offered selected taxpayers the option to receive their tax refunds in the form of a government-sponsored debit card.⁸ The Urban Institute evaluated the results of the pilot program and found that a government-sponsored debit card could benefit both the government (reducing the cost of delivering refunds) and the taxpayers, making it faster, safer, and more reliable to access tax refunds, as well as providing a way for low and moderate-income taxpayers to access mainstream financial services.⁹ The Urban Institute did note one key design flaw that may have impacted the uptake rate — pilot participants were prohibited from using the debit card to pay for tax preparation fees, which likely made this card less attractive to taxpayers who could not afford to pay \$150 to \$400 out of pocket for preparation fees.¹⁰

The Department of Treasury now requires that all federal benefit payments be delivered electronically, and recommends that those without a bank account use the Direct Express debit card (which is issued by Comerica Bank).¹¹ For example, the Social Security Administration (SSA) promotes the use of electronic payment to deliver Social Security or Supplemental Security Income benefits. Social Security recipients no longer have the option to request a paper check. For those who do not have an account with a bank or credit union, the SSA offers the Direct Express debit card as a method of accessing benefits.¹²

7 FDIC, *2013 FDIC National Survey of Unbanked and Underbanked Households* 7 (Oct. 2014), <https://www.fdic.gov/householdsurvey/2013report.pdf>.

8 The Department of Treasury cited low participation rates in the pilot program. Eric Kroh, *Treasury Won't Renew Debit Card Refund Program in 2012, Spokesman Confirms*, TAX NOTES TODAY (Nov. 1, 2011). However, the design of the pilot may have caused the low participation. See National Taxpayer Advocate 2012 Annual Report to Congress 334.

9 Caroline Ratcliffe, Signe-Mary McKernan, Urban Institute, *Tax Time Account Direct Mail Pilot Evaluation* (Sept. 5, 2012), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/412623-Tax-Time-Account-Direct-Mail-Pilot-Evaluation.PDF>.

10 *Id.*

11 See *Frequently Asked Questions*, <https://fiscal.treasury.gov/godirect/about-faq/> (last visited Oct. 17, 2016).

12 Social Security Administration (SSA), *How Do I Sign Up to Receive an Electronic Payment*, www.ssa.gov/deposit/howtosign.htm (last visited Sept. 20, 2016).

The IRS allows taxpayers to direct deposit up to three refunds to a single prepaid debit card (unaffiliated with Direct Express), meaning that taxpayers are able to take advantage of the direct deposit program even without a bank account.¹³ However, the Treasury-sponsored Direct Express debit card does not accept tax refund payments from the IRS at this time.¹⁴

The decision to exclude tax refunds from Direct Express cards is perplexing, given that the Earned Income Tax Credit (EITC) is one of the government's largest means-tested anti-poverty programs.¹⁵ If the EITC were administered outside of the tax system, the Department of Treasury would require this federal benefit to be paid electronically, and allow the use of Direct Express cards. With the EITC, however, taxpayers are left to pay for debit cards on the market, with no bargaining power like that which the federal government has for the Direct Express cards. This is an inconsistency that negatively impacts EITC participants.

The Use of Prepaid Debit Cards Can Be Costly for Both Taxpayers and the IRS

There are some substantial downsides to the use of prepaid debit cards to deliver tax refunds. First is the cost to the taxpayer. Taxpayers can incur numerous fees to enjoy the benefits of using prepaid debit cards. A prepaid debit card can feature an enrollment fee, a monthly maintenance fee, ATM withdrawal fees, ATM balance inquiry fees, and a fee to convert the remaining balance into a bank check, among others. The Consumer Financial Protection Bureau (CFPB) recently issued a rule (effective October 1, 2017) that will help ensure that consumers can make informed decisions when choosing and using prepaid cards and will better protect consumers' funds in prepaid cards in case of errors, loss, or theft.¹⁶ Figure 1.11.1 shows some of the fees charged by several prominent suppliers of prepaid debit cards.

13 IRS, *Direct Deposit Limits*, <https://www.irs.gov/individuals/direct-deposit-limits> (last visited Sept. 20, 2016).

14 See *Frequently Asked Questions*, <https://fiscal.treasury.gov/godirect/about-faq/> (last visited Oct. 17, 2016).

15 Congressional Budget Office (CBO), <https://www.cbo.gov/publication/43935> (last visited Nov. 21, 2016).

16 See Consumer Protection Financial Bureau (CFPB), <http://www.consumerfinance.gov/prepaid-rule/> (last visited Dec. 31, 2016).

FIGURE 1.11.1, Prepaid Debit Card Fees¹⁷

Prepaid Card Fees	Green Dot	Direct Express	Mango
Purchase Price	No purchase fee online. Up to \$4.95 in store.	\$0	\$0
Monthly Charge	Up to \$7.95. Waived in any monthly period when you have loaded at least \$1,000 or have at least 30 qualifying purchases posted to your account.	None	\$3.00
ATM Fee	None at MoneyPass® ATMs nationwide. At non-MoneyPass ATMs, \$2.50, plus any fees the ATM owner may charge.	One free withdrawal with each Federal Government deposit to your Card Account. Other ATM cash withdrawals \$0.85 each, plus any fees the ATM owner may charge.	\$2.00, plus any fees the ATM owner may charge.
Balance Inquiry	\$0.50 at non-MoneyPass ATMs	\$0	\$1.00
Reload Fee	Up to \$4.95	No information available	\$0 - your bank may charge a fee
Transfer Funds to U.S. Bank Account	Not allowed	\$1.50 each time	No information available
Teller Cash Withdrawal Fee	\$2.50	\$0	No information available
Foreign Transaction Fee	3%	3%	\$2.00
Foreign ATM	No information available	\$3.00 plus 3% of amount withdrawn	\$2.00 plus 2% of amount withdrawn
Replacement Card	\$4.95	\$4.00 after one (1) free each year	No information available
Customer Service Fee	No information available	\$0	\$0

Second, prepaid debit cards can be used to help facilitate refund fraud. According to the Treasury Inspector General for Tax Administration (TIGTA), the government is losing billions of dollars each year to tax refund fraud.¹⁸ With a traditional bank account, the IRS knows the name of the account holder and can order a refund trace from the Bureau of Fiscal Service to verify that a direct deposit went through.¹⁹ The use of prepaid debit cards may be appealing to perpetrators of tax refund fraud since no information other than a bank routing number and account number is required to request that a refund be loaded onto a prepaid debit card.

17 See <https://www.greendot.com/help>; https://www.usdirectexpress.com/how_it_works.html (the Treasury-recommended Direct Express® card is a prepaid debit card payment option for federal benefit recipients who don't have a bank or credit union account); <https://www.mangomoney.com/simple-fees>. There are 25,000 participating ATMs, including in 2,000 Walmart stores. <https://www.moneypass.com/business-services.html>.

18 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2*, 7 (Apr. 24, 2015).

19 A refund trace is the name of the process used to track a stolen, lost, or misplaced refund check and replace an authorized refund to the taxpayer. A refund trace may also be used to verify a direct deposit. Internal Revenue Manual (IRM) 21.4.2.2 (Oct. 1, 2016).

The IRS is unable to differentiate between a refund that is routed via direct deposit to a bank account and one that is routed to a prepaid debit card.²⁰ For this reason, the IRS cannot provide a reasonable estimate of how much of the billions lost in refund fraud were paid out via prepaid debit cards. There is anecdotal evidence that identity thieves prefer to use prepaid debit cards, presumably because there is very little useful information provided to the IRS about the owner of the prepaid debit card.²¹

The IRS should add “Direct Express” and “Other Payment Card” as an additional refund type options in the Refund section of each of the Form 1040 series.²² The IRS should also conduct a pilot, allowing refunds to be direct deposited to taxpayers with existing Direct Express cards, and compare the results with those who use a different prepaid debit card. Using this data, the IRS can be in a better position to analyze whether the use of prepaid debit cards to deliver refunds results in a higher rate of refund fraud, and test various ways the IRS could better validate the identity of the prepaid debit card holder.

The IRS Should Explore Using Payroll Cards to Deliver Refunds

Payroll cards are a subset of prepaid debit cards. Employers may load money onto payroll cards for employees who do not have bank accounts. Employers can save money by avoiding having to issue paper checks, and employees can get quick, convenient access to their funds.

Six million payroll cards were issued in 2014.²³ By 2019, an estimated 12.2 million workers will receive their wages via payroll cards, compared to only 2.2 million who will get paper checks.²⁴

Nineteen states already offer payroll card programs for their employees, as do many retailers in the private workforce, such as Walmart, Home Depot, Macy’s, and McDonalds.²⁵ The use of payroll cards to deliver tax refunds may be a viable option for the IRS.²⁶ Because the holder of a payroll card is an employee of a known company, the IRS will have reliable information about the recipient of the tax refund²⁷ — much more reliable information than it would have for an ordinary prepaid debit card. The IRS could work with the major providers of payroll services to educate employees of participating employers about the ease, convenience, and safeguards of requesting their federal tax refunds be direct deposited onto payroll cards.

20 IRS, Wage & Investment (W&I) response to TAS information request (Sept. 22, 2016).

21 IRS, *IRS’s Top 10 Identity Theft Prosecutions: Criminal Investigation Continues Efforts to Halt Refund Fraud*, IR-2016-45 (Mar. 21, 2016), <https://www.irs.gov/uac/Newsroom/IRSs-Top-10-Identity-Theft-Prosecutions-Criminal-Investigation-Continues-Efforts-to-Halt-Refund-Fraud>.

22 We appreciate that there is no room on the Form 1040 to insert additional lines. However, adding two checkboxes should not lengthen the form.

23 National Consumer Law Center, *Rating State Government Payroll Cards* 5 (Nov. 2015), <https://www.nclc.org/images/pdf/pr-reports/payroll-card-report.pdf>.

24 *Id.*

25 *Id.* at 1, 5.

26 See SOLE Paycard, *5 Reasons to Direct Deposit Your Tax Return onto Your SOLE Visa Payroll Card* (Nov. 18, 2015), www.solepaycard.com/company/news/direct-deposit-tax-return-sole-visa-payroll-card.

27 The Protecting Americans from Tax Hikes Act of 2015 (PATH Act) that was enacted Dec. 18, 2015, changes the due date for submitting wage information (Form W-2) and non-employee compensation (Form 1099-MISC) to the Social Security Administration. Starting in 2017, the deadline to file these information returns has been moved up to January 31, enabling the IRS to spot errors on returns and verify the legitimacy of tax returns much earlier in the filing season.

The IRS Should Consider How Other Federal and State Agencies Deliver Benefits and Subsidies

The IRS should consider how other federal and state agencies are delivering payments of benefits and subsidies. Some states give taxpayers the option of receiving state tax refunds on prepaid debit cards issued directly from the state.²⁸ As administrators of the prepaid debit cards, the states presumably will have more information about the cardholder than if the taxpayer used a third-party debit card.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Participate in a government-sponsored prepaid debit card program (such as Direct Express) offered at no cost to taxpayers.
2. Add “Direct Express” and “Other Payment Card” as additional refund type options in the Refund section of each of the Form 1040 series.
3. Conduct a pilot comparing the refund fraud rate of refunds delivered to the Direct Express card versus non-government-sponsored prepaid debit cards.
4. Work with large employers and major providers of payroll services to conduct a pilot evaluating the efficacy of using payroll cards to deliver federal tax refunds.

²⁸ See BankRate.com, *Should Your Tax Refund Go on a Prepaid Card?*, <http://www.bankrate.com/finance/taxes/tax-refund-on-prepaid-card-1.aspx> (last visited Sept. 20, 2016).

MSP
#12**PRIVATE DEBT COLLECTION (PDC): The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship****RESPONSIBLE OFFICIALS**

William Wilkins, Chief Counsel

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to Confidentiality*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

In 2006, when the IRS began using private collection agencies (PCAs) to collect delinquent tax debt, the National Taxpayer Advocate identified the practice as a serious threat to taxpayer rights.² The private debt collection (PDC) program did not meet IRS expectations or those of Congress, and the IRS discontinued the program in 2009.³ In 2015, however, Congress enacted legislation that requires the IRS

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 See National Taxpayer Advocate 2006 Annual Report to Congress 34-61, 458-462 (Most Serious Problem: *True Costs and Benefits of Private Debt Collection* and Legislative Recommendation: *Repeal Private Debt Collection Provisions*); National Taxpayer Advocate 2005 Annual Report to Congress 76-93 (Most Serious Problem: *Training of Private Debt Collection Employees*).
- 3 *IRS Conducts Extensive Review, Decides Not to Renew Private Debt Collection Contracts, IRS Employees More Flexible, More Cost Efficient* (Mar. 5, 2009), <https://www.irs.gov/uac/irs-conducts-extensive-review-decides-not-to-renew-private-debt-collection-contracts>; The Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, Div. D, Title I, § 106, 123 Stat. 524, 636 (providing that none of the funds made available in the Act could be used to fund or administer IRC § 6306 debt collection activities by private collection agencies (PCAs)). For a comprehensive analysis of the earlier Private Debt Collection (PDC) program, see National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 97 (Research Study: *The IRS Private Debt Collection Program: A Comparison of Private Sector and IRS Collections While Working the Private Collection Agency Inventory*). See Letter from Nina Olson, National Taxpayer Advocate, to Sen. Ron Wyden, Chairman, Committee on Finance; Sen. Orrin G. Hatch, Ranking Member, Committee on Finance; Rep. Dave Camp, Chairman, Committee on Ways and Means; Rep. Sander Levin, Ranking Member, Committee on Ways and Means; Rep. Charles W. Boustany, Jr., Chairman, Subcommittee on Oversight, Committee on Ways and Means; Rep. John Lewis, Ranking Member, Subcommittee on Oversight, Committee on Ways and Means (May 13, 2014) (National Taxpayer Advocate May 13, 2014 letter to Members of Congress).

to assign certain delinquent tax accounts to PCAs.⁴ The IRS plans to begin assigning delinquent taxpayer accounts to PCAs in Spring 2017.⁵ The National Taxpayer Advocate believes the IRS, in implementing the congressionally-mandated PDC program, could have achieved a better balance between conserving resources and protecting taxpayer rights. However, she acknowledges that the IRS has been forced to make difficult decisions as it developed procedures for assigning accounts to PCAs.

Over the last year, the National Taxpayer Advocate and her staff have negotiated with the IRS about proposed plans to implement the PDC program in ways that are arguably inconsistent with the law and taxpayer rights. Among other proposals, the IRS has considered:

- Assigning to PCAs the accounts of recipients of Social Security Disability Income (SSDI) benefits, who are subject to income limitations and whose recent returns showed median income of \$14,350;⁶
- Assigning to PCAs the accounts of taxpayers who receive Supplemental Security Income (SSI), which averaged \$539 per month and is not available to taxpayers who have more than \$2,000 in assets; the average household income for recipients of SSI was estimated to be no more than \$684 in May 2013;⁷
- Allowing PCAs to offer taxpayers installment agreements (IAs) that exceed five years — notwithstanding a statutory provision that authorizes PCAs to offer IAs for a period “not to exceed 5 years” — and monitor and receive commissions on payments made pursuant to those IAs;
- Allowing PCAs to solicit “voluntary” payments from taxpayers that do not satisfy the liability in full and are not made pursuant to an IA, despite the absence of any statutory language authorizing PCAs to request voluntary or partial payments;
- Not systemically preventing accounts of taxpayers who currently have a case pending in TAS from being assigned to PCAs; and
- Not recalling accounts assigned to PCAs when the taxpayers request assistance from TAS.

4 Fixing America’s Surface Transportation Act, Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-36 (2015) (FAST Act).

5 IRS, *Private Debt Collection* (Sept. 26, 2016), https://www.irs.gov/businesses/small-businesses-self-employed/private-debt-collection?_ga=1.43687392.413551195.1473171905.

6 IRS, Accounts Receivable Dollar Inventory (ARDI), Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), recent returns include those for tax year 2014 or later, data accessed Nov. 28, 2016.

7 Social Security Administration (SSA), Research, Statistics & Policy Analysis, *Monthly Statistical Snapshot, November 2016*, Table 3, https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/; SSA, *Social Security, A Guide to Supplemental Security Income (SSI) for Groups and Organizations* 11, 12, 16 (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-11015.pdf>; Government Accountability Office, GAO-16-674, *Supplemental Security Income, SSA Provides Benefits to Multiple Recipient Households but Needs System Changes to Improve Claims Management* 52, Table 10 (Aug. 2016).

While some of the above concerns have been resolved, many have not.⁸ Moreover, the IRS's planned implementation of the PDC program unnecessarily burdens taxpayers, particularly those in economic hardship:

- The IRS intends to assign to PCAs the accounts of low income taxpayers who receive Social Security Administration (SSA) or Railroad Retirement Board (RRB) retirement benefits, whose recent returns showed median income of \$19,000;⁹ and
- In assigning accounts to PCAs, the IRS does not consider the federal poverty level, which for a single person in 2016 was approximately \$11,880 and 65 percent of the least amount of the IRS's own allowable living expenses (ALEs) for a single person, which the IRS uses to determine, among other things, whether someone is able to provide for basic living expenses; 250 percent of the federal poverty level is approximately \$29,700.¹⁰

Among the National Taxpayer Advocate's additional concerns:

- PCAs are not required to return to the IRS accounts of taxpayers in economic hardship;
- The IRS does not require transparency of PCAs' calling scripts and training materials;
- The IRS will pay commissions on taxpayer remittances prompted by the initial contact letter from the IRS, rather than PCA action;
- The IRS does not plan to use Referral or Oversight units to facilitate IRS and taxpayer interaction with PCAs and provide oversight of PCAs; and
- Cases the IRS recalls from PCAs will not be worked to completion.

ANALYSIS OF PROBLEM

Background

In determining which tasks the IRS may lawfully assign to PCAs, the threshold question is whether the IRS's authority to outsource tax collection is spelled out primarily in Internal Revenue Code (IRC) § 6306 or whether the IRS has broader authority to outsource the collection of federal tax liabilities to PCAs for collection. This question is critical because IRC § 6306 is very specific and narrow in defining which collection activities the IRS may outsource. Therefore, if the IRS does not have broader authority to refer the collection of federal tax liabilities to PCAs for collection, the IRS may contract with PCAs to do only what IRC § 6306 authorizes. If the IRS has broader authority, then it would be necessary to assess the sources of that additional authority.

Both the Bush administration, which proposed the authorities described in IRC § 6306, and the Congress, which enacted the law, believed the IRS did not have the authority to use PCAs — at least in dealing directly with taxpayers.

⁸ As discussed below, on December 15, 2016, the IRS agreed to exclude the accounts of Social Security Disability Income (SSDI) and Supplemental Security Income (SSI) recipients from Potentially Collectible Inventory, a statutory term discussed below; and to allow PCAs to receive only one voluntary payment from a taxpayer who cannot pay in full within five years.

⁹ IRS, Accounts Receivable Dollar Inventory (ARDI), Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), recent returns include those for tax year 2014 or later, data accessed Nov. 28, 2016, 2016.

¹⁰ U.S. Dept. of Health and Human Resources, *Poverty Guidelines* (Jan. 25, 2016), <https://aspe.hhs.gov/poverty-guidelines>. As discussed below, the least amount of Allowable Living Expenses (ALEs) the IRS would have allowed in 2016 was \$18,396.

In the Administration's fiscal year (FY) 2004 and 2005 Bluebooks, the "Current Law" section of its PDC proposal stated: "Federal tax liabilities generally must be collected by the IRS and cannot be referred to a private collection agency (PCA) for collection."¹¹

Similarly, the House-Senate conference committee report accompanying the American Jobs Creation Act stated: "In general, Federal agencies are permitted to enter into contracts with private debt collection companies for collection services to recover indebtedness owed to the United States [citing 31 U.S.C. § 3718, which authorizes agency heads to enter into contracts with PCAs]. That provision does not apply to the collection of debts under the Internal Revenue Code [citing 31 U.S.C. § 3718(f), which excludes from this authorization the collection of debts owed pursuant to the Internal Revenue Code]."¹² Thus, both the Administration and Congress believed IRC § 6306 was required to authorize the use of PCAs to collect Federal tax debts.

In light of the agreed position that the IRS could not use PCAs to collect Federal tax debts without congressional authorization, it follows that the IRS may only use PCAs to collect Federal tax debts to the extent authorized by Congress.

In 2004, Congress enacted IRC § 6306, which authorizes the IRS to enter into "qualified tax collection contracts."¹³ The term "qualified tax collection contract" is defined in relevant part as a contract "which is for the services of any person (other than an officer or employee of the Treasury Department)":

- (A) to locate and contact any taxpayer specified by the Secretary,
- (B) to request full payment from such taxpayer of an amount of federal tax specified by the Secretary and, if such request cannot be met by the taxpayer, to offer the taxpayer an installment agreement providing for full payment of such amount during a period *not to exceed 5 years*, and
- (C) to obtain financial information specified by the Secretary with respect to such taxpayer.¹⁴

In the conference report accompanying the law, Congress described how it expected collection activity pursuant to "qualified collection contracts" would unfold:

Several steps are involved in the deployment of private debt collection companies. First, the private debt collection company contacts the taxpayer by letter. If the taxpayer's last known address is incorrect, the private debt collection company searches for the correct address. Second, the private debt collection company telephones the taxpayer to request full payment. If the taxpayer cannot pay in full immediately, the private debt collection company offers the taxpayer an installment agreement providing for full payment of the taxes over a period of as long as five years. If the taxpayer is unable to pay the outstanding tax liability in full over a five-year period, the private debt collection company obtains financial information from the taxpayer and will provide this information to the IRS for further processing and action by the IRS.¹⁵

11 Dept. of the Treasury, *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals* 98 (Feb. 2003); Dept. of the Treasury, *General Explanations of the Administration's Fiscal Year 2005 Revenue Proposals* 151 (Feb. 2004).

12 American Jobs Creation Act, H. REP. NO. 108-755, at 740-41 (2004) (Conf. Rep.).

13 The American Jobs Creation Act of 2004, Pub. L. 108-357, Title VIII, § 881(a)(1), 118 Stat. 1418, 1625-27 (2004) (enacting IRC § 6306).

14 IRC § 6306(b)(1) (emphasis added).

15 H. REP. NO. 108-755, 1782 (2004) (Conf. Rep.).

The IRS intends to assign to private collection agencies the accounts of low income taxpayers who receive Social Security Administration (SSA) or Railroad Retirement Board (RRB) retirement benefits, whose recent returns showed median income of \$19,000.

At the time this proposal was developed, there was significant discussion about what constitutes an “inherently governmental” function that cannot be outsourced as opposed to a ministerial act that can be contracted out. Under the Federal Activities Inventory Reform Act of 1998, any activity that requires the “exercise of discretion in applying Federal Government authority” is “inherently governmental” and must be performed solely by Federal Government employees.¹⁶ When Congress enacted IRC § 6306 in 2004, the IRS generally did not perform a financial analysis when it accepted full payments or IAs not to exceed five years. In considering IAs longer than five years, collection alternatives such as offers in compromise or partial payment IAs, and requests to place a taxpayer’s account into Currently Not Collectible (CNC)-Hardship status, the IRS generally performed a financial analysis to determine the taxpayer’s ability to pay — an assessment that involved the exercise of discretion. By limiting PCAs to requesting full payments or offering taxpayers IAs providing for full payment during periods not to exceed five years and by requiring PCAs to obtain financial information from taxpayers in all other cases and providing it to the IRS for further processing and action, Congress was careful to authorize PCAs to perform activities that are clear-cut and don’t get into areas where discretion is typically exercised. The statute is unambiguous on its face in describing which activities PCAs are authorized to perform.¹⁷

In 2015, over the objections of the National Taxpayer Advocate and many others,¹⁸ Congress amended IRC § 6306 to *require* the IRS to enter into “qualified tax collection contracts” with respect to certain “inactive tax receivables.”¹⁹ In doing so, however, it did not make any changes to provisions described above that delineate the boundaries of what PCAs may do. In September 2016, the IRS entered into contracts with four PCAs to implement the PDC program according to procedures contained in the PCA Policy and Procedure Guide (PPG) which, in our view, provides authorization for the PCAs to take actions beyond the scope of what is authorized by IRC § 6306.²⁰

16 Federal Activities Inventory Reform Act of 1998 (FAIR), Pub. L. No. 105-270 § 5(2)(B) 112 Stat. 2382, 2384-2385.

17 In *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984), the Court set out a two-step process for the interpretation of regulations: “When a court reviews an agency’s construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.”

18 National Taxpayer Advocate May 13, 2014 letter to Members of Congress; see e.g., Joe Davidson, *Congress Could Make the IRS Use Private Bill Collectors for Your Taxes*, WASH. POST (Nov. 3, 2015) (describing a letter from 16 U.S. senators to congressional leadership voicing opposition to the proposed PDC program; efforts by 11 representatives to remove the provision from the Fixing America’s Surface Transportation (FAST) Act, and attributing opposition to the provision to the National Treasury Employees Union, the National Council of La Raza, and the National Consumer Law Center); Michael Cohn, *NCCPAP Opposes Plan for IRS Private Debt Collection*, ACCOUNTING TODAY (May 27, 2014) (describing opposition by the National Conference of CPA Practitioners).

19 FAST Act, Pub. L. No. 114-94, Div. C, Title XXXII, § 32102, 129 Stat. 1312, 1733-34, (2015) (adding subsections (c) and (h) to IRC § 6306).

20 IRS, *Private Debt Collection* (Sept. 26, 2016), https://www.irs.gov/businesses/small-businesses-self-employed/private-debt-collection?_ga=1.14327154.413551195.1473171905. Section III of the IRS’s contract with PCAs, *Performance Work Statement Tax Collection Services*, in § 3.4 provides: “Contractor shall conduct operations in compliance with the most current version of the PPG [PCA Policy and Procedure Guide].” Unless otherwise noted, references to the PPG are to the October 28, 2016 version.

Certain Aspects of the IRS's PDC Program Are Inconsistent With IRC § 6306

Section ten of the PPG describes three payment options PCAs may pursue in dealing with taxpayers. The first option is to request full payment of the liability (*i.e.*, full payment within 120 days), a course of action clearly authorized by IRC § 6306(b)(1). The second option, however, is available when the taxpayer cannot pay the liability within 120 days but can pay the tax *within the period of limitations on collection* (referred to as the collection statute expiration date or CSED).²¹ In that event, the PCA employee can offer the taxpayer an IA for a corresponding number of years.²² For example, under the current version of the PPG, if the CSED does not expire for eight years, the PCA may offer the taxpayer an eight-year IA. As discussed above, this provision is not authorized by the plain meaning of IRC § 6306(b)(1).

A third option is available when the taxpayer cannot pay the tax within 120 days or within the CSED. In that event, the current version of the PPG states the PCA employee will solicit “voluntary payments.”²³ This means the PCA, without offering an IA or securing any financial information for analysis by the IRS, may periodically contact the taxpayer and secure payments that do not resolve the account. This solicitation, and resulting partial payments, may continue indefinitely, as interest continues to accrue on the unpaid liability.²⁴ This practice of soliciting voluntary payments is a significant departure from the manner in which the IRS Collection function proceeds, described below, and violates taxpayers’ rights.²⁵ Moreover, as discussed below, it also goes beyond the statutory authority conferred by IRC § 6306.

Additionally, neither the current PCA contract nor the PPG authorizes PCAs to collect financial information from taxpayers, one of the required components of a “qualified tax collection contract.” Thus, it is arguable that the IRS’s contracts with PCAs do not constitute “qualified tax collection contracts” within the meaning of IRC § 6306(b)(1) because they do not contain one of the three statutorily specified components of such contracts.²⁶

21 The IRS must generally collect tax within ten years after assessment. See IRC § 6502.

22 PCA Policy and Procedures Guide (PPG) § 11, *PCA Payment Arrangements*. The PCA can offer IAs only where the amount of the assessed tax, penalties, and interest does not exceed \$100,000.

23 In contrast, PPG § 10.2.1, *Voluntary Payments*; PPG § 10.2.2, *Alternative Collection Resolution* provides that the PCA employee “should” inform the taxpayer that alternative collection resolutions (*e.g.*, offer in compromise) are available through the IRS at irs.gov.

24 As discussed below, many taxpayers whose accounts will be assigned to PCAs are already in economic hardship and may agree to make payments they cannot afford. See vol. 2 Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*; vol. 2 Research Study: *IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies*.

25 It is also a departure from procedures used in the prior PDC program. PPG § 11.9, *IA Beyond PCA Authority* (2008 version), included among arrangements the PCAs did not have authority to make: “Proposed IA [installment agreement] is for a time period beyond 60 months” and “IA will not result in full payment prior to the expiration of the CSED.” PPG § 11.9.3, (2008 version) provided: “Note: When an IA covering more than 60 months or an IA not providing for full payment by the CSED is accepted by the IRS, the case will be recalled by the IRS.”

26 In contrast, PPG § 11.9.1 *Collection Information Statement* (2008 version), provided: “[t]he PCA employee must attempt to secure financial information for an IA [installment agreement] with any of the following: ...The amount the taxpayer offers to pay will not pay the sum of the aggregate assessed balance due for each tax period within 60 months” or “IA will not result in full payment prior to the expiration of the CSED.”

Allowing PCAs to Solicit “Voluntary” Payments That Do Not Resolve the Liability Violates Taxpayers’ Rights and Is Not Authorized by Statute

Taxpayers who are able to full-pay their liabilities in either a lump-sum or an IA of up to six years ordinarily may do so without providing financial information that must be analyzed by an IRS Collection employee.²⁷ By contrast, an IRS Collection employee generally must become involved where a taxpayer cannot full-pay within that period. For example, if a taxpayer cannot pay any amount, can pay some amount less than the full liability over the CSED, or can full-pay the liability over a period longer than six or seven years, an IRS employee must determine whether the taxpayer should be placed into CNC-Hardship status²⁸ or approved for an offer-in-compromise,²⁹ a partial-payment IA,³⁰ or a non-streamlined IA.³¹ The appropriate resolution is made on the basis of the taxpayer’s financial information, and IRS Collection employees exercise discretion in arriving at the appropriate resolution. These IRS procedures support taxpayers’ *right to a fair and just tax system* by considering facts and circumstances that might affect their ability to pay.

IRS Collection employees are generally *not* free to simply solicit payments from a taxpayer other than as part of an overall plan to fully resolve the liability.³² Rather, they are expected to support a taxpayer’s *right to finality* by fully resolving the account. Taxpayers whose accounts are assigned to PCAs might well qualify for CNC-Hardship status or other collection alternatives, but PCAs have no incentive to provide details about collection alternatives and, despite a clear statutory requirement, the PPG makes no provision for the PCAs to collect financial information that might help taxpayers qualify for those alternatives.³³

27 IRS, *Streamlined Processing of Installment Agreements* (Nov. 10, 2016), https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements?_ga=1.48328931.413551195.1473171905. Approval of full-pay IAs of up to six years is generally automatic when the tax liability does not exceed \$50,000, and taxpayers may enter into them online without speaking with an IRS employee or providing their financial information. The IRS is testing streamlined processing for tax liabilities that do not exceed \$100,000 and can be full paid within seven years. Taxpayers seeking any IA must be current with their filing obligations. Internal Revenue Manual (IRM) 5.14.1.4.2, *Compliance and Installment Agreements* (Sept. 19, 2014).

28 See IRM 5.16.1.1, *Currently Not Collectible Overview* (Aug. 25, 2014); IRM 5.16.1.2.9, *Hardship* (Aug. 25, 2014). IRM 5.15.1.16, *Making the Collection Decision* (Nov. 17, 2014), (including among acceptable collection decisions the designation of accounts as CNC due to economic hardship).

29 See IRC § 7122; Treas. § Reg. 301.7122-1(b)(2), authorizing compromises where there is doubt as to collectability, which “exists in any case where the taxpayer’s assets and income are less than the full amount of the liability.”

30 See IRM 5.14.2.1, *Overview* (Mar. 11, 2011)(explaining that “[i]f full payment cannot be achieved by the Collection Statute Expiration Date (CSED), and taxpayers have some ability to pay, the Service can enter into Partial Payment Installment Agreements (PPIAs).”

31 See IRM 5.14.1.4, *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014).

32 For example, IRM 5.1.10.3.2 *Effective Initial Contact* (Feb. 26, 2016), in paragraph (7), provides: “If the case is not resolved during the initial contact, discuss a realistic plan for case resolution with the taxpayer, establish and document a plan for resolving the case, such as: full pay (FP) by a specified date, installment agreement (IA), etc. This plan may be updated when it changes. For example, a plan to resolve a case as CNC (hardship) may change to FP when significant assets and/or income are discovered.” Similarly, IRM 5.14.1.4, *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014) directs “If taxpayers do not qualify for Guaranteed, Streamlined or In-business Trust Fund Express installment agreements, determine a plan for resolving the balance due accounts based on the Collection Information Statement (CIS) and supporting documentation provided by the taxpayer (See IRM 5.1.10.3.2 and IRM 5.15). Note: In determining the most appropriate plan for resolving the balance due, consider actions that are least intrusive to the taxpayer and meets the need of the government for efficient collection of the tax, including viable payment options provided in IRM 5.14.1.4.1 or 5.14.2 to ensure the rights of the taxpayers are protected, IRM 5.1.10.7.1.3.”

33 As noted above, the PDC program actually violates eight of the ten taxpayer rights contained in the Taxpayer Bill of Rights.

Congress Did Not Intend to Allow PCAs to Solicit “Voluntary” Payments That Do Not Fully Pay the Liability and Are Not Made Pursuant to an Installment Agreement (IA)

Under the Federal Activities Inventory Reform Act of 1998 (FAIR Act), any activity that requires the “exercise of discretion in applying Federal Government authority” is “inherently governmental” and must be performed solely by Federal Government employees.³⁴ As discussed above, Congress designed the PDC program in a manner that authorized PCAs to perform only limited activities that do not involve the exercise of discretion. For example, to avoid placing PCAs in the position of working with taxpayers whose cases require financial analysis, and thus involve the exercise of discretion, Congress authorized the PCAs only to request full payment or IAs not to exceed five years, and, if the taxpayer says he or she cannot pay the liability in full within five years, to collect financial information from the taxpayer to be forwarded to the IRS for analysis.

The IRS’s Explanation of Why Questioned Procedures Are Permissible Is Unconvincing

TAS requested clarification from IRS Office of Chief Counsel about the apparent departures from the way Congress intended PCAs to proceed. Counsel confirmed that IRC § 6306 does not allow PCAs to offer IAs exceeding five years but stated:³⁵

The contract may, however, provide that, with IRS approval of a taxpayer’s request for an installment agreement of longer than five years, the PCA can retain the account to monitor compliance with the agreement for its entire term. The IRS and PCA may agree on compensation for the performance of these functions, whether as commission on each payment or on some other basis. Nothing in section 6306 would preclude such an arrangement.³⁶

Thus, according to IRS Chief Counsel, by “retaining” an account, a PCA may monitor payments made pursuant to an IA that could only have been organized and entered into by the IRS (or possibly, as discussed below, with assistance from TAS) and receive commissions on those payments.

As for soliciting “voluntary” payments as described above, IRS Chief Counsel notes simply that “there is nothing prohibiting the Service from authorizing a private debt collector to make such a solicitation.”³⁷ Accordingly, the current version of the PPG allows for both monitoring of IAs in excess of five years and acceptance of repeated voluntary payments from taxpayers who cannot pay within five years.

Counsel’s interpretation strikes us as a results-oriented end-run around the statute. The IRS has made clear that it is facing extraordinary resource constraints, that it would like the PCAs to do more without requiring IRS involvement, and that it is not asking the PCAs to collect financial information because it does not have the resources to review any such financial information. While we sympathize with the IRS’s position, resource constraints do not justify misapplying an act of Congress. If the PCAs do not collect

34 Pub. L. No. 105-270, § 5(2)(B) 112 Stat. 2382, 2384-2385 (1998) (providing that the term “inherently governmental function” means a function that is so intimately related to the public interest as to require performance by Federal Government employees.” The term includes “activities that require either the exercise of discretion in applying Federal Government authority or the making of value judgments in making decisions for the Federal Government, including judgments relating to monetary transactions and entitlements. An inherently governmental function involves, among other things, the interpretation and execution of the laws of the United States so as (i) to bind the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise; ... (iii) to significantly affect the life, liberty, or property of private persons.”

35 IRS Chief Counsel response to TAS information request (Nov. 17, 2016).

36 *Id.*

37 *Id.*

Counsel's interpretation strikes us as a results-oriented end-run around the statute. The IRS has made clear that it is facing extraordinary resource constraints, that it would like the private collection agencies (PCAs) to do more without requiring IRS involvement, and that it is not asking the PCAs to collect financial information because it does not have the resources to review any such financial information. While we sympathize with the IRS's position, resource constraints do not justify misapplying an act of Congress.

financial information, any IRS "approval" (to use Counsel's word) of an IA exceeding five years is simply a *pro forma* rubber stamp of a PCA request to offer a taxpayer a longer-term IA — which effectively ignores the statutory language that an IA offered by a PCA must be limited to a period "not to exceed five years."

Allowing PCAs to accept an unlimited number of "voluntary payments" would also constitute an end-run around the statute. The reputation of PCAs for hounding debtors is well documented, including through vast numbers of complaints to the Federal Trade Commission. By restricting PCAs to accepting lump-sum full payments or full payment IAs not to exceed five years, Congress limited the risk that U.S. taxpayers would be subject to endless calls. If a taxpayer agrees to the authorized payment terms, there will be no more calls. If the taxpayer says he or she cannot comply those payment terms, the statute and legislative history together make clear the PCA should take financial information and then forward the information to the IRS, so again there should be no more calls.

But if the IRS now allows PCAs to call taxpayers repeatedly to request partial "voluntary payments," the PCAs may be hounding taxpayers in a manner that Congress did not see fit to authorize. Moreover, the taxpayer will not have the benefit of closure, as he or she would have when dealing with an IRS employee, because an IRS employee can conduct a financial analysis and offer to compromise the debt or place it into uncollectible status if the facts warrant. This would undermine the taxpayer's *right to finality*.³⁸

On December 15, 2016, and again on December 21, 2016, the National Taxpayer Advocate met with the Commissioner of Internal Revenue and other IRS officials, raising her concerns about the appropriateness of these procedures. As a result of these meetings, the Commissioner agreed that PCAs may accept one voluntary payment if the taxpayer says he or she cannot pay in full or within five years, but offers to make a one-time payment toward the debt. The National Taxpayer Advocate applauds the Commissioner's decision, and she and her staff will work with the IRS to ensure the PPG is revised accordingly.

However, the Commissioner agreed with the IRS that PCAs may "monitor" payments where the taxpayer has been referred back to the IRS for acceptance of a six- or seven-year IA (partially consistent with IRS

³⁸ These concerns are not merely theoretical. In studies included in Volume 2 herein, the National Taxpayer Advocate shows that almost 40 percent of taxpayers entering into an IA in 2014 agreed to make installment payments even though their Allowable Living Expenses exceeded their Total Positive Income, and the IRS could and should have systemically excluded a significant percentage of these taxpayers as CNC-hardship. See Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*; Research Study: *IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies*, vol. 2, *infra*.

internal policies for streamlined IAs, which were recently extended from five to six years)³⁹ and receive 25 percent of all such payments, notwithstanding that it was the IRS itself that placed the taxpayer into an IA.

The National Taxpayer Advocate remains concerned with the “monitoring” of accounts where a taxpayer has entered into an IA that exceeds five years. Where a PCA locates and contacts a taxpayer, but does not enter into an IA, the PCA should be paid a fee for those location and contact services. Under the statute, if the PCA enters into an IA, then the PCA is entitled to receive compensation up to 25 percent of the amounts collected. But there is no statutory authorization for the PCA to receive compensation for tasks performed for IAs exceeding five years in length. If the taxpayer defaults on such a contract, the ensuing contacts and resolution of the taxpayer’s case are far more likely to involve acts that require the exercise of judgment and discretion and therefore cannot be handled by the PCAs.

Moreover, paying PCAs a 25 percent commission for work that was or will need to be accomplished by the IRS constitutes a windfall to the PCAs. It also creates an incentive for the IRS to push taxpayers into six year IAs rather than longer IAs that may be more appropriate for the taxpayer’s specific situation, simply because the IRS itself will retain an additional 25 percent of the collections (in addition to the appropriations and user fees the IRS receives). In that case, not only the debtor taxpayer is harmed, but all taxpayers are harmed because fewer tax dollars are going to the public fisc.

Moreover, a TAS study included in Volume Two of this Report demonstrates that failure to conduct a financial analysis of taxpayers with delinquent accounts can erode current and future tax compliance:

- Many taxpayers initiate IAs even though their incomes are less than their ALEs, meaning that taxpayers are likely forgoing necessities to meet the terms of their IAs;
- Taxpayers are more likely to default on their IAs when their incomes are below their ALEs, suggesting that these taxpayers are entering into IAs they cannot afford;
- Taxpayers become more likely to be noncompliant in the years after they start an IA, suggesting that the terms of IAs are not necessarily realistic from the standpoint of a taxpayer’s ability to pay; and
- The involvement of TAS in IAs increases subsequent payment compliance and decreases the likelihood that taxpayers will default on their IAs. This fact suggests that additional financial analysis will increase the number of successful IAs and reduce subsequent noncompliance.⁴⁰

For all these reasons, the National Taxpayer Advocate recommends that the IRS revise the PCA contract to allow PCAs to monitor only IAs not exceeding five years and further provide for a fee schedule for locating and contacting taxpayers for cases where the taxpayer cannot full pay or enter into an IA up to five years. This approach will ensure PCAs get paid for all work they perform but also protect the public fisc, and it is consistent with the limited statutory authority provided by IRC § 6306.

39 See IRM 5.14.5.2 *Streamlined Installment Agreements* (Dec. 23, 2015). The IRS is currently conducting a pilot under which taxpayers may enter into installment agreements of up to seven years without the need for a financial analysis. For details, see <https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements>.

40 See Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*.

The IRS's Planned Implementation of the Private Debt Collection (PDC) Program Unnecessarily Burdens Taxpayers, Particularly Those in Economic Hardship

As discussed above, IRC § 6306(c) generally requires the IRS to assign to PCAs all “inactive tax receivables,” described as any “tax receivable” that meets any one of three criteria.⁴¹ A “tax receivable” for purposes of the statute is an account the IRS includes in its “potentially collectible inventory” (PCI).⁴² Potentially collectible inventory is an undefined term — that is, no provision of the IRC, the Treasury Regulations, or the Internal Revenue Manual (IRM) provides a definition of PCI. However, the Office of Chief Counsel has advised the National Taxpayer Advocate that PCI does not include accounts designated as CNC due to the economic hardship of the taxpayer.⁴³

The IRS is required by statute and by Treasury regulation to take certain actions when it knows taxpayers are experiencing economic hardship. IRC § 6343 requires the IRS to release a levy when it “has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer.”⁴⁴ Economic hardship “exists when a levy will cause an individual to be unable to pay his or her reasonable living expenses.”⁴⁵ In the *Vinatieri* case, the U.S. Tax Court held that when the IRS sustains even a proposed levy on a taxpayer it knows is in economic hardship, it abuses its discretion.⁴⁶ In light of the *Vinatieri* case, the IRS adopted procedures that require its employees to consider, before proceeding with a levy, whether the levy would create economic hardship for the taxpayer.⁴⁷ The same concerns apply with respect to PCAs — it is inappropriate to assign cases for collection knowing there is a great risk of economic hardship if collection — even voluntary payments — proceeds. The IRS should not be placing taxpayers at risk of not being able to meet their basic living expenses in order pay their taxes.

The IRS generally designates an account as CNC hardship after considering financial information the taxpayer provides and taking into account expenses the IRS would routinely allow — namely, ALEs.⁴⁸ Accounts that do not actually bear the CNC hardship designation, however, are not exempt from assignment to PCAs even though the taxpayer may be in economic hardship.⁴⁹

41 IRC § 6306(c)(2)(A) provides that “[t]he term ‘inactive tax receivable’ means any tax receivable if (i) at any time after assessment, the Internal Revenue Service removes such receivable from the active inventory for lack of resources or inability to locate the taxpayer, (ii) more than 1/3 of the period of the applicable statute of limitation has lapsed and such receivable has not been assigned for collection to any employee of the Internal Revenue Service, or (iii) in the case of a receivable which has been assigned for collection, more than 365 days have passed without interaction with the taxpayer or a third party for purposes of furthering the collection of such receivable.”

42 IRC § 6306(c)(2)(B).

43 IRS response to TAS fact check (Dec. 13, 2016). A number of conditions may cause the IRS to designate an account as currently not collectible (CNC), such as the inability to locate or contact the taxpayer, where the statutory period for collecting the tax has expired, where the amount owed is below tolerance levels, or where the taxpayer is in economic hardship. See IRM 5.16.1.2, *Currently Not Collectible Procedures* (Jan. 1, 2016). In addition, some tax receivables are statutorily excluded from eligibility for assignment to PCAs. IRC § 6306(d) provides that a tax receivable is not eligible for assignment to a PCA if it “(1) is subject to a pending or active offer-in-compromise or installment agreement, (2) is classified as an innocent spouse case, (3) involves a taxpayer identified by the Secretary as being (A) deceased, (B) under the age of 18, (C) in a designated combat zone, or (D) a victim of tax-related identity theft, (4) is currently under examination, litigation, criminal investigation, or levy, or (5) is currently subject to a proper exercise of a right of appeal under this title.”

44 IRC § 6343(a)(1)(D).

45 Treas. Reg. § 301.6343-1(b)(4).

46 *Vinatieri v. Comm’r*, 133 T.C. 392 (2009).

47 See IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014) which provides that when determining if a levy is appropriate, revenue officers are to consider “the taxpayer’s financial condition, including information discussed in IRM 5.1.12.20.1.1 related to economic hardship determinations,” and noting that “if the Revenue Officer can verify from the information available that the levy will cause an economic hardship, the levy will not be issued, because if there is economic hardship, the levy must be released under IRC 6343(a)(1)(D).”

48 See IRM 5.16.1.2.9, *Hardship* (Aug. 25, 2014).

49 Letter from Scott Prentky, Director, Collection to Chi Chi Wu, Staff Attorney, National Consumer Law Center (Sept. 12, 2016).

TAS Research identified almost 380,000 taxpayer accounts the IRS intends to assign to PCAs in the first phase of assignments scheduled for 2017.⁵⁰ Of these taxpayers, more than 273,000 filed a recent tax return:⁵¹

- Median income shown on the returns was about \$32,000;⁵² and
- More than a third of the returns showed income of less than \$20,000.⁵³

The *least* amount of ALEs the IRS would have allowed in 2016 was approximately \$18,000 for a single person. Thus, the expenses of some of these taxpayers actually exceeded their incomes, even assuming a single person household.⁵⁴ A TAS study included in this report found that almost 40 percent of taxpayers entering into IAs in 2014 agreed to make installment payments even though their ALEs exceeded their Total Positive Income (TPI).⁵⁵

The IRS Interprets the 2015 Legislation As Requiring It to Assign Accounts the IRS Itself Has Made a Policy Decision to Not Collect Because There Is a Great Risk of Causing Economic Hardship

Because the phrase “potentially collectible inventory” is not defined by statute or Treasury regulation and is not explained in the IRM or other IRS guidance, the National Taxpayer Advocate believes Congress intended to provide the IRS with some administrative flexibility in its definition of PCI. Thus, the National Taxpayer Advocate urged the IRS to exclude from its definition of “potentially collectible inventory” some accounts that the IRS itself does not subject to certain levies on the ground that these taxpayers would likely experience economic hardship.

The IRS Adopted a Proxy for Economic Hardship for Purposes of the Federal Payment Levy Program (FPLP)

IRC § 6331(h) authorizes the IRS to impose continuing levies on certain federal payments, including SSA and RRB retirement benefits, and the FPLP is the IRS’s automated program that carries out these levies.⁵⁶

50 There are 379,576 such accounts. IRS ARDI, CDW, data accessed Nov. 28, 2016. The IRS is in the process of identifying additional accounts eligible for assignment in 2017. IRS response to TAS information request (Nov. 18, 2016).

51 IRS ARDI, IRTF, CDW, data accessed Nov. 28, 2016, showing there were 273,105 such taxpayers. Recent returns include those for tax year 2014 or later. Not all taxpayers whose accounts are included in potentially collectible inventory had a 2015 filing requirement. See, e.g., IRC § 1; IRS Publication 501, *Exemptions, Standard Deduction, and Filing Information 2* (2015). For example, a single person under age 65 at the end of 2015 was not required to file a 2015 return unless his or her gross income was \$10,300 or more.

52 IRS ARDI, IRTF, CDW, data accessed Nov. 28, 2016, showing that median income reported on these returns was \$31,842.

53 *Id.*, showing that 38 percent of these returns reported income of less than \$20,000.

54 The lowest amount allowed for monthly housing and utilities in 2016 for a taxpayer under 65 was \$736, which is the amount allowed for taxpayers who live in Wade Hampton, AK. The lowest amount of monthly operating costs for one vehicle (not including ownership costs) was \$173, the amount allowed for taxpayers who live in Seattle, WA. The national standard for monthly food and clothing was \$570 and for health care it was \$54. Thus, the least amount of monthly ALE for a hypothetical taxpayer who was under 65, lived in Wade Hampton, AK but used the vehicle operating cost for Seattle, WA was \$1,533. Total annual expenses for this hypothetical taxpayer would be \$1,533 X 12 = \$18,396. IRS ALE (Mar. 28, 2016), <http://mysbse.web.irs.gov/Collection/toolsprocesses/AllowExp/Standards/default.aspx>.

55 See Research Study: *The Importance of Financial Analysis in Installment Agreements in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*.

56 See IRM 5.11.7.2, *Federal Payment Levy Program* (Sept. 23, 2016).

The IRS generally does not subject SSA and RRB payments to FPLP levies when the recipient's income is less than 250 percent of the federal poverty level, a measure that serves as a proxy for economic hardship.⁵⁷

Of the almost 380,000 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017:

- About 39,000 — or 10 percent — were recipients of SSA or RRB benefits in 2015;⁵⁸
- The recent returns of these 39,000 SSA or RRB recipients showed median income of about \$19,000;⁵⁹
- Of these 39,000 taxpayers, 14,300 filed recent returns showing income equal to or less than 250 percent of the federal poverty level.⁶⁰ The IRS would therefore generally not impose FPLP levies on these taxpayers' SSA or RRB benefits, yet it considers their accounts eligible for assignment to PCAs;
 - The median income of these 14,300 taxpayers was about \$9,700;⁶¹ and
 - 9,000 of the 14,300 taxpayers (or 63 percent) were actually living at or below the poverty level.⁶²

The IRS Excludes Social Security Disability Income Payments from FPLP Levies, Yet Recipients' Accounts May Be Assigned to PCAs

The IRS refrains from imposing FPLP levies on federal benefits paid to recipients of SSDI (without considering ALEs or applying a proxy for economic hardship).⁶³ In order to receive SSDI, taxpayers generally cannot earn over \$1,130 per month.⁶⁴ Of the almost 380,000 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017:

- About 11,000 — or three percent — were SSDI recipients in 2015.⁶⁵ The IRS would not impose FPLP levies on these taxpayers' SSDI benefits, yet it considers their accounts eligible for assignment to PCAs; and
- The median income shown on the recent returns filed by these taxpayers was \$14,350.⁶⁶

57 IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (June 23, 2014). For a description of the TAS model to estimate the income and expenses of taxpayers whose SSA, RRB, and SSDI income had been subject to Federal Payment Levy Program (FPLP) levies, which led to the adoption of the 250 percent proxy for economic hardship, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

58 IRS, ARDI, IRTF, IRMF, CDW, data accessed Nov. 28, 2016, showing that of the 379,576 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017, 38,619 received SSA benefits. TAS designed syntax to identify delinquencies being sent to the private debt collection companies based on information provided by the IRS; however, the IRS could neither verify or disprove the results.

59 *Id.*, showing that the median income shown on returns filed by these taxpayers was \$18,984.

60 *Id.*, showing 14,265 taxpayers filed returns for tax year 2014 or later.

61 *Id.*, showing that median income for these 14,265 taxpayers was \$9,727.

62 Because incomes were estimated using the most recent total positive income of tax years 2014 and 2015, the federal poverty level for the corresponding year was used to determine whether taxpayers were below the federal poverty level. *Id.*, showing that of the 14,265 taxpayers, 8,999 were living at or below the poverty level.

63 SB/SE-05-1015-0067, *Federal Payment Levy Program - Exclude SSA Disability Insurance Payments* (Oct. 7, 2015).

64 See SSA, *Update 2016* (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-10003.pdf>.

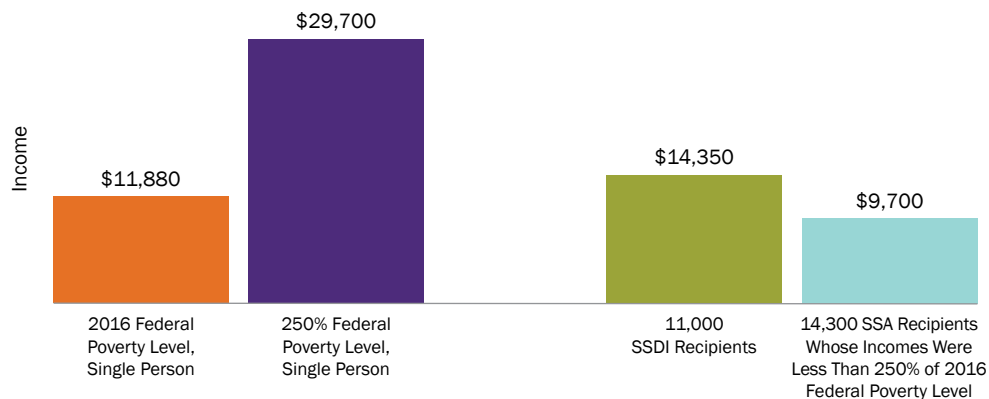
65 IRS, ARDI, IRTF, IRMF, CDW, data accessed Nov. 28, 2016, showing that of the 379,576 taxpayers whose accounts the IRS intends to assign to PCAs in the first release of 2017, 10,947 received SSDI benefits.

66 *Id.*, showing that of the 10,947 taxpayers who received SSDI benefits in 2015, 5,345 filed tax returns in 2014 or 2015. The median income shown on these returns was \$14,350.

This data is shown in Figure 1.12.1. Once these accounts are assigned to PCAs, these taxpayers may agree to make payments they cannot afford, which may mean they will not have sufficient funds left to pay for basic living expenses such as rent, utilities, food, medication, or medical treatment.⁶⁷

FIGURE 1.12.1

Median Income Shown on Returns of Taxpayers Whose Accounts the IRS Would Not Itself Collect Through Federal Payment Levy Program (FPLP) Levies But Intends to Assign to PCAs in 2017, Compared to 2016 Federal Poverty Level



The IRS Excludes Supplemental Security Income (SSI) Payments from FPLP Levies and Is Statutorily Prohibited From Imposing Non-FPLP Levies on SSI Payments, Yet Recipients' Accounts May Be Assigned to PCAs

Elderly, blind, or disabled persons may receive SSI. In order to receive SSI in 2016, a single person could not have:

- Earned income of more than \$1,551 per month;
- Unearned income of more than \$753 per month; or
- Assets worth more than \$2,000.⁶⁸

67 The 2008 TAS study also found that more than one-quarter of FPLP taxpayers who paid their tax liability, entered into an IA with the IRS, or were subject to an ongoing FPLP levy had incomes at or below the federal poverty level. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48, 49 (Research Study: *Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

68 SSA, *Social Security, A Guide to Supplemental Security Income (SSI) for Groups and Organizations* 11, 12, 16 (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-11015.pdf>.

The highest federal SSI payment to a single person in 2016 was \$733 per month.⁶⁹ The average SSI payment was \$539 in November of 2016.⁷⁰ The average household income for recipients of SSI was estimated to be no more than \$684 in May of 2013.⁷¹ For these reasons, the IRS itself refrains from subjecting SSI benefits to FPLP levies and is prohibited by law from subjecting SSI payments to non-FPLP levies.⁷² Of the taxpayers whose accounts the IRS intends to assign to PCAs, some are undoubtedly recipients of SSI, although systemic limitations have made it difficult to identify the number.⁷³

On December 15, 2016, the National Taxpayer Advocate met with the Commissioner of Internal Revenue and other senior IRS leaders to discuss the exclusion of these three taxpayer categories. The National Taxpayer Advocate reasoned that because the IRS had already made a determination under the FPLP that collecting from these taxpayers would create an economic hardship, it is very likely that these taxpayers are not collectible. However, all of these populations — the low income, elderly, and the disabled — are disproportionately vulnerable to pressure, as is evidenced by many of them falling victims to tax and other types of scams.⁷⁴ Moreover, TAS research studies reported in this Annual Report show that taxpayers agree to pay IRS debts even where they cannot afford to pay their basic living expenses, perhaps largely out of fear.⁷⁵ Thus *any collection contacts* with respect to taxpayers in these population groups place their health and welfare at risk.

Commendably, the IRS Commissioner agreed that SSDI and SSI taxpayers should be excluded from the PCA population because of the high risk that they would experience economic hardship. Because of the IRS's prior refusal to exclude these taxpayers, however, IRS personnel say this decision came too late in the process to implement the necessary programming to exclude these taxpayers. Thus, the IRS is saying that a portion of almost 11,000 SSDI taxpayers and an unknown number of SSI taxpayers will be included in at least the first batch of PCA cases. This unfortunate situation will continue unless and until the IRS completes the required programming to exclude these taxpayers, creating a substantial risk of harm.

The National Taxpayer Advocate was not successful in convincing the IRS Commissioner to exclude the accounts of taxpayers who receive Social Security retirement benefits and have income at or below 250

69 SSA, *Social Security, A Guide to Supplemental Security Income (SSI) for Groups and Organizations* 7 (Jan. 2016), <https://www.ssa.gov/pubs/EN-05-11015.pdf>. As the guide notes, some states provide supplemental benefits and “[i]f Social Security runs the state’s supplemental payment, one check is paid to the beneficiary each month that combines the federal and state SSI benefits. States may change the payment amounts based on where, and with whom, people live. Also, some states might not count other income.”

70 SSA, Research, Statistics & Policy Analysis, *Monthly Statistical Snapshot, November 2016*, Table 3, https://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/; Government Accountability Office (GAO), GAO-16-674, *Supplemental Security Income, SSA Provides Benefits to Multiple Recipient Households but Needs System Changes to Improve Claims Management* 52, Table 10 (Aug. 2016).

71 GAO-16-674, *Supplemental Security Income, SSA Provides Benefits to Multiple Recipient Households but Needs System Changes to Improve Claims Management* 52, Table 10 (Aug. 2016), reporting that where multiple household members receive SSI, the estimated average amount of earned and unearned income for the household is \$622, with a range of between \$560 and \$684 at the 95 percent confidence level. In one-recipient households, the estimated average monthly earned and unearned income is \$457, with a range of between \$440 and \$473 at the 95 percent confidence level.

72 IRM 5.11.7.2.1.1(e), *IRS/BFS Interagency Agreement - Federal Payments Subject to the FPLP* (Sept. 23, 2016); SSI payments are exempt from levy under IRC § 6334(a)(11), except as provided in IRC § 6331(h) for FPLP levies.

73 Because SSI payments are not reported to the IRS, IRS databases do not identify taxpayers with federal tax debt whose SSI payments are exempt from levy.

74 See, e.g., IRS, *Phone Scams Continue to be Serious Threat, Remain on IRS “Dirty Dozen” List of Tax Scams for the 2015 Filing Season* (Jan. 22, 2015), <https://www.irs.gov/uac/newsroom/phone-scams-continue-to-be-serious-threat-and-remain-on-irs-dirty-dozen-list-of-tax-scams-for-the-2015-filing-season>, (warning taxpayers that scammers “prey on the most vulnerable people, such as the elderly, newly arrived immigrants and those whose first language is not English”).

75 See Research Study: *IRS Should Use Its Internal Data to Determine If Taxpayers Can Afford to Pay Their Tax Delinquencies*, vol. 2, *infra*.

percent of the federal poverty level. The IRS argued that these taxpayers may have significant assets that would enable them to make payments from income (notwithstanding that the IRS itself has long excluded these taxpayers' accounts from FPLP levies). The National Taxpayer Advocate pointed out that the IRS could create a filter or algorithm (as TAS had done in past research studies) to identify taxpayers whose Form 1099 documents indicate the existence of assets above a certain value.⁷⁶ The Commissioner decided that for the first six months of the program, these taxpayers would be included in the PCA inventory; during that time, the IRS could explore how to screen for SSA recipients with incomes below 250 percent of the federal poverty level who also have substantial assets.

The National Taxpayer Advocate, while pleased with the exclusions of SSDI and SSI recipients, continues to be concerned about the harm to low income recipients of SSA retirement payments. The future earnings of low income retirees are generally quite limited, so if they pay more than they can reasonably afford in response to PCA pressure — as some inevitably will do — they may end up in economic hardship and remain unable to pay basic living expenses for extended periods of time. Therefore, TAS is developing outreach materials for Local Taxpayer Advocates as well as stakeholder groups and nonprofits who serve these populations. In this way, taxpayers or their caretakers or representatives will learn they do not have to pay the IRS — or PCAs — where the taxpayer is experiencing economic hardship.

The IRS's Private Debt Collection (PDC) Program Undermines TAS and Jeopardizes Taxpayer Rights

The IRS Does Not Intend to Systemically Prevent Accounts of Taxpayers Who Currently Have Cases Pending in TAS From Being Assigned to PCAs

Under IRC § 7811, the National Taxpayer Advocate has the authority to issue a Taxpayer Assistance Order (TAO) if she determines the taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the IRS is administering internal revenue laws.⁷⁷ "Significant hardship" means:

- (A) an immediate threat of adverse action;
- (B) a delay of more than 30 days in resolving taxpayer account problems;
- (C) the incurring by the taxpayer of significant costs (including fees for professional representation) if relief is not granted; or
- (D) irreparable injury to, or a long-term adverse impact on, the taxpayer if relief is not granted.⁷⁸

Once TAS opens a case, it works *all* of the taxpayer's issues to completion pursuant to procedures that have been in place since TAS's inception.⁷⁹ TAS does not close the case until all the issues have been resolved, which may culminate in the issuance of a TAO. For example, a taxpayer who is currently in

76 See National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*). Moreover, the IRS does not always insist that a taxpayer demonstrate a lack of income-generating assets from which to pay a tax liability. See Rev. Proc. 2015-57, 2015-51 I.R.B. 863, which allows certain taxpayers whose Federal student loans are discharged to exclude the discharged amount from gross income. The guidance notes that most borrowers whose loans are discharged "would be able to exclude from gross income all or substantially all of the discharged amounts based on fraudulent misrepresentations made by the colleges to the students, the insolvency exclusion, or another tax law authority." However, "determining whether one or more of these exceptions is available to each affected borrower would require a fact intensive analysis of the particular borrower's situation to determine the extent to which the discharged amount is eligible for exclusion under each of the potentially available exceptions. The Treasury Department and the IRS are concerned that such an analysis would impose a compliance burden on taxpayers, as well as an administrative burden on the IRS, that is excessive in relation to the amount of taxable income that would result."

77 See IRC § 7811(a)(1).

78 See IRC § 7811(a)(2).

79 See e.g., IRM 13.1.19.5.4, *Case Advocate OAR Responsibilities* (May 5, 2016).

Paying private collection agencies (PCAs) a 25 percent commission for work that was or will need to be accomplished by the IRS constitutes a windfall to the PCAs.

the collection queue may need assistance with requesting penalty abatement or audit reconsideration, which may eliminate or significantly reduce a balance due. Typically, TAS works with the taxpayer to gather and submit the necessary documentation and analysis with an Operations Assistance Request (OAR) to the IRS operating division that controls the case. If a balance due remains, TAS case advocates have the delegated authority to place taxpayers into streamlined IAs (*i.e.*, IAs up to six years in length).⁸⁰ If the taxpayer does not qualify for a streamlined IA but may qualify for a non-streamlined IA, TAS works with the taxpayer to gather the taxpayer's financial information and then submits the information to the IRS with an OAR, requesting the IRS enter into a non-streamlined IA. TAS case advocates follow similar procedures for handling CNC-Hardship cases and Offers in Compromise based on doubt as to collectability. If necessary, the National Taxpayer Advocate or her delegates issue TAOs to resolve these cases. Thus, there is no reason to assign active TAS cases to PCAs — TAS has all the tools to resolve the cases efficiently and effectively, as is required by IRC § 7803(c).

Additionally, assigning open TAS cases to PCAs means taxpayers may be contacted by PCAs while they are working with TAS. This will create confusion for taxpayers and more work for the IRS and TAS as taxpayers contact the IRS and TAS for information about how to proceed. Taxpayers will feel angry at being “shuttled” from TAS to a PCA, especially when they have been assured that collection activity will cease while the case is pending in TAS, a practice that has existed between the IRS and TAS since TAS's inception in 1998. Moreover, assigning open TAS cases to PCAs may mean that PCAs may receive commissions on payments taxpayers make as a result of TAS's and the IRS's work — resulting in a windfall for PCAs and a drain on the public fisc.

To avert these inefficiencies, and to avoid undermining taxpayer confidence in TAS and the IRS, TAS requested that the IRS assign a transaction code for open TAS cases. The transaction code could be used to systemically prevent a TAS case from being included in PCA inventory for the period of time the case is open in TAS. TAS would adopt procedures to ensure the code would be placed on the account when the case is first opened in TAS, and removed when TAS closes the case. Thus, if the collection issue is closed unresolved in TAS, or if the taxpayer is unresponsive or uncooperative, the account could be returned to the pool of PCA-eligible accounts. At the time this report goes to print, there is general agreement to exclude TAS cases from PCA inventory, yet despite two meetings with the Commissioner and other senior IRS officials, there is no agreement as to whether the IRS will use a transaction code for TAS cases. The National Taxpayer Advocate and her staff will continue to press the IRS to move forward with programming this transaction code and developing procedures and training for both PCAs and TAS employees.

The IRS Has Not Provided Adequate Guidance to PCAs on When to Refer a Taxpayer to TAS and Does Not Intend to Recall Accounts From PCAs When the Taxpayers Request Assistance From TAS

As discussed below, PCAs are required to refer a taxpayer to TAS when the taxpayer “indicates” that payment of the balance due immediately or through a payment arrangement would leave him or her unable to pay necessary living expenses.⁸¹ Alternatively, a taxpayer whose case has been assigned to a PCA may independently contact TAS or the IRS. TAS will open a case for that taxpayer if a TAS

⁸⁰ See IRM 13.1.4.2.3.9, *Installment Agreements* (Oct. 31, 2004). Streamlined installment agreements, generally available for individual taxpayers when the total tax liability is \$50,000 or less, do not require a financial statement. See IRM 5.14.5.2, *Streamlined Installment Agreements* (Dec. 23, 2015).

⁸¹ PPG § 12.3, *Unable to Pay* (discussed below).

case acceptance criterion is met (*e.g.*, the taxpayer is experiencing economic harm or is about to suffer economic harm).⁸²

Our first concern is that the PPG violates both IRC §§ 6306 and 7811 by adopting a narrow definition of when a case should be referred to TAS. Taxpayers are eligible for TAS assistance when they are experiencing or are about to experience significant hardship, as defined by IRC § 7811, the regulations thereunder, and the related TAS IRM.⁸³ Significant hardship includes both economic and systemic burdens, and contemplates more than just being unable to meet one's basic living expenses. Moreover, IRC § 6306 provides that a qualified tax collection contract "prohibits each person providing such services under such contract from committing any act or omission which employees of the Internal Revenue Service are prohibited from committing in the performance of similar services."⁸⁴ By not providing guidance and training to PCA employees on the full definition of significant hardship (and required referrals to TAS), the IRS operates in a manner not authorized by IRC § 6306 and also violates taxpayers' *right to a fair and just tax system*, which includes 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."⁸⁵

Our second concern relates to what happens to PCA cases once the taxpayer is referred to TAS. TAS requested that the IRS adopt procedures to recall these TAS cases from the PCAs, as its contract with PCA permits.⁸⁶ PCAs should not receive windfall compensation attributable to work that is actually done by TAS or the IRS (as is the case where an OAR is issued). If the IRS does not honor the National Taxpayer Advocate's request to recall cases from PCAs when they seek assistance from TAS and TAS opens a case, the National Taxpayer Advocate may issue TAOs to the IRS and PCAs to achieve that result.⁸⁷

Provisions in the IRS's Contracts With Private Collection Agencies (PCAs) Burden Taxpayers and Tax Administration

The following aspects of the planned PDC program compromise taxpayer rights and increase burden on both taxpayers and tax administration:

- PCAs are not required to return to the IRS accounts of taxpayers in economic hardship. The PPG provides that a PCA *may* return an account to the IRS if the PCA deems the taxpayer is unable to pay and has exhausted all reasonable collection efforts, but the guide does not elaborate on what

82 IRM 13.1.7.2, *TAS Case Criteria* (Feb. 4, 2015).

83 IRC § 7811(a)(2); Treas. Reg. §301.7811-1(a)(4); IRM 13.1.2.3.3, *Significant Hardship* (Jan. 27, 2009).

84 IRC § 6306(b)(2).

85 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

86 The contract with the PCAs, in Section III, *Performance Work Statement Tax Collection Services*, in part 4.3.9.1, includes "Taxpayer Advocate Service (TAS)" among the reasons why the IRS would recall an account. The other examples of reasons why the IRS would recall an account are those enumerated in IRC § 6306(d) as accounts not eligible for assignment to PCAs (*e.g.*, because there is a pending or active installment agreement or offer in compromise, a pending request for innocent spouse relief, the taxpayer is deceased, under age 18, the victim of identity theft, in a designated combat zone, etc.).

87 The 2004 legislation that gave the IRS authority to use PCAs also amended IRC § 7811 to provide that the National Taxpayer Advocate's Taxpayer Assistance Order (TAO) authority extends to PCAs. IRC § 7811(g), added by the American Jobs Creation Act of 2004, Pub. L. 108-357, Title VIII, § 881(c), 118 Stat. 1418, 1626-7 provides: "Application to persons performing services under a qualified tax collection contract. Any order issued or action taken by the National Taxpayer Advocate pursuant to this section shall apply to persons performing services under a qualified tax collection contract (as defined in section 6306(b)) to the same extent and in the same manner as such order or action applies to the Secretary." IRC § 6306(k)(2) was also added, cross referencing IRC § 7811(g).

the PCA employee should consider when determining if a taxpayer is unable to pay.⁸⁸ Because PCAs will earn a commission on those payments, PCA employees have no incentive to inquire into the taxpayer's economic condition.

- The IRS does not require transparency of PCA procedures. The IRS has committed to providing PCA calling scripts to TAS for review, but it remains to be seen whether that commitment will include providing operational plans or other information that contains materials, such as calling scripts, that provide the framework for PCAs' contacts with taxpayers.⁸⁹
- The IRS will pay commissions on taxpayer remittances prompted by IRS action rather than PCA action. PCAs may not contact taxpayers or receive commissions on payments made by taxpayers for ten calendar days after the PCA receives the account.⁹⁰ In the ten-day interim period, the IRS notifies the taxpayer that it assigned the account to a PCA. The letter from the IRS, rather than any action by the PCA, may trigger payments by taxpayers, yet the PCA will receive a commission on the payments as long as they are received after the ten-day period.
- Unlike during the 2006-2009 iteration of the PDC program, the IRS will not use a Referral Unit to facilitate interactions with PCAs, and there is no clear procedure for penalizing PCAs for conduct that generates taxpayer complaints.⁹¹ This means there will be no assistance from the IRS in determining whether a taxpayer should be treated as unable to pay. Moreover, taxpayers requesting penalty abatement, audit reconsiderations, or military deferment will likewise be directed to file a request directly with the IRS, in which case the PCA will suspend collection activity for 60 days while the IRS considers the abatement or deferral request. For FY 2016, it took 91 days on average for the IRS to respond to correspondence from individual taxpayers.⁹² Thus, the taxpayer may need to make multiple contacts with the PCA just to extend the 60-day period. This burden could be avoided by the IRS simply by recalling the case pending the outcome of the audit reconsideration or other determination.
- Cases recalled from PCA inventory will not be worked to completion. After a taxpayer requests not to work with PCAs, his or her account will be returned to the same inactive status from which it originated, thus "potentially contributing to a perception that ignoring tax collection may be a successful strategy."⁹³ Taxpayers may conclude that the IRS, although it alerted them to their tax debt and placed their account with a PCA, is not actually interested in working with them to resolve it.

88 PPG § 12.3, *Unable to Pay*.

89 Letter from Scott Prentky, Director, Collection to Chi Chi Wu, Staff Attorney, National Consumer Law Center (Sept. 12, 2016).

90 Section 5.3, *Initial Contact Letters* PCA Policy and Procedures Guide; Section 4.1 of PCA contracts (providing "[t]he Contractor shall receive commission on any payment received 11 calendar days or more after the date the account is transferred to the Contractor.>").

91 Section 1203 of the IRS Restructuring and Reform Act of 1998 specified ten acts or omissions (known as the "10 Deadly Sins") for which an IRS employee is to be fired, most of which involve mistreatment of taxpayers. IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. 105-206, § 1203, 112 Stat. 685, 720-721. As the GAO has noted: "Most, but not all, of the acts or omissions involve mistreatment of taxpayers." GAO, GAO-04-1039R, *IRS' Efforts to Evaluate the Section 1203 Process for Employee Misconduct and Measure Its Impacts on Tax Administration 1* (2004). There is no statutory or contractual requirement that PCAs fire employees who are found to have mistreated taxpayers.

92 IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: CIS Closed Case Cycle Time* (FY 2016).

93 National Taxpayer Advocate 2008 Annual Report to Congress 328, 331 (Status Update: *The IRS's Private Debt Collection Initiative is Failing in Most Respects*).

CONCLUSION

The IRS, in carrying out the congressional mandate that it outsource collection of certain tax debts, is implementing a program that is inconsistent with the statutory definition of which activities the PCAs are authorized to conduct. Moreover, the IRS is not taking adequate measures to prevent PCAs from receiving the accounts of taxpayers against whom the IRS would not normally seek to collect through automatic levies because they are likely to be experiencing economic hardship. The IRS also is not adequately training PCA employees on TAS referral criteria, or adopting adequate procedures for recalling cases from the PCAs where a taxpayer is accepted into TAS.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Revise the PPG to allow PCAs to offer IAs of up to five years — rather than for the period that remains on the collection statute expiration date — to comply with the law.
2. Revise the PPG to clarify that PCAs are not authorized to monitor IAs arranged by the IRS or TAS, and are not entitled to commissions on payments taxpayers make pursuant to those IAs.
3. Revise the PPG to remove the option of soliciting voluntary payments that do not satisfy the liability and are not made pursuant to an IA in order to comply with the law.
4. Revise the PPG to provide that PCAs must refer taxpayers to TAS where the taxpayer so requests, where payment of the balance due immediately or through a payment arrangement would create a significant hardship, including long term or adverse impact, where the taxpayer is unable to pay necessary living expenses, or where the taxpayer is experiencing systemic burden in resolving his or her issue.
5. Assign a Master File code to open TAS cases and systemically prevent open TAS cases from being assigned to PCAs.
6. Recall cases from PCAs when taxpayers request assistance from TAS and TAS opens a case.
7. Implement the necessary programming as soon as possible to remove recipients of SSDI or SSI payments from the population of accounts that are eligible for assignment to PCAs.
8. Adopt an interpretation of “potentially collectible inventory” that excludes the accounts of taxpayers whose SSA and RRB retirement benefits are not subject to FPLP levies because their incomes are less than 250 percent of the federal poverty level and develop a filter to identify those who appear to have significant assets.
9. Revise the contract with PCAs to require PCAs to disclose all materials that impact taxpayers’ contacts with PCAs, including operational plans, training materials, instructions to staff, the content and format of taxpayer letters, and calling scripts.
10. Include in required training for all PCA employees the National Taxpayer Advocate’s taped training on taxpayer rights.
11. Send taxpayers whose accounts will be assigned to PCAs the IRS initial contact letter at least 14 days before transferring their accounts to PCAs and do not pay commissions to PCAs on any payments received after the initial IRS contact letter is sent and before the first PCA contact with the taxpayer.
12. Designate a group of Collection employees to work to completion cases that are recalled from PCAs.

MSP
#13**ALLOWABLE LIVING EXPENSE (ALE) STANDARD: The IRS's Development and Use of ALEs Does Not Adequately Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Households While Complying With Their Tax Obligations****RESPONSIBLE OFFICIAL**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHT(S) IMPACTED¹

- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Internal Revenue Code (IRC) § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”² Most importantly, Congress instructed the IRS to analyze the facts of each case involving these allowances and stipulated that if application of the allowances results in a taxpayer not being able to provide for basic living expenses, then the allowances should not be used.³ The resulting Allowable Living Expense (ALE) standards have come to play a major role in analyzing several types of IRS collection cases.⁴ Moreover, the IRS ALEs have been incorporated into several non-tax government programs.⁵

The IRS allows an expense if it is “necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.”⁶ In its efforts to base the allowed expenses on reliable and consistent data, the IRS relies heavily on the Bureau of Labor Statistics (BLS). In particular, the IRS uses the Consumer Expenditure Survey (CES), which gathers expenditure information for consumers.⁷ Since this survey measures what people spend to live, it does not take into account what the goods or

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See also Treas. Reg. § 301.7122-1(c)(2)(i).

3 IRC § 7122(d)(2)(B).

4 Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, is used to determine monthly expenses and primarily relies on the ALE standards. This form is necessary for many types of case resolutions, including certain installment agreements and offers in compromise (OIC). Internal Revenue Manual (IRM) 5.15.1.1(3), *Overview and Expectations* (Nov. 17, 2014).

5 For instance, debtors filing for bankruptcy are instructed to use the IRS’s ALE standards to calculate income and expenses. 11 U.S.C. § 707(b)(2). Additionally, when a debtor to a federal student loan is subject to a proposed wage garnishment, that debtor may object to the proposed garnishment by arguing it would create a financial hardship. 34 C.F.R. § 34.24(a). The debtor must provide credible documentation showing, among other things, his or her basic living expenses as established by the IRS’s ALE standards. 34 C.F.R. § 34.24(e)(2).

6 IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012).

7 BLS, CES *Frequently Asked Questions*, <http://www.bls.gov/cex/csxfaqs.htm#q1>.

services actually cost to live. Taxpayers of limited means pay for what they can afford and thus may forego expenses otherwise determined by the IRS definition to be necessary.

By focusing on what expenses are *allowable* instead of *adequate*, the IRS has exercised its discretion in a way that does not comport with congressional intent, since “allowable” is not synonymous with “adequate” or “basic.”⁸ Instead, the IRS should adopt standards that allow for a *sufficient* or *adequate* standard of living.⁹

The National Taxpayer Advocate has the following concerns with the current ALE standards:

- Taxpayers of limited means are harmed because the current ALEs are based on data that reflect what taxpayers spend, rather than what they actually need to spend to maintain the health and welfare of their households;
- The current ALEs do not reflect an understanding of what amount of money is sufficient to maintain a basic lifestyle;
- The ALEs do not account for the income and expenditure fluctuations within and between income levels and other household demographics;
- The ALEs should be updated to include expenses necessary to maintain the health and welfare of households today, including an allocation for digital access and technology, child care, and retirement savings; and
- Alternative methods to measure household health and welfare provide better insight into necessary expenses and establish the expenses as a floor, rather than a cap.¹⁰

A reevaluation of the ALE standards is crucial, given the IRS’s Future State initiative, which focuses on increasing online tools and reducing telephone and face-to-face interactions with taxpayers.¹¹ If the ALE standards do not reflect the financial realities of taxpayers, then increased use of online tools and automated programs based on these ALEs will exacerbate the financial harm to these taxpayers. IRC § 7122(d)(2)(B) requires that the IRS make decisions involving the ALE standards on a case-by-case basis. Heavy reliance on online accounts reduces the opportunity for a person-to-person exchange that will identify the financial circumstances necessary for a case-by-case analysis, and the appropriate application of, or deviation from, allowable expenses standards.

8 Congressional intent for maintaining an adequate and basic standard of living can be seen in how Congress has addressed “economic hardship” for IRS Collection purposes, which is defined as an inability to pay “reasonable basic living expenses.” Treas. Reg. § 301.6343-1(b)(4).

9 “Sufficient” is defined as “adequate; of such quality, number, force, or value as is necessary for a given purpose.” Whereas, “allowable” is defined as “acceptable according to the rules; permissible.” BLACK’S LAW DICTIONARY (10th ed. 2014).

10 The National Taxpayer Advocate raised concerns about the ALE standards when Congress was contemplating the change to IRC § 7122 in 1998. As Executive Director of The Community Tax Law Project, the National Taxpayer Advocate testified that “The impact of the current standards is illustrated by a recent case in which I represented an individual who lived in a blighted inner-city neighborhood and used public transportation. The ACS [Automated Collection Service] employee refused to allow his bus fare for travel to a grocery store at the shopping mall, although he needed to go there in order to keep his food expenses within the IRS guidelines.” *IRS Restructuring: Hearings Before the Comm. on Finance, 105th Cong. 333 (1998)* (statement of Nina E. Olson, Executive Director, The Community Tax Law Project).

11 IRS, *Future State Initiative*, <https://www.irs.gov/uac/newsroom/future-state-initiative>.

ANALYSIS OF PROBLEM

Background

As mentioned above, IRC § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.” Additionally, the pertinent section of Treasury Regulations reads as follows:

A determination of doubt as to collectibility will include a determination of ability to pay. In determining ability to pay, the Secretary will permit taxpayers to retain *sufficient* funds to pay basic living expenses. The determination of the amount of such basic living expenses will be founded upon an evaluation of the individual facts and circumstances presented by the taxpayer’s case. To guide this determination, guidelines published by the Secretary on national and local living expense standards will be taken into account.¹² (Emphasis added).

To fulfill Congress’s mandate in IRC § 7122(d)(2)(A), the IRS developed a system of expenses which must meet the “necessary test.” The IRS considers an expense to be necessary if it is “necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.”¹³ The necessary test is an exercise of IRS discretion and is not found in the U.S. Tax Code or Treasury Regulations.

The IRS further divides expenses into three categories: ALEs, other necessary expenses, and other conditional expenses.¹⁴ This discussion will focus on ALEs.

There are ALEs for items such as food and clothing, housing and utilities, and transportation.¹⁵ Expenses for food, clothing, and other miscellaneous items, as well as for out-of-pocket healthcare expenses, are based on national standards. These standards come from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey (CES).¹⁶ For these expenses, the taxpayer is allowed the total national standard without questioning the amount he or she actually spends (as long as the taxpayer does not spend more than the standard amount).¹⁷

Housing and utility expenses and transportation costs are based on Census and BLS data by county.¹⁸ One downside to using county-based measurements is that there can be wide variations in cost within one county. In 2014, one report found that rents for one and two bedroom apartments in Orange County,

12 Treas. Reg. § 301.7122-1(c)(2)(i).

13 IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012).

14 “Other necessary expenses” are expenses that meet the necessary expense test and are normally allowed. This is the category for child care costs, which are allowed if they are “reasonable,” making them subject to an individual IRS employee’s judgment. Conditional expenses are expenses which may not meet the necessary expense test, but may be allowed based on the circumstances of an individual case. IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012).

15 IRM 5.15.1.7, *Allowable Expense Overview* (Oct. 2, 2012).

16 The BLS is part of the United States Department of Labor. United States Department of Labor, *About BLS*, <http://www.bls.gov/bls/infohome.htm>. Out-of-pocket healthcare expenses are based on Medical Expenditure Panel Survey data, which comes from the U.S. Department of Health and Human Services. IRM 5.15.1.7 (Oct. 02, 2012). The CES program “consists of two surveys, the Quarterly Interview Survey and the Diary Survey, that provide information on the buying habits of American consumers, including data on their expenditures, income, and consumer unit (families and single consumers) characteristics.” BLS, CES, <http://www.bls.gov/cex/> (last visited Sept. 9, 2015).

17 IRM 5.15.1.7(3), *Allowable Expense Overview* (Oct. 2, 2012).

18 IRM 5.15.1.7(4), *Allowable Expense Overview* (Oct. 2, 2012). In addition to mortgage or rent, housing expenses include such things as utilities (gas, electricity, water, etc.), garbage removal, cable television, internet service, telephone, and cell phone.

California varied between \$858 to more than \$2,000 in Santa Ana and between \$1,325 to more than \$3,000 in Lake Forest.¹⁹

Transportation costs consist of nationwide figures for loan or lease payments and additional amounts for operating costs broken down by Census Region and Metropolitan Statistical Area. Taxpayers are generally allowed the local standard or what they actually pay each month, whichever is less.²⁰ If the amount claimed is more than the total allowed by the standards, the taxpayer must provide documentation to substantiate those expenses are necessary.²¹ Thus, the local standards for housing and transportation expenses serve as a cap on what taxpayers can claim.

Taxpayers of Limited Means Are Harmed Because the Current ALEs Are Based on Data That Reflect What Taxpayers Spend, Rather Than What They Actually Need to Spend to Maintain the Health and Welfare of Their Households

Deviation from application of the standards is allowed when, based on a taxpayer's facts and circumstances, such application would create an economic hardship for the taxpayer.²² However, commentators and practitioners observe that many IRS employees do not exercise flexibility in determining when to make a deviation. For instance, the Internal Revenue Service Advisory Council (IRSAC) noted that employees in Automated Collection Service (ACS) seem less likely to be flexible than revenue officers, but Appeals employees are "more likely" to deviate from the standards.²³ The National Taxpayer Advocate has also addressed concerns with the use and application of ALE standards in individual taxpayer cases.²⁴

One tax attorney testified before Congress that a strict adherence to ALE standards can cause taxpayers to file bankruptcy unnecessarily.²⁵ The harm that taxpayers experience when a deviation does not occur was also seen in *Leago v. Commissioner*.²⁶ In *Leago*, the taxpayer did not contest that he owed a tax liability of approximately \$94,433. However, Mr. Leago suffered from a brain tumor that required surgery estimated to cost \$100,000. Mr. Leago had no health insurance. As part of a collection due process (CDP) hearing in response to a proposed levy, Mr. Leago requested that his liability be classified as currently not collectable (CNC) due to financial hardship and health problems, which the IRS did not agree to do.²⁷ The Tax Court remanded the case back to Appeals for a supplemental CDP hearing. The settlement officer excluded any expenses for health care because Mr. Leago was not currently paying these expenses

19 Internal Revenue Service Advisory Council (IRSAC), *General Report* 80 (Nov. 19, 2014).

20 IRM 5.15.1.9, *Local Standards* (Nov. 17, 2014).

21 IRM 5.15.1.9(1)(a), *Local Standards* (Nov. 17, 2014).

22 IRC § 7122(d)(2)(B); IRM 5.15.1.1(7) (Nov. 17, 2014).

23 IRSAC, *General Report* 83 (Nov. 19, 2014). See also IRS, Small Business/Self Employed (SB/SE) Research, *Final Report: Assessing the Impact of the Allowable Living Expense Standards Focus Group*, NCH0160 (Dec. 2010).

24 National Taxpayer Advocate Objectives Report to Congress Fiscal Year (FY) 2017 131-35 (Area of Focus: *The IRS Should Reevaluate How It Develops and Uses Allowable Living Expense Standards*); National Taxpayer Advocate 2006 Annual Report to Congress 83-109 (Most Serious Problem: *IRS Collection Payment Alternatives*); National Taxpayer Advocate 2005 Annual Report to Congress 270-91 (Most Serious Problem: *Allowable Expense Standards for Collection Decisions*).

25 *Practices and Procedures of the Internal Revenue Service: Hearings Before the Comm. on Finance*, 105th Cong. 39 (1997) (statement of Robert Schriebman, tax attorney).

26 T.C. Memo. 2012-39.

27 Prior to levying a taxpayer's property, in most instances, the IRS must provide the taxpayer with an opportunity to have a hearing before Appeals. During this hearing, the taxpayer may raise various issues, including alternative collection options to the levy. IRC § 6330.

and instead offered him a partial-pay installment plan (PPIA) in the amount of \$200 per month. Mr. Leago declined to accept this payment plan.²⁸

Throughout the process, the IRS failed to acknowledge the cost of a life-saving surgery for Mr. Leago because he simply could not afford it. That is, because Mr. Leago was not currently paying toward the cost of having brain surgery, the IRS refused to include the necessary expense in its calculation of basic living expenses, thereby placing payment of a federal debt above the necessary (future) expenses to preserve the taxpayer's health and ensuring the taxpayer would not be able to afford a necessary surgery. Today, this IRS action would violate the taxpayer's *right to privacy*, which ensures that IRS enforcement action will be no more intrusive than necessary. Additionally, another taxpayer with the ability to pay for the surgery could have received a different outcome in his or her financial analysis than Mr. Leago, in violation of Mr. Leago's *right to a fair and just tax system*.

As it is now, the standards are based on the average or median expenditures derived from U.S. government data sources (e.g., U.S. Census Bureau or the BLS) representing the actual expenditures of broad segments of the population and not what individual goods and services actually cost. While this approach may seem reasonable at first glance, the National Taxpayer Advocate previously expressed concerns that, in reality, the application of these standards to individual taxpayer cases may lead to erroneous conclusions regarding the appropriate use of reasonable collection payment alternatives.²⁹

By focusing on what expenses are *allowable* instead of *adequate*, the IRS has exercised its discretion in a way that does not comport with Congressional intent, since “allowable” is not synonymous with “adequate” or “basic.”

By focusing on what taxpayers actually pay instead of what a “basic living” service or good actually costs, the financial circumstances of some taxpayers, such as those who must forego paying certain basic living expenses to make ends meet, are not fully realized. If a taxpayer does not have sufficient funds to meet all of his or her necessary costs of living, the taxpayer should not be treated differently than a taxpayer who can afford to pay for all of his or her necessary costs of living.³⁰

Alternatively, some taxpayers may incur expenses that are higher than the average.³¹ These taxpayers should not be forced to reduce their standard of living to the poverty level in order to pay their taxes. Without knowing what constitutes the standard of living required to maintain the health and welfare of a household, it is not possible to determine if a taxpayer has paid too little or too much for an expense.

28 Subsequently, Mr. Leago proposed an OIC based on doubt as to collectibility with special circumstances. In his collection information sheet (CIS), he reported \$3,100 per month for future expenses related to his brain surgery. T.C. Memo. 2012-39 at 4. The settlement officer who reviewed this offer again denied the future medical expense because it represented an amount Mr. Leago was not currently paying. T.C. Memo. 2012-39 at 5. The court again remanded the case. T.C. Memo. 2012-39 at 9. The court opinion does not shed light on the outcome for Mr. Leago after the second remand.

29 National Taxpayer Advocate 2005 Annual Report to Congress 270-91; National Taxpayer Advocate 2006 Annual Report to Congress 83-109.

30 It may seem that trying to survive below basic living standards is a situation reserved for only a small population of taxpayers. In fact, the opposite is true. One estimate is that 59 percent of Americans will encounter a year or more of poverty by the time they are 75 years old. Mark Rank, *Rethinking the Scope and Impact of Poverty in the United States*, 6 CONN. PUB. INT. L.J. 165, 171 (2007).

31 The ALE standards may also fail to acknowledge that some taxpayers “need to maintain higher professional standards in their dress, personal appearance, and vehicle, so that for production of income, a realtor, corporate executive, or physician may have different ‘necessary expenses.’” IRSAC, *General Report* 84 (Nov. 19, 2014).

The Current ALEs Do Not Reflect an Understanding of What Amount of Money Is Sufficient to Maintain a Basic Lifestyle

Before the IRS can establish a standard for living expenses, it must understand what amount of money is sufficient for a basic standard of living. The IRS has not established how much it costs to maintain a basic standard of living. As a baseline, the United States often uses the poverty threshold to determine if a person has enough money to survive day-to-day. A person is considered to be living in poverty if his or her family's income falls below an income threshold set up by family size and composition.³² The current method for determining the poverty level was developed between 1963 and 1964 by Mollie Orshansky, an economist at the Social Security Administration (SSA).³³ The official measure multiplies by three the cost of a minimum food diet from 1963 prices in today's prices.³⁴ The poverty threshold is not a measure of a sufficient standard of living.

In 2010, the Census Bureau introduced the Supplemental Poverty Measure (SPM) which extends the official poverty measure by taking into consideration government benefits and expenses that are not in the official measure.³⁵ The SPM was the result of mounting concerns over the inadequacy of the official poverty measure.³⁶ Instead of focusing on minimal food costs from 1963, the SPM considers the "mean of expenditures on food, clothing, shelter, and utilities (FCSU) over all two child consumer units in the 30th to 36th percentile range multiplied by 1.2."³⁷ Additionally, income is not measured just by pre-tax cash income but also includes noncash government benefits, taxes, and expenses related to work.³⁸ The SPM serves as an acknowledgement that the current poverty threshold cannot be used on its own to measure poverty.

What was sufficient to maintain a basic, healthy standard of living in 1963 has evolved over time. In 1963, families spent one-third of their budget on food. By 2004, it was reported that food expenditures had fallen to about one-seventh of total expenditures.³⁹ Currently, food represents only ten percent of a family's expenses.⁴⁰

32 U.S. Census Bureau, *How the Census Bureau Measures Poverty*, <http://www.census.gov/topics/income-poverty/poverty/guidance/poverty-measures.html>. U.S. Census Bureau, *Measuring America: How Census Measures Poverty* (Jan. 2014), http://www.census.gov/library/visualizations/2014/demo/poverty_measure-how.html.

33 Gordon M. Fisher, *The Development and History of the Poverty Thresholds*, 55 Soc. Sec. Bull. 3 (Winter 1992).

34 U.S. Census Bureau, *Measuring America: How Census Measures Poverty* (Jan. 2014), http://www.census.gov/library/infographics/poverty_measure-how.html. Food was chosen as the original standard of adequacy because it was the only generally accepted standard available at the time. Mollie Orshansky, *Counting the Poor: Another Look at the Poverty Profile*, 28 Soc. Sec. Bull. 5 (1965). The multiplier of three for costs of food was used since research at the time showed that families spent one-third of their budget on food. *Id.* at 9. For a discussion on how Ms. Orshansky came to this decision, see Gordon M. Fisher, *The Development and History of the Poverty Thresholds*, 55 Soc. Sec. Bull. 5 (Winter 1992).

35 U.S. Census Bureau, *The Supplemental Poverty Measure: 2014*, 1 (Sept. 2015).

36 *Id.*

37 *Id.* at 2.

38 *Id.*

39 Douglas J. Besharov and Peter Germanis, *Reconsidering the Federal Poverty Measure*, 9 (June 14, 2004).

40 The Pew Charitable Trusts, *Household Expenditures and Income*, 5 (Mar. 2016).

The IRS's recent decision to decrease some ALE standards highlights the difficulties in identifying and measuring what it costs to maintain a basic standard of living.⁴¹ The IRS decreased the amounts for some of the allowable expenses based on "current data showing a decline in expenditures."⁴² Between 2015 and 2016, the expenses allowed for out-of-pocket healthcare and transportation decreased, as did the national standards for food, clothing, housekeeping supplies, and miscellaneous.⁴³ TAS is unaware of how IRS assumptions can be tested using the current system of ALE standards, since the standards are based on averages spent by consumers, rather than an analysis of what individuals and families actually need in order to provide for a basic living.

It is not apparent that expenditures have actually declined. One source has reported on the impact of the Great Recession. It found that from 2004 to 2008, median household income grew by 1.5 percent while median expenditures grew by 11 percent.⁴⁴ However, the 2014 median income has *decreased* by 13 percent from 2004 levels while expenditures increased by nearly 14 percent.⁴⁵

As an example, the cost of child care expenses has increased. Average weekly child care expenses for families with working mothers who paid for child care rose more than 70 percent from 1985 (\$87) to 2011 (\$148).⁴⁶ This increase is felt to varying degrees based on income. Families with employed mothers whose monthly income was \$4,500 or more paid an average of \$163 a week for child care, representing 6.7 percent of their family income. Families with monthly income of less than \$1,500 paid much less (\$97 a week on average) but that represented 39.6 percent of their family income.⁴⁷

The ALEs Do Not Account for the Income and Expenditure Fluctuations Within and Between Income Levels and Other Household Demographics

The BLS, which is a primary source for ALE data, advises caution in interpreting its consumer expenditure data when relating averages to individual circumstances. The warning reads:

Caution should be used in interpreting the expenditure data, especially when relating averages to individual circumstances. The data shown in the published tables are averages for demographic groups of consumer units. Expenditures by individual consumer units may differ from the average even if the characteristics of the group are similar to those of the

41 IRS, *Collection Financial Standard* (March 2016), https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards?_ga=1.142286002.1851601558.1476275435. Also in 2015, the IRS announced plans to deviate from normal procedures in Automated Collection System (ACS), Automated Collection System Support (ACSS), and Compliance Services Collection Operations (CSCO) cases that involve collection information statements (CIS). IRS, *Memorandum For SBSE Directors, Collection Policy And Campus Collection* (Dec. 17, 2015). The deviation affected PPIAs, non-streamlined installment agreements, and CNC determinations. The deviation allowed employees in some cases to disregard the need for taxpayers to substantiate what they reported on the CIS and instead rely on internal verification (unless a discrepancy was identified). This deviation was done to address a backlog of work, not to study ALE standards. The IRS tracked cases in the deviation to ensure that procedures of the deviation were followed. The IRS did not track details of cases, such as how it was resolved or which expenses were allowed a deviation, so TAS is unable to ascertain how this deviation impacted taxpayers. However, the IRS has plans to track cases with an extension of the deviation planned for FY 2017.

42 IRS, *Collection Financial Standards* (March 2016), <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Collection-Financial-Standards>.

43 TAS Research analysis of IRS 2015 ALE Standards and IRS 2016 ALE Standards. Housing costs also decreased in 2,314 counties out of 3,221 counties. *Id.*

44 The Pew Charitable Trusts, *Household Expenditures and Income*, 3 (Mar. 2016).

45 *Id.*

46 Pew Research Center, *Rising Cost of Child Care May Help Explain Recent Increase in Stay-at-Home Moms* (Apr. 8, 2014), <http://www.pewresearch.org/fact-tank/2014/04/08/rising-cost-of-child-care-may-help-explain-increase-in-stay-at-home-moms/>.

47 *Id.*

individual consumer unit. Income, family size, age of family members, geographic location, and individual tastes and preferences all influence expenditures.⁴⁸

The standards are based on inexact projections of the amounts that people spend on a given item. A number of the IRS standards are based on average annual expenditures reported by people who responded to a survey (*e.g.*, the CES). Thus, there is a good chance the taxpayer's expense is greater than what was reported in the survey (or the IRS standards). On the other hand, there is also a similar chance the taxpayer's spending will be less than the survey average. In situations where the taxpayer has an expense greater than the standard, the IRS should be aware that the money to pay this expense will affect the taxpayer's ability to pay expenses in the other categories. Moreover, while some of this greater spending may be a matter of taste and preference, some above-average spending may be necessary to maintain the health and welfare of the household (or for the production of income). In situations where the taxpayer has an expense less than the standard, the taxpayer may need to make greater expenditures for the health and welfare of his household but cannot do so because of limited means.

The IRS also cannot assume that spending habits are consistent over income levels. For instance, while housing costs now account for about 25 percent of a family's pre-tax income, among low income renters, some may spend up to half of their pre-tax income on rent.⁴⁹ And while low income families may spend less for transportation costs, what they do spend takes up more of their income. Low income families spent 16 percent of their income on transportation expenses while middle income households spent 11 percent.⁵⁰ In this case, the IRS needs to know what expenditures the taxpayer is not making in order to meet their rent obligations.

Low income workers often struggle to make ends meet. It has been noted that achieving this balance each month could be "ephemeral in the event of any increased need or drop in income."⁵¹ Of course, this strain is not felt only by low income families. When income levels are broken into thirds, the typical household in the middle third found its financial slack drop from \$17,000 in 2004 to \$6,000 in 2014.⁵² This means that middle income families now have less opportunity to create a cushion for unexpected expenses, bouts with unemployment or long-term illness, or to make long-term savings a reality.

Additionally, the ALE standards are not sensitive to the fact that certain characteristics may make a person more susceptible to falling below the poverty line. For instance, while children represented 23.3 percent of the population in 2014, they compromised 33.3 percent of the people living in poverty.⁵³ Age and gender interact to create higher poverty rates among women over 65. The poverty rate for women aged 65 and older was 12.1 percent, while the poverty rate for men aged 65 and older was 7.4 percent.⁵⁴ The poverty rate for White Americans of non-Hispanic origin was 10.1 percent while the poverty rate among Blacks was 26.2 percent.⁵⁵ Professor Mark Rank, of Washington University in St. Louis, has suggested that to understand the scope of poverty in the United States, we ought to consider the risk that each

48 BLS, *CES Frequently Asked Questions*, <http://www.bls.gov/cex/csxfaqs.htm#q13>.

49 The Pew Charitable Trusts, *Household Expenditures and Income*, 7 (Mar. 2016).

50 *Id.* at 8.

51 Gregory Acs and Austin Nichols, The Urban Institute, *Working to Make Ends Meet: Understanding the Income and Expenses of America's Low-Income Families*, 30 (Sept. 2005).

52 The Pew Charitable Trusts, *Household Expenditures and Income*, 11 (Mar. 2016). The financial slack of the bottom third actually fell into the negative during the same time period, from \$1,500 in 2004 to negative \$2,300 in 2014.

53 Carmen DeNavas-Walt and Bernadette D. Proctor, U.S. Census Bureau, *Income and Poverty in the United States: 2014*, 14 (Sept. 2015).

54 *Id.* at 15.

55 *Id.* at 14.

American will face poverty at some point during his or her adulthood. He explains, “Just as we have acquired increasing knowledge regarding the likelihood that an individual, for example, may develop heart disease during their lifetime, so too can we ask what is the life course risk of encountering an economic event such as poverty?”⁵⁶

The ALE Standards Should Be Updated to Include Expenses Necessary to Maintain the Health and Welfare of Households Today, Including an Allocation For Digital Technology Access, Child Care, and Retirement Savings

A major critique of the current poverty measures has been that the recognized expenses are out of date.⁵⁷ When Ms. Orshanksy developed the poverty standards, she recognized the need for updating her method. She remarked, “as yesterday’s luxuries become tomorrow’s necessities, who can define for today how much is enough?”⁵⁸ The IRS should follow Ms. Orshanksy’s guidance and update the expenses that are necessary for a basic, healthy standard of living today.⁵⁹

Before the IRS can establish a standard for living expenses, it must understand what amount of money is sufficient for a basic standard of living.

Currently, the IRS treats child care costs as an “other expense,” subject to individual IRS employee judgment, even though it is difficult to imagine a working family getting by without child care expenses.⁶⁰ While being treated as an “other expense” does not mean that claims for child care are likely to be denied, it does mean there is no uniform application, or a national or local standard for amount. Other categories of expenses that have become universally accepted for a 21st century basic standard of living, such as an allotment for basic digital technology in the household and retirement savings, are not acknowledged at all by the ALE standards or poverty threshold.

The current ALE standards allow for internet services as part of housing and utility costs. However, there is no provision for a computer or other tool to access the internet, such as a tablet.⁶¹ Also, the IRS explicitly does not allow retirement savings as a necessary expense.⁶² One survey by the Board of Governors of the Federal Reserve found that 31 percent of non-retired respondents had no retirement savings or pension.⁶³ This deficit in retirement savings is important to consider because Social Security benefits account for only about 40

56 Mark Rank, *Rethinking the Scope and Impact of Poverty in the United States*, 6 CONN. PUB. INT. L.J. 165, 169 (2007).

57 Diana Pierce and Jennifer Brooks, *Wider Opportunities for Women*, *The Self-Sufficiency Standard for the Washington, D.C. Metropolitan Area*, 2 (Fall 1999).

58 Mollie Orshanksy, *Counting the Poor: Another Look at the Poverty Profile*, 28 Soc. Sec. Bull. 5 (1965).

59 These adjustments have occurred in non-IRS venues. As mentioned above, Congress has adopted the use of the IRS’s ALE standards in bankruptcy cases. 11 U.S.C. § 707(b)(2)(A)(ii)(I). However, Congress has allowed for additional expenses beyond the ALE standards. Notably, debtors may deduct expenses for protection from family violence and an extra five percent for food and clothing (if the extra expense is necessary). 11 U.S.C. § 707(b)(2)(A)(ii)(I). Debtors may also deduct expenses for care and support of an “elderly, chronically ill, or disabled” family member. 11 U.S.C. § 707(b)(2)(A)(ii)(II). And unlike the ALE standards, debtors may deduct up to \$1,500 per year in educational expenses for a minor. 11 U.S.C. § 707(b)(2)(A)(ii)(IV).

60 IRM 5.15.1.10(3), *Other Expenses* (Nov. 17, 2014).

61 IRM 5.15.1.7(4), *Allowable Expense Overview* (Oct. 2, 2012).

62 IRM 5.15.1.27(2), *Retirement or Profit Sharing Plans* (Nov. 11, 2014).

63 Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014*, 38-39 (May 2015). According to the survey, the rate of retirement savings is tied directly to an individual’s income. Eighty-two percent of the respondents making over \$100,000 per year had at least some retirement savings or pension. Meanwhile, among respondents making under \$40,000 per year, only 42 percent had any retirement savings. *Id.*

percent of retirees' total income, meaning Americans should be funding retirement plans to make up the shortfall.⁶⁴

Alternative Methods to Measure Household Health and Welfare Provide Better Insight into Necessary Expenses and Establish the Expenses As a Floor Rather Than a Cap

The current ALE system allows for a consistent approach for analyzing taxpayers' expenses. However, this system does not meet the needs of taxpayers who cannot afford to pay for all of the allowable expenses and it does not take into consideration all necessary expenses. In light of the above information, the IRS needs to consider alternative approaches to determining household health and welfare.

FAMILY BUDGETS

Family budgets are a relative measure of what a particular family needs to live modestly in a certain community.⁶⁵ The concept differs from the poverty threshold in two ways: it allows for more consumption of goods and services, and it adds the various costs of each budget component without adjusting for income.⁶⁶ Applying this concept to the ALE standards would help ensure that all taxpayers have sufficient expenses for a basic standard of living and that each taxpayer receives equitable treatment.

THE SELF-SUFFICIENCY STANDARD

Another option to consider is the self-sufficiency standard. Here, the IRS would ask "at what point does a family have sufficient income and resources (such as health benefits) to meet their needs adequately, without public or private assistance?"⁶⁷ Unlike the poverty threshold, which is based on the cost of a single item (food) and assumes a fixed ratio, the self-sufficiency standard considers the cost of each item independently, which allows each category to increase at different rates.⁶⁸ The self-sufficiency standard also varies by geographic location and includes more modern expenses.⁶⁹

The self-sufficiency standard highlights why the ALE standards need to establish a floor, rather than a cap on expenditures. Since families have unique circumstances, they will incur different expenses. For instance, a family with a handicapped child may have additional expenses related to specialized education or housing needs. The current system, which is based on allowable expenses that are capped, does not acknowledge that taxpayers' lives cover a spectrum of circumstances.

64 See Social Security Administration, <http://www.ssa.gov/policy/docs/ssb/v65n3/v65n3p1.html>; Association for the Advancement of Retired Persons, *Affording Retirement: Social Security Alone Isn't Enough*, http://www.aarp.org/work/social-security/info_06_2010/ss_isnt_enough.html.

65 Sylvia Allegretto, *Basic Family Budgets: Working Families' Incomes Often Fail to Meet Living Expenses Around the United States*, 36 INT'L J. OF HEALTH SERV. 3, 444-45 (2006).

66 James Lin and Jared Bernstein, Economic Policy Institute, *What We Need to Get By*, 1 (Oct. 29, 2008).

67 Diana Pierce and Jennifer Brooks, *Wider Opportunities for Women, The Self-Sufficiency Standard for the Washington, D.C. Metropolitan Area*, 3 (Fall 1999).

68 *Id.*

69 University of Washington Center for Women's Welfare, *Measuring Poverty*, <http://selfsufficiencystandard.org/node/91>.

CONCLUSION

Congress intended that taxpayers be allowed a sufficient amount of living expenses to provide for the health and welfare of their households and for the provision of income, prior to resolving IRS liabilities. The current ALE standards do not fulfill this intent. The current standards are based on outdated measurements and assumptions and are implemented in a way that keeps some taxpayers in poverty or reduced circumstances in order to meet their taxpaying obligations.

Taxpayers have a responsibility to pay their taxes. However, this responsibility should not come at the cost of not being able to afford basic living expenses. When something like the situation in *Leago* occurs, it is proof that the current standards do not take into account the taxpayer's specific facts and circumstances, clearly violating the taxpayer's *right to a fair and just tax system*.

To meet the intent of Congress, the IRS needs to reevaluate how it develops and uses the ALE standards. Before the IRS can start that process, however, it must understand what it costs to maintain the health and welfare of a household in the 21st century. The costs must be updated to include such things as child care, technology, and retirement savings. Furthermore, the standards must reflect the minimum amount necessary to maintain the health and welfare of a household, not the maximum. In doing so, the IRS will ensure that every taxpayer is allowed sufficient expenses for maintaining the health and welfare of his or her household while meeting his or her tax-paying obligations.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In conjunction with TAS, consider the family budget or self-sufficiency standard as an alternative method to calculate the cost of providing for the health and welfare of households. The alternative method should not be a cap to allowable expenses, but should represent the floor for what can be claimed.
2. Expand the standard to include additional expenses for basic technology in the household, child care, and retirement savings.
3. Reconsider the recent decrease in ALE standards for national standards, out-of-pocket healthcare, housing, and transportation.

**MSP
#14****APPEALS: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values****RESPONSIBLE OFFICIAL**

Donna C. Hansberry, Chief, Appeals

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

An independent and effective Office of Appeals (Appeals) within the IRS is essential for quality tax administration and meaningful protection of taxpayer rights. Appeals' mission is to resolve tax controversies on a basis that is fair and impartial to both the government and the taxpayer and in a manner that will enhance public confidence in the integrity and efficiency of the IRS.² To the extent that Appeals achieves these goals, the result will be an increase in timely and efficient resolution of disputes between taxpayers and the IRS, a heightened level of trust on the part of taxpayers, and an expansion of overall taxpayer compliance.³

Recently, Appeals has faced significant resource constraints. For example, Appeals' funding has fallen by approximately 11.2 percent, from \$221.1 million in fiscal year (FY) 2013 to \$196.4 million in FY 2016.⁴ Further, the number of Appeals Hearing Officers (Hearing Officers) has been reduced by approximately 24 percent between FY 2013 and FY 2016.⁵

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Internal Revenue Manual (IRM) 8.1.1.1(1), *Accomplishing the Appeals Mission* (Feb. 10, 2012).

3 See, e.g., S. REP. No. 105-174, at 84 (1998); Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia's Tax Disputes Resolution Procedures*, 27 AUSTL. TAX F. 525, 528-29 (2012); Erich Kirchler, *THE ECONOMIC PSYCHOLOGY OF TAX BEHAVIOR* (2007); Tom R. Tyler, *WHY PEOPLE OBEY THE LAW* (2006).

4 IRS, *Appeals Business Performance Review (BPR), Fourth Quarter FY16*, 24 (Nov. 7, 2016), <http://appeals.web.irs.gov/stratplan/documents/Appeals-BPR-Q4-2016.doc>, IRS, *Appeals Business Performance Review (BPR), Fourth Quarter FY13*, 24 (Nov. 7, 2013), <http://appeals.web.irs.gov/stratplan/documents/Appeals-BPR-Q4-2013.doc>.

5 Appeals response to TAS supplemental information request (Oct. 28, 2016). The term "Hearing Officer" refers to any Settlement Officer, Hearing Officer, Appeals Account Resolution Specialist, or other employee holding hearings, conferences or who otherwise resolves open case issues in Appeals. It further encompasses individuals who conduct or review administrative hearings or who supervise Hearing Officers. See IRS, *AJAC FAQs*, <http://appeals.web.irs.gov/about/ajac-faq.htm> (updated July 7, 2014).

Appeals has responded to these limitations by implementing policies and procedures, some of which create hardships for taxpayers and detract from Appeals' long-term mission. The National Taxpayer Advocate has expressed concerns regarding a number of approaches adopted by Appeals, including:

- Fostering an inhospitable Appeals environment;⁶
- Limiting taxpayers' right to an in-person conference;⁷
- Reducing the quality of substantive reviews under the Appeals Judicial Approach and Culture (AJAC) project;⁸ and
- Failing to sufficiently protect the rights of taxpayers when conducting Collection Due Process (CDP) appeals and Collection Appeals Program (CAP) hearings.⁹

Appeals' proposed trajectory, which would either exacerbate or ignore many of these concerns, is set forth in its preliminary design for a future vision. This Concept of Operations (CONOPS) is a guiding set of principles that serves as a roadmap for where Appeals would like to be in the next five years.¹⁰ To date, however, Appeals' CONOPS is limited by its reliance on a "one size fits all" model that is primarily bureaucratic- and enforcement-oriented. By contrast, the National Taxpayer Advocate urges Appeals to embrace a future vision premised on a collaborative model of taxation that would more successfully engage taxpayers as participants in the voluntary tax system.

ANALYSIS OF PROBLEM

Appeals' CONOPS Is Partially Driven by Declining Operating Budgets in Recent Years

Reductions in funding and additional demands to demonstrate return on investment have put pressure on the IRS, including Appeals, to increase revenues and lower costs.¹¹ The number of Appeals cases has dropped slightly, but then stabilized over the last few years. During that time, however, the number of Hearing Officers has sharply declined. These trends can be seen in the following figure:

FIGURE 1.14.1, Appeals Workload by Fiscal Year¹²

Fiscal Year	Case Receipts Settlements	Hearing Officers
FY 2013	123,113	924
FY 2014	113,608	852
FY 2015	113,870	768
FY 2016	114,362	705

6 National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

7 National Taxpayer Advocate 2014 Annual Report to Congress 46-54.

8 National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

9 National Taxpayer Advocate 2014 Annual Report to Congress 185-96; National Taxpayer Advocate 2015 Annual Report to Congress 91-99.

10 IRS, *Appeals Business Performance Review (BPR), Fourth Quarter FY15*, 2 (Nov. 16, 2015), <http://appeals.web.irs.gov/stratplan/documents/Appeals-BPR-Q4-2015.doc>. Subsequently, Appeals has renamed this initiative "Appeals' Future State." The term CONOPS, however, will be retained herein for the sake of brevity.

11 IRS, *Office of Appeals Concept of Operations (CONOPS)*, 4 (Aug. 31, 2015) (on file in TAS archives).

12 Data for this figure was drawn from the Appeals response to TAS supplemental information request (Oct. 28, 2016).

During this same period, however, the percentage of Examination-based Appeals cases that are docketed in the United States Tax Court (known as “docketed Appeals cases”) has increased in comparison to non-docketed Appeals cases.¹³ This increase of approximately 12 percent, which is shown below, may mean that taxpayers’ procedural rights to an appeal are being abridged, or that they are growing increasingly impatient regarding the timeliness of reviews available via the standard administrative process.¹⁴ This explanation could account for why an increasing percentage of taxpayers are finding it necessary to take their cases to courts, which, in turn, send the cases back for Appeals’ consideration, a circumstance causing both delay and expense for taxpayers and the IRS.

FIGURE 1.14.2, Non-Docketed Versus Docketed Appeals Cases by Fiscal Year

Fiscal Year	Non-Docketed Case Receipts	Docketed Case Receipts	Non-Docketed Percentage	Docketed Percentage
FY 2013	33,101	23,577	58%	42%
FY 2014	28,144	24,703	53%	47%
FY 2015	26,009	25,203	51%	49%
FY 2016	26,421	23,812	53%	47%

Over time, the number of Hearing Officers has decreased significantly more than the amount of work they are required to perform. This need to do more with less presents challenging issues that underlie Appeals’ CONOPS, and the National Taxpayer Advocate understands Appeals’ concerns regarding resources. Appeals’ need for operational efficiency and cost-effectiveness, however, is not, in the long run, best served by such steps as limiting access to in-person or geographically proximate conferences, or reducing the quality of substantive review. Rather, taxpayers who choose to engage in dialogue with the IRS through participation in the Appeals process should be encouraged, educated, and welcomed as partners in the voluntary tax system.

Appeals’ CONOPS Does Not Yet Address Many of the Core Taxpayer Service Issues Currently Existing Within Appeals

Appeals’ CONOPS is inevitably impacted by the resource challenges to which Appeals is currently subject. Nevertheless, CONOPS also presents an exceptional opportunity to improve the taxpayer experience within Appeals. To date, however, Appeals’ CONOPS is primarily amorphous and aspirational.¹⁵ It begins with an examination of Appeals’ current state, based on which Appeals identifies six challenges and associated changes that will inform its future vision. These issues relate to inefficient

13 Examination-based cases represent the best data set for observing trends in this context, as Collection-based cases overwhelmingly give rise to nondocketed appeals (approximately 99.9%). Appeals response to TAS supplemental information request (Oct. 28, 2016). If taxpayers file a valid petition for review in the U.S. Tax Court, the case often is referred back to Appeals for possible settlement if they have not previously had an opportunity to present their case to Appeals. See IRM 8.4.1.4(1), *Appeals Authority Over Docketed Cases*, (Oct. 26, 2016).

14 This increase of approximately 12 percent is based on data provided by Appeals in its response to TAS supplemental information request (Oct. 28, 2016). The percentages shown in the following table are calculated through dividing the non-docketed and docketed case receipts, respectively, by total case receipts, shown in Figure 1 above.

15 In response to an information request, Appeals provided TAS with an Aug. 31, 2015 document discussing Appeals’ CONOPS. According to Appeals, all subsequent materials are in internal pre-decisional phases and are not yet available for release. Appeals’ response to TAS information request (June 6, 2016). Given the period of time elapsed, it is somewhat difficult to tell whether Appeals has created additional Future State documents that it is affirmatively withholding pending an ongoing pre-decisional process, or whether there simply has been little-to-no progress on Appeals’ Future State (other than the name change) since the August 31, 2015 draft, which TAS was provided.

resolution pathways sometimes chosen by taxpayers, workload predictability, technology, Appeals workforce skillsets, attrition, and case management.¹⁶

Appeals' CONOPS then briefly articulates the principles, features, and initiatives intended to address these challenges. To this point, Appeals' CONOPS deals primarily in broad generalities and provides few specifics. It alludes to a tailored Appeals path in which cases would receive a particular treatment based on the issue or taxpayer type.¹⁷ It also briefly discusses transparent and consistent communications with taxpayers regarding the Appeals process.¹⁸ Nevertheless, Appeals' CONOPS does not yet furnish a detailed plan for achieving these or any other goals.

The pathway outlined by Appeals' CONOPS is too indistinct to allow for in-depth analysis. However, some of its features, such as those that contemplate accepting only cases that have an "actual disagreement" and adopting a process that provides taxpayers with only "one opportunity to settle their case in Appeals" are concerning in that they could exacerbate the problems already created by the manner in which AJAC has been implemented.¹⁹ Also, Appeals' CONOPS's idea of making alternative dispute resolution (ADR) available earlier in the tax controversy process is encouraging, but if it is not combined with a more systemic revision of the IRS's overall ADR program, it likely will continue to receive only tepid interest and minimal use.²⁰

From a broader, more fundamental perspective, Appeals' CONOPS appears to be focused primarily on internal Appeals logistics, such as technology, training, career paths, case management, and communications, all of which are worthy candidates for systemic enhancement. Nevertheless, to be truly significant and effective, Appeals' CONOPS should center on the taxpayer experience and seek to improve the case resolution environment via engagement with the taxpayer.

Taxpayers who choose to engage in dialogue with the IRS through participation in the Appeals process should be encouraged, educated, and welcomed as partners in the voluntary tax system.

TAS Urges Appeals to Adopt a Future Vision That Is More Collaborative and Taxpayer Friendly

To the extent that Appeals is willing to expand the current focus of CONOPS beyond primarily internal issues, Appeals has the opportunity to establish a more welcoming environment for taxpayers and to facilitate streamlined case resolutions. For example, taxpayers and tax practitioners often feel that a live meeting with a Hearing Officer is an important element in the proper presentation and clear understanding of their case.²¹ Moreover, an in-person meeting can sometimes be crucial for the accurate communication of ideas and can assist Hearing Officers in gauging credibility and assessing the strength of the taxpayer's case.²² The absence of in-person conferences "... puts taxpayers and their representatives

16 IRS, *Office of Appeals Concept of Operations (CONOPS)*, 8 (Aug. 31, 2015) (on file in TAS archives).

17 *Id.* at 12.

18 *Id.* at 15.

19 *Id.* at 12. Among other things, TAS's concern regarding these reasonable-sounding goals is that they could be code words for further decreasing substantive reviews and increasing case transfers to Compliance. See discussion *infra*. See also National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

20 IRS, *Office of Appeals Concept of Operations (CONOPS)*, 15 (Aug. 31, 2015) (on file in TAS archives). For a more in-depth discussion of ADR and how it might be expanded by the IRS, see Most Serious Problem: *Alternative Dispute Resolution (ADR): The IRS is Failing to Effectively Utilize ADR as a Means of Achieving Mutually Beneficial Outcomes for Taxpayers and the Government*, *infra*.

21 TAS conference call with practitioners associated with the American Bar Association (ABA) Tax Section (Apr. 28, 2016).

22 *Id.*

at a great disadvantage,” and “... substantially increases professional fees and extends the timeline in which to resolve cases.”²³

Appeals, however, has expanded the number of states without any Hearing Officers possessing case responsibilities by 33 percent (from nine to 12) between 2011 and the present.²⁴ Although taxpayers living in these states without an Appeals presence, or in portions of other states not located near an Appeals office, may still be able to obtain an in-person conference, they generally are left with the option of waiting until a Hearing Officer “rides circuit” in their area, or traveling sometimes substantial distances and incurring significant costs to obtain their desired meeting.

Further, Appeals has taken affirmative steps to clarify that in-person conferences are a matter of discretion for the Hearing Officer, not a matter of right for the taxpayer, and will be considered only under specific circumstances.²⁵ “By putting in place business rules around when Appeals provides in-person conferences, the changes shift the decision from the taxpayer to Appeals.”²⁶ Several taxpayer representative groups have expressed objections that this approach may decrease the fairness and ultimate number of case resolutions reached in Appeals.²⁷ Moreover, the issue of how this new policy will be applied in the case of CDP appeals remains an open and troubling question.²⁸

The National Taxpayer Advocate raised concerns about these policies to Appeals leadership in a Spring 2016 meeting.²⁹ Appeals justified the move away from in-person conferences by explaining that:³⁰

- Approximately 59 percent of taxpayers requesting an in-person conference, which has the effect of shifting a case from Campus Appeals to Field Appeals, do not ultimately hold the requested conference;
- Field-based Hearing Officers complain that, because of these in-person conference requests, they are asked to handle lower-graded cases, such as those relating to the Earned Income Tax Credit (EITC) and itemized deductions;
- Field-based Hearing Officers assigned to cases involving in-person conferences often are not experts in the applicable subject matter; and
- Campus facilities are not designed to accommodate in-person conferences, while Field appeals (which is where such cases are transferred) are substantially more expensive to conduct.

23 Dave R. Stubblefield, Michael D. Williams, CPA, Kenneth M. Horwitz, JD, *Growing Concerns of Appeals’ Face-to-Face Meetings*, Texas Society of Certified Public Accountants (Jan. 25, 2016), <http://tscpafederal.typepad.com/blog/2016/01/growing-concerns-of-appeals-face-to-face-meetings.html>. See also Letter from Texas Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (May 13, 2016) (on file in TAS archives).

24 These states are comprised of Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont, and Wyoming. The territory of Puerto Rico also lacks a permanent Appeals office. Appeals response to TAS information request (June 6, 2016). See also National Taxpayer Advocate 2014 Annual Report to Congress 46.

25 IRM 8.6.1.4.1, *Conference Practice* (Oct 1, 2016).

26 Open letter from Kirsten Wielobob, Chief, Appeals (Nov. 16, 2016).

27 See Letter from American College of Tax Counsel to Kirsten Wielobob, Chief, Appeals (Oct. 10, 2016) (on file in TAS archives); Leslie Book, *Technology and the Tax System: A Less Personal Appeals Office Coming Our Way*, PROCEDURALLY TAXING (Oct. 13, 2016), <http://procedurallytaxing.com/technology-and-the-tax-system-a-less-personal-appeals-office-coming-our-way/>. Letter from Texas Soc’y of Cert. Pub. Accts. to John Koskinen, Comm’r of IRS (May 13, 2016) (on file in TAS archives). The ABA Tax Administrative Practice Committee also has an ongoing comment project regarding changes to Appeals processes with respect to in-person appeals. Email from ABA Tax Administrative Practice Committee (Oct. 12, 2016) (on file in TAS archives).

28 IRM 8.22.4.1(2), *Collection Due Process (CDP) Technical IRM Overview* (Mar. 29, 2016).

29 Notes from meeting between the National Taxpayer Advocate and Appeals Executives (May 31, 2016) (on file with TAS).

30 *Id.*

In response, the National Taxpayer Advocate pointed out that many of the requests for in-person conferences likely result from an attempt by taxpayers to obtain a Hearing Officer with knowledge of the local economy, which is a reasonable and appropriate desire that should be accommodated.³¹ To facilitate this local presence and these in-person conferences, Appeals should expand its geographic footprint by strategically moving some Hearing Officers out of campuses and back to permanent postings in states where Appeals is underrepresented, or in many cases, unrepresented.

In answer to the complaints of Field-based Hearing Officers about working lower-graded cases, the National Taxpayer Advocate explained that EITC issues are as complicated as many transactions, are intensely factual, and are often based on the credibility of witnesses.³² Care must be taken not to use CONOPS as a means of disproportionately and unfairly forcing EITC cases, and those of other low-income taxpayers, to campuses. The National Taxpayer Advocate suggested to Appeals leadership that they consider re-grading certain cases and blending higher-graded and lower-graded Hearing Officers within Campus and Field Appeals. This approach would allow a better matching of appropriately graded cases to particular Hearing Officers. It would also more strategically tailor the expertise of particular Hearing Officers to the substantive knowledge requirements of individual cases. Likewise, necessary expertise can be added on a consulting basis, which would have the further benefit of helping Hearing Officers expand their skillsets.³³

Appeals' concerns regarding the additional expense of Field Appeals and the large percentage of cases in which requested in-person conferences are not ultimately held are reasonable. The best solution, however, for taxpayers and Appeals is to increase the trust of taxpayers in the quality of Campus appeals. Further, as previously recommended by the National Taxpayer Advocate, the IRS in general, and Appeals in particular, should continue to expand its implementation of Virtual Service Delivery.³⁴ Increased confidence in Campus appeals, as well as widespread availability of virtual face-to-face conferences, likely would reduce the number of requests for in-person conferences, would keep more cases in the campuses, and would be more cost-effective for Appeals. This increased trust would also have the less tangible, but no less real benefit, of improving the experience that many taxpayers have with Appeals.

A more flexible and taxpayer-friendly approach can be an excellent means of moving the Appeals process toward a collaborative, conversational model, rather than one that, under AJAC, has lately been driven too much by rigid procedures and tight timelines. Appeals has increasingly been pushing taxpayers to “fully cooperate” with Compliance demands, even where those demands may be the subject of good faith disagreement, an approach that is coercive rather than collaborative.³⁵

Last year, the National Taxpayer Advocate published a Most Serious Problem analyzing AJAC and making a number of recommendations, including that AJAC restrictions be loosened to provide Hearing Officers with more discretion in the resolution of cases.³⁶ The IRS responded that Hearing Officers already have discretion to determine whether additional factual development or analysis is needed, at which point cases are sent back to Compliance for additional investigation.³⁷ Nevertheless, under AJAC policy and practice, Hearing Officers are provided with minimal ability to determine when even modest factual investigation

31 Notes from meeting between the National Taxpayer Advocate and Appeals Executives (May 31, 2016) (on file with TAS).

32 *Id.* See IRC § 32.

33 Notes from meeting between the National Taxpayer Advocate and Appeals Executives (May 31, 2016).

34 National Taxpayer Advocate 2014 Annual Report to Congress 154-62.

35 IRS, *Fact Sheet—IRS Clarifies Office of Appeals Policies* (Oct. 1, 2016), www.irs.gov/PUP/individuals/factsheet.pdf.

36 National Taxpayer Advocate 2015 Annual Report to Congress 82-90.

37 National Taxpayer Advocate 2017 Objectives Report to Congress 80-84.

or verification can be done in Appeals. Additional authority and flexibility for Hearing Officers to determine when their own case development could assist case resolution would decrease delay and expense for both taxpayers and the government.

This trend by Appeals of relying on internal IRS procedures as a means of bypassing meritorious arguments of taxpayers and avoiding substantive issues raised by taxpayers or TAS is one that should be reversed by a broader change in Appeals' culture that can start with CONOPS. Appeals' CONOPS should move beyond its present focus on internal processes and be expanded with the goals of improving the taxpayer experience, relying on a collaborative process, and perpetuating a culture of protecting taxpayers and working with taxpayers and TAS to resolve issues.

This more taxpayer-friendly approach would be especially welcome in the Collection context, which perhaps represents Appeals' greatest opportunity and responsibility with respect to taxpayers and the tax system. Toward that end, Appeals should revitalize CAP by allowing Hearing Officers to consider collection alternatives as part of their deliberations and then remand cases to Compliance for further action. Additionally, Appeals should rigorously apply the balancing test to CDP appeals as a means of ensuring that Collection actions are reasonable and are no more intrusive than necessary. Most taxpayers contesting Collection actions, as with those filing Examination-based appeals, wish to be compliant and would welcome the facilitation of Appeals in considering and implementing appropriate case resolutions.

CONCLUSION

The National Taxpayer Advocate and external stakeholders have recently expressed concerns regarding a range of Appeals' programs and policies. These concerns, however, are left unaddressed by Appeals' CONOPS, which sets forth Appeals' projected roadmap over the next five years. To this point, Appeals' CONOPS is so vague and aspirational as to prevent meaningful analysis. It appears, however, to contemplate primarily bureaucratic initiatives and hints at procedural changes that would ignore or exacerbate the problems already existing within Appeals. This limited focus may help clear dockets in the short run, but runs the risk of disadvantaging taxpayers, jeopardizing tax compliance, and increasing the resources needed for tax enforcement in the long run.

Appeals should use the opportunity presented by CONOPS to embrace a future vision premised on working collaboratively with taxpayers to achieve mutually acceptable negotiated settlements. As part of this more taxpayer-friendly process, Appeals should enhance taxpayer trust and dialogue by making in-person conferences available where they are requested in good faith, being mindful of the prevailing geographic and local contexts out of which tax cases arise, and allowing taxpayers access to Hearing Officers with relevant subject matter expertise. Further, Hearing Officers should be provided with the time, authority, and flexibility needed to fully develop cases and to explore potential outcomes with taxpayers. TAS urges an Appeals Future State that recognizes the desire of most taxpayers to be compliant and that is designed to work with them in furtherance of this goal.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt an Appeals future vision in which Appeals adopts policies and organizes itself in a way that makes in-person Appeals conferences readily available to good-faith taxpayers who request a live conference as part of the case resolution process.
2. Adopt an Appeals future vision in which Appeals expands its geographic footprint and strategically reallocates Campus-based and Field-based Hearing Officers to increase the confidence of taxpayers that they will have access to Hearing Officers with requisite local knowledge and substantive expertise, regardless of the assigned location.
3. Adopt an Appeals future vision in which Appeals revises its procedures to allow Hearing Officers additional discretion and time to personally undertake factual development and provide more in-depth substantive review in seeking fair and efficient resolutions of Examination-based and Collection-based Appeals cases.

**MSP
#15****ALTERNATIVE DISPUTE RESOLUTION (ADR): The IRS Is Failing to Effectively Use ADR As a Means of Achieving Mutually Beneficial Outcomes for Taxpayers and the Government****RESPONSIBLE OFFICIALS**

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 Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM²

Alternative dispute resolution (ADR) is the process of resolving a dispute through non-judicial means, typically by placing the case in non-binding mediation or in binding arbitration.³ These proceedings are generally conducted by neutral parties, such as mediators, administrative law judges (ALJs), or ombudsmen. Researchers, commentators, and stakeholders have published substantial in-depth analysis regarding the effectiveness and flexibility of ADR in a variety of contexts. Further, studies in this area demonstrate that efficient ADR can have a beneficial impact on tax compliance and tax administration.⁴

The IRS itself has acknowledged that ADR can play a useful role within its operations. “A primary objective of the [IRS] is to resolve tax controversies at the lowest level without sacrificing the quality and integrity of those determinations. [ADR], or mediation programs achieve this objective.”⁵ Additionally, the IRS has expressed the view that at least some aspects of ADR can successfully be used “[t]o promote issue resolution at earlier stages and decrease the overall time from return filing to ultimate issue resolution.”⁶

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Volume 3 of the 2016 Annual Report to Congress contains an extended literature review related to this topic. Literature Review: *Options for Alternative Dispute Resolution (ADR)*, vol. 3, *infra*.

3 Throughout this Most Serious Problem, alternative dispute resolution (ADR) will be used as a collective term referring both to mediation and arbitration. More specific terms will be adopted where distinctions among the various forms of ADR become relevant.

4 See, e.g., Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia's Tax Disputes Resolution Procedures*, 27 *AUSTL. TAX F.* 525 (2012); Amy S. Wei, *Can Mediation Be the Answer to Taxpayers' Woes?: An Examination of the Internal Revenue Service's Mediation Program*, 15 *OHIO ST. J. ON DISP. RESOL.* 549, 549 (2000).

5 Internal Revenue Manual (IRM) 8.26.3.1(1), *Objective and Authority for Fast Track Mediation (FTM)* (Dec. 5, 2014).

6 Rev. Proc. 2003-40, 2003-25 I.R.B. 1044.

Nevertheless, the IRS is underutilizing this potentially valuable tool and is administering ADR in a way that is unattractive to taxpayers. For example, taxpayers and their representatives could reasonably question the accessibility, cost effectiveness, and impartiality of ADR proceedings.⁷ These doubts likely help to explain why during fiscal year (FY) 2016, the IRS reported only 306 ADR case receipts—less than one-half of one percent of the total Appeals case receipts for the year.⁸

ADR, if thoughtfully and creatively implemented, could substantially increase the efficiency and timeliness of case resolutions. In turn, an effective ADR program would protect taxpayer rights, reduce taxpayer burden and cost, encourage voluntary compliance, and economize scarce IRS resources. The IRS can take important initial steps toward building ADR into a highly useful mechanism for administrative dispute resolution by remedying existing problems, such as:

- The narrow scope of ADR, which excludes a wide range of cases, including controversies flowing from most Campus Collection actions;
- The effective veto power possessed by the IRS over all potential ADR proceedings; and
- The practice of staffing ADR programs with Appeals Officers, who may not be perceived by taxpayers as neutral parties.

ANALYSIS OF PROBLEM

The IRS Could Benefit Substantially From ADR Lessons Learned From Commentators, Businesses, Various Federal Agencies, and Tax Authorities of Certain Foreign Countries

ADR finds longstanding precedent throughout history, including application among Phoenician merchants, use by Alexander the Great's father, and inclusion in George Washington's will.⁹ Specifically, "... ADR techniques can be placed on a continuum, ranging from left to right in complexity from simple two-party negotiations to mediation to binding arbitration, with an unlimited number of hybrid techniques in between."¹⁰

The private sector has been quick to understand and seek the benefits of ADR, particularly arbitration. According to the RAND Institute for Civil Justice (RAND), some studies have indicated that over 70 percent of consumer contracts possess arbitration clauses.¹¹ Likewise, the majority of corporate counsels

7 IRS personnel generally serve as the "neutral" party in ADR proceedings. See e.g. IRM 8.26.3.1(2), *Objective and Authority for Fast Track Mediation (FTM)* (Dec. 5, 2014).

8 Fiscal year (FY) 2016 data provided by Appeals (Oct. 19, 2016).

9 Ji Hun Kim and Nicholas M. McGrath, *Mediation: Can't We All Just Get Along?*, 30 Sept. AM. BANKR. INST. 52, 52 (2011); R. Jeff Knight, *Alternative Dispute Resolution in Tax Cases* (Jan. 23, 2013), <http://ccintranet.prod.irs.counsel.treas.gov/OrgStrat/Offices/sbse/Presentation%20Materials>; A.B.A., Sec. of Disp. Resol., *Benefits of Arbitration for Commercial Disputes*, http://www.americanbar.org/content/dam/aba/events/dispute_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf (last visited Mar. 8, 2016).

10 Steven C. Wrappe, *Advance Pricing Agreements: The IRS Rediscovered Alternative Dispute Resolution*, 63 TAX NOTES 1343, 1345 (June 6, 1994).

11 Douglas Shontz, Fred Kipperman, and Vanessa Soma, RAND Inst. For Civ. Just., *Business-to-Business Arbitration in the United States: Perceptions of Corporate Counsel*, 2 (2011). See also Mandy Walker, *The Arbitration Clauses Hidden in Many Consumer Contracts*, CONSUMER REPORTS (Sep. 29, 2015), <http://www.consumerreports.org/cro/shopping/the-arbitration-clause-hidden-in-many-consumer-contracts>.

surveyed by RAND believe that contractual arbitration is better, faster, and cheaper than litigation.¹² Moreover, according to studies cited by the American Bar Association Section of Dispute Resolution:

- 80 percent of attorneys and 83 percent of business people report that arbitration is a fair and just process;
- 86 percent of corporate counsels are satisfied with international arbitration; and
- Over 90 percent of parties involved in arbitration voluntarily comply with the outcome.¹³

Likewise, some federal agencies, such as the Environmental Protection Agency (EPA), the United States Air Force (Air Force), and the Social Security Administration (SSA) have used ADR to great advantage. For example, issues resolved via ADR within the EPA demand less than 50 percent of the time from staff leads than would be required in more contentious traditional proceedings.¹⁴ Eighty-seven percent of the staff leads surveyed by the EPA with respect to their particular cases believed that ADR “was a good investment for EPA.”¹⁵

The Air Force reports that large disputes that took an average of five years to resolve through litigation are now being resolved by the use of ADR in an average of just over 12 months.¹⁶ According to the Air Force, it has avoided paying over \$275 million in contractor claims since the “ADR First” policy was instituted in 2000.¹⁷

Where SSA is concerned, ADR is conducted by ALJs who are provided free of charge and who are housed in a wholly independent unit from other SSA groups. Of the approximately 700,000 ALJ decisions rendered each year, only approximately 16,000 (less than 3 percent) are appealed to federal courts.¹⁸

Recognizing the benefits of ADR, the tax authorities of several foreign countries have also sought to institute a range of ADR programs. For example, Hong Kong utilizes an appeals system incorporating aspects of binding arbitration in which taxpayers can bring cases before a Board of Review comprised of a chairman with legal training and at least two members with expertise in other professions.¹⁹ In Australia, the government and taxpayers are encouraged to pursue ADR by a legal requirement that

12 Douglas Shontz, Fred Kipperman, and Vanessa Soma, RAND Inst. For Civ. Just., *Business-to-Business Arbitration in the United States: Perceptions of Corporate Counsel*, ix (2011).

13 A.B.A., Sec. of Disp. Resol., *Benefits of Arbitration for Commercial Disputes*, http://www.americanbar.org/content/dam/aba/events/dispute_resolution/committees/arbitration/arbitrationguide.authcheckdam.pdf (last visited Mar. 8, 2016).

14 Conflict Prevention and Resol. Ctr., U.S. Env'tl. Protection Agency, *FY 2014 Environmental Collaboration and Conflict Resolution (ECCR) Policy Report to OMB-CEQ*, 18-19 (Feb. 17, 2015).

15 *Id.* at 19-20.

16 Off. of the Att'y Gen., *Report for the President on the Use and Results of Alternative Dispute Resolution in the Executive Branch of the Federal Government*, 155 (Apr. 2007).

17 The Air Force ADR Program, *Report to the Secretary of the Air Force on the Air Force Alternative Dispute Resolution Program*, 1 (Dec. 2012).

18 *Information About SSA's Office of Disability Adjudication and Review*, https://www.ssa.gov/appeals/about_odar.html (last visited Mar. 16, 2016). Note that SSA has been criticized for the backlog of cases awaiting administrative law judge (ALJ) hearings and at least one Congressional committee has questioned whether ALJs allow too many claims in order to clear dockets quickly. These caseload issues, however, do not appear inherent to Social Security Administration's (SSA) ADR design, but rather to ALJ understaffing and documentation requirements. See *generally Systemic Waste and Abuse at the Social Security Administration: How Rubber-Stamping Disability Judges Cost Hundreds of Billions of Taxpayer Dollars: Hearing Before the H. Comm. on Oversight and Govt. Reform*, 114th Cong. (2014). David Fahrenthold, *The Biggest Backlog in the Federal Government*, WASH. POST, Oct. 18, 2014, <http://www.washingtonpost.com/sf/national/2014/10/18/the-biggest-backlog-in-the-federal-government/>.

19 *Tax Dispute Resolution: A New Chapter Emerges, Tax Administration Without Borders*, Ernst & Young, 2010; *Tax Disputes: Alternative Dispute Resolution (ADR), Functions and Procedures*, Board of Review (Inland Revenue Ordinance) (Mar. 15, 2016), www.info.gov.hk/bor/en/functions-procedures.htm (on file in TAS archives).

Alternative Dispute Resolution (ADR), if thoughtfully and creatively implemented, could substantially increase the efficiency and timeliness of case resolutions. In turn, an effective ADR program would protect taxpayer rights, reduce taxpayer burden and cost, encourage voluntary compliance, and economize scarce IRS resources.

they file a “genuine steps” statement outlining the attempts they made to avoid litigation before court proceedings can begin.²⁰ Although relatively new, Australia’s ADR procedures appear to be producing good results in achieving resolutions more frequently and earlier in the objection and appeals process.²¹ Likewise, ADR implemented by Her Majesty’s Revenue and Customs (HMRC) in the United Kingdom seems to be working well, with some data suggesting that ADR resolutions can be achieved approximately seven times faster than litigation decisions.²² Further, the HMRC’s 2013 ADR Project Evaluation Report indicates that 58 percent of all cases selected for ADR were fully resolved, while a further eight percent were partially resolved.²³

A Quality ADR Program Can Be an Important Contributor to Successful Tax Administration

When implemented effectively, ADR can have a particularly salutary effect on tax compliance and the voluntary tax system.²⁴ Its flexibility and participatory nature increase perceptions of equity and procedural justice.²⁵ In turn, such perceptions can positively impact tax compliance behavior in the future.²⁶

Specifically, “the tax compliance literature identifies that factors associated with tax disputes resolution procedures can influence taxpayers’ level of compliance.”²⁷ Of the various factors influencing tax compliance behavior, quality of contact with the tax authorities and taxpayers’ perceptions of fairness are particularly strengthened or diminished by an effective ADR program.²⁸ Generally, people who feel they have been treated in a procedurally fair manner by an organization are more likely to trust that organization and are more willing to accept even a negative outcome.²⁹ Further, “people value respectful treatment by authorities and view those authorities that treat them with respect as more entitled to be obeyed.”³⁰ ADR done well can help generate the types of interactions and perceptions that will perpetuate the compliant behavior necessary to the success of the voluntary tax system.

20 *Tax Disputes and Controversy Update—Focus on Alternative Dispute Resolution*, KPMG, (Aug. 5, 2014), <https://home.kpmg.com/xx/en/home/insights/2014/08/focus-on-alternative-dispute-resolution.html>.

21 *Id.*

22 Hui Ling McCarthy, *Tribunal Fees—A Tax on Justice*, (Jan. 1, 2016), <http://www.taxadvisermagazine.com/article/tribunal-fees-%E2%80%93-tax-justice>.

23 *Id.*

24 Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia’s Tax Disputes Resolution Procedures*, 27 *AUSTL. TAX F.* 525 (2012); Amy S. Wei, *Can Mediation Be the Answer to Taxpayers’ Woes?: An Examination of the Internal Revenue Service’s Mediation Program*, 15 *OHIO ST. J. ON DISP. RESOL.* 549, 549 (2000).

25 Tonya M. Scherer, *Alternative Dispute Resolution in the Federal Tax Arena: The Internal Revenue Service Opens Its Doors to Mediation*, 2 *J. OF DISP. RESOL.* 215 (1997).

26 Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 *FLA. TAX REV.* 599 (2007); John Hasseldine and Peggy Hite, *Key Determinants of Compliance and Non-Compliance*, 2007 *TNT* 205-40, 379 (2007).

27 Melinda Jone and Andrew J. Maples, *Mediation as an Alternative Option in Australia’s Tax Disputes Resolution Procedures*, 27 *AUSTL. TAX F.* 525, 528 (2012).

28 *Id.*

29 *Id.* at 525, 531.

30 *Id.* at 525, 531.

The IRS Is Failing to Utilize the Potential Advantages ADR Offers

The IRS acknowledges the various benefits conferred by ADR. Despite operating a range of ADR programs, the IRS underutilizes this tool for achieving cost-effective, mutually desirable negotiated settlements.

The IRS offers the following ADR options:³¹

- Fast Track Settlement (FTS) — available to taxpayers in Large Business and International (LB&I), Small Business/Self Employed (SB/SE), and Tax Exempt and Government Entities (TE/GE) when issues are fully developed by Compliance; applicable to factual and legal disputes and eligible for Hazards of Litigation settlement; standard appeal rights still available if no agreement reached.³²
- Fast Track Mediation – Collection (FTM) — available for Offer-in-Compromise or Trust Fund Recovery Penalty cases involving fully developed factual or legal issues; otherwise-applicable appeal rights retained if no agreement reached.³³
- Post Appeals Mediation (PAM) — available for Non-Collection and Collection cases with respect to factual or legal disputes where no settlement has been achieved with Appeals; ability to litigate retained if no agreement reached.³⁴

These ADR programs, however, accounted for only 306 case receipts during FY 2016—less than one half of one percent of the total Appeals case receipts for that same year.³⁵ Moreover, only 251 cases were actually resolved through a negotiated settlement during FY 2016. This ADR activity is shown in the following figure:

31 Fast Track Settlement cases are separately tracked based on the Operating Division from which they originate: Large Business and International (LB&I), Small Business/Self-Employed (SB/SE), and Tax Exempt and Government Entities (TE/GE). However, this discussion aggregates Fast Track Settlement cases for the sake of simplicity. Post-Appeals Mediation (PAM) for Non-Collection and Collection cases likewise are discussed in the aggregate for the same reason. Further, Appeals sometimes characterizes Appeals proceedings overall, as well as related programs such as Collection Due Process (CDP) appeals, the Collection Appeals Program (CAP), and Early Referral to Appeals as all constituting aspects of ADR. While all of these programs involve some degree of review and dialogue, they do not present meaningful alternatives to the IRS's current tax controversy process and therefore are not characterized as ADR for purposes of this discussion.

32 Rev. Proc. 2003-40, 2003-25 I.R.B. 1044; IRM 8.26.1 (Sep. 24, 2013); IRM 8.26.2 (Oct. 1, 2012); IRM 8.26.7 (Mar. 28, 2014).

33 Rev. Proc. 2016-57; IRM 8.26.3 (Dec. 5, 2014); *Id.*

34 Rev. Proc. 2014-63, 2014-53 I.R.B. 1014; IRM 8.26.5 (Aug. 17, 2015); IRM 8.26.9 (Mar. 16, 2015).

35 FY 2016 data provided by Appeals (Oct. 19, 2016).

FIGURE 1.15.1³⁶

ADR Program	Receipts	Settlements	Settlement Percentage	Average Days to Settlement
Fast Track Settlement – LB&I	65	70	108%	72
Fast Track Settlement – SB/SE	142	105	74%	51
Fast Track Settlement – TE/GE	17	11	65%	55
Fast Track Mediation	0	0	n/a	n/a
Post Appeals Mediation – Non-Collection	68	9	13%	59
Post Appeals Mediation – Collection	14	2	14%	124
Total	306	197	64%	60

The settlement percentages in those relatively few cases pursued by taxpayers and accepted by the IRS appear to be positive, at least in the case of the FTS program. Nevertheless, the overall aggregate case receipts of the IRS's ADR program have been steadily declining over the last three years.³⁷ This drop can be seen in the following figure:

FIGURE 1.15.2³⁸

Fiscal Year	Receipts	Settlements	Settlement Percentage
2014	413	310	75%
2015	383	232	61%
2016	306	197	64%

Many reasons contribute to the underutilization of ADR within the IRS. Initially, ADR is excluded in a wide range of circumstances, including cases that the IRS interprets as being subject to controlling precedent and most Campus Collection cases.³⁹ Moreover, it is only available where the IRS agrees to pursue it, effectively giving the IRS a strategic veto over all potential ADR proceedings.⁴⁰ If the IRS offered ADR on a broader scale with fewer limitations, ADR likely would be used more often and would become an option with which taxpayers and their representatives are increasingly well-versed.

Another inherent problem with ADR, as currently administered by the IRS, is that potential participants are not yet convinced that they will recognize enough meaningful time or cost savings to induce them

36 FY 2016 data provided by Appeals (Oct. 19, 2016). "Settlement percentage" is calculated by dividing the number of settlements by the number of receipts. This comparison is illustrative rather than exact, as occasionally, cases received in one year are settled in a subsequent year, which, among other things, can result in a settlement percentage in excess of 100 percent. The term "days to settlement" refers to the actual average number of days elapsed between the time a case is accepted into the ADR program and the time the parties reach an agreed settlement. Cases that are not successfully settled are excluded from this average. Appeals prefers the term "agreed closures" to the term "settlements" that has been adopted for purposes of this comparison.

37 Appeals response to TAS information request (Jun. 6, 2016), as supplemented by FY 2016 data provided by Appeals (Oct. 19, 2016).

38 *Id.*

39 Rev. Proc. 2003-40, § 3.03, 2003-25 I.R.B. 1045; Rev. Proc. 2016-57, § 3.04.

40 See, e.g., Rev. Proc. 2014-63, § 7.01, 2014-53 I.R.B. 1016.

to move beyond the standard tax controversy procedures with which they are most comfortable.⁴¹ As discussed above, the experiences of other governmental agencies and certain foreign tax authorities indicate that ADR flourishes once parties become convinced that an equitable outcome can be obtained more quickly and cheaply than through standard administrative and judicial channels. The IRS has yet to design an ADR system possessing sufficient volume and efficiency to persuasively make such a case.

Additionally, acceptance of ADR within the IRS may well be inhibited by the perception, deserved or not, that the “neutral facilitator” lacks independence. In commercial ADR, external neutrals, completely unassociated with the interested parties, act as facilitator. In the case of many successful government ADR programs, such as that developed by SSA, the neutral may technically be part of the agency, but the neutral is housed in a separate group within the agency and generally has no duties other than working in the ADR program.⁴² By contrast, the IRS uses Appeals Officers as neutrals who are drawn from the Office of Appeals and who are not solely dedicated to ADR cases. When not involved in an ADR proceeding, these neutrals generally work the standard Appeals docket. As a result, taxpayers contemplating ADR may question whether they are receiving a truly independent neutral and whether the outcomes produced by ADR would be any more advantageous than what would be generated via a standard Appeals proceeding.

The IRS Can Transform Its ADR Program into a Valuable Component of Tax Administration

In order to reverse the relative unpopularity of its ADR program, the IRS must institute some systemic improvements. As a threshold matter, the scope of ADR availability should be substantially increased and the effective IRS veto power removed. ADR should generally be available to all taxpayers upon request.⁴³ If the IRS wishes the program to succeed, it must allow taxpayers to choose when ADR would be beneficial.

As part of this expansion, the IRS should employ ADR actively at the Compliance level as well as at the Appeals stage. As has been suggested by the Canadian Tax Mediation Association, ADR during the examination process can help the parties better understand the issues and reach agreement on disputed facts.⁴⁴ This clarification of positions early on can often resolve cases much sooner in the proceedings than would otherwise occur and can help minimize the tendency of the parties to become entrenched in their arguments.⁴⁵ Moreover, even if resolution is not achieved, a facilitated dialogue can narrow and develop the issues so that time and resources can be more effectively focused later in the administrative process.

In order for taxpayers to embrace a voluntary program, they must be persuaded that it will produce beneficial, cost-effective outcomes. As a result, the IRS must expand the program, publicize its availability, and encourage its use through effective communications to taxpayers automatically generated

41 Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 59 (2012) (on file in TAS archives).

42 SSA, *Hearing and Appeals*, https://www.ssa.gov/appeals/hearing_process.html (last visited Mar. 16, 2016).

43 Reasonable exceptions to this general availability would include frivolous requests intended to delay or impede tax administration.

44 Canadian Tax Mediation Association, *Tax Mediation: An Innovation Promoting Transparent Exchanges Between Tax Authorities and Taxpayers* (2015) (on file in TAS archives).

45 See, e.g., Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 74 (2012) (on file in TAS archives).

by procedural triggers.⁴⁶ As part of this effort, the IRS should publish evaluative statistics, such as the percentage of settled ADR cases and the average hours spent to resolve an ADR case versus average hours to resolve standard cases. If this data is positive, that information will go a long way toward building the popularity of ADR programs. On the other hand, if the information is less-than-compelling, the IRS must figure out why and take decisive steps to make meaningful changes in its ADR program. Until quantifiable statistics indicating an effective and desirable program are presented, taxpayers' interest in ADR likely will remain tepid.

The average hours to resolution measure is particularly significant in that the time spent to resolve a case directly correlates to costs incurred by both taxpayers and the IRS. Effective ADR programs generally can demonstrate that the hours required to resolve an ADR case are substantially fewer than those spent to resolve standard administrative or judicial proceedings.⁴⁷ While expanding its ADR program, the IRS should, at the same time, reexamine applicable procedures in light of this principle and take all possible steps to streamline the efficiency and timeliness of case resolution. Among other things, this streamlining can be achieved by improving the scheduling process, reducing related paperwork, increasing accessibility to ADR personnel, and allowing video conferencing where requested by the parties.⁴⁸ As part of this fundamental redesign of its ADR program, the IRS should also consider circumstances in which a revised and improved arbitration offering could supplement mediation as an attractive and efficient alternative to litigation.

Likewise, to perpetuate the independence (both actual and perceived) of neutral facilitators, the IRS should establish a separate unit housing neutrals assigned solely to the IRS's ADR program. This reorganization would increase the trust of taxpayers that a neutral was indeed neutral and would further taxpayers' *right to a fair and just tax system*. Additionally, it would allow IRS personnel assigned to this unit to focus on refining their skills and enhancing their performance as ADR facilitators and, where applicable, decision-makers.

46 Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 62 (2012) (on file in TAS archives).

47 See, e.g., Conflict Prevention and Resol. Ctr., U.S. Evtl. Protection Agency, *FY 2014 Environmental Collaboration and Conflict Resolution (ECCR) Policy Report to OMB-CEQ*, 18-19 (Feb. 17, 2015). One of the reasons the IRS excludes most Campus Collection cases from ADR may be because these cases are already designed for quick resolution by virtue of minimal direct contact with taxpayers and limited issue development. Nevertheless, higher levels of taxpayer satisfaction and increased long-term tax compliance could be achieved by making Campus cases eligible for ADR. Further, the refusal to do so raises an access to justice issue for lower-income taxpayers, who have a large portion of their cases routed to Campuses. While lower-income taxpayers without representation may be less likely to initiate ADR proceedings than other taxpayers, they can obtain assistance from Low Income Tax Clinics (LITCs), which operate in a similar fashion to Legal Aid Societies in SSA ADR hearings. First, however, they must be informed by Appeals that LITCs exist and that LITCs can assist them in the ADR process.

48 Brittany Horth, Ladun Omideyi, and Mike Werner, *Internal Revenue Service Office of Appeals' ADR Programs*, Harvard Negotiation and Mediation Clinical Program Project, slide 20 (2012) (on file in TAS archives).

CONCLUSION

ADR has been widely embraced by businesses, various federal agencies, and tax authorities of certain foreign countries. Moreover, studies in this area demonstrate that efficient ADR can have a positive impact on tax compliance and tax administration. The IRS has acknowledged the benefits of ADR but has yet to capitalize on ADR's vast potential for increasing the quality of tax administration. Throughout FY 2016, the combined IRS ADR program generated less than 306 case receipts.

The IRS can realize the advantages of a quality ADR program by implementing a series of systemic changes, such as expanding the scope of its ADR program, publishing applicable ADR data, and establishing a separate ADR unit. Improving and expanding ADR would require a short-term investment but would yield long-term cost savings for both the IRS and taxpayers. It also would improve taxpayer satisfaction and thereby contribute to voluntary tax compliance.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Expand ADR to all taxpayers upon request, including at the Compliance level, as well as at the Appeals stage.
2. Publish quarterly data relating to the settlement percentages and the cost-effectiveness of ADR.
3. Reduce the administrative burdens surrounding ADR, allow video conferencing where desired by the parties, and examine scenarios in which a redesigned arbitration option can represent an attractive alternative to litigation.
4. Establish a separate unit to house IRS personnel assigned exclusively to the ADR program.

MSP
#16**FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights****RESPONSIBLE OFFICIALS**

Douglas W. O'Donnell, Commissioner, Large Business and International Division
Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Foreign Account Tax Compliance Act (FATCA) was passed in 2010 in response to IRS and congressional concerns that U.S. taxpayers were not fully disclosing the extent of financial assets held abroad.² In passing FATCA, Congress hoped to reign in “tax cheats” and to collect substantial amounts of previously inaccessible revenue.³ Although the concerns giving rise to FATCA are understandable, the IRS's approach to FATCA implementation has created significant compliance burdens and risk exposures to a variety of impacted parties including non-resident aliens, U.S. citizens living abroad, and foreign financial institutions (FFIs).⁴

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat 71 (2010) (adding Chapter 4 of IRC §§ 1471-1474; 6038D), collectively referred to as the Foreign Account Tax Compliance Act (FATCA).
- 3 See e.g., J. Comm. on Tax'n (JCT), “*Estimated Revenue Effects of the Revenue Provisions Contained In Senate Amendment 3310, the “Hiring Incentives to Restore Employment Act,” Under Consideration by the Senate,*” JCX-5-10 (Feb. 23, 2010), Doc 2010-3977, 2010 TNT 36-20; Brian Kindle, *FATCA may identify tax cheats, but its dragnet for financial criminals may produce an even bigger yield*, Association of Certified Financial Crime Specialists (Mar. 1, 2012), <http://www.acfcs.org/fatca-may-identify-tax-cheats-but-its-drag-net-for-financial-criminals-may-produce-an-even-bigger-yield/>.
- 4 See e.g., SIFMA, *Comments on the Final FATCA Regulations* (June 21, 2013), 2, <http://www.sifma.org/comment-letters/2013/sifma-submits-comments-to-the-us-department-of-treasury-and-the-irs-on-final-fatca-regulations/>; Treas. Reg. § 1.1474-1(f); Letter from American Citizens Abroad to Jacob Lew, Sec'y, Treasury, and John Koskinen, Cmm'r, IRS (Sept. 15, 2015), <https://www.americansabroad.org/media/files/files/f74d1b79/same-country-exemption-letter.pdf>. The hardships experienced by non-resident aliens often occur under Chapter 3 of the IRC (IRC §§ 1441-1443), which is not part of FATCA. Nevertheless, as it went about implementing FATCA, the IRS determined that it would begin treating Chapter 3 refund claims synonymously with its treatment of Chapter 4 refunds. See Notice 2015-10, 2015-20 I.R.B. 965. As a result, the issues experienced by non-resident aliens when filing Forms 1040NR, U.S. Nonresident Alien Income Tax Return, seeking amounts shown as withheld on Forms 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, are discussed in this Most Serious Problem as being related to FATCA.

The IRS has adopted an enforcement-oriented regime with respect to international taxpayers.⁵ Its operative assumption appears to be that all such taxpayers should be suspected of fraudulent activity, unless proven otherwise. This assumption results in the IRS ignoring stakeholders, dismissing useful comments and suggestions, and misallocating resources.⁶ At various points, this perspective has resulted in the IRS freezing over 102,000 refund claims from non-resident aliens, creating and then suspending use of a semi-automated matching tool, and implementing a regime that places unnecessary burdens on both taxpayers and businesses.⁷

The IRS has taken this approach despite a lack of comprehensive statistical data establishing the existence of widespread noncompliance or fraud on the part of Form 1040NR filers seeking Form 1042-S refunds, and despite TAS analysis indicating that the vast majority of these taxpayers actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population.⁸ Instead, the IRS should pursue a service- and assistance-oriented strategy for the vast majority of international taxpayers, coupled with a data-driven, narrowly targeted enforcement program. This approach would no longer disadvantage the compliant majority in an effort to prevent potential fraud by a few bad actors. In the meantime, the National Taxpayer Advocate remains concerned that:

- IRS processes for reviewing and validating Chapter 3 and Chapter 4 refund requests continue to unnecessarily burden taxpayers;
- Contemplated Chapter 3 and Chapter 4 regulations would explicitly make the availability of credits and refunds to covered taxpayers contingent on the actions of withholding agents;
- U.S. expatriates are particularly vulnerable to FATCA-related hardships;
- Passport revocations and denials could cause substantial problems for both U.S. expatriates and residents; and
- FFIs face regulatory uncertainty, reputational risk, and ongoing expenditures regarding FATCA and related information reporting obligations.

5 National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84.

6 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84; National Taxpayer Advocate 2015 Annual Report to Congress 346-52; National Taxpayer Advocate 2013 Annual Report to Congress 238-48.

7 Compliance Data Warehouse (CDW), Individual Master File (IMF) and Individual Returns Transaction File (IRTF) Extract Cycle as of 201634 (Aug. 2016); IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

8 TAS bases this determination on an analysis of data relating to reporting compliance. For example, since 2008 the “no change” rate for cases involving audits of Form 1040NR filers who also filed a Form 1042-S has generally exceeded the audit “no change” rate for all Form 1040NR filers as well for as all Form 1040 filers. Data drawn July 12, 2016 from IRS CDW, IRTF, IRMF, and Audit Information Management System (AIMS). Further, Form 1040NR taxpayers claiming Form 1042-S refunds have a lower percentage of high-scoring Discriminant Index Function (DIF) returns in comparison to filers overall — see particularly Total Positive Income (TPI) Class 72, which encompassed most taxpayers in this group. Data drawn March 25, 2016 for tax year (TY) 2014 from IRS CDW, IRTF and IMF.

ANALYSIS OF PROBLEM

IRS Processes for Reviewing and Validating Chapter 3 and Chapter 4 Refund Requests Continue to Unnecessarily Burden Taxpayers

The FATCA Program has generated a number of technology-based data management systems. These systems, on which over \$100 million have been spent, are designed to:⁹

- Allow FFIs to establish online accounts with the IRS and participate in a standardized worldwide residence-based information reporting regime;
- Facilitate financial institution reporting to the IRS and the exchange of information between the IRS and foreign tax authorities under intergovernmental agreements; and
- Compile FATCA-related data filed by taxpayers, such as via Form 8938, *Statement of Specified Foreign Financial Assets*, and Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, and match those against related compliance data coming from FFIs and withholding agents.

Many of these systems, however, are not fully functional and are not yet adequate to process the various data streams being collected from other governments, FFIs, and withholding agents under FATCA. Large amounts of data are being collected, but the ability to effectively match that data as part of the tax compliance process has not been fully developed. For example, although the IRS spent \$15 million developing and implementing an automated matching tool with respect to Chapter 3 and Chapter 4 withholding and refunds, that tool has not produced the intended business results, and the IRS does not have a timetable for when it will be remedied and brought online.¹⁰

In the interim, the IRS pursued its systemic matching program through the use of a newly developed semi-automated matching tool supplemented by high-level manual review.¹¹ This program generated widespread disallowances of Form 1042-S refunds claimed by non-residents on their Forms 1040NR.¹² This policy fell especially hard on international students, who, as a category, generally seek small-dollar refunds and represent a particularly low-risk taxpayer group.¹³ Many of these disallowances occurred for reasons that often were beyond taxpayers' control, such as transcription errors within the IRS and poor data quality.¹⁴

The National Taxpayer Advocate and various stakeholders raised concerns about the matching program and the problems it caused for non-residents.¹⁵ These cautions, however, were repeatedly dismissed by

9 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-20-077, 2-3 (Aug. 31, 2016). See the TIGTA report for a more detailed discussion of the FATCA Program systems deployment and the actual or contemplated functionalities associated with each release.

10 TIGTA, Ref. No. 2016-20-077, 4, 8 (Aug. 31, 2016).

11 Internal Revenue Manual (IRM) 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (Aug. 1, 2016). (See Servicewide Electronic Research Program: <http://serp.enterprise.irs.gov/databases/irm.dr/current/21.dr/21.8.dr/21.8.1.dr/21.8.1.11.14.2.htm>).

12 IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

13 *Id.*; National Taxpayer Advocate 2017 Objectives Report to Congress 123-30.

14 Notes from TAS conference call with Large Business and International (LB&I) (Apr. 29, 2016) (on file in TAS archives).

15 TAS General Project 34152; Briefing paper, NACUBO, *Widespread Tax Problems for International Students* (Apr. 21, 2016) (on file in TAS archives); Letter from Donna Kopley, President, Arctic International LLC, to Nina Olson, National Taxpayer Advocate (Apr. 18, 2016) (on file in TAS archives).

the IRS officials charged with operating the program.¹⁶ Only when congressional inquiries were received did the IRS take the problems seriously.¹⁷ Ultimately, an investigation of the process determined that IRS transcription errors and rigid processes were primarily responsible for the excessive number of false positives generated by the systemic matching program.¹⁸

... the IRS should pursue a service- and assistance-oriented strategy for the vast majority of international taxpayers, coupled with a data-driven, narrowly targeted enforcement program.

The IRS announced that it would lift the freezes placed on refunds of withholding tax reported on Forms 1042-S and that it would discontinue its policy of instituting future freezes until it redesigned the process for examining such claims.¹⁹ This redesign, which is currently ongoing, appears to be primarily focused on ways of alleviating the most obvious and egregious inequities to which taxpayers were subject under the prior program. Rather than retaining the prior concepts, which derive from the incorrect assumption that international transactions are more likely to be fraudulent, the process redesign should center around improving and then adapting the already-developed policies, procedures, and systems applied in the domestic context to the majority of international taxpayers.²⁰ Such an approach would effectively utilize IRS resources and fairly apply the U.S. tax laws to international taxpayers. In order for this effort to be successful, however, the IRS must abandon its enforcement-only bias against international taxpayers, become less insular in its approach, better coordinate among its own Operating Divisions, and listen to the observations and recommendations of the National Taxpayer Advocate and stakeholders who have valuable perspectives to contribute.

The IRS should treat domestic and international taxpayers similarly unless and until comprehensive statistical data indicates significantly different compliance patterns for specific groups of taxpayers. To the extent those patterns are established, the IRS would have a basis for treating certain categories of taxpayers differently and would also have a means of implementing effective and proportionate compliance initiatives (including enforcement) against those groups most likely to be noncompliant. Until such time,

¹⁶ TAS General Project 34152.

¹⁷ Letter from Rep. Lloyd Doggett to John Koskinen, Comm'r, IRS (Apr. 22, 2016) (on file in TAS archives); Letter from John Koskinen, Comm'r, IRS to Rep. Lloyd Doggett (June 6, 2016) (on file in TAS archives).

¹⁸ IRM 21.8.1.11.14.2, *FATCA - Programming Beginning January 2015 Affecting Certain Forms 1040NR* (Aug. 1, 2016). (See SERP: <http://serp.enterprise.irs.gov/databases/irm.dr/current/21.dr/21.8.dr/21.8.1.dr/21.8.1.11.14.2.htm>); IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding*, (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

¹⁹ IRS, *IRS Takes Steps to Help Students; Outlines Interim Process for Obtaining Refunds of Withholding Tax Reported on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding* (June 6, 2016), <https://www.irs.gov/uac/irs-takes-steps-to-help-students-and-others-outlines-interim-process-for-obtaining-refunds-of-withholding-tax-reported-on-form-1042s-foreign-persons-us-source-income-subject-to-withholding>.

²⁰ In the Return Integrity & Compliance Services (RICS) Integrity & Verification Operation (IVO) employed domestically, the IRS freezes potentially questionable claims while seeking to validate the withholding through its own systems and directly with the employer. IRM 25.25.1.1 (Feb. 19, 2015). See also National Taxpayer Advocate 2015 Annual Report to Congress 47 Fig. 1.4.1. This program itself is in need of substantial improvements in order to achieve an acceptable target rate of false positives.

the IRS's enforcement-oriented approach with respect to international taxpayers likely will continue to be unsystematic, unjustified, and unsuccessful.²¹

Contemplated Chapter 3 and Chapter 4 Regulations Would Explicitly Make the Availability of Credits and Refunds to Covered Taxpayers Contingent on the Actions of Withholding Agents

As previously discussed by the National Taxpayer Advocate, this new international enforcement regime under which the burdens and risks are disproportionately shifted to largely compliant taxpayers takes troubling shape in Chapter 3 and Chapter 4 withholding regulations currently under development by the IRS and Treasury.²² Specifically, these regulations would allow full credits or refunds only after a taxpayer files a tax return accompanied by the requisite Form 1042-S if the IRS can confirm that the withholding agent remitted the full amount of the aggregate liabilities for which the withholding agent is responsible.²³ In the event that a withholding agent has only partially satisfied its deposit requirements with the IRS, the regulations would provide for a *pro rata* allocation of the amount deposited among taxpayers seeking to claim credits or refunds for the withholding in question.²⁴

Some exceptions may be developed for certain scenarios, such as in cases where the under deposit of tax is *de minimis*, or in cases where the withholding agent in question has a demonstrated history of compliance with its deposit requirements.²⁵ These proposed exceptions, however, would not always address circumstances where proper amounts were *actually withheld* from taxpayers' accounts. Thus, good-faith taxpayers, for reasons completely beyond their control, could be denied a credit or refund of amounts withheld pursuant to U.S. tax law. This shift in creditor risk from the IRS, which is best positioned to enforce and collect withholding liabilities, to individual taxpayers, who are often powerless to remedy such failures, jeopardizes taxpayers' *right to a fair and just tax system* and *right to pay no more than the correct amount of tax*.²⁶ Such a regime undermines the fundamental perceptions of equity on which the voluntary tax compliance system depends.²⁷

As in the domestic context, the IRS should accept responsibility for bringing its enforcement resources to bear against noncompliant withholding agents, rather than innocent taxpayers.²⁸ This approach is feasible as withholding agents, even those active in the international arena, are overwhelmingly domestic (approximately 86 percent) and, to the extent they engage in noncompliant behavior, can be compelled by the IRS to remit the withholding payments they have collected, even where non-resident taxpayers are involved.²⁹

21 IRC § 6611(e)(4) provides that no overpayment interest will accrue on Chapter 3 and Chapter 4 refunds paid within 180 days of when the tax return is due or filed, whichever is later. Nevertheless, this statutory authority to avoid paying interest on such refunds should not be construed as a mandate for perpetually delaying those refunds in the absence of a reasonable basis for doing so and without an effective system for reviewing the claims. Simply because the IRS *can* freeze Chapter 3 and Chapter 4 refunds without quickly incurring interest charges, does not mean that the IRS *should* freeze these refunds at all or for the full 180 days.

22 National Taxpayer Advocate 2015 Annual Report to Congress, 346-52. See also Notice 2015-10, 2015-20 I.R.B. 965.

23 Notice 2015-10, III.A., 2015-20, I.R.B. 965.

24 *Id.*

25 *Id.*

26 See TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

27 Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 Fla. Tax Rev. 599 (2007); John Hasseldine and Peggy Hite, *Key Determinants of Compliance and Non-Compliance*, 2007 TNT 205-40, 379 (2007).

28 National Taxpayer Advocate 2015 Annual Report to Congress, 346-52.

29 LB&I response to TAS information request (Sep. 6, 2016). Treas. Reg. § 1.1461-1T(c). See also IRC §§ 6601, 6651(a)(2), and 6656.

U.S. Expatriates Are Particularly Vulnerable to Foreign Account Tax Compliance Act (FATCA)-Related Hardships

The IRS's enforcement-based orientation regarding offshore issues can also be especially problematic for U.S. expatriates. Some American citizens residing abroad have reported experiencing banking “lock-out” by FFIs that have chosen to eliminate their U.S. client base in order to minimize their exposure to FATCA reporting requirements and potential penalties.³⁰ As a recommendation to help solve this problem and minimize the burden of FATCA compliance for both individual U.S. taxpayers and FFIs, the National Taxpayer Advocate previously proposed that the IRS and Treasury adopt a “same country exception.”³¹ This exception would exclude from FATCA coverage financial accounts held in the country in which a U.S. taxpayer is a *bona fide* resident, would mitigate concerns about the collateral consequences of FATCA raised by U.S. non-residents, and would reduce reporting burdens faced by FFIs.

No action has been taken by the IRS or Treasury with respect to this recommendation. This idea of a same country safe harbor has also been placed before Congress by the National Taxpayer Advocate, American Citizens Abroad, and Democrats Abroad.³² The National Taxpayer Advocate reiterates her recommendation that the FATCA regime incorporate a same country exception.

In a recent survey of U.S. expatriates conducted by Americans Abroad Global Foundation and the University of Nevada-Reno, 91 percent of respondents indicated that FATCA compliance placed them at a disadvantage compared with ordinary citizens from their country of residence.³³ Further, 86 percent articulated the belief that the law should be revised to reduce some of the associated burdens by adopting a “Same Country Exception.”³⁴ The survey report concludes, “There appears to be a consensus among many respondents that their government does not recognize how the FATCA legislation is negatively affecting them and limiting their ability to maintain banking and financial relationships. Most feel that their government is not doing enough to try and address their concerns and problems.”³⁵

Perhaps because of the perceptions expressed in the University of Nevada study, along with other reasons including banking lock-out and the additional compliance burdens imposed by FATCA and related information reporting regimes, the number of expatriates renouncing their U.S. citizenship has continued to rise.³⁶ In calendar year 2015, a record 4,279 individuals renounced their U.S. citizenship or long-term residency — a 25 percent increase over 2014, which likewise had been a record-breaking year.³⁷ As

30 See Letter from American Citizens Abroad to Jacob Lew, Sec'y, Treasury, and John Koskinen, Cmm'r, IRS (Sept. 15, 2015), <https://www.americansabroad.org/media/files/files/f74d1b79/same-country-exemption-letter.pdf> (last visited Oct. 21, 2016).

31 *National Taxpayer Advocate Seeks End to Duplicative FATCA Reporting*, 2015 TNT 71-16 (Apr. 14, 2015).

32 Letter from American Citizens Abroad to Jacob Lew, Sec'y, Treasury, and John Koskinen, Cmm'r, IRS (Sept. 15, 2015), <https://www.americansabroad.org/media/files/files/f74d1b79/same-country-exemption-letter.pdf>; Democrats Abroad, *FATCA Update: October - December 2015*, http://www.democratsabroad.org/fatca_update_oct_december_2015 (last visited Feb. 12, 2016). See also National Taxpayer Advocate 2015 Annual Report to Congress 353-62.

33 *A Study of the Consequences of the Foreign Account Tax Compliance Act on Americans Living Overseas: Survey Results and Interpretations*, University of Nevada, 10, Table 1. <http://www.unr.edu/Documents/business/accounting/FATCASurveyReportFinalDraftDecember2015.pdf>.

34 *Id.* at 13.

35 *Id.* at 14.

36 81 Fed. Reg. 6598-02, 2016-02312.

37 International Tax Blog, *New Expatriate Record for 2015 – Nearly 4,300 Expatriations* (Feb. 5, 2016) http://intltax.typepad.com/intltax_blog/2016/02/new-expatriate-record-2015-nearly-4300-expatriations.html; Russell Newlove, *Why Expat Americans are Giving up their Passports*, BBC News (Feb. 12, 2016), <http://www.bbc.com/news/35383435>. See also 81 Fed. Reg. 6598-02, 2016-02312.

explained by one expatriate, “If it weren’t for FATCA and the decision by the bank [lock-out], I’d never be doing this.”³⁸

Passport Revocations and Denials Could Cause Substantial Problems for Both U.S. Expatriates and Residents

Another enforcement provision that exacerbates the disproportionate burden on expatriates is the recently enacted law allowing for the revocation or denial of passports for taxpayers who owe the IRS more than \$50,000.³⁹ For U.S. residents, the lack of a passport typically would constitute an irritation; for expatriates, however, it could represent a crisis: “Americans abroad need their passports for many routine activities of daily life, such as banking, registering in a hotel, or registering a child for school, and mistakes could be disastrous.”⁴⁰ Additionally, concern has been expressed regarding potentially dangerous in-country events or circumstances to which expatriates might sometimes be exposed because of passport revocation.⁴¹

The IRS is currently developing processes and procedures relating to the implementation of this additional tax enforcement mechanism. In this process, the IRS should learn from its experiences with Chapter 3 and Chapter 4 refunds and carefully coordinate and collaborate within its own Operating Divisions and within the Department of State. Moreover, the IRS should protect the rights of taxpayers by, among other things:

- Broadly interpreting hardship and other discretionary exclusions;
- Providing an administrative appeal before certifying a “seriously delinquent tax debt” to the Department of State;
- Encouraging the Department of State to adopt expansive definitions of humanitarian and emergency exceptions; and
- Informing the taxpayer of the availability of TAS assistance before passport revocation or denial occurs.⁴²

Great care should be taken in the implementation of this law to ensure that its application is reasonable and proportionate with respect to both U.S. citizens residing abroad and in the United States.

Foreign Financial Institutions (FFIs) Face Regulatory Uncertainty, Reputational Risk, and Ongoing Expenditures Regarding the Foreign Account Tax Compliance Act (FATCA) and Related Information Reporting Obligations

The IRS’s shift to enforcement-based international tax administration places significant compliance burdens and costs of implementation on FFIs as well as taxpayers. For example, a broad range of U.S.-source payments to FFIs are subject to a 30 percent withholding tax, unless the FFIs agree to provide

38 Russell Newlove, *Why Expat Americans are Giving up their Passports*, BCC NEWS (Feb. 12, 2016), <http://www.bbc.com/news/35383435>.

39 Fixing America’s Surface Transportation Act (FAST), Pub. L. No. 114-94, Title XXXII, Subtitle A, § 32101 (Dec. 4, 2015), adding IRC § 7345. See also Chris Matthews, *Pay Your Taxes or Lose Your Passport*, FORTUNE MAGAZINE (Nov. 20, 2015), <http://fortune.com/2015/11/20/irs-taxes-passport/>.

40 Chris Matthews, *Pay Your Taxes or Lose Your Passport*, FORTUNE MAGAZINE (Nov. 20, 2015), <http://fortune.com/2015/11/20/irs-taxes-passport/>.

41 Alexander Lewis, *New Law Will Revoke Passports for Delinquent Tax Debts*, 2015 TNT 234-6 (Dec. 7, 2015). See also Fixing America’s Surface Transportation Act (FAST), Pub. L. No. 114-94, Title XXXII, Subtitle A, § 32101 (Dec. 4, 2015).

42 See Fixing America’s Surface Transportation Act (FAST), Pub. L. No. 114-94, Title XXXII, Subtitle A, § 32101 (Dec. 4, 2015), adding IRC § 7345.

comprehensive information regarding accounts of U.S. taxpayers.⁴³ Additionally, FATCA charges withholding agents with the responsibility of determining whether they are obliged to undertake FATCA withholding and implementing it when required.⁴⁴

In turn, FFIs who have reached agreements with the IRS to avoid being subject to systematic withholding must impose withholding on any of their own customers defined as “recalcitrant account holders.”⁴⁵ Although FFIs have some latitude in identifying recalcitrant account holders, customers are in jeopardy of facing withholding if they are unable to provide the FFI with either a Form W-9 to certify they are U.S. persons, or a Form W-8BEN to certify they are foreign persons.⁴⁶ When in doubt, FFIs are incentivized to over-withhold, as failure to do so can result in liability for the uncollected withholding and exposure to penalties.⁴⁷

FATCA implementation has been characterized by a change from information gathering to withholding and enforcement.⁴⁸ This heavy-handed approach, especially when combined with the complexity surrounding IRS requirements, has negative consequences, both for FFIs and the IRS. For example, the IRS has made a number of changes to Form 8966, *Foreign Account Tax Compliance Act (FATCA) Report*, which is used to collect information for identifying noncompliance, without providing helpful instructions or adequately coordinating with foreign tax authorities.⁴⁹ As explained by industry stakeholders in a 2015 IRS FATCA roundtable:

Complexity is a big issue under FATCA. Regional/community banks that do not have the resources to make all of the changes needed to respond to the complexity are struggling with clarity and lack of understanding of what the rules are. As a result, FFIs run the risk of IRS sanctions if they mistakenly use incorrect codes for reporting or misinterpret the rules in validating W-8s.⁵⁰

43 IRC § 1471(a); IRC § 1473(1). IRC § 1471(d)(1)(B) exempts from the reporting and withholding requirements those accounts that are held by individuals at the same FFI and have an aggregate value of \$50,000 or less. Note that an FFI can provide information either as a participating FFI or pursuant to an intergovernmental agreement negotiated between the U.S. and the FFI's home country.

44 IRC §§ 1471 – 1474; Notice 2016-08, 2016-06 I.R.B. 304.

45 IRC § 1471(b)(1)(D)(i).

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

47 IRS, *IRS FATCA Roundtable: Industry Concerns and Suggestions*, 5 (Nov. 16, 2015). See also Notice 2016-08, 2016-06 I.R.B. 304

48 *Id.* at 3.

49 *Id.*

50 *Id.* at 2-3.

The IRS could reduce compliance burdens on FFIs and ultimately achieve more effective results if it adopted a collaborative model of tax administration with respect to FFIs. A significant step in this regard would be to simplify and clarify the definition of “good faith efforts” under IRS published guidance.⁵¹ As things stand now, “... over-reporting, over-withholding, and misinformation could make it difficult for the IRS to use the information it is receiving as intended, and may lead to false-positives.”⁵² The IRS should “distinguish between FFIs that are colluding with their local authorities to avoid FATCA and FFIs that are making genuine, ‘good faith’ efforts to comply, but are unable to because of the complexity of the law.”⁵³

The IRS should acknowledge the colossal efforts undertaken by FFIs to comply with FATCA rules. At the same time, it should begin working cooperatively with them to maintain and improve reporting rather than simply penalizing them for noncompliance. Instead of threatening penalties, the IRS should encourage correction of erroneous reporting and focus its efforts on giving FFIs the clarity and consistent guidance needed for reasonable, cost-effective compliance with FATCA.

CONCLUSION

The IRS has gradually shifted to an enforcement-based regime with respect to international taxpayers.⁵⁴ The underlying assumption is that all such taxpayers should be suspected of fraudulent activity until they can prove otherwise, an outlook that causes the IRS to mistrust stakeholders, dismiss useful comments and suggestions, and misallocate resources.⁵⁵

One manifestation of this perspective has been the development and implementation of processes for reviewing and validating Chapter 3 and Chapter 4 refund requests that continue to unnecessarily burden taxpayers. Contemplated Chapter 3 and Chapter 4 regulations would exacerbate these problems by making the availability of credits and refunds to covered taxpayers contingent on the actions of withholding agents, over whom taxpayers have little, if any, control. Further, U.S. expatriates are particularly vulnerable to FATCA-related hardships such as banking lock-out and other conceptually similar legislation, such as IRC § 7345, which allows for potential passport revocation and denial.

FFIs likewise face regulatory uncertainty, reputational risk, and ongoing expenditures regarding FATCA and related information reporting obligations. The IRS could achieve better results and reduce burdens placed on taxpayers and FFIs if it followed a collaborative model of taxation that sought to identify and focus on the relatively few bad actors while at the same time recognizing the good faith efforts of the compliant majority.

51 IRS, *IRS FATCA Roundtable: Industry Concerns and Suggestions*, 3 (Nov. 16, 2015).

52 *Id.* at 7.

53 *Id.* at 7.

54 National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84.

55 See *id.* National Taxpayer Advocate 2015 Annual Report to Congress 346-52; National Taxpayer Advocate 2013 Annual Report to Congress 238-48.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Implement policies and procedures for reviewing and issuing Chapter 3 and Chapter 4 refund claims that mirror those processes currently in place with respect to domestic taxpayers under IRC § 31 and related regulations.
2. Adopt a same country exception that excludes from FATCA coverage financial accounts held in the country in which a U.S. taxpayer is a *bona fide* resident.
3. Protect the rights of taxpayers potentially impacted by the new law regarding revocations and denials of passports by broadly interpreting hardship and other discretionary exclusions; providing an administrative appeal before certifying a “seriously delinquent tax debt” to the Department of State; working with the Department of State to encourage it to adopt expansive definitions of humanitarian and emergency exceptions; and informing taxpayers of the availability of TAS assistance before passport revocation or denial occurs.
4. Reduce burdens on FFIs by adopting a collaborative model of tax administration that encourages FFIs to correct erroneous reporting and focuses on providing the clarity and consistent guidance needed for reasonable, cost-effective compliance with FATCA.

MSP
#17**INSTALLMENT AGREEMENTS (IAs): The IRS Is Failing to Properly Evaluate Taxpayers' Living Expenses and Is Placing Taxpayers in IAs They Cannot Afford****RESPONSIBLE OFFICIALS**

Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

Internal Revenue Code (IRC) § 6159 authorizes the IRS to enter into an agreement with a taxpayer to pay any tax due in installments to facilitate full or partial collection of the tax.² Collectively, these agreements are known as installment agreements (IAs), of which the IRS offers several types to assist taxpayers in resolving their tax liabilities.³ Across all types of IAs, the default rate — the rate at which taxpayers fail to make payments as agreed — is over 13 percent in fiscal year (FY) 2016.⁴ This seemingly low overall default rate masks issues with certain types of IAs and economic hardship for taxpayers who continue to pay IAs despite not having enough income to support the payments proposed by the IRS. TAS review of IRS data found:

- Partial Pay Installment Agreements (PPIAs) have a default rate of nearly 28 percent;⁵
- IAs worked by IRS field employees and Automated Collection Services (ACS) defaulted at rates of 26 and 20 percent, respectively;⁶

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 IRC § 6159.

3 Internal Revenue Manual (IRM) 5.14, *Installment Agreements* (Jan. 7, 2016).

4 IRS, *Installment Agreement (IA) Default Rate Report* (Oct. 6, 2016). Overall, 13.23 percent of all IAs defaulted in FY 2016.

5 IRS, *IA Default Rate Report* (Oct. 6, 2016). PPIAs defaulted at a rate of 27.84 percent in FY 2016.

6 *Id.* Field worked IAs defaulted at a rate of 26.24 percent and Automated Collection Services (ACS) IAs defaulted at a rate of 20.11 percent in FY 2016.

- Nearly 300,000 taxpayers who should have qualified for currently not collectible (CNC) status had entered into installment agreements in calendar year 2014 despite their income being below the IRS allowable living expense (ALE) standards;⁷ and
- Over 46,000 taxpayers with balances due of greater than \$10,000, whose incomes were less than their ALEs, and who entered into IAs in 2014 subsequently defaulted by FY 2016.⁸ This is about 43 percent of the taxpayers with these characteristics.

The higher rates of default on certain types of IAs and the number of taxpayers who may be paying their IAs at the expense of necessary living expenses indicates that the IRS is not conducting appropriate financial analysis or providing the tools for taxpayers to conduct an analysis before entering into streamlined IAs and is placing taxpayers in IAs that they cannot afford. The consequences to the taxpayer and the IRS of placing taxpayers in unaffordable IAs include:

- Rework for the IRS when a taxpayer defaults;
- Wasted IRS resources;
- The inability of a taxpayer to qualify for another guaranteed IA in the subsequent five year period;⁹ and
- An additional user fee for the taxpayer if the taxpayer requests a reinstatement of a defaulted IA.¹⁰

The IRS has the data available to determine if a taxpayer has the appropriate income to support payments under an IA and should use this data in making determinations about the taxpayer's ability to pay and appropriate collection alternatives for each taxpayer in order to prevent rework for the IRS, reduce burden and frustration for taxpayers, and craft individual taxpayer solutions that encourage current and future compliance.¹¹ As the IRS moves on its "Future State" plans, it should focus on using data and technology to assist taxpayers entering into realistic and affordable payment arrangements instead of relying upon a one-size-fits-all strategy.

ANALYSIS OF PROBLEM

Background

Taxpayers are required to pay their taxes throughout the year in a pay as they go fashion, either through income tax withholding from their paychecks or through quarterly estimated tax payments. However, in Tax Year 2015, the IRS received over 27 million returns with balances due; of those, over seven million did not include full payment with the return.¹² The IRS generally has ten years from the date

7 Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*. TAS research found 286,141 taxpayers who entered into an IA in 2014 despite TPI less than ALEs after eliminating accounts where abatements were at least half of the balance (including accruals), refund offsets that were at least 95 percent of the balance, or cases where the IRS classified a taxpayer prior to CNC subsequent to the initial TDA in 2014.

8 Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*. TAS research found that 42.8 percent of taxpayers with total positive income (TPI) less than their ALEs who had balances due of greater than \$10,000 and entered into IAs in FY 2014 defaulted by FY 2016.

9 IRM 5.14.11.5(2)(b) (Jan. 1, 2015).

10 IRM 5.19.1.5.4.6(4) (Sept. 29, 2014).

11 TAS, *Importance of Financial Analysis in Installment Agreements Research Study* (2016).

12 IRS, *Individual Returns Transaction File* (Dec. 20, 2016); IRS, *Compliance Data Warehouse* (Dec. 20, 2016).

TAS research suggests that the IRS is placing taxpayers into Installment Agreements (IA) where their total positive income is less than their Allowable Living Expenses. Taxpayers may agree to an IA they can't afford out of fear of the IRS, a misunderstanding of the options available, or out of obligation to repay their debts at any costs.

of assessment to collect the tax due — known as the collection statute expiration date (CSED).¹³ There are a variety of payment options for taxpayers that depend on factors such as the amount owed and the taxpayer's compliance history.¹⁴

IAs are offered as a collection alternative mutually beneficial to taxpayers and the IRS — taxpayers can make payments to the IRS over time and spread out the burden of paying their tax accounts, and the IRS can increase revenue by collecting portions of tax due rather than nothing.¹⁵ The IRS offers several types of IAs.¹⁶ Congress has recognized the value of IAs, and in the IRS Restructuring and Reform Act of 1998 (RRA 98), it required the IRS to accept an IA proposal from a taxpayer if the taxpayer owed less than \$10,000, had not failed to file a required tax return in the previous five years, failed to pay any tax shown on such return or entered into an IA, could not full pay the liability when due, and would full pay the tax due within three years of the agreement.¹⁷ This is known as a “guaranteed” IA.

Subsequently, the IRS administratively created a “streamlined” IA by increasing the limit of tax due allowed under “guaranteed” IAs and the length of time granted to the taxpayer to repay the debt.¹⁸ Today, streamlined IAs are available to taxpayers with balances due of \$50,000 or less which will be repaid in installments in six years or less.¹⁹ Other IAs, such as regular (non-streamlined) IAs and PPIAs require financial analysis and the completion of a Collection Information Statement (CIS) and generally require user fees and result in the filing of a Notice of Federal Tax Lien (NFTL).²⁰

13 IRC § 6502(a).

14 See, e.g., IRC § 6159; IRC § 7122.

15 When a taxpayer enters into an IA, interest continues to accrue daily on the balance due from the due date of the first IA payment. IRC § 6601(b). A taxpayer who fails to pay the full balance due on the return is subject to the failure to pay (FTP) penalty under IRC § 6651 at a rate of 0.5 percent of the balance due per month or fraction of a month up to 25 percent of the total tax due. While the FTP penalty continues to accrue for the duration of an IA, Congress has encouraged the use of IAs by reducing the penalty to 0.25 percent per month or fraction of month on balances due where the taxpayer has entered into an IA. IRC § 6651(h).

16 IRM 5.14, *Installment Agreements* (Jan. 7, 2016).

17 IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3467, 112 Stat. 685 (1998) (codified at IRC § 6159(c)). This legislation codified the IRS's standard practice. Conf. Rep. No. 105-599, at 292-93 (1998). “Streamlined,” “guaranteed,” and “in-business trust fund express” IAs are all very similar and none of them require an analysis of the taxpayer's ability to pay. See IRM 5.14.5.1 (May 23, 2014).

18 See Memorandum from Assistant Commissioner (Collection), *Increase in Streamlined Installment Agreement Dollar Authority* (Mar. 31, 1998), reprinted as, *Memo on Streamlined Installment Agreements Released*, 1999 TNT 111-26 (June 10, 1999). See also IRM 5.14.2.2 (Oct. 18, 1999); Memorandum from Assistant Commissioner (Collection), *Increase in Streamlined Installment Agreement Authority* (Mar. 17, 1999), reprinted as, *Memo on Streamlined Installment Agreements Released*, 1999 TNT 111-24 (June 10, 1999). However, this guidance contemplated a conversation between the IRS and taxpayers. *Id.* (noting “[t]axpayers should be questioned on the amount they can pay every month...”).

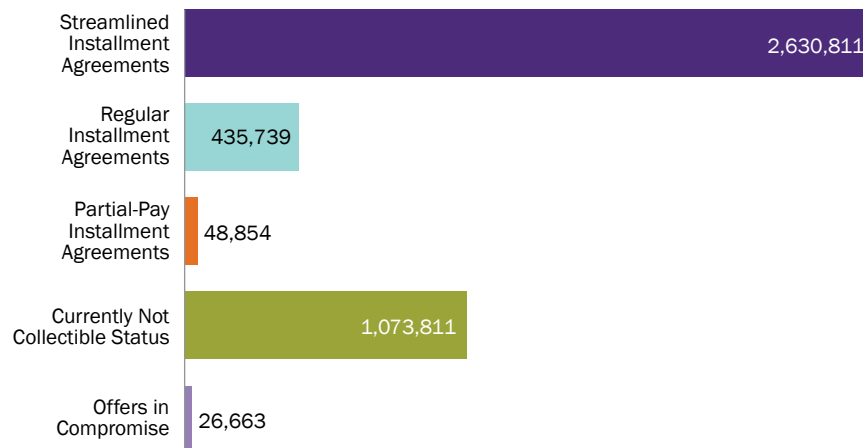
19 IRM 5.14.5, *Streamlined Installment Agreements* (Dec. 23, 2015).

20 IRM 5.14.1.2, *Installment Agreements and Taxpayer Rights* (Jan. 1, 2016). See, e.g., 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 302-10; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. See also Taxpayer Assistance Directives (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, <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>. However, under IRC § 6323(j)(1)(B), the IRS may withdraw a Notice of Federal Tax Lien (NFTL) if the taxpayer enters into an IA, causing unnecessary burden and delay for the taxpayer to then request the withdrawal of an NFTL issued in concurrence with an IA.

The IRS granted over 3,000,000 IAs of all types in FY 2016.²¹ This includes 2,630,811 streamlined IAs compared to 48,854 PPIAs, and 435,739 regular IAs.²² In contrast, the IRS approved 26,663 offers in compromise (OICs) and placed 1,073,811 accounts into CNC status in FY 2016.²³ IAs, and in particular, streamlined IAs, are the most frequently used collection alternative at the IRS.

FIGURE 1.17.1

Alternative Collection Arrangements in FY 2016



Allowable Living Expenses May Not Reflect the True Ability of Taxpayers to Make Installment Agreement Payments

Expenses are allowable if they are “necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.”²⁴ IRC § 7122(d)(2)(A) mandates that the IRS “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”²⁵ These ALEs are used to calculate a taxpayer’s ability to make IA payments. However, the standard of “necessary” is not defined in this context in the IRC or Treasury Regulations; instead, the IRS has determined what are “necessary” expenses using its own discretion. In fact, the Treasury Regulations relating to ALEs specifically state that taxpayers shall retain “sufficient” income to pay basic living expenses and this amount should be determined based on the individual taxpayer’s circumstances.²⁶

ALEs are based on both national and localized costs using data from the Bureau of Labor Statistics and the Census Bureau.²⁷ Notably, ALEs have not been updated to include expenses that many families

21 IRS, Collection Activity Report 5000-6 (Oct. 3, 2016). The IRS granted 3,115,404 IAs of all types in FY 2016.

22 *Id.*

23 IRS, Collection Activity Reports 5000-108 (Oct. 4, 2016), 5000-149 (Oct. 3, 2016).

24 IRM 5.15.1.7(1), *Allowable Expense Overview* (Oct. 2, 2012). For a full discussion of the National Taxpayer Advocate’s concerns about ALEs, see Most Serious Problem: *The IRS Should Reevaluate How It Develops and Uses Allowable Living Expense (ALE) Standards to Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Household While Complying with Their Tax Obligations*, *supra*.

25 See also Treas. Reg. § 301.7122-1(c)(2)(i).

26 Treas. Reg. § 301.7122-1(c)(2)(i).

27 IRM 5.15.1.7 (Oct. 2, 2012).

Nearly 300,000 taxpayer accounts that should have qualified for currently not collectible status ... (69 percent) are being resolved by the taxpayer making payments, not because of abatements by the IRS or offsets of the taxpayers' refunds, indicating that the taxpayers are paying their accounts despite having total positive income less than Allowable Living Expenses, suggesting the taxpayers are prioritizing paying the IRS over meeting their necessary living expenses.

consider necessary to function in today's society. For example, the IRS considers childcare to be an "other expense" rather than a necessary expense, even where both parents are employed full time, thus leaving it to the determination of the individual IRS employee as to whether the expense will be considered necessary.²⁸ It would be counter-productive for this expense to be disallowed where both parents are working and would be better able to pay their tax liability with two incomes.²⁹

TAS research suggests that the IRS is placing taxpayers into IAs where their total positive income (TPI) is less than their ALEs. Taxpayers may agree to an IA they can't afford out of fear of the IRS, a misunderstanding of the options available, or out of obligation to repay their debts at any costs. Nearly 300,000 taxpayer accounts that should have qualified for currently not collectible (CNC) status had entered into installment agreements in calendar year 2014 despite their income being below the IRS ALEs.³⁰ These taxpayer accounts (69 percent) are being resolved by the taxpayer making payments, not because of abatements by the IRS or offsets of the taxpayers' refunds, indicating that the taxpayers are paying their accounts despite having TPI less than ALEs, suggesting the taxpayers are prioritizing paying the IRS over meeting their necessary living expenses.³¹ By the IRS's definition, taxpayers who cannot meet their necessary living expenses are experiencing economic hardship.³² These taxpayers would therefore qualify for a mandatory release of an IRS levy, yet the IRS accepts IAs from these taxpayers despite the payments causing economic hardship.³³ Additionally, TAS research found higher default rates for taxpayers with TPI less than ALEs. Taxpayers with TPI less than ALEs and balances due of \$1,001 to \$10,000 who entered into IAs in FY 2014 defaulted at a rate of nearly 25 percent by FY 2016, compared to an overall default rate in this income category of less than 23 percent. Similarly, taxpayers with TPI less than ALEs and balances due of greater than \$10,000 who entered into IAs in FY 2014 defaulted at a rate of almost 43 percent by FY 2016 compared to an overall default rate in this category of less than 38 percent.³⁴

28 IRM 5.15.1.10(3), *Other Expenses* (Nov. 17, 2014).

29 The latest Census Bureau Report found that nearly 33 percent of children age five and under in 2011 were in non-relative care. Census Bureau, *Who's Minding the Children?* (Apr. 2013).

30 Research Study: *The Importance of Financial Analysis in Installment Agreements (IAs) in Minimizing Defaults and Preventing Future Payment Noncompliance*, vol. 2, *infra*. TAS research found 286,141 taxpayers who entered into an IA in 2014 despite TPI less than ALEs after eliminating accounts where abatements were at least half of the balance (including accruals), refund offsets that were at least 95 percent of the balance, or cases where the IRS classified a taxpayer prior to CNC subsequent to the initial TDA in 2014.

31 *Id.*

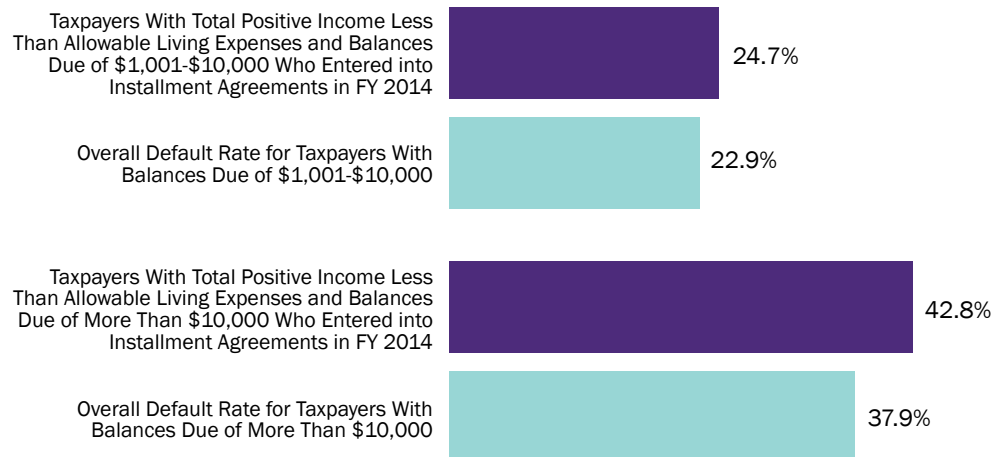
32 IRM 5.11.2.3.1.4, *Economic Hardship* (Apr. 15, 2014).

33 *Id.*

34 TAS, *Importance of Financial Analysis in Installment Agreements* (2016).

FIGURE 1.17.2

Default Rates by Balance Due



Certain Types of Installment Agreements Have Higher Rates of Default

Taxpayer in PPIAs Default at a Higher Rate Than All Other Types of IAs

The American Jobs Creation Act of 2004 amended IRC § 6159(a) to permit the IRS to accept IAs in full or partial collection of tax.³⁵ Such partial collection IAs, which will not full pay the tax liability before the statutory period for collection expires (referred to, in the IRS, as the collection statute expiration date or CSED), are known as PPIAs. The IRS may grant a PPIA where the taxpayer cannot full pay the liability before the CSED, but has some ability to pay.³⁶ In order to obtain a PPIA, the taxpayer must submit a full CIS in order for the IRS to assess ability to pay.³⁷

Although IRS employees are required to determine ability to pay using the CIS, which relies on ALEs, PPIAs have a higher default rate than all other IA types.³⁸ PPIAs default at a rate of nearly 28 percent compared to 13 percent for all IAs.³⁹ By definition, these taxpayers are not able to full pay their liability in the IRS's determination. With such a high default rate, the financial analysis completed to determine the ability of the taxpayers under PPIAs to pay may not be capturing the true ability of these taxpayers to pay the amount determined. One factor that may contribute to this default rate is the disallowance of "conditional" expenses for PPIAs.⁴⁰ Taxpayers in regular IAs are allowed conditional expenses if they can full pay the liability in six years and within the CSED.⁴¹ For example, education and legal fees (those not related to professional representation in matters before the IRS) are deemed conditional.⁴² A taxpayer working towards completing a college degree would be required to stop attending classes which

35 The American Jobs Creation Act of 2004 (Pub.L. 108-357).

36 IRM 5.14.2.1 (Mar. 11, 2011).

37 IRM 5.14.2.1.1, *Streamlined Installment Agreement Requirements* (Sept. 19, 2014).

38 IRS, *IA Default Rate Report* (Oct. 6, 2016).

39 *Id.*

40 IRM 5.14.2.1.1 (Sept. 19, 2014).

41 IRM 5.19.13.1.2.7, *Conditional Expenses* (Nov. 25, 2014).

42 *Id.*

may trigger repayment requirements for student loans, further impacting the taxpayer's ability to pay. Or, if a taxpayer was involved in a custody suit over a minor child, legal fees would not be permitted. The taxpayer's custody suit would not go away as a result of a tax debt and the taxpayer would need to continue paying an attorney to proceed with the suit, possibly resulting in a default on the IA.

Taxpayers in IAs Worked by the Field or in ACS Default at Higher Rates Than Those Worked by Other Groups

Most contact employees across the IRS can set up IAs with taxpayers; including employees in the Small Business/Self-Employed Division (SB/SE) Campus Collection Operations, ACS employees, Automated Collection System Support (ACSS) employees, Compliance Services Collection Operations (CSCO) employees, as well as Collection Field function Revenue Officers & Taxpayer Assistance Center (TACs) employees, and Tax Compliance Officers and Revenue Agents in the Examination Division, who can set up IAs at the completion of an audit as well as Wage and Investment (W&I) employees who answer the National Taxpayer Advocate Toll-Free Line.⁴³ In TAS, Intake Advocates and Case Advocates as well as Customer Service Representatives also have the delegated authority to set up streamlined IAs.⁴⁴

Field and ACS worked IAs have higher default rates than all IAs overall and higher default rates than IAs worked by other IRS work groups.⁴⁵ Field IAs default at a rate of 26 percent and ACS IAs at a rate of 20 percent. This is in comparison to an overall IA default rate of 13 percent, a default rate of only about nine percent for CSCO, and a rate of 11 percent for Exam-worked IAs.⁴⁶

The disparate default rates for IAs worked by different IRS work groups should be studied. The IRS may find that the taxpayer populations served by different IRS working groups have unique characteristics and needs. Such information would allow the IRS to tailor training on all alternative collection methods to the particular working group and taxpayer populations served and potentially increase collectibility.⁴⁷

The IRS Needs to Focus on Realistic and Affordable Resolution of a Tax Account Based on a Thorough Financial Analysis of the Taxpayer's Ability to Pay Upfront

The goal of an IA should be to create a payment plan that is realistic for the taxpayer given the taxpayer's individual circumstances. If an IA is not the best solution for the taxpayer and the IRS, alternatives such as OICs should be explored. For example, field employees may work with more noncompliant taxpayers where special strategies are needed to ensure that the taxpayers come into and remain in compliance throughout the IA process. Developing training aimed at creating strategies to address the issues in these taxpayer populations may assist these employees in crafting IAs that will help these taxpayers remain compliant or in placing the taxpayer in a different, more suitable collection arrangement given the circumstances, such as an OIC.

43 IRS, *Streamlined Processing of Installment Agreements*, <https://www.irs.gov/businesses/small-businesses-self-employed/streamlined-processing-of-installment-agreements> (last visited Dec. 20, 2016).

44 IRM 13.1.4.2.3.9 (Oct. 31, 2004). See also TAS, *Authority of Taxpayer Advocate Service Employees to Perform Certain Tax Administration Functions* (July 27, 2015).

45 IRS, *IA Default Rate Report* (Oct. 6, 2016).

46 *Id.*

47 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 37 (Research Study: *IRS Collectibility Curve*).

Congress has long viewed the OIC as a viable collection alternative to bring taxpayers back into compliance, writing in the RRA 98 Conference Report:

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.⁴⁸

Proper financial analysis upfront may point to the OIC being a better option than a lengthy IA such as an extended six-year IA or a PPIA. Additionally, an OIC has the added benefit of bringing finality to the taxpayer and the IRS as requiring five years of tax compliance from the taxpayer.⁴⁹ When taxpayers default on IAs, it results in an endless cycle of IRS rework and taxpayer burden, which could be avoided if the IRS used the data it has available prior to accepting an IA and only placed those taxpayers with demonstrated ability to pay in IAs

Training on IAs, ALEs, and alternative collection solutions should be developed based on specific taxpayer populations and delivered to these employees. Focusing on determining the ability to pay, and ensuring that employees allow all necessary expenses when determining the payment amount for the IA may help create IAs that these taxpayers can afford. As a general policy, the IRS should not accept IAs that cause economic hardship. It could avoid this result by developing a screening algorithm that will identify when a taxpayer's income is less than his or her ALEs. In order to prevent creating economic hardship in such cases, the IRS would be required to pursue alternate collection solutions crafted to the taxpayer's unique circumstances, including CNC-hardship or an OIC.⁵⁰ All IRS employees authorized to enter into IAs should utilize this filter, and it should be incorporated into the online IA tool on irs.gov.

CONCLUSION

Taxpayers who enter into IAs they cannot afford risk defaulting on the agreement and being subject to further collection efforts. Alternatively, they may attempt to pay the IRS at the expense of meeting their basic living needs. Further compounding this problem are ALEs where the analysis leaves major household expenses up to the individual discretion of an IRS employee and ALEs that are based on standard expenses that do not reflect the reality of today's society. Setting taxpayers up to fail at compliance does not comport with taxpayers' rights, specifically the *right to finality* and *the right to a fair and just tax system*. More comprehensive financial analysis, including the development of an ability-to-pay estimator that uses the taxpayer's most recent income data, revised and updated ALEs, expanded use of OICs, and targeted employee training will assist the IRS and taxpayers in ensuring the success of IAs and the compliance of taxpayers who enter into IAs.

48 H.R. REP. NO. 105-599, at 288-89 (1998) (Conf. Rep.).

49 IRS, *Form 656 Offer in Compromise* (Feb. 2016).

50 IRM 5.11.2.3.1.4, *Economic Hardship* (Apr. 15, 2014).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Modify the ALEs in accordance with the recommendations in the Most Serious Problem on ALEs.
2. Develop an internal ability-to-pay estimator that will populate with the most current taxpayer income information for use by all employees offering IAs.
3. Revise IRMs and employee training to require use of the estimator even in streamlined IA applications and provide employees with a decision tree indicating where other collection alternatives are more appropriate than IAs.

MSP #18 INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): IRS Processes for ITIN Applications, Deactivations, and Renewals Unduly Burden and Harm Taxpayers

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

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

DEFINITION OF PROBLEM

Each year, approximately 4.6 million taxpayers ineligible for Social Security numbers (SSNs) require Individual Taxpayer Identification Numbers (ITINs) to comply with their tax filing and payment obligations, claim dependents, and receive tax benefits.² Foreign taxpayers rely on ITINs to avoid mandatory withholding on some types of U.S. source income³ and upon the disposition of U.S. real property interests,⁴ or to meet the requirements of third parties such as banks, who request ITINs for information reporting and withholding purposes.⁵ Failure to timely obtain an ITIN can lead to harsh financial consequences such as late filing penalties, higher withholding, and the permanent loss of certain tax credits.

Changes in application requirements, program administration, and insufficient staffing have contributed to delays in obtaining ITINs for thousands of taxpayers.⁶ During the busiest time of the 2016 filing season, the average weekly inventory of unassigned ITIN applications with tax returns was nearly 80,000, reflecting a significant backlog.⁷ ITIN applications and associated return filings have dropped

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 See, e.g., IRC § 24(e). For detailed characteristics of Individual Taxpayer Identification Number (ITIN) applicants in recent years, see National Taxpayer Advocate 2015 Annual Report to Congress 198-200.

3 Chapter 3 of the Code generally requires withholding agents to collect the substantive tax liability of nonresident aliens imposed under IRC §§ 871(a), 881(a), and 4948 by withholding on certain payments of U.S. source fixed or determinable annual or periodical income. See IRC §§ 1441-1443. See also IRC §§ 1471-1474 (Chapter 4).

4 Foreign Investment in Real Property Tax Act (FIRPTA) of 1980, Pub. L. No. 96-499, Subtitle C, 94 Stat. 2599, 2682 (1980).

5 See IRC § 6041.

6 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 196, 202; National Taxpayer Advocate 2013 Annual Report to Congress 214, 221.

7 IRS, *ITIN Production Reports* (March 5, 2016 through June 11, 2016).

62.5 percent between 2011 and 2015,⁸ suggesting some taxpayers may have stopped filing returns due in part to the difficulty of obtaining an ITIN.

The Protecting Americans from Tax Hikes (PATH) Act of 2015, signed into law in late 2015, made significant changes to the ITIN program, while codifying some existing administrative procedures.⁹ The law includes positive changes, such as expanding the Certified Acceptance Agent (CAA) program¹⁰ and requiring the IRS to study the ITIN application process. However, it creates significant challenges for the IRS, such as the rigid schedule for deactivating millions of ITINs. Some provisions, such as the requirement for an ITIN to be issued by the tax return due date in order to receive the Child Tax Credit (CTC) or American Opportunity Tax Credit (AOTC), could have devastating consequences. The National Taxpayer Advocate is concerned that:

- The IRS's deactivation plans have the potential to create confusion and result in taxpayers not renewing their ITINs in time to file returns timely;
- The IRS has not exercised the flexibility the PATH Act grants for acceptable documentation, thereby leaving a significant number of applicants needing to mail original documents to the IRS;
- Math error procedures for taxpayers whose ITIN applications are rejected or whose ITINs are deactivated infringe on taxpayer rights;
- Taxpayers may not receive the CTC or the AOTC if they do not know to file timely, or if the IRS mishandles or loses their returns; and
- The general requirement for new ITIN applicants to apply during the filing season burdens applicants, creates delays, hampers fraud detection, and exacerbates the other problems ITIN applicants face.

ANALYSIS OF PROBLEM

Background

Purpose of ITINs

Any person required to file a tax return, statement, or other document must include a taxpayer identifying number (TIN).¹¹ A person must also provide his or her TIN to a third party if the IRS requires the third party to include the person's TIN on a return or document.¹² In 1996, the IRS created ITINs to help taxpayers who need a TIN to comply with the law, but who are ineligible for an SSN.¹³ ITINs are "important for the effective operation of the IRS automatic data processing system."¹⁴

8 In processing year (PY) 2011, 2,317,374 ITIN applications (Forms W-7) were received compared to 869,575 in PY 2015. IRS, ITIN Comparative Reports (Dec. 31, 2011) and (Dec. 30, 2015), respectively.

9 Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV (2015) (hereinafter PATH Act).

10 Certified Acceptance Agents (CAAs) were previously referred to and at times still referred to as "Certifying Acceptance Agents" by the IRS. See, e.g., Internal Revenue Manual (IRM) 3.21.263.3.1, *Acceptance Agent (AA) or Certifying Acceptance Agent (CAA)* (Sept. 12, 2016).

11 IRC § 6109(a)(1); Treas. Reg. § 301.6109-1(b).

12 IRC § 6109(a)(2); Treas. Reg. § 301.6109-1(c).

13 Taxpayer Identifying Numbers (TINs), 61 Fed. Reg. 26788 (May 29, 1996) (codified at Treas. Reg. § 301.6109-1).

14 ITINs "improv[e] the IRS' ability to identify and access database records; to match information provided on tax and information returns, statements, and other documents with the proper taxpayers; and to provide better customer service to taxpayers." Taxpayer Identifying Numbers (TIN), 60 Fed. Reg. 30211, 30212 (proposed June 8, 1995) (codified at Treas. Reg. § 301.6109-1).

All United States (U.S.) citizens and persons considered U.S. residents under the Internal Revenue Code (IRC) are required to file and pay U.S. taxes on their worldwide income and need a TIN to do so.¹⁵ Under the IRC, an individual is a resident for tax purposes if he or she is a lawful permanent resident, which is consistent with immigration law.¹⁶ However, an individual is also a resident for tax purposes if he or she is present in the United States a minimum number of days, regardless of immigration status,¹⁷ which creates a tension between tax law and immigration law. In these cases, it is especially important for the IRS to protect a taxpayer's *right to confidentiality*, which generally prohibits the IRS from sharing any taxpayer information with the Department of Homeland Security.¹⁸ If the IRS fails to protect this right, taxpayers may stop filing and paying their taxes out of fear of deportation. The IRS has been able to navigate the difficult balance between the tax law and immigration law through the ITIN program, and the National Taxpayer Advocate believes that any disruption of this balance will undermine voluntary compliance.

Overview of the PATH Act ITIN Changes

The PATH Act establishes requirements for how taxpayers apply for ITINs, what documentation is required, how long an ITIN is effective, how the IRS treats deactivated ITINs, and when an ITIN must be issued to receive certain tax credits. Applicants residing in the United States can apply in person to an IRS employee or CAA, or by mail.¹⁹ Applicants abroad can no longer use a CAA, but can now apply in person to a designated official at a U.S. diplomatic mission or consular post.²⁰ Applicants must submit documentation to prove identity, residency, and foreign status.²¹ The IRS may only accept original documents or “certified copies meeting the requirements of the Secretary,” which allows the IRS to decide what constitutes a certified copy and who can certify copies of which documents.²² The law envisions an expansion of the CAA program, allowing state and local governments, federal agencies, and others authorized by the IRS to be CAAs.²³

The PATH Act will create challenges for taxpayers and the IRS. Under the law, all ITINs issued after 2012 will remain in effect unless the ITIN holder does not file a tax return with the ITIN, or is not

15 See, e.g., IRC § 61. Individuals considered nonresident aliens under the IRC are required to file and pay tax on income derived from sources within the United States. See IRC §§ 1, 2, 871, 7701(b).

16 IRC § 7701(b)(1)(A)(i).

17 To become a resident for tax purposes, an individual must be generally present in the U.S. on at least 183 days during a three year period that includes the current year. See *generally* IRC § 7701(b); Treas. Reg. § 301.7701(b)-1(c).

18 See IRC § 6103. There is a limited exception for sharing information related to criminal or terrorist activities, or emergency circumstances. IRC § 6103(i)(3).

19 PATH Act, § 203(a) (codified at IRC § 6109(i)(1)(A)). This section codifies prior administrative policy.

20 PATH Act, § 203(a) (codified at IRC § 6109(i)(1)(B)). Congress has introduced legislation to clarify that CAAs are available for ITIN applicants outside the United States. See Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(1) (2016); H.R. 4891, 114th Cong. § 2(e)(1) (2016); Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(2) (2016); H.R. 6439, 114th Cong. § 101(f)(2) (2016).

21 PATH Act, § 203(a) (codified at IRC § 6109(i)(2)(A)).

22 PATH Act, § 203(a) (codified at IRC § 6109(i)(2)(B)).

23 PATH Act, § 203(c). As part of a required study, the IRS must evaluate ways to expand CAA availability and participation. PATH Act, § 203(d).

included on another's return as a dependent for three consecutive taxable years.²⁴ ITINs issued before 2013 will expire at the earlier of:

- After a period of three consecutive years of nonuse (defined above), with the first deactivations required to have begun the last day of 2015; or
- On the “applicable date” scheduled between 2017 and 2020.²⁵

The National Taxpayer Advocate has long advocated for the IRS to deactivate ITINs no longer used for tax administration purposes.²⁶ However, attempts to expedite the deactivations before proper systems are in place could harm taxpayers. Other PATH Act provisions that will harm taxpayers include the law's extension of math error authority²⁷ to situations where the taxpayer uses a deactivated ITIN on his or her return,²⁸ and the prohibition on claiming the CTC and the AOTC if the taxpayer's ITIN was issued after the due date for filing the tax return for the taxable year.²⁹

Overview of IRS Changes in Response to the PATH Act

In response to the PATH Act, the IRS has made significant changes to the ITIN program. For example, the IRS has restricted which passports can qualify as stand-alone documents for dependents³⁰ and has created a list of secondary documents that can be submitted with a passport, which includes identification documents not previously considered.³¹ As discussed below, some of the IRS's changes either partially or fully implement prior National Taxpayer Advocate recommendations.

Changes to the Certified Acceptance Agent (CAA) Program

The National Taxpayer Advocate called attention to the IRS's unreasonably short application season for CAAs, and the IRS announced it will accept CAA applications year round.³² The National Taxpayer Advocate has repeatedly recommended that CAAs be allowed to certify documents for dependents.³³ Although the IRS did not adopt this recommendation fully, it agreed to allow CAAs to review two types of documents for dependents.³⁴ The National Taxpayer Advocate has also encouraged the IRS to solicit

24 PATH Act § 203(a) (codified at IRC § 6109(i)(3)(A)). The PATH Act § 203(f) provides that the amendments made in § 203 only apply to ITIN applications made after the effective date for the legislation. Congress has introduced legislation to clarify, among other items, that the effective date provision in § 203(f) does not apply to the provisions regarding already issued ITINs. Technical Corrections Act of 2016, S. 2775, 114th Cong. § 2(e)(3) (2016); H.R. 4891, 114th Cong. § 2(e)(3) (2016). Tax Technical Corrections Act of 2016, S. 3506, 114th Cong. § 101(f)(5) (2016); H.R. 6439, 114th Cong. § 101(f)(5) (2016).

25 PATH Act § 203(a) (codified at IRC § 6109(i)(3)(B)). But see PATH Act § 203(f), which provides the amendments in § 203 only apply to ITIN applications made after the effective date.

26 See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 334.

27 The IRS is currently authorized to correct mathematical or clerical errors — arithmetic mistakes and the like — and assess any tax increase using summary assessment procedures that do not provide the taxpayer an opportunity to challenge the proposed deficiency in the United States Tax Court before the tax is assessed. See IRC §§ 6213(b)(1), (g)(2).

28 PATH Act § 203(e) (codified at IRC § 6213(g)(2)).

29 PATH Act §§ 205, 206 (codified at IRC §§ 24(e), 25A(i)(6)).

30 “Beginning Oct. 1, 2016, the IRS will no longer accept passports that do not have a date of entry into the U.S. as a stand-alone identification document for dependents from countries other than Canada or Mexico or dependents of military members overseas.” IRS Works to Help Taxpayers Affected by ITIN Changes; Renewals Begin in October, IR-2016-100 (Aug. 4, 2016).

31 If the passport lacks a date of entry, applicants can provide U.S. school records or if over 18 years old, a rental or bank statement or a utility bill (with the applicant's name and U.S. address). *Id.*

32 See National Taxpayer Advocate Fiscal Year (FY) 2017 Objectives Report to Congress 152; IRS, New ITIN Acceptance Agent Program Changes, <https://www.irs.gov/individuals/new-itin-acceptance-agent-program-changes> (last updated Oct. 3, 2016).

33 See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 196, 212.

34 CAAs can now review birth certificates and passports for dependents. IRS, *New ITIN Acceptance Agent Program Changes*, <https://www.irs.gov/individuals/new-itin-acceptance-agent-program-changes> (last updated Oct. 3, 2016).

comments regarding expansions to the CAA program,³⁵ and the IRS recently sought public comments on CAA eligibility and ways to increase participation.³⁶

Implementation of a Deactivation Program

The IRS has initiated a deactivation and renewal program for ITINs. The agency faces barriers to deactivating the volume of ITINs required within the timeframe specified in the PATH Act and has come up with an alternative plan. Accordingly, all ITINs that have not been used in the last three years will be deactivated at the start of 2017, regardless of when they were issued.³⁷ ITINs issued prior to 2013 that have been used in the last three years will be deactivated on a rolling basis, starting with ITINs with the middle digits 78 and 79, which the IRS issued between 1996 and 2000.³⁸ Only taxpayers who have filed in the last three years will receive a letter telling them to renew.

Of the approximately 11 million Individual Taxpayer Identification Numbers (ITINs) planned to be deactivated in January 2017, the IRS only sent letters to 440,000 taxpayers whose ITINs were used on a return during the last three years, telling them they need to renew.

Applicants needing to renew their ITINs were able to file renewal applications starting October 1, 2016.³⁹ Unlike most new ITIN applications, renewal applications can be submitted without a tax return.⁴⁰ The IRS accepts ITIN applications during the renewal period from all family members claimed on the return so long as at least one family member needs to renew due to having the numbers 78 or 79. During the renewal period, identification documents will be returned within 60 days.⁴¹ Although the IRS will acknowledge receipt of the ITIN application and identification documents, the renewal application cannot be approved and the ITIN reissued until early 2017 because of the time required to reprogram the necessary databases and systems.⁴²

The National Taxpayer Advocate expressed concern about the need for formal IRS guidance regarding the consequences of using a deactivated ITIN on a third-party information return.⁴³ For these returns, examples of which include Forms 1099-INT (used to report interest income) and 1099-DIV (used to report dividends and stock distributions), the third-party financial institution may require the taxpayer to provide a TIN to open the account, even though the taxpayer may not have a U.S. return filing requirement. The IRS has now clarified that taxpayers with ITINs that have expired according to the PATH Act but are only being used on information returns filed by third parties do not need to renew their ITINs unless they need to

35 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 151.

36 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

37 IRS response to TAS Information request (Nov. 29, 2016).

38 The IRS's approach is to start deactivating ITINs with the oldest issuance dates, determined by the middle two digits of the ITIN. The IRS limited deactivations to these groups of ITINs "due to a lack of the necessary resources to service requests for ITIN renewals for the impacted population of approximately 20 million users." IRS response to TAS Information request (Nov. 29, 2016).

39 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

40 Following the National Taxpayer Advocate's objections to the IRS requiring renewal applications to be submitted with a tax return, the IRS agreed to allow all renewal applicants (including those who had not filed a tax return in the last three years) to apply for renewal without submitting a tax return and outside of the filing season. See National Taxpayer Advocate comments on Notice 2016-48, *Implementation of PATH Act ITIN Provisions* (July 26, 2016); email from Debra Holland, Commissioner, Wage & Investment Division (W&I) to National Taxpayer Advocate (July 28, 2016) (on file with TAS).

41 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

42 Conference call between TAS and W&I (Oct. 3, 2016); IRS Response to TAS information request (Nov. 29, 2016); IRS response to TAS fact check (Dec. 20, 2016).

43 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 158-59.

file an individual return.⁴⁴ Further, the IRS will not penalize third parties under IRC §§ 6721 and 6722 solely because they have listed an expired ITIN on an information return.⁴⁵

Requirement for Claiming the Child Tax Credit (CTC) or American Opportunity Tax Credit (AOTC) With an ITIN

The National Taxpayer Advocate has also expressed concerns about how the IRS will implement § 205 of the PATH Act, which requires an ITIN to be issued before the tax return due date in order to receive the CTC or AOTC. The IRS announced “[t]he issuance date of a renewed ITIN is the date the ITIN was originally issued, not the renewal date.”⁴⁶ Thus, § 205 should have no effect on renewal applicants. For new ITIN applicants, starting March 14, 2017, when programming changes are in place, the ITIN will be deemed to be issued on the date the ITIN application and associated tax return (if attached) are received.⁴⁷ As long as the applicant timely files and is otherwise entitled to the credits, a delay in processing the ITIN should not prevent the applicant from receiving the CTC or AOTC per § 205.

The IRS’s Deactivation Plans Will Create Taxpayer Confusion and Lead to Taxpayers Not Renewing Their ITINs in Time to File Returns Timely

Although tying the deactivation to the middle digits of the ITIN provides simplicity for taxpayers, the National Taxpayer Advocate is concerned some taxpayers will not be notified that their ITINs will expire and others may be confused about the status of their deactivated ITINs that are still being used on third-party information returns. Of the approximately 11 million ITINs planned to be deactivated in January 2017, the IRS only sent letters to 440,000 taxpayers whose ITINs were used on a return during the last three years, telling them they need to renew.⁴⁸ The IRS identified 440,000 taxpayers whose ITINs were used recently and sent approximately 309,000 letters, taking into account that some households have multiple ITIN holders with the digits 78 or 79, and sending only one letter to each household.⁴⁹

The IRS’s decision not to notify taxpayers who did not file a return in the last three years impairs a taxpayer’s *right to be informed* by excluding those who temporarily had no filing requirement.⁵⁰ Taxpayers required to renew who did not receive a letter may be confused about whether their ITINs are expiring and if they must wait until the filing season to apply for an ITIN with a tax return (which

44 IRS Notice 2016-48, *Implementation of PATH Act ITIN Provisions*, IRB 2016-33 (Aug. 15, 2016).

45 *Id.*

46 *Id.*

47 Under the current procedure for new applications, an ITIN is deemed to be issued on the date the ITIN is assigned. IRS response to TAS information request (Nov. 29, 2016); IRS response to TAS fact check (Dec. 20, 2016).

48 “The 11 million ITINs deactivating in January represent ITINs not present on a tax return at least once in the last three consecutive tax years. Approximately 440,000 ITINs have the middle digits 78/79 and have been used on a tax return within the last three consecutive tax years.” IRS response to TAS fact check (Dec. 20, 2016). See also IRS response to TAS information request (Nov. 29, 2016). As of September 13, 2016, the IRS has issued 273,000 (of an anticipated 309,000 letters). IRS internal communication, *IRS Announces Important Individual Tax Identification Number Program Changes* (Sep. 19, 2016) (on file with TAS), <http://win.web.irs.gov/articles/2016/ITIN-policy-changes.htm>.

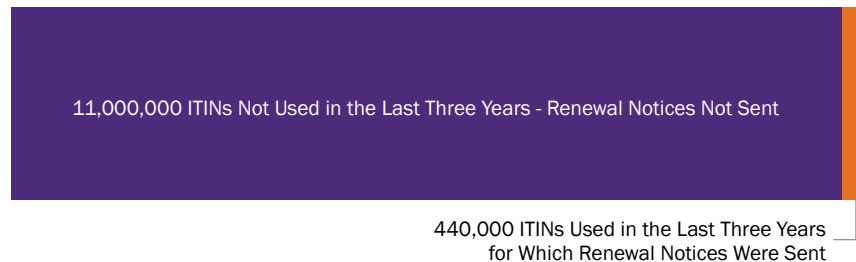
49 IRS response to TAS information request (Nov. 29, 2016); IRS response to TAS fact check (Dec. 20, 2016).

50 The IRS anticipates more than 300,000 of the approximately 11 million ITIN holders subject to deactivation who have not filed a return in the past three years to apply for renewal in 2017. IRS response to TAS information request (Nov. 29, 2016).

is unnecessary).⁵¹ As shown in Figure 1.18.1, the IRS attempted to notify by mail only 4 percent of taxpayers whose ITINs the IRS will deactivate on January 1, 2017.⁵²

FIGURE 1.18.1

ITINs to Be Deactivated in 2017; Limited Renewal Notices



The response rate to the ITIN renewal letters has been only 16 percent, despite the IRS's expectation that all of the approximately 440,000 ITIN holders subject to deactivation who filed a return in the last three years will be renewing their ITINs.⁵³ This low rate indicates the IRS's communication strategy has not been effective in reaching the taxpayers who need to renew early.⁵⁴

Another major issue is the length of time between when a renewal application is filed (starting October 1, 2016) and when a renewal request is processed and an ITIN issued (beginning January 3, 2017).⁵⁵ During this period, the IRS inspects and returns the original documents (corresponding if the application or documents were deemed insufficient),⁵⁶ and promises to notify taxpayers if they may use their ITINs at a date in the future, no earlier than February 21, 2017.⁵⁷ The IRS is unable to process the actual

51 See Instructions for Form W-7, 4 (Sept. 2016).

52 See IRS response to TAS information request (Nov. 29, 2016). The 440,000 ITINs comprise those with middle digits 78 and 79 that have been used within the last three tax years; the approximate 11 million ITINs comprise all ITINs that have not been used within the last three tax years. The IRS sent a renewal notice to the primary taxpayer if any of the ITINs listed on that taxpayer's prior returns are one of the 440,000 recently used. Because multiple such ITINs may have been listed on a single taxpayer's return, the IRS only sent one notice to each primary taxpayer, which resulted in 309,000 notices being sent.

53 *Id.* When told by a reporter that the response rate to the letters telling ITIN holders to renew was 16 percent, the IRS Commissioner said it did not surprise the IRS. *Tax Analysts Exclusive: Conversations: Koskinen Looks to Future of Tax Administration, IRS Budget*, 2016 TNT 240-2, TAX NOTES TODAY (Dec. 14, 2016). The IRS later told TAS it expects the entire population of approximately 450,000 ITIN holders with middle digits 78 and 79, who have filed a return in the past three years, to renew their ITINs. Email from W&I to TAS (Dec. 1, 2016) (on file with TAS). *Id.*

54 See David van den Berg, *Taxpayer Response to ITIN Expiration Letters is Slow So Far*, 2016 TNT 241-5, TAX NOTES TODAY (Dec. 15, 2016) ("Most ITIN renewal applications will occur during and after tax season, which will cause significant delays for much-needed tax refunds for already cash-flow-challenged working families." (quoting Francine Lipman, William S. Boyd Professor of Law, University of Nevada, Las Vegas)).

55 See Letter 5872 (Sep. 2016), Internal Management Document (IMD) review 3607.

56 During this time, "[c]orrespondence may be sent to the applicant when the Form W-7 and/or submitted documents are insufficient to successfully renew the ITIN. In addition, the Form W-7 and identification document information is captured into a simulated database. In January 2017, [the IRS] will begin transferring the data from the simulated database into the ITIN-RTS [Real Time] system to begin processing the renewal applications in order of receipt." IRS response to TAS fact check (Dec. 20, 2016). The IRS sent notices to approximately 23,000 renewal applicants whose applications were insufficiently documented or complete. IRS, *ITIN Production Report* (Dec. 17, 2016).

57 The IRS will notify taxpayers of their ITIN application status seven weeks (nine to eleven weeks if application is submitted during the filing season or from overseas) from January 3, 2017 or from the mailing date of the ITIN application, whichever is later. IRS response to TAS fact check (Dec. 20, 2016); Letter 5872 (Sept. 2016).

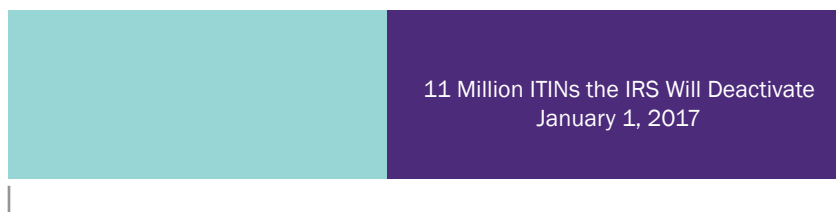
applications until early 2017 because it did not have sufficient time to reprogram the required databases and systems.⁵⁸ If taxpayers change addresses during this time, it could lead to them failing to receive their ITIN notifications, or worse, their identities being stolen if they no longer reside at the address where the notification is sent. Taxpayers who do not receive a notification will create more work for the IRS in the form of phone calls to find out if an ITIN has been processed.

For taxpayers with deactivated ITINs that are still being used on third-party information returns, there may be confusion when they need to file an individual return. If they have not filed an individual return or been included as a dependent on one in the last three years, these taxpayers will not be notified that their ITINs have expired and may mistakenly believe their ITINs are still valid because they are actively being used.

Another issue is the treatment of ITINs that have expired under the law, but which have not been deactivated by the IRS. The PATH Act provides that ITINs issued prior to 2008 will no longer be in effect,⁵⁹ but the IRS is only deactivating ITINs that have not been used in the last three years or contain the middle digits 78 or 79 (issued between 1996 and 2000).⁶⁰ Thus, ITINs issued after this time but prior to 2008 that have been used in the last three years will expire under the law on January 1, 2017, but not be deactivated by the IRS at this time.

FIGURE 1.18.2, ITINs Requiring Deactivation under the PATH Act, ITINs Planned to be Deactivated by the IRS in 2017⁶¹

PATH Act Requires Deactivation of 20 Million ITINs



20 Million ITINs That Have Expired Or Will Expire by January 1, 2020 Under the PATH Act

Although presumably the IRS will process a return filed with such an ITIN as if the ITIN is currently valid, a problem could arise if the IRS disallows or adjusts items on the return, and the taxpayer wishes to challenge the disallowance in court. If the ITIN had expired under the law, the Court would have to disallow any exemptions or credits for which an ITIN is required, even if the IRS had told the taxpayer the ITIN was valid and they did not need to renew.⁶² Having the systems in place to allow all applicants

58 IRS response to TAS information request (Nov. 29, 2016).

59 PATH Act § 203(a) (codified at IRC § 6109(i)(3)(B)). But see PATH Act § 203(f), which provides the amendments in § 203 only apply to ITIN applications made after the effective date.

60 IRS response to TAS information request (Nov. 29, 2016).

61 See IRS response to TAS information request (Nov. 29, 2016). “We estimate we will expire more than 11 million ITINs in January 2017, all of the unused ITINs as well as those with middle digits of 78 and 79 that are still in use.” The IRS estimates an “impacted population of approximately 20 million.” *Id.*

62 In this scenario, the Tax Court would have to have knowledge of the ITIN’s issuance date in order to determine when the ITIN expired under the law. The IRS maintains information regarding the ITIN date of issuance on its internal system, the ITIN Real Time System. IRM 3.21.263.1, *Overview* (Oct. 4, 2016). A Taxpayer Identification Number (TIN) is required to claim a personal exemption for the taxpayer, taxpayer’s spouse, or a dependent, and to claim the Child Tax Credit. See IRC §§ 151(e), 24(e).

to renew their ITINs, even if there was no impending deactivation for those ITINs by the IRS, would mitigate this problem, but not fully solve it.⁶³

The IRS Has Not Exercised the Flexibility the PATH Act Grants for Acceptable Documentation, Thereby Leaving a Significant Number of Applicants Needing to Mail Original Documents to the IRS

Although the IRS has finally permitted CAAs to review passports and birth certificates for dependents,⁶⁴ many dependents may still need to mail in their original documents. As shown in the table below, a significant number of dependents need to use other identification documents.

FIGURE 1.18.3, Most Common Dependent Documents Submitted With ITIN Applications during Processing Years 2015 and 2016⁶⁵

Type of Identification Document	December 31, 2015	September 30, 2016
Civil Birth Certificate	180,297	73,366
Passport	175,957	70,042
School Records	81,139	31,933
Medical Records	52,924	20,163
Foreign Voters Registration Card	34,781	16,438

The PATH Act gives the IRS latitude to provide alternatives to accepting only original documents or copies certified by the issuing agency.⁶⁶ In addition to allowing CAAs and Taxpayer Assistance Centers (TACs) to certify all identification documents for all applicants,⁶⁷ the IRS could determine other types of documents also meet the requirements of a “certified copy.”⁶⁸ Yet, the IRS has failed to exercise this discretion and has not identified additional types of certified copies. Furthermore, the IRS should consider accepting notarized copies as certified copies when from specific jurisdictions where a notary is considered a public officer and is authorized to verify the content of documents.⁶⁹

63 See Legislative Recommendation: *Individual Taxpayer Identification Numbers (ITINs): Amend the Protecting Americans from Tax Hikes (PATH) Act of 2015 to Revise the Expiration Schedule for ITINs*, *infra*.

64 See Instructions for Form W-7 (Sept. 2016).

65 IRS Response to TAS information request (Nov. 29, 2016) (citing the Compliance Data Warehouse (CDW) Tables Form_W7, Form_W7_VISA, retrieved Oct. 27, 2016). The IRS acknowledges this data may be incomplete. *Id*.

66 See IRC § 6109(i)(2)(B).

67 In late 2016, the IRS expanded the list of documents a TAC can certify for primary or secondary taxpayers to 11 documents. For dependents, TACs can only certify three types of documents. There are currently 179 TACs that can verify ITIN documents. IRS response to TAS information request (Nov. 29, 2016). CAAs can only verify passports and birth certificates for dependents. Instructions for Form W-7 (Sept. 2016).

68 For example, copies could be certified by state or other Federal agencies other than the issuing agency or clerks of courts, and or copies could be properly apostilled and authenticated by U.S. diplomatic missions abroad. See U.S. Department of State, Authentications and Apostilles, <http://travel.state.gov/content/travel/en/legal-considerations/judicial/authentication-of-documents/notarial-and-authentication-apostille.html> (last visited on Sep. 26, 2016).

69 For example, in France, a notary is a public officer, acting on behalf of the State, appointed by the Minister of Justice. He or she authenticates instruments, which includes a guarantee as to the content and date of the instrument, giving the instrument the legal status of a final judgment. Notaires de France, *The role of the Notaire*, <http://www.notaires.fr/en/role-notaire> (last visited Oct. 26, 2016).

Due to the lack of free and accessible alternatives, including TACs,⁷⁰ some applicants may still have to mail in original documents. As one taxpayer explains:

So, imagine if I take your wallet and I put it in the postal box and say, “Hey, wait, it’s going to come back to you.” It’s the same when the IRS tells them, “I’m sending it back to you,” but you’re going to put that in a box and not have anything to say who you are. It’s not an easy thing to do.⁷¹

Mailing original documents results in lost documents and additional work for the IRS.⁷² The IRS will only return documents by expedited mail if the taxpayer has provided a prepaid envelope or TAS makes a request based on significant hardship.⁷³ In 2015, the IRS returned 5,839 passports to embassies when it could not find a better address.⁷⁴ Compounding this problem is the PATH Act’s elimination of the ability for CAAs to review documents for applicants abroad.⁷⁵ The IRS has not authorized any designees at diplomatic or consular posts abroad to receive ITIN applications due to limited resources cited by the Department of State. However, until a recent meeting on December 2, 2016, which may have been prompted by TAS’s inquiries, the IRS had not met with the Department of State regarding this topic since May 2015, prior to the passage of the PATH Act.⁷⁶

Finally, requiring original documents leads to a high rejection rate, with almost a third of applications rejected during the past three years.⁷⁷ In recent years, the number one reason for suspending ITIN applications was that documentation did not meet IRS criteria.⁷⁸ By requiring that original documents be mailed, the IRS is discouraging applicants from using documents like passports or birth certificates in favor of more informal documents like school records, which may not meet the IRS’s narrow requirements for those documents.⁷⁹

70 The IRS had reported that Taxpayer Assistance Centers can offer ITIN services only on Tuesdays and Thursdays, but has since clarified “[w]hile Accounts Management assistors will continue to schedule the majority of ITIN service appointments on Tuesdays and Thursdays, we will closely monitor the traffic to determine if this service should be offered on additional days.” IRS, *Taxpayer Assistance Center (TAC) Locations Where In-Person Document Review is Provided*, <https://www.irs.gov/uac/tac-locations-where-in-person-document-verification-is-provided> (last updated Sept. 1, 2016); IRS response to TAS fact check (Dec. 20, 2016). See National Taxpayer Advocate FY 2017 Objectives Report to Congress 150-51.

71 Statement of German Tejeda, Senior Director, Income Policy Food Bank for New York City, Public Forum, Hostos Community College, Bronx, New York (Mar. 18, 2016).

72 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 152.

73 See Internal Revenue Manual (IRM) 3.21.263.4.10, *Taxpayer Advocate Service (TAS) Assistance* (Oct. 19, 2015), IRM 3.21.263.5.3.4.2.4, *Returning Original Supporting Identification Documents to Applicant* (Oct. 19, 2015).

74 The IRS does not track the number of lost original documents. IRS response to TAS information request (Nov. 29, 2016).

75 See Legislative Recommendation: *Certified Acceptance Agents (CAAs): Amend the PATH Act to Authorize CAAs to Certify Individual Taxpayer Identification Number Applications for Taxpayers Residing Abroad*, *infra*. See also Letter from Richard M. Reedman, President, Nat’l Ass’n of Enrolled Agents, to John A. Koskinen, Commissioner, Internal Revenue Service (Dec. 13, 2016) (on file with TAS) (expressing opposition to the IRS terminating the contracts of CAAs operating abroad).

76 IRS response to TAS fact check (Dec. 20, 2016). In response to TAS’s information request, the IRS stated it is working to set up another meeting with the Department of State to ask for assistance in some key countries due to the PATH Act’s elimination of CAAs abroad. IRS response to TAS information request (Nov. 29, 2016). Currently, there are 275 U.S. consulates and embassies that provide a similar service for Social Security number applicants. See email from Department of State governmental liaison to TAS (Sept. 9, 2015) (on file with TAS); email from Social Security Administration governmental liaison to TAS (Sept. 23, 2015) (on file with TAS).

77 IRS, *ITIN Comparative Reports* (Dec. 3, 2016, Dec. 30, 2015, and Dec. 31, 2014).

78 National Taxpayer Advocate 2015 Annual Report to Congress 208.

79 For example, a school record “must be dated and contain the student’s name, course work with grades (unless under age 6), date of grading period(s) (unless under age 6), and school name and address.” Instructions for Form W-7 (Sept. 2016).

Math Error Procedures for Applicants Whose ITIN Applications Are Rejected or Whose ITINs Are Deactivated Infringe on Taxpayer Rights

After the IRS rejects an ITIN application, it forwards the paper tax return to be processed, stripping the return of the persons without SSNs or valid ITINs and denying associated exemptions and deductions.⁸⁰ The IRS uses its math error procedure to recalculate the tax. In 2015 and 2016 the IRS denied approximately 400,000 personal exemptions during return processing, due to a problem with the Taxpayer Identification Number (TIN), which includes both incorrect SSNs and incorrect ITINs.⁸¹ Letters notifying taxpayers that the IRS has disallowed their personal exemptions for ITIN related reasons often lack a clear explanation of the reason for disallowance. Stating “We didn’t allow your personal exemption because your ... ITIN ... is missing” is confusing because of course the ITIN was missing on the return — the taxpayer was not allowed to apply for the ITIN prior to filing the return.⁸² Instead of telling the taxpayer that the ITIN is “missing”, the IRS notice should acknowledge the ITIN application, explain that the IRS denied it, and clearly explain to the taxpayer the reason for the denial. This notice infringes upon the taxpayer’s *right to be informed*.

The Protecting Americans from Tax Hikes (PATH) Act gives the IRS latitude to provide alternatives to accepting only original documents or copies certified by the issuing agency. ... Yet, the IRS has failed to exercise this discretion and has not identified additional types of certified copies.

The PATH Act will lead to more math error notices because it provides the IRS with math error authority in situations where a taxpayer lists a deactivated ITIN on a return.⁸³ Taxpayers unaware that their ITINs have expired may not find out until they file a return with the deactivated ITIN and receive a math error notice. A taxpayer whose ITIN was deactivated in error and was denied credits to which he or she is entitled will lose the opportunity to challenge eligibility for the credits in the U.S. Tax Court if he or she does not respond timely to the math error notice. This procedure may deprive low income or overseas taxpayers, in particular, of fundamental due process protections and infringe on their *right to challenge the IRS’s position and be heard*.⁸⁴

Taxpayers May Not Receive the Child Tax Credit (CTC) or American Opportunity Tax Credit (AOTC) if They Do Not Know to File Timely or if Their Returns Are Mishandled or Lost

Although the IRS policy regarding when a renewed ITIN is considered to be issued is beneficial to taxpayers, there may still be taxpayers who miss out on the CTC or AOTC if they do not understand the need to file their returns timely. The IRS has not issued formal guidance clarifying that the ITIN resulting from a new ITIN application will be deemed issued on the date the return is received. It is not

80 See IRM 3.21.263.4.5(2), *Internal Revenue Service Number (IRSN)* (Jan. 1, 2015).

81 IRS, Transmitter Control Code Electronic Output Network System Report 480-62-11 (Dec. 29, 2015 and Dec. 1, 2016). See Taxpayer Notice Codes (TPNC) 205 (primary taxpayer), 206 (spouse), and 605 (dependent), described in IRM 3.12.3-2 (Jan. 1, 2016). The notices relate to denied personal exemptions for failure to provide a valid ITIN or SSN. The IRS additionally denied deductions and credits for failure to obtain or provide any TIN. See, e.g. TPNCs 234 and 235.

82 The IRS is developing new explanatory paragraphs to address the denial of CTC and AOTC resulting from expired ITINs. Email from Office of Taxpayer Correspondence (Aug. 24, 2016). For a more detailed discussion of the National Taxpayer Advocate’s concerns about the poor quality of IRS Math Error notices, see National Taxpayer Advocate 2014 Annual Report to Congress 163-71 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*).

83 PATH Act § 203(e) (codified at IRC § 6213(g)(2)(O)).

84 See Legislative Recommendation: *International Due Dates: Amend Internal Revenue Code § 6213(b)(2)(A) to Provide Additional Time to Request Abatement of a Math or Clerical Error Assessment to Taxpayers Living Abroad Similar to the Timeframe Afforded to Taxpayers to Respond to a Notice of Deficiency, infra*.

Requiring most new Individual Taxpayer Identification Number (ITIN) applications during the filing season results in less flexibility for applicants, longer wait times for original documents to be returned and an ITIN issued, overburdened Taxpayer Assistance Centers, and a heavier, more concentrated workload for the IRS.

until page 4 of the Form W-7 instructions that taxpayers are warned that failure to timely file a tax return and Form W-7 “may” result in denial of CTC or AOTC.⁸⁵ Furthermore, the IRS’s main ITIN webpage says nothing about the need to file on time to receive the CTC or AOTC.⁸⁶ The IRS should conduct targeted outreach to communities with a high number of CTC claims to ensure taxpayers are aware of this requirement.

Even if they file on time, taxpayers may also be denied CTC or AOTC if their returns are lost or mishandled⁸⁷ and they cannot prove the IRS received the return or ITIN application prior to the due date.⁸⁸ Taxpayers may also face problems if the IRS incorrectly rejects their applications because they will have to reapply, and the IRS has stated “[a]n applicant error that results in a rejected Form W-7 application may impact the assignment/issuance date of the ITIN.”⁸⁹ It is unknown whether the IRS will use the date of the original ITIN application submitted with the return or the date of the second ITIN application.

The General Requirement for New Applicants to Apply for an ITIN During the Filing Season Burdens Applicants, Creates Delays, Hampers Fraud Detection, and Exacerbates the Other Problems ITIN Applicants Face

One of the most significant problems with the ITIN process has persisted for over a decade and exacerbates the other problems discussed above. In 2003, the IRS began requiring most ITIN applications to be filed with a paper tax return.⁹⁰ There are limited exceptions for nonresidents claiming the benefits of a tax treaty and having income, payments, or transactions subject to third-party reporting or withholding.⁹¹ While the recent accommodation for renewal applicants to apply prior to the filing season is very positive, at least for the 2017 filing season the IRS will not be processing the renewal applications and issuing the ITINs until the actual filing season. Furthermore, the accommodation excludes the 800,000 first time applicants who apply annually, unless they are family members of the renewal applicants.⁹² The paper driven process results in applicants waiting up to 14 weeks to receive

85 Instructions for Form W-7 (Sept. 2016).

86 IRS, ITIN, <https://www.irs.gov/individuals/individual-taxpayer-identification-number-itin> (updated Oct. 12, 2016).

87 See National Taxpayer Advocate 2015 Annual Report to Congress, 202. The IRS does not track the number of complaints regarding lost returns. IRS response to TAS information request (Nov. 29, 2016).

88 Although the IRS has stated the ITIN will be considered to be issued on the date the ITIN application and associated return (if attached) are received, the IRS’s internal math error procedures appear to flag a CTC claim or AOTC claim based solely on the date the return is received. See IRM 3.11.3.14.5.5, Line 52 - Child Tax Credit (Schedule 8812) (Sept. 23, 2016); IRM 3.11.3.44.4, *Form 8863, Part III - Student and Educational Institution Information* (Sept. 14, 2016). These IRM references are based on the manual process to address tax year 2015 returns filed in 2016 with new ITIN assignments. Starting Jan. 1, 2017, the math error will be systemically checked. Beginning March 14, 2017, programming changes will be in place to compute the ITIN Assignment Date as the IRS Received Date. IRS response to TAS fact check (Dec. 20, 2016).

89 IRS response to TAS fact check (Dec. 20, 2016).

90 See National Taxpayer Advocate 2003 Annual Report to Congress 60-86 (Most Serious Problem: *Individual Taxpayer Identification Number (ITIN) Program and Application Process*).

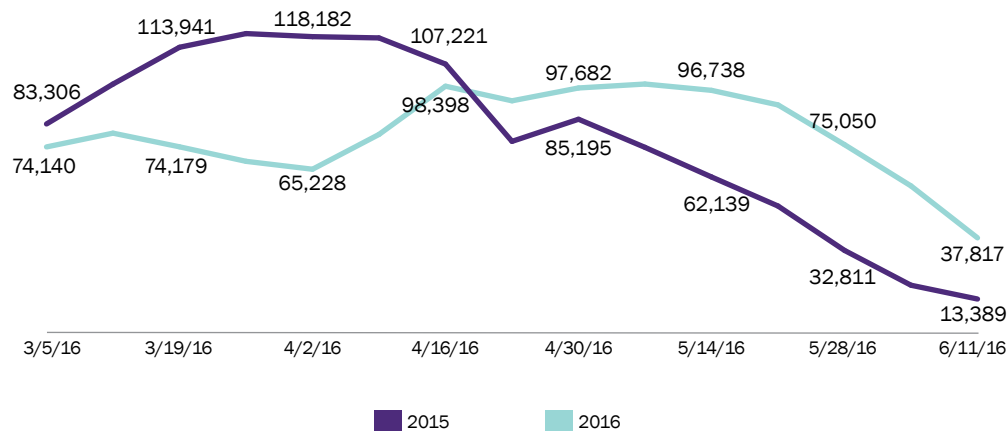
91 See Form W-7 instructions (Sep. 2016). In PY 2015, about 53,900 out of 874,800 ITIN applicants (six percent) claimed an exception for filing without a tax return. IRS, CDW, Form W-7 Database (data drawn Dec. 13, 2016).

92 IRS, *ITIN Production Report* (Dec. 3, 2016). Receipts for the first 11 months of PY 2016 totaled 795,765 applications with returns, 67,423 without returns, and prior year carryover of 31,695.

their tax refunds, compared to the three weeks for taxpayers with SSNs.⁹³ The following chart reflects the increase in the average weekly backlog over the prior year.

FIGURE 1.18.4

Weekly Backlogs of Applications With Returns Awaiting Input



Requiring most new ITIN applications during the filing season results in less flexibility for applicants, longer wait times for original documents to be returned and an ITIN issued, overburdened TACs, and a heavier, more concentrated workload for the IRS. It also prevents applicants from electronically filing their returns, which increases the potential for identity theft, increases the risk of returns being lost or misprocessed, and undermines taxpayers' *right to a fair and just tax system*.⁹⁴ Accepting ITIN applications year round would allow the IRS to identify trends throughout the year and later apply rules to detect fraudulent returns through the enhanced Return Review Program (RRP). It may also help the IRS avoid labor intensive and taxpayer-burdensome compliance initiatives during the filing season that unnecessarily delay refunds.⁹⁵

The National Taxpayer Advocate has previously suggested alternatives to submitting a tax return to prove a tax administration purpose for an ITIN, such as submitting pay stubs or bank statements.⁹⁶ Not only does the IRS accept these to prove income belonged to a person in the case of a Form W-7 and Form W-2 name mismatch,⁹⁷ but the IRS now accepts bank statements to prove residency for the purpose of issuing

93 See *2016 Tax Season Refund Frequently Asked Questions*, <http://www.irs.gov/Refunds/Tax-Season-Refund-Frequently-Asked-Questions> (last updated July 29, 2016).

94 See IRS Publication 4852, *Talkpoints for Managers* (Jan. 2016) (advising federal employees to e-file their tax returns to increase accuracy and avoid mistakes such as math errors and omissions).

95 The IRS's Form 1042S verification project delayed legitimate tax refunds for foreign students due in part to untimely assignment of ITINs. See National Taxpayer Advocate FY 2017 Objectives Report to Congress 80-84 (Area of Focus: *IRS Implementation and Enforcement of Withholding on Certain Payments to Foreign Persons Is Burdensome, Error-Ridden, and Fails to Protect the Rights of Affected Taxpayers*); see also, Most Serious Problem: *Foreign Account Tax Compliance Act (FATCA): The IRS's Approach to International Tax Administration Unnecessarily Burdens Impacted Parties, Wastes Resources, and Fails to Protect Taxpayer Rights*, *supra*. See also Systemic Advocacy Management System (SAMS) 34152.

96 See National Taxpayer Advocate 2015 Annual Report to Congress 212.

97 Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Sept. 2016); Form W-2, *Wage and Tax Statement* (2016). A name mismatch occurs when the taxpayer's name on the Form W-7 is different from the taxpayer's name on Form W-2. See IRM 3.21.263.5.10.8, *Correspondence Inventory Procedures* (Aug. 18, 2014).

the ITIN.⁹⁸ The IRS should “re-evaluate evidence of filing requirements,” as promised in its response to last year’s Annual Report to Congress.⁹⁹

CONCLUSION

The IRS has made some major changes to the ITIN program in response to the PATH Act, but falls short in terms of making it possible for all taxpayers to timely comply with their filing and payment obligations. The National Taxpayer Advocate remains concerned that the IRS has not included TAS in ITIN cross-functional teams nor has it sought TAS’s input regarding the sweeping changes, which fail to protect key taxpayer rights, such as 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*.¹⁰⁰ While the PATH Act presents significant challenges for the IRS, it also offers the IRS latitude to make much needed changes. Nothing in the legislation prevents the IRS from accepting ITIN applications for all applicants year-round with proof of a tax administration purpose. ITIN applicants will continue to face barriers to filing and paying their taxes until the IRS further revises its ITIN policies and procedures.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Prioritize and accelerate the programming and implementation of the necessary systems to process ITIN renewal applications and reissue ITINs upon receipt of renewal applications.
2. Identify additional types of documentation that can be considered “certified copies,” such as copies certified by state or other Federal agencies other than the issuing agency, copies certified by clerks of courts, copies properly apostilled and authenticated by U.S. diplomatic missions abroad, and notarized copies from specific jurisdictions.
3. Allow all ITIN applicants to apply for an ITIN at any time of the year without a tax return as long as they provide evidence of a legitimate tax administration purpose for the ITIN.

98 IRS Works to Help Taxpayers Affected by ITIN Changes; Renewals Begin in October, IR-2016-100 (Aug. 4, 2016).

99 See National Taxpayer Advocate FY 2017 Objectives Report to Congress vol. 2, 116.

100 See National Taxpayer Advocate FY 2017 Objectives Report to Congress 148-49.

**MSP
#19****FORM 1023-EZ: The IRS's Reliance on Form 1023-EZ Causes It to Erroneously Grant Internal Revenue Code § 501(c)(3) Status to Unqualified Organizations****RESPONSIBLE OFFICIAL**

Sunita Lough, Commissioner, Tax Exempt and Government Entities Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Finality*

DEFINITION OF PROBLEM

In 2014, the IRS adopted Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, which requires applicants to merely attest, by checking boxes on the form, that they meet the requirements for qualification as IRC § 501(c)(3) organizations.² Most applications for IRC § 501(c)(3) status are now submitted on Form 1023-EZ and the IRS approves 94 percent of Form 1023-EZ applications.³

The IRS erroneously approves Form 1023-EZ applications at an unacceptably high rate:

- According to the IRS's pre-determination reviews of a portion of Form 1023-EZ applicants, 25 percent do not qualify for exempt status because they do not meet the "organizational test,"⁴
- According to a 2015 TAS study of a representative sample of approved Form 1023-EZ applicants in 20 states that make articles of incorporation viewable online at no cost, 37 percent do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law;⁵

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Among other things, organizations eligible to submit Form 1023-EZ must generally have annual gross receipts of less than \$50,000 and assets of less than \$250,000. See *Form 1023-EZ Eligibility Worksheet*, questions 1-3.

3 Tax Exempt and Government Entities (TE/GE) Fiscal Year (FY) 2016 Third Qtr. Business Performance Review (BPR), at 5 (Sept. 2016) (noting that 58 percent of all applications for IRC § 501(c)(3) status were submitted on Form 1023-EZ).

4 TE/GE response to TAS information request (Oct. 5, 2016). As described below, the "organizational test" generally requires an applicant's organizing document to contain adequate purpose and dissolution clauses. See Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4); 1.501(c)(3)-1(b)(2).

5 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-31 (*Study of Taxpayers That Obtained Recognition As IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*). As described below, the "organizational test" generally requires an applicant's organizing document to contain adequate purpose and dissolution clauses. See Treas. Reg. §§ 1.501(c)(3)-1(b)(1)(i)(a), (b); 1.501(c)(3)-1(b)(4); 1.501(c)(3)-1(b)(2).

- According to the IRS's analysis, at least 17 percent of the Form 1023-EZ applicants in the sample TAS analyzed in its 2015 study do not meet the organizational test;⁶ and
- According to a 2016 TAS study using similar methodology as the 2015 TAS study, 26 percent of approved Form 1023-EZ applicants do not meet the organizational test.

On October 25, 2016, the IRS Deputy Commissioner for Services and Enforcement sustained the National Taxpayer Advocate's September 26, 2016 Taxpayer Advocate Directive (TAD) which directs the Tax Exempt and Government Entities division (TE/GE) to require Form 1023-EZ applicants to submit a brief narrative statement of their actual or planned activities.⁷ The Deputy Commissioner rescinded the portion of the TAD that directs TE/GE to require Form 1023-EZ applicants to submit summary financial information and organizing documents not already available from a State online database.⁸

ANALYSIS OF PROBLEM

Background

An applicant seeking to qualify as an organization described in IRC § 501(c)(3) must demonstrate that it meets an “organizational test” and an “operational test.”⁹ The “organizational test” requires an applicant’s “organizing document” to establish that it is “organized and operated exclusively” for one of eight enumerated exempt purposes.¹⁰ The “operational test” requires the applicant to engage primarily in activities which accomplish one or more of the eight exempt purposes specified in IRC § 501(c)(3).¹¹ No more than an insubstantial part of its activities can be not in furtherance of an exempt purpose,¹² and the organization must be operated to further public rather than private interests.¹³

In 2014, TE/GE adopted “streamlined” procedures that allowed some organizations whose Form 1023 applications needed further development to provide “assurance of meeting the organizational and operational tests through representational attestations” (as opposed to submitting substantiating

6 TE/GE response to National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016). TAD 2016-1 is attached as an appendix to this Most Serious Problem.

7 Memorandum from the Deputy Commissioner for Services and Enforcement to the National Taxpayer Advocate (Oct. 25, 2016).

8 *Id.*

9 Treas. Reg. § 1.501(c)(3)-1(a)(1) (providing that “[i]f an organization fails to meet either the organizational test or the operational test, it is not exempt.”).

10 IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (providing “[a]n organization is organized exclusively for one or more exempt purposes only if its articles of organization,” among other things, limit the purposes of such organization to one or more exempt purposes); Treas. Reg. § 1.501(c)(3)-1(b)(4) (providing “[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization’s assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization’s articles or by operation of law, be distributed for one or more exempt purposes...”). In some states, sometimes referred to as *cy pres* states, a dissolution clause is not required because by operation of state law, the organization’s assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. See Rev. Proc. 82-2, 1982-1 C.B. 367.

11 See Treas. Reg. § 1.501(c)(3)-1(c)(1) (providing that “[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3)”).

12 See Treas. Reg. § 1.501(c)(3)-1(c)(1) (providing that “[a]n organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose”).

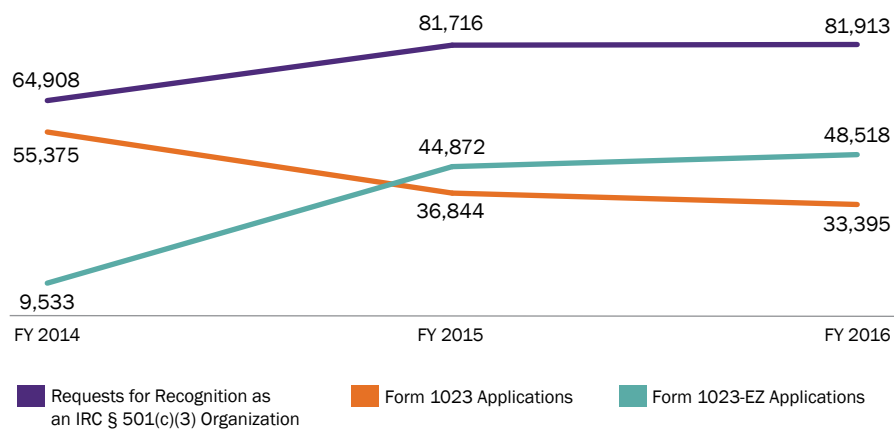
13 Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

documents).¹⁴ In July 2014, TE/GE introduced Form 1023-EZ, which incorporates the “attestation” feature of the streamlined procedures.

Applications for exempt status under IRC § 501(c)(3) immediately increased following introduction of the streamlined procedures and Form 1023-EZ. Figure 1.19.1 shows the total number of applications for IRC § 501(c)(3) status, the number submitted on Form 1023, and the number submitted on Form 1023-EZ.

FIGURE 1.19.1¹⁵

Requests for Recognition as an IRC § 501(c)(3) Organization, FYs 2014-2016



As Figure 1.19.1 demonstrates, Form 1023-EZ fueled an increase in overall applications for IRC § 501(c)(3) status and has overtaken Form 1023 as the primary vehicle for requesting such status.

Many Form 1023-EZ Applicants Are Recognized As IRC § 501(c)(3) Organizations Even Though They Do Not Qualify for That Status

TE/GE subjects a sample of Form 1023-EZ filers to pre-determination review, rather than relying solely on their attestations. The 2,405 pre-determination reviews TE/GE had completed as of August 19, 2016, showed that Form 1023-EZ applicants did not meet the organizational test 25 percent of the time, despite their attestations to the contrary.¹⁶ Yet TE/GE approves Form 1023-EZ applications 94 percent of the time.¹⁷

A 2015 TAS study of a representative sample of 408 corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ was approved found that 149 of the

¹⁴ See TE/GE-07-0214-02, *Streamlined Processing Guidelines for All Cases* (Feb. 28, 2014).

¹⁵ TE/GE response to TAS fact check (Nov. 28, 2016); TE/GE FY 2016 BPR First Qtr. Business Performance Review (BPR) at 4, 18 (Mar. 2016); TE/GE response to TAS information request (Nov. 14, 2016).

¹⁶ TE/GE response to TAS information request (Oct. 5, 2016).

¹⁷ TE/GE FY 2016 Third Qtr. BPR at 5 (Sept. 2016).

The 2016 TAS study showed that of 323 organizations in the representative sample, 85 organizations, or 26 percent, do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law.

organizations in the sample (37 percent) did not satisfy the organizational test.¹⁸ Prior to the release of the report, TAS shared with TE/GE the Employee Identification Numbers (EINs) of all 149 of these organizations and TE/GE advised TAS it did not agree with all of TAS's conclusions.¹⁹ However, TE/GE refused to provide a list of organizations whose organizing documents, according to its analysis, were sufficient.²⁰ The National Taxpayer Advocate's September 26, 2016, Taxpayer Advocate Directive directed the IRS to share its list with TAS, and TE/GE complied with that directive on October 5, 2016.²¹

According to TE/GE's analysis of the 149 organizations, documents for 13 were no longer available online, and one organization was selected for pre-determination review.²² Of the remaining organizations, TE/GE concluded that "only" 70 had failed to meet the organizational test.²³ Thus, according to TE/GE's analysis (and assuming that all 14 organizations TE/GE did not review met the organizational test), there is an "organizational test non-compliance rate" of 17 percent.²⁴

In 2016, TAS conducted a research study using methodology similar to that used for the 2015, study. TE/GE provided TAS Research a data file with the names, EINs, state of incorporation, ruling date, and addresses of all corporations whose Form 1023-EZ applications were approved from July 1, 2015, through June 30, 2016.²⁵ From the data file, TAS Research identified a representative random sample of 323 organizations from the 20 states that make articles of incorporation viewable online at no cost.²⁶ TAS evaluated the organizations in the sample using the same data collection instrument that was used for the 2015 TAS study. The results of the study are statistically valid at the 95 percent confidence level with a margin of error no greater than +/-5 percent.²⁷ The 2016 TAS study showed that of 323 organizations

18 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 13 (*Study of Taxpayers that Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ*).

19 TE/GE response to TAS information request (July 12, 2016).

20 Email from Director, Exempt Organizations – Rulings & Agreements (Aug. 4, 2016), on file with TAS.

21 TE/GE response to National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016).

22 As of Oct. 11, 2016, TAS found all 13 organizations' documents online for their respective states. TE/GE's list notes, with respect to one organization "Selected for pre-determination review. Signed attestation stating they amended." As of Nov. 2, 2016, we were unable to find any record of any amendment to that organization's articles of incorporation.

23 TE/GE response to National Taxpayer Advocate TAD 2016-1, *Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS* (Oct. 5, 2016).

24 TE/GE response to TAS fact check (Nov. 28, 2016). Out of a sample size of 408 approved organizations, a finding that 70 did not meet the organizational test represents an error rate of 17 percent. To the extent the organizations TE/GE did not review also did not meet the organizational test, the error rate would be greater. Moreover, TAS does not entirely accept TE/GE's analysis. TAS would concede that the organizing documents of 13 of the 149 corporations could reasonably be construed as meeting the organizational test, but adheres to its conclusion that the other 136 organizations did not meet the organizational test. Out of a sample of 408, a finding that 136 organizations did not meet the organizational test represents an erroneous approval rate of 33 percent.

25 TE/GE response to TAS information request (Sept. 23, 2016). There were 38,196 separate organizations in this file. Of these organizations, 16,295, or approximately 43 percent, were incorporated in the 20 states in which the Secretary of State maintains a website that permitted TAS to view legible copies of corporations' articles of incorporation at no charge.

26 TAS initially identified 330 organizations for further analysis, but articles of incorporation for seven organizations could not be located on the official site for the state in which, according to TE/GE, the organization was formed. These organizations were thus excluded, resulting in a sample size of 323.

27 Study findings can be projected to the population of 16,295 organizations from states in our study.

in the representative sample, 85 organizations, or 26 percent, do not meet the organizational test and therefore do not qualify as IRC § 501(c)(3) organizations as a matter of law. Moreover, in the representative sample of 323 organizations, the articles of incorporation of 12, or four percent, showed that two were limited liability companies, two were churches, seven were schools, colleges or universities or supporting organizations, and one was a private operating foundation. These organizations are never eligible to file Form 1023-EZ, yet they possess a determination letter from the IRS and are holding themselves out as tax exempt.²⁸

Post-Determination Audits Are Inadequate Substitutes for Pre-Determination Oversight

TE/GE estimates that it takes an average of 17 hours to conduct a post-determination audit of an organization that filed Form 1023-EZ.²⁹ It takes an average of five hours to conduct a pre-determination review of a Form 1023-EZ application.³⁰ Thus, TE/GE could carry out roughly three pre-determination reviews for every post-determination audit. Because pre-determination reviews are generally carried out by higher-graded employees than those who perform audits, audits do not necessarily cost three times more than pre-determination reviews. Moreover, pre-determination reviews could avert the expenses of administrative appeals and litigation stemming from a post-determination audit that culminates in a proposed revocation of exempt status.³¹ In any event, by identifying an organization's non-qualification earlier in the process, while the IRS still has leverage and the stakes for the organization are lower, an organization may self-correct, thus averting noncompliance. The cost of noncompliance includes unreported taxable income and claimed deductions for charitable contributions that are later determined to be impermissible.³² Additional compliance costs include the erosion of taxpayer trust, consumer abuse, and the heightened potential for fraud.

Form 1023-EZ Burdens Potential Donors and State Charity Officials, Who Can No Longer Rely on the IRS's Determinations

Some state charity officials warn potential donors that organizations whose exempt status was obtained by filing Form 1023-EZ require more thorough review to assess whether they are indeed IRC § 501(c)(3) organizations, and some institutional grantors simply treat those organizations as ineligible to receive

28 See *Form 1023-EZ Eligibility Worksheet*, questions 7, 10, 11, 21, and 25. Organizations that do not meet the Form 1023-EZ eligibility requirements may qualify as IRC § 501(c)(3) organizations, but they must apply for recognition using a full Form 1023.

29 TE/GE response to TAS information request (July 12, 2016). These correspondence examinations are conducted primarily by Tax Compliance Officers in the EO Compliance Area. It appears that employees who conduct these audits would normally be graded as GS-9 or lower. See Internal Revenue Manual 4.75.27.1, *Overview* (June 1, 2010).

30 *Id.* As TE/GE notes, “[t]hese determinations are conducted by Revenue Agents in EO Determinations that are generally Grade 11 or 12 employees. This estimate only includes time directly attributable to the case by the Revenue Agent. It does not include other processing time, such as time required by clerical staff to establish the case, assign the case to the group, close the case from the system, issue final letters, backend scan paper documents into the system, manage paper files, etc. It also does not include managerial time to assign the case to the agent, review letters, and review cases for closure; nor does it include potential time charged by Quality Assurance personnel for quality review.”

31 See Rev. Proc. 2016-5, § 12, 2016-1 I.R.B. 188 (providing for revocation (which may be retroactive) or modification of a determination letter recognizing exemption, and affording the same procedures for appealing such revocation or modification as those applicable to denials of an initial application for exempt status); IRC § 7428 (providing for review by the Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia of the IRS's determination with respect to the initial or continuing qualification or classification of an organization under IRC § 501(c)(3)).

32 Organizations exempt from tax under IRC § 501(c)(3) are generally not required to pay tax on their related income and may receive tax deductible contributions. See IRC §§ 501 and 170(c)(2). An organization determined to not have been tax exempt would be treated as a taxable entity required to report and pay tax on income (whether related to the erstwhile exempt purpose or not).

grants.³³ At least one state plans to collect data about how often an IRS determination letter granting IRC § 501(c)(3) status on the basis of a Form 1023-EZ application is insufficient for state registration purposes.³⁴ Anecdotal evidences suggests the frequency may be as high as 25 percent of the time in that state.³⁵

CONCLUSION

Experience with Form 1023-EZ shows that a significant portion of approved Form 1023-EZ applicants do not qualify for IRC § 501(c)(3) status as a matter of law. In spite of this evidence, TE/GE has continued to rely on Form 1023-EZ and has chosen to substitute time-consuming audits for pre-determination oversight. Moreover, by relinquishing its upfront leverage for achieving compliance via the determination letter process, the IRS has simply shifted the burden of consumer protection and verification downstream to states and donors. This has opened up a gap in which taxpayers and consumers are harmed.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that:

1. In addition to revising Form 1023-EZ to require applicants to provide a brief narrative statement of their actual or planned activities, as directed by the National Taxpayer Advocate's sustained TAD, revise Form 1023-EZ to:
 - a. Require applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to submit their organizing documents; and
 - b. Require applicants to submit summary financial information such as past and projected revenues and expenses.
2. Make a determination about qualification as an IRC § 501(c)(3) organization only after reviewing an applicant's narrative statement of actual or planned activities, organizing documents, and summary financial information.
3. Where there is a deficiency in an organizing document, require an applicant to submit a copy of an amendment to its organizing document that corrects the deficiency and has been approved by the state, even where the documents are available online at no cost, before conferring exempt status.

33 Notes of TAS interview of the President of the National Association of State Charities Officials (NASCO) (Aug. 25, 2015), on file with TAS.

34 Notes of TAS interview of Assistant Director, Charitable Trusts Unit, New Hampshire Dept. of Attorney General (Aug. 10, 2016), on file with TAS.

35 *Id.*

APPENDIX 1, TAXPAYER ADVOCATE DIRECTIVE FROM NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE



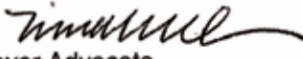
THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE

September 26, 2016

Response Due: December 28, 2016
Completed By: December 28, 2016

MEMORANDUM FOR SUNITA LOUGH, COMMISSIONER,
TAX EXEMPT AND GOVERNMENT ENTITIES

FROM:

Nina E. Olson 
National Taxpayer Advocate

SUBJECT:

Taxpayer Advocate Directive 2016-1, Revise Form 1023-EZ to Require Additional Information from Applicants, Require Review of Such Additional Information Before Making a Determination, and Explain Your Conclusions With Respect to Each of 149 Organizations Identified by TAS

TAXPAYER ADVOCATE DIRECTIVE

Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a Taxpayer Advocate Directive (TAD). A TAD may be issued to (1) mandate administrative or procedural changes to improve the operation of a functional process, or (2) grant relief to groups of taxpayers (or all taxpayers) when its implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.¹

¹ Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a TAD "to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers." Internal Revenue Manual (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).

Internal Revenue Manual (IRM) 13.2.1.6.1 (July 16, 2009) provides that in advance of issuing a TAD, the National Taxpayer Advocate attempts to work with and communicate with the owners of the process in order to correct the problem. I included the issue of erroneous approvals of Form 1023-EZ applications as a Most Serious Problem in my most recent Annual Report to Congress, and supported my concerns with the findings of a TAS research study.² As described in my Fiscal Year 2017 Annual Report to Congress, I attempted to resolve this issue, and TE/GE rejected my recommendation that it take corrective measures.³ I noted that I would continue to advocate for taxpayers by issuing this TAD.⁴ TE/GE's responses to my recommendations, included in Volume 2 of my Fiscal Year 2017 Annual Report to Congress, show the IRS's continuing refusal to take corrective measures.⁵ These reports serve as a formal memorandum issued to the responsible operating area within the meaning of IRM 13.2.1.6.1.2 (July 16, 2009). Therefore, all procedural requirements for issuing this TAD have been satisfied.⁶

I now direct you to take the following actions with respect to Form 1023-EZ:

1. Revise Form 1023-EZ to require applicants to submit:
 - a. A brief narrative statement of their actual or planned activities;
 - b. Summary financial information such as past and projected revenues and expenses; and
 - c. Their organizing documents (unless the documents are already retrievable from a State online database); and
2. Change your procedures to require review of these materials prior to making a determination.

Prior to the release of my 2016 Annual Report to Congress, TAS shared with you the EINs of 149 organizations whose articles of incorporation were insufficient for

² National Taxpayer Advocate 2015 Annual Report to Congress 36-44 (Most Serious Problem: Form 1023-EZ: Recognition as a Tax-Exempt Organization is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to be Taxable); vol. 2, 1-32 (Research Study: Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ), attached.

³ National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 181-183 (Area of Focus: *The IRS Is Aware That a Significant Proportion of Form 1023-EZ Applications It Approves Are Submitted by Organizations That Do Not Meet the Legal Requirements for IRC § 501(c)(3) Status, But It Has Not Acted to Correct Known Errors and Has Not Revised the Form to Prevent These Erroneous Approvals*), attached.

⁴ National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 183 (Area of Focus: *The IRS Is Aware That a Significant Proportion of Form 1023-EZ Applications It Approves Are Submitted by Organizations That Do Not Meet the Legal Requirements for IRC § 501(c)(3) Status, But It Has Not Acted to Correct Known Errors and Has Not Revised the Form to Prevent These Erroneous Approvals*), attached.

⁵ TE/GE response to the National Taxpayer Advocate 2015 Annual Report to Congress, reported in National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress vol. 2, 11-16 (Aug. 24, 2016).

⁶ IRM 13.2.1.6.2(1), *TAD Appeal Process* (July 16, 2009).

qualification as an IRC § 501(c)(3) organization. You indicated that you did not agree with TAS's conclusions in all cases. Therefore, in addition to the above actions, I also direct you to:

3. Provide TAS the Employer Identification Numbers (EINS) for the entities whose organizing documents you agree are insufficient for qualification as an IRC § 501(c)(3) organization; and
4. Provide TAS the EINs for the entities whose organizing documents you believe are sufficient for qualification as an IRC § 501(c)(3) organization and explain your conclusion with respect to each of these entities.

Please provide a written response to this TAD on or before **December 28, 2016**, or elevate this TAD to the Commissioner of Internal Revenue within ten (10) calendar days of the date on this TAD. If you are complying with this TAD, the actions above must be completed no later than **December 28, 2016**.

I. Issues

The IRS adopted Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* in July of 2014. Because the form does not elicit enough information from applicants to allow the IRS to make a determination as to whether the organization qualifies under IRC § 501(c)(3) as an organization exempt from taxation under IRC § 501(a), TE/GE erroneously grants exempt status at an unacceptably high rate.

II. Procedural History

I have voiced concerns about the adoption of Form 1023-EZ since it was proposed in 2014.⁷ My concern was that the IRS, by adopting the form, would essentially abdicate its responsibility to make determinations as to whether an organization meets the qualifications under IRC § 501(c)(3) for tax-exempt status. Subsequent events showed my concern was justified.

According to the applicable statutory framework, an applicant seeking to qualify as an organization described in IRC § 501(c)(3) must demonstrate that it meets an "organizational test" and an "operational test."⁸ The "organizational test" requires an applicant's organizing document to establish that it is "organized and operated exclusively" for one of eight enumerated exempt purposes.⁹ The

⁷ See National Taxpayer Advocate Fiscal Year (FY) 2015 Objectives Report to Congress 54-7.

⁸ Treas. Reg. § 1.501(c)(3)-1(a)(1) (providing that "[i]f an organization fails to meet either the organizational test or the operational test, it is not exempt.")

⁹ IRC § 501(c)(3); Treas. Reg. § 1.501(c)(3)-1(b)(1)(i) (providing "[a]n organization is organized exclusively for one or more exempt purposes only if its articles of organization," among other things, limit the purposes of such organization to one or more exempt purposes); Treas. Reg. § 1.501(c)(3)-1(b)(4) (providing "[a]n organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such

“operational test” requires the applicant to engage primarily in activities which accomplish one or more of the eight exempt purposes specified in IRC § 501(c)(3).¹⁰ No more than an insubstantial part of its activities can be not in furtherance of an exempt purpose,¹¹ and the organization must be operated to further public rather than private interests.¹²

TE/GE has known since it introduced Form 1023-EZ that its reliance on the form led it to approve applications by organizations that did not meet the legal requirements to be considered an IRC § 501(c)(3) organization. This is because Form 1023-EZ applications that do not receive pre-determination review are approved 95 percent of the time, but applications that are subject to slightly more scrutiny are approved only 77 percent of the time. When an application is rejected after being subjected to pre-determination review, it is often because the organization does not or cannot respond to basic inquiries from the IRS about its activities.

TAS provided TE/GE with further evidence of the unreliability of Form 1023-EZ. In 2015, TAS analyzed the organizing documents of a representative sample of corporations in 20 states that make articles of incorporation viewable online at no cost whose Form 1023-EZ was approved. The study concluded that 149 out of 408 organizations, or 37 percent, did not satisfy the organizational test and therefore were not, as a matter of law, IRC § 501(c)(3) organizations.

TAS shared the EINs of the 149 organizations with the Exempt Organizations (EO) function of TE/GE and requested that EO assist these organizations by reviewing their organizing documents and requiring them to correct any deficiencies. EO informed TAS it does not agree that all 149 applications were erroneously approved, but refused to explain its conclusions about specific organizations' applications with TAS. EO refused to contact even those organizations it acknowledges do not meet the organizational test, a legal requirement for qualifying as an IRC § 501(c)(3) organization, and whose applications were indeed approved in error. Instead, EO referred all 149 organizations to EO Examination, which may or may not result in audits.¹³

assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes...”). In some states, sometimes referred to as *cy pres* states, a dissolution clause is not required because by operation of state law, the organization's assets would be distributed upon dissolution for one or more exempt purposes, or to the federal government, or to a state or local government, for a public purpose. See Rev. Proc. 82-2, 1982-1 C.B. 367.

¹⁰ See Treas. Reg. § 1.501(c)(3)-1(c)(1), providing that “[a]n organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3).”

¹¹ See Treas. Reg. § 1.501(c)(3)-1(c)(1), providing that “[a]n organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.”

¹² Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

¹³ As EO informed TAS, “we did our own review of the 149 organizations and agreed that 59 of those failed the purpose test requirement but only 15 failed the dissolution requirements (note: some of those 15 may have also failed the purpose test); however, just that circumstance alone

TAS also recommended that TE/GE revise Form 1023-EZ to avert future erroneous approvals. The IRS has refused to adjust Form 1023-EZ to solicit information from applicants that would allow it to truly make a determination as to whether they qualify for status as an IRC § 501(c)(3) organization.

III. Analysis

In view of EO's indifference to the TAS research study findings, it appears that EO has effectively written the organizational test out of existence. By improperly granting an organization IRC § 501(c)(3) status when it does not meet the legal requirements, the IRS burdens all taxpayers. Approved organizations do not report and pay tax on income that should be subject to tax, and donors claim deductions for contributions that should not be deductible.

The cursory review afforded by Form 1023-EZ invites noncompliance and manipulation. Here is an example of the relevant portion of the articles of incorporation of one corporation whose Form 1023-EZ was approved:

My father [named individual], suffered [sic] a spinal cord injury in February 2013, which left him a quadriplegic [sic]. His physicians and physical therapists say he is capable of recovering and walking again but his insurance ((name of State) Medicaid) will not cover the expense, so we are hosting fundraisers/benefits to try to raise the money on our own to pay for his therapy out of pocket.¹⁴

This organization's articles of incorporation, which do not identify any exempt purpose, do not meet the organizational test. Moreover, the articles appear to prevent the organization from operating to further public rather than private interests - they effectively prevent it from meeting the *operational* test. A simple review of this corporation's articles of incorporation would presumably have led the IRS to question whether the organization truly qualifies for tax-exempt status under IRC § 501(c)(3). Instead, by exempting this organization from paying taxes and allowing deductible contributions to it, the IRS failed to apply the law and failed to protect the interests of all taxpayers.

Form 1023-EZ applicants are also harmed because they are deprived of an essential service - effective review of their request for tax-exempt status under

wouldn't likely necessitate subsequent revocation by Exam. In addition, we explained our risk mitigation efforts via the pre- and post-determination process (PDC) of the EZ to identify on-going compliance issues with the form. The listing of 149 organizations was turned over to EO Examination as a TAS referral. The organizations will be considered for audit under the established examination referral procedures." Email from Director, EO – Rulings & Agreements Executive Lead (Aug. 4, 2016), on file with TAS.

¹⁴ This is the entire text that appears as the "purposes/nature of the business" in the articles of incorporation of an organization included in the TAS study described above. As of July 14, 2016, this corporation was still listed on the IRS's publicly accessible Select Check database as one to which tax deductible contributions may be made.

IRC § 501(c)(3). Defects in organizations' procedures or practices that come to light in a subsequent audit may trigger revocation of tax-exempt status (which may be retroactive). This outcome could be avoided by advising an applicant from the outset when a proposed organizational structure does not meet the organizational test and may even prevent the organization from meeting the organizational test.

Moreover, the IRS has simply shifted the burden of consumer protection and verification downstream to states and donors. Some state charity officials now warn potential donors that organizations whose exempt status was obtained on the basis of Form 1023-EZ require more thorough review to ascertain whether they are indeed IRC § 501(c)(3) organizations, and some institutional grantors simply treat those organizations as ineligible to receive grants.¹⁵

The harm caused by lack of meaningful review is far from abstract. Most applications for tax-exempt status under IRC § 501(c)(3) are now made using Form 1023-EZ, and as noted above, the IRS approves 95 percent of Form 1023-EZ applications.

IV. Requested Actions

Because the IRS has refused to revise Form 1023-EZ or to assist taxpayers whose Form 1023-EZ was erroneously approved, I am issuing this TAD to protect the rights of taxpayers and prevent undue burden. In light of the significant harm taxpayers are suffering as a result of the IRS's failure to act, I direct you to take the following actions:

I now direct you to take the following actions with respect to Form 1023-EZ:

1. Revise Form 1023-EZ to require applicants to submit:
 - a. A brief narrative statement of their actual or planned activities;
 - b. Summary financial information such as past and projected revenues and expenses; and
 - c. Their organizing documents (unless the documents are already retrievable from a State online database); and
2. Change your procedures to require review of these materials prior to making a determination.

In addition, with respect to the 149 organizations whose EINs TAS shared with you, I direct you to:

¹⁵ Notes of TAS interview of the President of the National Association of State Charities Officials (NASCO) (Aug. 25, 2015) on file with TAS.

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3. Provide TAS the EINS for the entities whose organizing documents you agree are insufficient for qualification as an IRC § 501(c)(3) organization; and
4. Provide TAS the EINS for the entities whose organizing documents you believe are sufficient for qualification as an IRC § 501(c)(3) organization and explain your conclusion with respect to each of these entities.

Please provide a written response to this TAD on or before **December 28, 2016**, or elevate this TAD to the Commissioner of Internal Revenue within ten (10) calendar days of the date on this TAD. If you are complying with this TAD, the actions above must be completed no later than **December 28, 2016**. Please send any response or questions to me, with a copy to TAS Attorney Advisor Jill MacNabb.

Attachments

- (1) National Taxpayer Advocate 2015 Annual Report to Congress 36-44 (Most Serious Problem: *Form 1023-EZ: Recognition as a Tax-Exempt Organization is Now Virtually Automatic for Most Applicants, Which Invites Noncompliance, Diverts Tax Dollars and Taxpayer Donations, and Harms Organizations Later Determined to be Taxable.*)
- (2) National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 1-32 (Research Study: *Study of Taxpayers That Obtained Recognition as IRC § 501(c)(3) Organizations on the Basis of Form 1023-EZ.*)
- (3) National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 181-183 (Area of Focus: *The IRS Is Aware That a Significant Proportion of Form 1023-EZ Applications It Approves Are Submitted by Organizations That Do Not Meet the Legal Requirements for IRC § 501(c)(3) Status, But It Has Not Acted to Correct Known Errors and Has Not Revised the Form to Prevent These Erroneous Approvals.*)
- (4) TE/GE response to the National Taxpayer Advocate 2015 Annual Report to Congress, reported in National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress vol. 2, 11-16 (Aug. 24, 2016).

cc: John A. Koskinen, Commissioner of Internal Revenue
John M. Dalrymple, Deputy Commissioner, Services and Enforcement

MSP
#20**AFFORDABLE CARE ACT (ACA): The IRS Has Made Progress in Implementing the Individual and Employer Provisions of the ACA But Challenges Remain****RESPONSIBLE OFFICIALS**

Carolyn A. Tavenner, Director, Affordable Care Act Office
 Mary Beth Murphy, Commissioner, Small Business/Self-Employed Division
 Debra Holland, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*

DEFINITION OF PROBLEM

The IRS is charged with implementing certain provisions of the Patient Protection and Affordable Care Act of 2009 (ACA).² In addition to the existing provisions impacting individuals, some provisions of the ACA impacting employers became effective in tax year (TY) 2015.

In order to ensure that taxpayer rights are protected, TAS has been actively involved with the implementation of the ACA provisions. Some of the issues we reviewed include:

- In 2016, the IRS performed a systemic Individual Shared Responsibility Payment (ISRP) “recovery” to abate certain clearly identifiable ISRP overpayments;
- Premium Tax Credit (PTC) cases rose to become the fourth highest category of TAS case receipts during fiscal year (FY) 2016;³
- Advance Premium Tax Credit (APTC) recipients who incorrectly filed Form 1040-EZ, *Income Tax Return for Single and Joint Filers With No Dependent*, experienced delays in processing their returns;
- The IRS has developed procedures to address “silent returns” (*i.e.*, returns that do not have the minimum essential coverage (MEC) checkbox marked; Form 8965, *Health Coverage Exemptions*; or an amount for the ISRP);

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Patient Protection and Affordable Care Act of 2009 (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act (HCERA) of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

3 TAS Case Advocacy, *Figure 4.1.4, Top 10 Issues for Cases Received in TAS, FYs 2015-2016, infra*.

- Current ISRP exemption procedures impose an unnecessary burden on taxpayers requesting religious exemptions;
- APTC recipients who receive large lump sum payments of Social Security Disability Insurance (SSDI) may be caught off guard by having to repay APTC amounts, as well as penalties and interest;
- Whether employees in the newly-established ACA Business Exam unit would receive specialized training on the parts of ACA implementation that impact businesses, including training on concepts such as applicable large employer (ALE), MEC, and employer shared responsibility payment (ESRP); and
- Whether the IRS would be prepared to handle the additional volume of information-reporting data expected as a result of the ACA provisions impacting businesses becoming effective for the 2017 filing season.

ANALYSIS OF PROBLEM

Background: Filing Season (FS) 2016 Overall Results

The 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.⁴ During the 2016 filing season, eligible individual taxpayers claimed the PTC on TY 2015 returns. The following figure provides preliminary data through August 25, 2016 regarding the extent to which individual taxpayers claimed the PTC on their TY 2015 returns.

FIGURE 1.20.1, Reporting of the Premium Tax Credit on Forms 8962 for TY 2015 Returns Through August 25, 2016⁵

Returns Filed with Forms 8962, Premium Tax Credit (PTC)	5.7 million
Total PTC Amount Claimed	\$17.1 billion
Average PTC Amount Claimed Per Return	\$2,999
Returns Reporting Advanced PTC	5.3 million (94% of returns with Form 8962)
Total Advanced PTC Reported	\$18.9 billion
Prepared Returns Filed With Forms 8962 (Paid or Volunteer)	3.6 million (62% of returns with Form 8962)

4 ACA, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by HCERA, Pub. L. No. 111-152, 124 Stat. 1029 (2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).

5 IRS response to TAS information request (Nov. 4, 2016). This data is based on returns that had posted as of the end of August 2016, and is preliminary and subject to change as the IRS reviews the data, processes additional tax year (TY) 2015 returns, and conducts compliance activities.

Individual taxpayers who did not have MEC or qualify for an exemption were required to make an ISRP on their TY 2015 returns. The following figure provides preliminary data through August 25, 2016 on the reporting of ISRPs on TY 2015 returns.

FIGURE 1.20.2, Reporting of Individual Shared Responsibility Payments (ISRP) on TY 2015 Returns Through August 25, 2016⁶

Returns With ISRP	6.1 million
Average ISRP	\$452
Prepared Returns Reporting ISRP (Paid or Volunteer)	3.9 million (64%)
Returns Filed With Forms 8965, Health Coverage Exemptions	12.2 million
Returns Filed With Forms 8965 Claiming Household Coverage Exemption (Form 8965 Part II)	3.6 million
Returns Filed With Forms 8965 Claiming Coverage Exemption (Part III)	8.6 million
Prepared Returns Filed With Forms 8965	6.6 million (54%)

The IRS Systemically Addressed Tax Year 2014 Individual Shared Responsibility Payment (ISRP) Overpayments

In the 2015 Annual Report to Congress, the National Taxpayer Advocate raised concerns about the significant number of taxpayers who overstated the ISRP on TY 2014 returns.⁷ Between mid-November 2015 and early January 2016, the IRS issued Letters 5600-C, *Overstated SRP Letter*, to almost 319,000 taxpayers informing them of the potential overpayment and instructing them to file an amended return and attach Form 8965, *Health Coverage Exemptions*, if applicable.⁸

The IRS subsequently performed a systemic ISRP “recovery” to abate the ISRP on approximately 151,000 returns for the following taxpayers who did not appear to owe the ISRP for TY 2014:⁹

- Taxpayers who did not claim their personal exemption; and
- Taxpayers with gross income below the filing threshold.

We will continue to work with the IRS to determine whether this recovery resolved most of the TY 2014 overpayments. The IRS has stated that it currently has no plans to address TY 2015 ISRP overstatements

⁶ IRS response to TAS information request (Nov. 4, 2016). This data is based on returns that had posted as of the end of August 2016, and is preliminary and subject to change as the IRS reviews the data, processes additional TY 2015 returns, and conducts compliance activities.

⁷ National Taxpayer Advocate 2015 Annual Report to Congress 167-79. For TY 2014, over 400,000 taxpayers overstated their ISRP, totaling over \$50 million. The average Individual Shared Responsibility Payment (ISRP) overstatement was approximately \$123 per return (this average only includes returns with an ISRP overstatement). IRS Wage and Investment Research and Analysis (currently Wage and Investment Strategies and Solutions) analysis on ISRP overstatements, through cycle 34 (Aug. 27, 2015), on file with TAS Research. The IRS cannot calculate the exact amount of ISRP overpayments until all dependents have filed their TY 2014 tax returns (the amount of the ISRP depends on household income (HHI) pursuant to IRC § 5000A(c)).

⁸ IRS response to TAS information request 6 (Nov. 4, 2016).

⁹ IRS response to TAS fact check (Dec. 19, 2016); IRS response to TAS information request 6 (Nov. 4, 2016); IRS, Servicewide Electronic Research Program (SERP) Alert 16A0229, SRP Adjustments – Work Stoppage Effective Immediately (Aug. 5, 2016, rev. Aug. 19, 2016).

due to the small volume. It attributes this significant reduction to outreach conducted to tax practitioners and software providers.¹⁰ We encourage the IRS to continue performing this outreach for future tax years.

Taxpayers Are Seeking TAS Assistance for Premium Tax Credit (PTC) Issues

Taxpayers claiming the APTC are required to file Form 8962, *Premium Tax Credit (PTC)*, to reconcile the APTC received during the year with the PTC the taxpayer is actually entitled to receive. Taxpayers use Form 1095-A, *Health Insurance Marketplace Statement*, to prepare Form 8962. When the taxpayer files the return, the IRS ACA Verification System (AVS) checks the Marketplace Exchange Periodic Data (EPD)¹¹ on all individual tax returns to verify if the taxpayer received the APTC and reconciled the APTC on Form 8962.¹² If AVS indicates that the taxpayer received APTC but the taxpayer does not reconcile APTC on Form 8962, the IRS will correspond with the taxpayer by issuing Letter 12C, *Individual Return Incomplete for Processing: Forms 1040, 1040A, & 1040EZ*, and hold the return in an Error Resolution/Rejected Returns unit pending a response.¹³

PTC cases quickly became the fourth highest category of TAS case receipts during FY 2016.¹⁴ In FY 2016, TAS received 10,910 cases with PTC issues. In comparison, TAS received 3,318 PTC cases in FY 2015 — an approximately 229 percent increase over a one-year period.¹⁵ To better understand the cause of the increase, TAS's ACA Rapid Response Team analyzed a random sample of cases. A primary issue leading to the increase in PTC case receipts was that returns were held in the Wage and Investment (W&I) Error Resolution System (ERS) to process taxpayers' response to the IRS Letter 12C. The Letter 12C requested information necessary to process returns with a discrepancy or a missing Form 8962. Specifically, the analysis found the following:¹⁶

- 90 percent involved the IRS ERS/Reject unit;
- 87 percent did not reconcile the APTC. Of these cases, three percent involved APTC paid on a policy under another individual's name (not the taxpayer or spouse);
- 83 percent involved an unfiled Form 8962;
- 20 percent involved math error, Automated Questionable Credit, or an Examination issue; and

10 IRS response to TAS information request 7 (Nov. 4, 2016). As of Cycle 26, the first cycle of July 2016, the number of tax returns received with an over-assessed individual SRPs related to dependents and income below the filing threshold was approximately 6,000 in TY 2015.

11 The IRS receives Exchange Periodic Data (EPD) from the exchanges, stores the EPD in the Coverage Data Repository (CDR), and uses the EPD to verify the accuracy of the maintained data to verify Premium Tax Credit (PTC) claimed by taxpayers. Submission Processing uses the IRS ACA Verification System (AVS) to identify mismatches between taxpayer and third party data. Internal Revenue Manual (IRM) 21.6.3.4.2.13.3, *At-Filing Overview* (Oct. 1, 2015). For a detailed description of the EPD and CDR, see Treasury Inspector General for Tax Administration, *Affordable Care Act – Coverage Data Repository: Risks With Systems Development and Deployment*, Ref. No. 2015-23-041 (June 2, 2015).

12 IRM 3.14.1.6.9.13(2) (Jan. 1, 2016); IRM 21.6.3.4.2.16.3 (Oct. 1, 2015).

13 IRS response to TAS fact check (Dec. 19, 2016).

14 TAS Case Advocacy, *Figure 4.1.4, Top 10 Issues for Cases Received in TAS, FYs 2015-2016, infra.*

15 *Id.*; Business Performance Management System (BPMS), Receipts - Core Issues by Business Operating Division (BOD) & Criteria – Cumulative, FY 2016: 1-October through 12-September (10/01/2016); Business Performance Management System (BPMS), Receipts – Core Issues by BOD & Criteria – Cumulative, FY 2015: 1-October through 12-September (10/01/2015).

16 Unless otherwise indicated, the data in this discussion are drawn from a random sample of 400 cases with a PTC primary or secondary issue code from a population of 8,009 cases TAS received between October 2015 and April 2016. TAS reviewers used an electronic data collection instrument (DCI) to record data from case history reviews from the Taxpayer Advocate Management Information System (TAMIS). Thirty-four cases were excluded from the results because three taxpayers withdrew their cases from TAS and 31 cases were miscoded with a PTC issue code. Cases contained multiple issues so the percentages will not total to a 100 percent. The results are statistically valid at the 95 percent confidence level with a margin of error no greater than +/- 5 percent. Business Objects TAMIS report (April 2016).

- 12 percent involved Marketplace-related issues, such as bad data transmitted to the IRS, missing Forms 1095-A, *Health Insurance Marketplace Statement*, or Form 1095-A errors.

These numbers are not surprising given the considerable PTC compliance activities conducted by the IRS. Between January and August 2016, the IRS received approximately 1.7 million returns on which the taxpayers did not reconcile APTC received by reporting it on Form 8962. In response, the IRS issued Letters 12C to this group of taxpayers. About 50 percent of these taxpayers responded to the IRS with information needed to reconcile the APTC. In addition to the other compliance treatments discussed herein (including the issuance of Letters 12C and holding returns in ERS), the following chart sets forth the W&I audit numbers for PTC returns for FS 2016 through August 2016:¹⁷

FIGURE 1.20.3, Premium Tax Credit Compliance Issues

New Start PTC Exams TY 2014 (W&I)	23,354
New Start PTC Exams TY 2015 (W&I)	25,418
PTC Exam Closures TY 2014 (W&I)	20,410
PTC Exam Closures TY 2015 (W&I)	1,967

The IRS receives monthly information from the Marketplace, which may include corrections, so in some cases, the taxpayer's information may have been updated since the IRS sent Letter 12C.¹⁸ Some cases may simply require a subsequent review of the Coverage Data Repository (CDR) for updated information. If a subsequent review of the CDR shows an update since the issuance of Letter 12C and confirms that the information reported on the return is correct, the IRS should continue processing the return. If a review of the CDR does not show any updates and does not confirm the information reported on the tax return, the taxpayer must contact the Marketplace for a corrected Form 1095-A. Taxpayers impacted by this issue have sought assistance from TAS but the IRS should build in procedures to perform subsequent reviews of these cases to avoid unnecessary delays and reduce burden on taxpayers.

TAS has recommended the IRS reject electronic filed returns when the taxpayer received APTC but did not reconcile. This approach would allow taxpayers to reconcile their returns immediately and re-file electronically, thereby minimizing return processing delays.

Delays Involved in Processing Returns for Advanced Premium Tax Credit (APTC) Recipients Who Incorrectly Filed Form 1040EZ

During FS 2016 through August, the IRS received almost 223,000 Forms 1040EZ, *Income Tax Return for Single and Joint Filers with No Dependents*, from APTC recipients.¹⁹ When APTC recipients incorrectly file Form 1040EZ, they do not file the required Form 8962 to reconcile the APTC amounts received. As

17 Information received from the ACA Office (Dec. 27, 2016). IRS response to TAS information request 2-5 (Nov. 4, 2016). The data includes W&I exam starts and closures through August 2016. It does not include Small Business/Self Employed Division (SB/SE) exam starts and closures.

18 IRS response to TAS fact check (Dec. 19, 2016); SERP, *Responding to PTC Letters, 12C* – Paragraph 5, Note (last update Mar. 25, 2016). The IRS has posted information on its website for taxpayers who receive Letters 12C. See IRS, *Understanding Your Letter 0012C*, <https://www.irs.gov/individuals/understanding-your-letter-0012c> (last visited June 3, 2016). In addition, the IRS has posted information to assist impacted taxpayers who received corrected or voided Form 1095-A. See IRS, *Corrected or Voided Form 1095-A*, <https://www.irs.gov/Affordable-Care-Act/Individuals-and-Families/Corrected-or-Voided-Form-1095A> (last visited June 3, 2016).

19 IRS response to TAS information request (Nov. 4, 2016) (the IRS was unable to provide data on the number of days to resolve these conversion issues).

a result, when they file Form 1040EZ, taxpayers experience an additional delay in getting their return processed. After the taxpayers provide the IRS with Form 8962 and other documents for reconciliation, the IRS must convert the Form 1040EZ to a Form 1040, and the additional time needed for the conversion process resulted in processing delays.²⁰

IRS Future Actions on “Silent Returns”

The IRS plans to reject electronically filed “silent returns” beginning in FS 2017.²¹ Silent returns are ones for which the taxpayer did not: 1) check the box on the return to indicate the tax family had full-year health care coverage, 2) complete and attach Form 8965, *Health Coverage Exemptions*, to show tax family members had exemptions from health coverage requirements, or 3) self-assess an ISRP on the return. Silent returns filed by paper will go to the Error Resolution/Rejected Returns unit as the IRS issues Letter 12C, informing the taxpayer of the issue.²² If the taxpayer does not respond to the Letter 12C, the IRS will issue a notice to inform the taxpayer that the IRS estimated an ISRP and made an adjustment accordingly. If the taxpayer’s original return claimed a refund, the IRS will offset the refund with the ISRP balance.²³

If the taxpayer responds to the Letter 12C with an ISRP amount, the IRS will issue a notice to inform the taxpayer that it changed the refund amount, or the amount owed on the tax return, based on the ISRP provided in the response. If the taxpayer responds with an ISRP amount that equals more than the maximum assessment, the IRS will issue a notice to inform the taxpayer that it reduced the ISRP down to the maximum.²⁴ Finally, if the taxpayer believes that he or she is eligible for an ISRP exemption, Letter 12C instructs the taxpayer to submit Form 8965. If the taxpayer provides Form 8965, then Submission Processing will process it.²⁵

Current Procedures Impose Unnecessary Burden on Taxpayers Requesting Religious Exemptions for the Individual Shared Responsibility Payment (ISRP)

Internal Revenue Code (IRC) § 5000A sets forth various exemptions from the ISRP, one of which is the exemption for religious conscience. Specifically, an individual can obtain an exemption for any month in which he or she is a member of a recognized sect or division that is recognized by the Social Security Administration (SSA) as conscientiously opposed to accepting any insurance benefits, including Medicare and Social Security.²⁶ Members of these religious groups, including the Amish and Mennonites, already request an exemption from Social Security and Medicare taxes on IRS Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*. The taxpayer files the form directly with the SSA, which makes the exemption determination and then forwards the form to the IRS.²⁷

Despite the fact that the ACA defines the ISRP exemption through reference to the social security tax provision, to receive an ISRP exemption, eligible taxpayers are required by regulation to apply to the

20 Systemic Advocacy Management System (SAMS) 34625 and 34628.

21 IRS response to TAS information request (Nov. 4, 2016).

22 *Id.* IRM 3.12.3.14, *Error Code 157* (Jan. 1, 2017).

23 IRM 3.12.3.14.1.5, *No Reply Procedures* (EC 157, SRP) (Jan. 1, 2017); IRM Exhibit 3.12.3-2, *Taxpayer Notice Codes* (Jan. 1, 2017).

24 IRM 3.12.3.14.1.4, *Reply Procedures* (EC 157, SRP) (Jan. 1, 2017).

25 *Id.*

26 IRC §§ 5000A(d)(2); 1402(g)(1).

27 IRM 4.19.6.4.1, *Form 4029 – Procedures* (Dec. 14, 2015).

By streamlining Affordable Care Act exemption procedures to claim an Individual Shared Responsibility Payment exemption for these taxpayers, the IRS would save both the taxpayers and the Marketplace time and paperwork and reduce confusion.

relevant health insurance marketplace for an exemption certification number (ECN).²⁸ The taxpayer must then enter the ECN on Form 8965, *Health Coverage Exemptions*, to claim the exemption.²⁹

Through the National Taxpayer Advocate Public Forums, it has come to our attention that thousands of Amish constituents have applied for and have never received ECNs despite repeated attempts to contact the insurance Marketplace and responding to requests for missing information. Marketplace employees are unable to locate and provide correct information for the ECN application process in a timely manner. There is a five page ECN application required at the birth of an eligible individual and another four page application for a new ECN when the individual turns 21 years old. The procedure is time-consuming, confusing, and redundant given the well-established IRS Form 4029 process for the exemption from Social Security and Medicare taxes.³⁰

A less burdensome solution would be to discard the ECN application process and allow taxpayers to enter “4029 exempt” instead of an ECN on Form 8965. The IRS would be able to verify the information internally, because it already receives the Form 4029 from SSA. By streamlining the ACA exemption procedures to claim an ISRP exemption for these taxpayers, the IRS would save both the taxpayers and the marketplace time and paperwork and reduce confusion.³¹ To address this issue, the National Taxpayer Advocate has included in this report a related legislative recommendation.³²

Treasury Has Concluded There Is No Administrative Fix for Issues With Lump Sum Social Security Disability Insurance (SSDI)

When taxpayers receive lump sum Social Security Disability Insurance (SSDI) payments, the additional income may push their household income (HHI) above 400 percent of the federal poverty line for the applicable family size, which will make them ineligible for the PTC.³³ For those taxpayers who received APTC during the tax year, they will need to repay the entire amount because the repayment limitations do not apply if HHI is above the 400 percent federal poverty line threshold.³⁴ The National Taxpayer Advocate raised concerns about this issue in her 2015 Annual Report to Congress as well as her FY 2017 Objectives Report.³⁵ In addition, Senator Angus S. King (I-Maine) raised this issue in a letter to the Secretary of Treasury and Commissioner of Internal Revenue John Koskinen.³⁶

28 45 C.F.R. § 155.605.

29 IRS, *Individual Shared Responsibility Provision – Exemptions: Claiming or Reporting*, <https://www.irs.gov/affordable-care-act/individuals-and-families/aca-individual-shared-responsibility-provision-exemptions#Exemptions> and Who Grants Them (last visited Aug. 22, 2016).

30 Oral Statement of Wayne H. Wengerd, Director, Old Order Amish Steering Committee, National Taxpayer Advocate Public Forum 27-29 (Aug. 16, 2016); Luca Gattoni-Celli, *Amish Community Leader Describes IRS Challenges At TAS Forum*, TAX NOTES (Aug. 17, 2016).

31 Luca Gattoni-Celli, *Amish Community Leader Describes IRS Challenges at TAS Forum*, TAX NOTES (Aug. 17, 2016).

32 See Legislative Recommendation: *Streamline Religious Exemptions: Streamline the Religious Exemption Process for the Individual Shared Responsibility Payment (ISRP)*, *infra*.

33 IRC § 36B(c)(1)(A).

34 IRC § 36B(f)(2).

35 National Taxpayer Advocate 2015 Annual Report to Congress 167-79; National Taxpayer Advocate FY 2017 Objectives Report to Congress 141-42.

36 A copy of the letter is posted at <https://www.king.senate.gov/download/?id=E7B96C93-2D10-4B01-B8FD-31FCA4ACAA51&inline=file> (last visited Apr. 13, 2016).

TAS requested that the Office of Chief Counsel consider issuing guidance to relieve the financial burden administratively. However, subsequent to this request, the Office of Legislative Affairs in the Department of Treasury responded to the aforementioned letter from Senator King and indicated that it cannot identify an administrative basis to exclude retroactive lump sum SSDI payments from the calculation of modified adjusted gross income for purposes of the PTC and APTC. Treasury's response also indicated that it is continuing to review this issue.³⁷ Based on this response, it is unlikely that the Office of Chief Counsel will grant TAS's request for relief through administrative guidance, in which case we will consider pursuing a legislative recommendation. In the meantime, TAS Systemic Advocacy is working on a project to better educate the public on the consequences of receiving lump sum payments, including SSDI payments.

The IRS Has Yet to Fully Develop Training to Employees Responsible for Making Employer Shared Responsibility Payment (ESRP) Assessments on Applicable Large Employers (ALEs)

Certain provisions of the ACA that impact employers became effective in TY 2015. Employers and the IRS have had a few years to digest the new requirements, but 2016 was the first year some of these provisions came into play.

Applicable Large Employers (ALEs)

IRC § 4980H(a)(1) imposes an assessable payment if an ALE fails to offer its full-time employees (and dependents) an opportunity to enroll in MEC under an eligible employer-sponsored plan, and PTC was paid to at least one full-time employee. In general, an employer is considered an ALE if it employs 50 or more full-time employees, or a combination of full-time and part-time employees that equals at least 50 full-time equivalents (FTEs).³⁸

An employer calculates its full-time employees based on each employee's hours of service. For purposes of the ESRP, an employee is considered full-time for a calendar month if he or she averages at least 30 hours of service per week. Under the final regulations, for purposes of determining full-time employee status, 130 hours of service in a calendar month is treated as the monthly equivalent of at least 30 hours of service per week.³⁹

Employer Shared Responsibility Payment (ESRP)

IRC § 4980H provides that ALEs will be subject to an ESRP if (1) it fails to offer its full-time employees the opportunity to enroll in MEC under an eligible employer-sponsored plan, and (2) a PTC was paid to at least one full-time employee. The amount of the ESRP under IRC § 4980H(a) is \$2,000 per full-time employee per year (determined on a monthly basis).⁴⁰ If an ALE offers MEC but it is not considered affordable, it will be assessed an ESRP of \$3,000 for each employee (determined on a monthly basis) that purchases health insurance from the exchange and is granted a tax credit and/or subsidy for health insurance.⁴¹

37 *Treasury Addresses Treatment of Retroactive SSDI Payments*, TAX NOTES TODAY (Aug. 31, 2016).

38 IRC § 4980H(c)(2).

39 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage.

40 IRC § 4980H(c)(1). The ESRP provisions provide an inflation adjustment mechanism beginning in years after 2014. IRC § 4980H(c)(5).

41 IRC § 4980H(b)(1).

Minimum Essential Coverage (MEC) and Minimum Value

MEC and minimum value relate to the determination of ESRP. MEC is defined in IRC § 5000A(f) and the regulations under that section, and includes employer-provided health care coverage. IRC § 36B(c)(2)(C)(ii) provides the definition of minimum value. An employer-sponsored health plan meets this standard if it is designed to pay at least 60 percent of the total cost of medical services for a standard population.

Although the IRS developed and delivered a substantial amount of training prior to the 2016 filing season, much of that training focused on the components of the ACA that affected individual taxpayers.⁴² With certain provisions of the ACA impacting employers becoming effective for the 2015 tax year, the IRS has to ensure that its employees who work ACA-related issues are properly trained on the aspects of the ACA that impact business taxpayers.

For example, ALEs not in compliance with the provisions under IRC § 4980H may be subject to an assessable payment, referred to as the ESRP. These ESRP cases will be worked by a special group of Employment Tax Compliance Officers.⁴³ The training for this group will be delivered in January 2017.⁴⁴ The training materials are currently under development, so TAS did not have an opportunity to review them for completeness and whether they adequately protect taxpayer rights.

The Inability of the IRS to Adequately Test the Accuracy of Information Reporting Data Before the Filing Season May Cause Significant Taxpayer Burden

The IRS relies on information reports to verify data relevant to the ESRP liability and eligibility for the Small Business Health Care Tax Credit. IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. IRC § 6056 requires annual information reporting by ALEs relating to the health insurance that the employer offers (or does not offer) to its full-time employees. Below is a list of information returns the IRS created to meet these reporting requirements:

- Form 1095-B, *Health Coverage* (used by health insurance issuers and carriers to report information about individuals who are covered by MEC and therefore aren't liable for the individual shared responsibility payment; due to the IRS by February 28 (or March 31 if filing electronically));⁴⁵
- Form 1094-B, *Transmittal of Health Coverage* (used by health insurance issuers and carriers to submit Form 1095-B);
- Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage Insurance* (furnished by ALEs to any full-time employee for one or more months of the year; due to the IRS by February 28 (or March 31 if filing electronically));⁴⁶ and
- Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns* (used by ALEs to submit Form 1095-C).

42 See National Taxpayer Advocate 2014 Annual Report to Congress 71.

43 IRS response to TAS information request (Nov. 4, 2016).

44 *Id.*

45 IRS, *Instructions for Forms 1094-B and 1095-B* (2015), www.irs.gov/pub/irs-pdf/i109495b.pdf.

46 IRS, *Instructions for Forms 1094-C and 1095-C* (2015), www.irs.gov/pub/irs-pdf/i109495c.pdf.

The IRS was not equipped to test the accuracy of information reporting data before the 2016 filing season. Prior to the 2016 filing season, the IRS had estimated that it would receive and process an estimated 77 million new Forms 1095-C from ALEs.⁴⁷ By the end of August, the IRS had received substantially more than this estimated amount — approximately 104 million — with 5.4 percent of such Forms 1095-C being rejected.⁴⁸ Reasons for rejected returns include faulty transmission validation, missing (or multiple) attachments, error reading the file, or duplicate files.⁴⁹

The IRS had little opportunity to identify problems and even less opportunity to fix them early in the filing season to prevent potential rejected returns and delays for taxpayers. Furthermore, without legislative action from Congress, the IRS is not able to expand the taxpayer identification number (TIN) matching program to include health insurers and self-insured employers that are required to file Form 1095-B, which may lead to mismatches and unnecessary notices.⁵⁰

If the IRS receives incomplete or inaccurate data, taxpayers will be harmed.⁵¹ For example, ALEs may unnecessarily be required to substantiate coverage to employees if the data is unreliable and contains false positives. If the IRS receives inaccurate data regarding coverage, it may erroneously assess ESRPs on ALEs, which can be costly and time-consuming for both employers and the IRS to rectify.

CONCLUSION

The IRS has made significant progress on the implementation of the tax provisions of the ACA. The 2016 filing season was especially challenging for the IRS as it implemented several ACA provisions that impacted employers and processed a significant amount of new information returns from insurers and ALEs. TAS commits to continue actively working with the IRS to ensure that taxpayer rights are protected, especially as the IRS implements the remaining compliance initiatives surrounding these provisions. We are concerned that TAS PTC case receipts spiked over the past year and will evaluate administrative and legislative fixes to resolve the underlying issues in an effort to reduce taxpayer burden.

TAS will continue to address ACA-related issues as they arise and identify systemic problems. TAS will assign ACA Rapid Response Team members to immediately address any potential ACA systemic issues that arise. In addition, we encourage both internal and external stakeholders to report any suspected ACA systemic issues on TAS's Systemic Advocacy Management System.⁵²

47 IRS response to TAS information request (Oct. 22, 2015).

48 IRS response to TAS information request (Nov. 4, 2016). After the initial rejection, the transmitter could have resubmitted the Form 1095-C and gotten through.

49 *Id.*

50 See National Taxpayer Advocate 2015 Annual Report to Congress 167-79 (Most Serious Problem: *The IRS Is Compromising Taxpayers Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*); National Taxpayer Advocate 2015 Annual Report to Congress 383-88 (Legislative Recommendation: *Affordable Care Act Information Reporting: Allow Taxpayer Identification Number Matching for Filers of Information Returns Under IRC §§ 6055 and 6056*).

51 See National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Math Error Authority: Limit the IRS's Summary Assessment Authority*); National Taxpayer Advocate 2014 Annual Report to Congress 75-76 (discussing TIN matching for Form 1095-B; the IRS will use Form 1095-B to verify compliance with IRC § 5000A).

52 Stakeholders can report suspected systemic issues at www.irs.gov/sams.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Apply the ISRP overpayment recovery procedures used for TY 2014 to TY 2015 ISRP overpayments and to overpayments made in future tax years.
2. Take preventive measures to avoid ISRP overpayments in the future, such as distributing educational notices to preparers associated with overpayments and conducting a comprehensive review and testing of private-sector tax filing software to ensure that the overpayment problems do not recur.
3. Reject electronic filed returns when the taxpayer received APTC and did not reconcile on Form 8962, *Premium Tax Credit (PTC)*, as the IRS plans to do for silent returns that do not include Form 8965, *Health Coverage Exemptions*.
4. Develop procedures to perform reviews of cases for which the IRS issued Letter 12C to determine if the CDR has been updated with new Marketplace data.
5. Ensure instructions to the Form 1040 series returns and the Form 8962 clearly state that the taxpayer cannot file Form 1040EZ if the APTC was paid on the taxpayer's behalf.
6. Conduct outreach and education on the consequences of receiving large lump sum SSDI distributions to APTC recipients and the Social Security Administration.