



Executive  
Summary

*Preface &  
Highlights*

NATIONAL TAXPAYER ADVOCATE

# Annual Report to Congress

2019

[www.TaxpayerAdvocate.irs.gov/2019AnnualReport](http://www.TaxpayerAdvocate.irs.gov/2019AnnualReport)



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## PREFACE: Introductory Remarks by the Acting National Taxpayer Advocate

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I respectfully submit for your consideration the National Taxpayer Advocate's 2019 Annual Report to Congress. This is the first Annual Report since 2000 that has not been submitted by Nina Olson. Nina retired on July 31, 2019, after leading the Taxpayer Advocate Service for over 18 years. During her time as the National Taxpayer Advocate, Nina fought tirelessly for taxpayer rights and created an organization of advocates who will carry on her legacy. The Taxpayer Advocate Service and all taxpayers are forever grateful for her advocacy.

### Changes to the Annual Report to Congress

The 2019 Annual Report looks decidedly different from previous reports in several ways. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code, as amended by the Taxpayer First Act (TFA), requires the National Taxpayer Advocate to submit this report each year and to include in it, among other things, a description of the ten most serious problems encountered by taxpayers as well as administrative and legislative recommendations to mitigate those problems. Previously, the report was required to contain a description of at least 20 of the most serious problems facing taxpayers. By reducing the number of Most Serious Problems to the top ten, we have been able to focus on what we consider to be the critical issues currently impacting taxpayers, the IRS, and tax administration. In Appendix 3, you will find a scorecard detailing how TAS assessed the Most Serious Problems in this year's report.<sup>1</sup>

TAS also took the opportunity to reevaluate the Annual Report as a whole and make a few other changes. The Most Serious Problems are shorter, which gives these sections a sharper focus on how the identified problem impacts taxpayers and the IRS. All parts of the report except our legislative recommendations are now consolidated into one volume. For ease of reference and use, we present all of our active legislative recommendations, from this year and prior years, in the "Purple Book." The report also contains a description of the ten tax issues most frequently litigated in the federal courts over the past year, as required by statute, as well as several research studies.

Consistent with the Taxpayer First Act, TAS worked with the IRS to verify the data contained in this report.<sup>2</sup> The only notable exception to this verification process is the research studies found later in this report.

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- 1 See Appendix 3, *Identifying the Most Serious Problems*, *infra*. The table in Appendix 3 presents factors considered by the National Taxpayer Advocate in determining the areas of tax administration that merited inclusion in this year's report. Each Most Serious Problem topic is categorized with a Low, Medium, or High degree of relevance to each factor.
  - 2 IRC § 7803(c)(2)(B)(ii)(XII) requires that the National Taxpayer Advocate, "with respect to any statistical information included in [this] report, include a statement of whether such statistical information was reviewed or provided by the Secretary under section 6108(d) and, if so, whether the Secretary determined such information to be statistically valid and based on sound statistical methodology." The data cited in the National Taxpayer Advocate's annual reports generally come from one of three sources: (i) publicly available data such as the IRS Data Book, Government Accountability Office (GAO) reports, and Treasury Inspector General for Tax Administration (TIGTA) reports; (ii) IRS databases to which TAS has access; and (iii) IRS data that is provided by the Operating Divisions pursuant to TAS information requests. Once data has been compiled, TAS's Office of Research and Analysis double checks it. Then TAS sends the IRS all data included in the "most serious problems" section of the report and most data included in other sections of the report for final verification prior to publication (except where noted). On the rare occasion where TAS and the IRS have a disagreement about data, we generally discuss it, and if a disagreement persists, we note it in the report.

### A Period of Change Within the IRS

The Taxpayer First Act marks changes not just for the Taxpayer Advocate Service, but for the IRS as well. By passing the Taxpayer First Act, Congress has sent the IRS a clear message that it needs to rethink the way it operates — the services it provides, its organizational structure, the way it trains employees, and the technology it uses.<sup>3</sup>

The IRS’s mission is to “[p]rovide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.”<sup>4</sup> Currently the IRS is struggling on both fronts. Its current inability to meet taxpayers’ customer service needs results in an inability to enforce the law fairly for all taxpayers.

The President’s Management Agenda emphasizes the importance of high-quality customer service and cites the American Customer Satisfaction Index (ACSI) and the Forrester U.S. Federal Customer Experience Index™ as key benchmarks.<sup>5</sup> Those indices find the IRS is among the lowest performing federal agencies when it comes to the customer experience. The ACSI report for 2018 ranks the Treasury Department tied for 10th out of 12 federal departments and says that “most [IRS] programs score . . . well below both the economy-wide national ACSI average and the federal government average.”<sup>6</sup> The 2019 Forrester report ranked the IRS as 13th out of 15 federal agencies and characterized the IRS’s score as “very poor.”<sup>7</sup>

As I will discuss below, funding constraints are a significant part of the problem. The IRS receives approximately 100 million telephone calls every year,<sup>8</sup> and to provide “top quality service,” as its mission statement commits it to do,<sup>9</sup> it requires adequate funding to hire enough employees to answer those calls. But the problems in IRS customer service go beyond just the budget.

While we support the IRS’s efforts to expand online accounts and communicate with taxpayers digitally, initiatives like those will not by themselves make the IRS into a customer-focused agency. To truly transform the organization, the IRS must start with a culture shift. If the culture of the organization is one where employees look to minimize interactions with taxpayers in an effort to move work, or where taxpayers who owe money are automatically viewed negatively, then expanding digital services will not improve customer service. The IRS needs to take a holistic view of how it operates and understand what is and is not working. Working collaboratively with TAS to understand what we are seeing in our cases is one of the best ways for the IRS to understand the pain points taxpayers experience and which processes are most likely to break down. Couple this information with a focus on training IRS employees on empathy and taxpayer interaction, as well as focusing on tracking customer service measures such as

3 See Taxpayer First Act, Pub. L. No. 116-25, §§ 1101 (directing the IRS to develop a comprehensive customer service strategy), 1302 (directing the IRS to modernize its organizational structure), 2402 (directing the IRS to submit to Congress a comprehensive training strategy), and 2101 (creating the statutory position of “chief information officer” and directing that individual to develop a multi-year IT strategic plan).

4 See IRS, *The Agency, Its Mission and Statutory Authority* (Aug. 9, 2019), <https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority> (last visited Dec. 12, 2019).

5 Office of Management and Budget, *President’s Management Agenda 7, 28* (2018), [https://www.performance.gov/PMA/Presidents\\_Management\\_Agenda.pdf](https://www.performance.gov/PMA/Presidents_Management_Agenda.pdf).

6 American Customer Satisfaction Index, *ACSI Federal Government Report 2018*, at 3-4 (2019).

7 Forrester Research, Inc., *The US Federal Customer Experience Index, 2019*, at 15-16 (June 11, 2019).

8 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2012 through FY 2019).

9 IRS Mission Statement (Aug. 2019), <https://www.irs.gov/about-irs/the-agency-its-mission-and-statutory-authority>.

first contact resolution and fairness, and the IRS can begin the cultural change needed to fundamentally improve its approach to serving its customers.

However, the IRS's shortcomings in its customer service also impact the agency's ability to fairly administer the tax law. At the same time that the IRS is faced with reevaluating its customer service strategy, the Commissioner has placed a renewed focus on enforcement.<sup>10</sup> TAS has been supportive of some of these efforts, particularly increased Revenue Officer hiring to help ensure the agency has a physical presence throughout the country.<sup>11</sup> But this enforcement focus must be coupled with an improvement in taxpayer service *within* enforcement. If the IRS is going to go out into communities to talk to taxpayers who owe back taxes, then those same taxpayers need to be able to get answers to their questions when they call the IRS or have an indicator placed on their account to designate when they might be at risk of economic hardship before they set up a payment plan.<sup>12</sup> To do otherwise will cause harm to those who can least afford it.

To start, the IRS should prioritize improving telephone service on its compliance lines. While the IRS needs to improve telephone service across the board, it is particularly critical that it answer calls from taxpayers after it has garnished wages, levied on bank accounts, or filed notices of federal tax lien against a taxpayer's house. These enforcement actions prompt many taxpayers to call the IRS to resolve their delinquent liabilities, and some of these taxpayers face economic hardship, such as pending eviction, as a result of IRS compliance actions.

By law, the IRS is required to release levies that are causing economic hardships.<sup>13</sup> But taxpayers often cannot reach the IRS to make it aware of their hardships. In fiscal year (FY) 2019, the IRS received about 15 million calls on its consolidated Automated Collection System lines.<sup>14</sup> IRS employees answered only 31 percent, and taxpayers who managed to get through waited on hold an average 38 minutes.<sup>15</sup> The IRS has an obligation to be accessible to these taxpayers, and it should not ramp up enforcement actions beyond the point where it has enough telephone assistants to handle the taxpayer calls those actions generate.

The level of service is even worse for taxpayers calling the balance due line to make payment arrangements or set up installment agreements. Live assistants last fiscal year answered only 26 percent of those calls and wait times averaged about 45 minutes. These are live taxpayers on the line, trying to talk to the IRS about the money they owe.<sup>16</sup> Yet the IRS does not answer 74 percent of these calls. To treat taxpayers with respect, taxpayer services like this must be prioritized. TAS will continue to evaluate the IRS's progress in future reports.

10 See, e.g., Joshua Rosenberg, *Rettig Wants IRS Audits To 'Touch Every Neighborhood'*, LAW 360 (Oct. 29, 2019) (quoting the Commissioner as saying the IRS should "touch every neighborhood" in choosing which taxpayers to audit and that, directly or indirectly, "[w]e want to touch everyone.").

11 See National Taxpayer Advocate 2018 Annual Report to Congress 240 (Most Serious Problem: *Field Collection: The IRS Has Not Appropriately Staffed and Trained Its Field Collection Function to Minimize Taxpayer Burden and Ensure Taxpayer Rights Are Protected*) (recognizing the importance of the individualized case work and geographic presence of revenue officers (ROs)).

12 See National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 51-52 (*Direct the IRS to Study the Feasibility of Using an Automated Formula to Identify Taxpayers at Risk of Economic Hardship*).

13 IRC § 6343 (a)(1)(D).

14 IRS, Joint Operations Center, Snapshot Reports: Enterprise Snapshot (week ending Sept. 30, 2019). IRS data for the consolidated ACS lines includes calls to the Installment Agreement/Balance Due telephone line. The Installment Agreement/Balance Due line assists taxpayers who have unpaid taxes but whose cases generally have not yet been assigned to ACS.

15 *Id.*

16 IRS, Joint Operations Center, Snapshot Reports: Product Line Detail (week ending Sept. 30, 2019).

While every organization must find ways to operate within its resources, it should be noted that the IRS's ability to do its job has been constrained by a significant reduction in resources over the past decade. Since FY 2010, the IRS budget has been reduced by about 20 percent after adjusting for inflation, and the IRS workforce has shrunk by about 22 percent.<sup>17</sup> These cuts make little business sense.

The IRS functions as the “accounts receivable” department of the federal government, and it is remarkably efficient. In FY 2018, the IRS collected nearly \$3.5 trillion on a budget of about \$11.43 billion, producing an overall return on investment (ROI) of more than 300:1.<sup>18</sup> However the IRS cannot continue to be as effective as it has been with a declining budget. As we discuss in our legislative recommendation regarding IRS funding, the current rules for setting IRS funding levels should be reconsidered. A private sector business would continue to provide more funding for its accounts receivable department as long as the funding produced a positive return on investment. Yet the federal budget process generally treats the IRS purely as a cost center, with no explicit recognition that a dollar appropriated to the IRS generally returns substantially more than one dollar in return. We encourage Congress and the Office of Management and Budget to take a hard look at improving the procedures for setting IRS funding levels.

### Report Contents and Taxpayer First Act Implementation

This year's Annual Report starts with a look at the Taxpayer First Act. The first group of Most Serious Problems focuses on the IRS's efforts to revise its customer service strategy and some of the key issues it needs to address if it is truly going to transform the way it serves taxpayers and practitioners. We also look at how the IRS's ability to improve customer service is tied to its IT modernization efforts and how adequate IRS funding ultimately impacts both of these areas. The remaining Most Serious Problems look at more focused problems facing taxpayers and practitioners in the areas of customer service and enforcement. Specifically, how the IRS is interacting with certain groups — such as return preparers, users of Free File, and multilingual taxpayers — and what the IRS needs to do to improve those interactions. We also examine how certain IRS initiatives — such as the presence of IRS compliance personnel in Appeals conferences, the Offer in Compromise program, and Combination letters — are impacting taxpayer rights, and we make recommendations for increasing their effectiveness.

To implement key provisions of the Taxpayer First Act, the IRS has established a dedicated office to oversee and coordinate the agency's TFA implementation efforts. The office is being led by the Commissioner's Chief of Staff and includes executives from the Wage & Investment Division, the Small Business/Self-Employed Division, and the Chief Information Officer's Information Technology function. IRS leadership declined to include a representative from TAS. I find this deeply concerning. Congress created the Office of the Taxpayer Advocate to serve as the statutory voice of the taxpayer within the IRS. No one has a better view into the problems that taxpayers and practitioners face day to day when working with the IRS than TAS. Over the last 20 years, TAS has worked more than 4.4 million cases resulting from problems with IRS systems or processes.<sup>19</sup> That history with individual and business taxpayers' problems gives TAS unique insight, perspective, and information that could be a key resource for identifying areas in need of improvement as the IRS develops a comprehensive customer service strategy.

17 IRS response to TAS information request (Oct. 2, 2019).

18 IRS, 2018 Data Book, Table 1: Collections and Refunds, by Type of Tax (May 2019); Department of the Treasury, *FY 2020 Budget-in-Brief* 69 (2019), <https://home.treasury.gov/system/files/266/FY2020BIB.pdf>.

19 Taxpayer Advocate Management System (TAMIS) data pulled by TAS (Oct. 1, 2001 to Oct. 1, 2019).

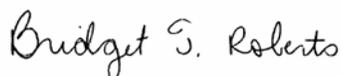
As the IRS decides how to implement the aptly named “Taxpayer First Act,” I believe TAS should have a seat at the table to the same extent as key IRS operating divisions, particularly for purposes of implementing the Act’s requirements that the IRS develop a comprehensive customer service strategy, modernize its organizational structure, create online taxpayer accounts, and develop a comprehensive employee training strategy that includes taxpayer rights. Having been excluded from the core implementation group, TAS will participate on executive teams and lower-level working groups and will offer our recommendations to the extent we have an opportunity to do so.

### Closing Thoughts

March 2020 marks the 20th anniversary of the Taxpayer Advocate Service.<sup>20</sup> Now more than ever, the role of TAS is vital to effective tax administration. In the face of numerous challenges, many of which are detailed in this report, TAS will continue to be here to assist taxpayers who experience economic hardships due to their tax problems and taxpayers who fall through the cracks of the IRS bureaucracy. TAS will continue to advocate for systemic changes within the IRS where IRS procedures are imposing undue burdens on taxpayers. And TAS will continue to use its reports to Congress to identify significant issues and recommend administrative and legislative actions to resolve those issues.

While I am honored to serve as the Acting National Taxpayer Advocate and will continue to serve in this capacity for as long as necessary, the Office of the Taxpayer Advocate — and taxpayers — deserve a permanent appointee.<sup>21</sup> As in other organizations, acting leaders are caretakers — charged with keeping the trains running on time but lacking the authority to make significant changes and often not taken as seriously as permanent officials. It has now been five months since Nina Olson retired. Given the current crossroads at which the IRS finds itself, it is critical that a permanent National Taxpayer Advocate be appointed as quickly as possible to help ensure the IRS protects taxpayer rights and meets its obligations to taxpayers.

Respectfully submitted,



Bridget T. Roberts  
Acting National Taxpayer Advocate  
December 31, 2019

20 TAS was established in its current form by the Internal Revenue Service Restructuring and Reform Act (RRA 98), Pub. L. No. 105-206, § 1102, 112 Stat. 685, 698-702 (1998) (codified at IRC §7803(c)). After extensive planning, TAS commenced operations in March 2000.

21 IRC § 7803(c)(1)(B)(ii) provides, in relevant part: “The National Taxpayer Advocate shall be appointed by the Secretary of the Treasury after consultation with the Commissioner of Internal Revenue and the Oversight Board.” The IRS issued a public statement on May 13 soliciting applications. See IRS Statement, *IRS seeking candidates interested in National Taxpayer Advocate position* (May 13, 2019), <https://www.irs.gov/newsroom/irs-statement-on-the-national-taxpayer-advocate-position>. In June and early July, the Commissioner and Assistant Secretary (Tax Policy) interviewed leading candidates for the position. No appointment has been made and no additional information has been provided since that time.

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## THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

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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 the ten most serious problems encountered by taxpayers each year. For 2019, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving ten such problems.

## **MSP #1 CUSTOMER SERVICE STRATEGY: The IRS Needs to Develop a Comprehensive Customer Service Strategy That Puts Taxpayers First, Incorporates Research on Customer Needs and Preferences, and Focuses on Measurable Results**

### **Problem**

The Taxpayer First Act requires the IRS to create and submit a comprehensive customer service strategy to Congress by July 1, 2020. As the IRS develops this strategy, the National Taxpayer Advocate has identified several concerns with the IRS's current approach to customer service that the new plan should address. Most importantly, the IRS does not currently view itself as a service organization first and foremost. In addition, customer service decisions are not informed by using multi-disciplined, comprehensive research into customer needs and preferences. Forcing some taxpayers to use digital channels undermines taxpayer rights. Moreover, a service strategy would be incomplete if it did not address services to practitioners. Finally, the new strategy should correct the current absence of meaningful customer service measures to effect desired results and it should not be merely aspirational — it needs to include an implementation plan complete with cost estimates.

### **Analysis**

The IRS provides service through various communication channels such as the internet, phone, and in-person assistance. Taxpayers and representatives have different preferences for each of these channels and these preferences may vary depending on the specific needs of the taxpayer or the type of task the taxpayer or representative is trying to accomplish. The IRS must base service strategy decisions on research into customer needs, rather than on what the IRS thinks is best and lowest cost. The IRS's reduction in staff and the number of Taxpayer Assistance Centers (TACs), the switch to appointments only in the TACs and the low percentage of telephone calls answered by live assistors, leaves taxpayers with little choice but to attempt to complete tax-related tasks on the internet (which often does not resolve the taxpayer's issue) or to spend money for professional assistance.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS ensure every taxpayer segment and business operating division are included in the customer service strategy; appoint a Chief Customer Experience Officer, reporting to the Commissioner or Deputy Commissioner; establish a 311-type phone system; work with the National Institute of Standards and Technology to determine how to make e-authentication requirements as least burdensome as possible; work with TAS to develop a taxpayer anxiety index; conduct research into why taxpayers and practitioners do not use certain service channels for particular tasks; track the subject of taxpayer and practitioner complaints for each service channel; conduct research into why a significant number of customers who call the various IRS phone lines hang up either before or after they are placed in a queue for a particular phone line; develop meaningful and transparent measures to monitor the success of all customer service initiatives, including first contact resolution and more transparent telephone level of service measures; coordinate with the team developing the Servicewide return preparer strategy; collaborate with TAS throughout the development of the strategy; and couple the strategy with an implementation plan, complete with cost estimates for various initiatives.

The National Taxpayer Advocate recommends that Congress provide the necessary funding to the IRS for the adequate staffing, budget, and technology needed to provide a robust, world class customer service experience.

## **MSP #2 INFORMATION TECHNOLOGY MODERNIZATION: The IRS Modernization Plan's Goal to Improve the Taxpayer Experience Is Commendable, But the IRS Needs Additional Multi-Year Funding to Bring It to Fruition**

### **Problem**

Aging IRS information technology (IT) infrastructure continues to plague the IRS and directly impact taxpayers. To address the IRS's failing IT infrastructure and its need for updated technology, the IRS developed its Integrated Modernization Business Plan (Plan), which aims to improve "the taxpayer experience, by modernizing core tax administration systems, IRS operations and cybersecurity." While this Most Serious Problem raises a few issues with the Plan, if implemented, the Plan would greatly improve the IRS's IT infrastructure, make tax administration more efficient, and enable the IRS to provide better taxpayer service. While the Plan does not address all of the IRS's IT issues, for the IRS to make any progress in modernizing its systems, its efforts must be fully funded.

### **Analysis**

In April 2019, the IRS released the Plan and a related Companion Document to address various components of the IRS IT strategy for the near future. This multi-year Plan will need to be further updated to comply with all of the requirements of the Taxpayer First Act, but the Plan is a great start, focusing in large part on updates to IRS systems to improve taxpayer experience and service.

The Plan's success will largely depend on the funding it receives, and full, dedicated, multi-year funding is needed for the Plan's complete implementation. The IRS estimates the Plan will cost approximately \$2.3 to \$2.7 billion overall, including \$289.7 million spent in fiscal year (FY) 2019 and \$300 million forecast for FY 2020. However, it will likely need more than \$2 billion for the remaining years to meet its estimated cost for total implementation. Without this full funding, the IRS will fall short of its goals to modernize its systems and enhance taxpayer service.

A part of the IRS's modernization will be major updates to IRS IT systems, which are some of the oldest still in use in the federal government. However, IT modernization projects are massive and generally span years. In order to be able to award funding for these projects, the IRS needs consistent multi-year funding. For example, the Plan includes the IRS's existing efforts to standardize technology support for IRS business processes, creating an Enterprise Case Management (ECM) system. Through ECM the IRS plans to create a simplified infrastructure, hopefully eliminating the need to maintain or rebuild older IT systems. ECM is currently estimated to take six years to develop and implement, so absent continued multi-year funding, the IRS will be unable to make progress in its ECM efforts.

One concern TAS has with the Plan, is that while the Plan modernizes the Individual Master File (IMF) by implementing Customer Account Data Engine (CADE) 2, which will help the IRS provide better service and support to individual taxpayers, the Plan does not include modernization of the Business Master File (BMF). This gap in the Plan could result in an inability for the IRS to provide the same level of service to business taxpayers that it will provide to individual taxpayers.

The IRS has been rolling out numerous services to improve taxpayer service in the past several years and is looking at similar improvements to enhance taxpayer service in the near term. These improvements can help address current issues with taxpayer services. For example, overwhelmed phones can be aided by customer callback rollout, which allows taxpayers to request a call back when an employee is free instead of waiting on hold. Taxpayers with minor issues that only require a brief interaction with the IRS can use Webchat, freeing up the phone lines for customers who need more in-depth assistance, which

could help to reduce call waiting times. The IRS is trying to roll out Secure Messaging, which allows taxpayers and IRS employees to exchange documentation safely, securely, and quickly without having to use traditional channels like mail and fax. New and improved online taxpayer accounts can securely provide information on amount of taxes owed, payment options, and payment history, in addition to access to tax transcripts.

### Recommendations

The National Taxpayer Advocate recommends the IRS modify the Plan to conform to the requirements of the TFA, by itemizing the anticipated project costs and potential risks, such as the 2018 end-of-filing-season IT crash, if the Plan is not fully funded; conduct independent verification and validation of its modernization plan to verify that it will result in complete modernization of IRS IT systems, similar to the independent verification and validation required in the Taxpayer First Act of the CADE 2 and ECM systems; and include for all modernization projects a process and plan to release funding as results are demonstrated in the programs relating to taxpayer and/or customer experience improvements. The National Taxpayer Advocate also recommends that the IRS include in future modernization plans the modernization of the BMF system.

The National Taxpayer Advocate recommends that Congress provide the IRS with additional dedicated, multi-year funding to replace its aging IT systems pursuant to a plan that sets forth specific goals and metrics and is evaluated annually by an independent third party.

### **MSP #3 IRS FUNDING: The IRS Does Not Have Sufficient Resources to Provide Quality Service**

#### **Problem**

Due to antiquated technology, a smaller workforce, and an increasing workload, the IRS cannot provide quality service without additional funding.

#### **Analysis**

Between fiscal years (FY) 2010 and 2019, when the number of income tax returns increased by about nine percent, the IRS's appropriation (after adjusting for inflation) and number of employees declined by more than 20 percent. As a result, in FY 2019, telephone assistors answered only about 29 percent of the calls the IRS received, and most of the IRS's adjustments correspondence in open inventory had not been answered within the timeframes the IRS has established for itself (generally 45 days).

Modern technology could improve service. For example, only a few of the IRS's phone lines use customer callback technology, which frees callers from waiting on hold. Because the IRS lacks an enterprise-wide case management system, each function's employees must transcribe or import information from other electronic systems, and mail or fax it to other functions.

Moreover, the IRS cannot reasonably (and should not) ramp up enforcement without additional funding for service and operations support. In calendar year (CY) 2019, the Return Integrity Verification Operation (RIVO) delayed more than seven times as many refunds as in 2017 (*i.e.*, increasing from 219,210 in CY 2017 to 1,650,999 in CY 2019), resulting in a five-fold increase in taxpayers asking TAS for help (from 16,432 in CY 2017 to 89,584 in CY 2019). Between FYs 2018 and 2019, Automated Collection System levies increased by 114 percent (from 200,024 to 427,596) and lien filings increased by 93 percent (from 184,368 to 356,609). The IRS took these additional compliance actions without making sure there were enough telephone assistors to handle the resulting calls. Only about ten percent of taxpayers calling its lien lines reached a telephone assistor, and those who got through waited on hold for an average of 58.1 minutes in FY 2019. Enforcement actions like levies and liens can cause severe economic hardship for some taxpayers, so when the IRS takes these actions, it is critical that it have the resources to assist taxpayers who call or visit the IRS.

#### **Recommendations**

The National Taxpayer Advocate recommends that Congress provide the IRS with sufficient funding to improve taxpayer service and modernize its information technology systems. Any increase in funding for enforcement should be coupled with sufficient additional funding for service and operations support to ensure the enforcement actions do not unduly harm taxpayers.

## **MSP #4 PROCESSING DELAYS: Refund Fraud Filters Continue to Delay Taxpayer Refunds for Legitimately Filed Returns, Potentially Causing Financial Hardship**

### **Problem**

The IRS has designed a number of filters to assist in the detection and prevention of non-identity theft (non-IDT) refund fraud (the Pre-Refund Wage Verification Program or PRWVH). Despite improvements to this program for filing season 2019, issues persisted that affected both taxpayers and TAS, including: delays in releasing legitimate refunds; false positive rates (FPR) as high as 71 percent; and inadequate information as to the reasons for refund delays and what steps taxpayers can take to expedite the process.

### **Analysis**

Taxpayers whose returns are selected into the non-IDT refund fraud program often experience delays in receiving the refunds claimed on their original returns. About a quarter of the returns selected by a new filter for filing season 2019 took more than 40 days to be processed. This delay was due in part to the Social Security Administration's (SSA) slow transmittal of paper Form W-2 information, which is used to verify information on returns. Further, nearly half the legitimate returns that comprise the 71 percent FPR took more than four weeks to be processed. Additionally, out of a review of 309 TAS PRWVH case receipts between August 25 and August 31, 2019, 236 waited an average of 141 days from the date the returns were filed to be screened and determinations made that the information on the returns could not be verified. While it is essential for the IRS to prevent fraud and protect revenue, these processing delays caused a financial hardship for many taxpayers. Compounding taxpayers' frustration is that not all taxpayers whose refunds are held as part of the non-IDT refund fraud program receive the same periodic update notices, and when taxpayers do receive a letter, it does not always provide guidance as to what they can do to expedite the process. The financial hardship caused by refund delays, along with inadequate IRS notices, contributed to a 405 percent increase in TAS non-IDT refund fraud inventory from January 1 through September 30, 2019, compared with the same timeframe in 2017.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS work with SSA to speed up the transmission of paper Form W-2 data to earlier in the year; identify acceptable FPR and Operational FPR ranges each year as part of its refund fraud projections; continue to learn from the returns that were part of the FPR to further refine the filters and continually work to lower the false positive rate; increase RIVO staffing to improve the processing time for validating information on returns, and assigning returns to a compliance stream for further treatment; send an interim letter every 60 days to all taxpayers whose returns are being held in the PRWVH; revise Letter 4464C initial contact notice instructing taxpayers to review their returns to verify that all the information is accurate and correct, and if a mistake is identified, to file an amended return; and instruct RIVO to send Letter 86C, Referring Taxpayer Inquiry/Forms to Another Office, informing the taxpayer that their return has been referred to another IRS function, and providing the taxpayer with the name of the specific function and contact information.

## MSP #5 **FREE FILE: Substantial Free File Program Changes Are Necessary to Meet the Needs of Eligible Taxpayers**

### Problem

To increase electronic filing (e-filing), the IRS partners with Free File, Inc. (FFI), a group of private-sector tax return preparation software providers, to offer free federal tax preparation software products accessible through IRS.gov to approximately 105 million eligible taxpayers. While the rate of e-filing has approached 90 percent for tax year 2018 individual returns, less than two percent (or about 2.5 million returns) were filed using Free File program software products. In addition, data on repeat usage suggests that taxpayers who use Free File have generally been dissatisfied with it. Among taxpayers who used Free File software in 2017, nearly half (47 percent) did not use Free File software again in 2018. Based on issues raised by ProPublica, an assessment of the program by MITRE Corporation, and previous concerns raised by the Taxpayer Advocate Service, the National Taxpayer Advocate believes that the current program is not promoting the best interests of taxpayers. FFI member companies are steering eligible taxpayers away from their Free File program software products and toward their commercial products. In addition, cross-marketing of fee-based services on Free File program software can confuse taxpayers and gives the impression of IRS endorsement. Moreover, the low usage rate of the program proves that the program is not meeting the needs and preferences of eligible taxpayers. Finally, the IRS does not perform routine quality testing of the Free File program software.

### Analysis

The MITRE 2019 Free File report confirmed the ProPublica allegations that many members prevented taxpayers from finding their free software services by using a coding device to hide Free File services from internet search results or buying ads that directed taxpayers towards their fee-based software products. FFI members also continue to market paid services, such as paid state tax filing services, to taxpayers who use their free services. The National Taxpayer Advocate believes that these deceptive practices violate the intent of the agreement between FFI and the IRS and create the illusion of the IRS endorsing these products. The IRS should prohibit such practices, which allow FFI members to capitalize on taxpayers' confusion, impinging on taxpayers' *right to be informed* and *to quality service*.

The MITRE 2019 Free File Report argues that the reason for the low usage rate of the program is that many taxpayers prefer to use other return preparation methods. The National Taxpayer Advocate believes that poor usage is attributable to little guidance and software options available to taxpayers when using the Free File program, which results in taxpayers selecting Free File software that lacks capability to prepare their returns. Only four of the 11 FFI members offer services to taxpayers of all ages, and even these have restrictions based on the taxpayer's state of residence, income, or eligibility for the Earned Income Tax Credit. Four other FFI members have age limitations that start before the age of 60, and only one FFI member provided Free File software in another language (Spanish). The National Taxpayer Advocate believes that the IRS should ensure that the agreement provides an easy, assessable Free File platform for taxpayers to protect their *right to be informed*, *to quality service*, and *to a fair and just tax system*.

Finally, the MITRE 2019 Free File Report found that the IRS provides adequate oversight, but the National Taxpayer Advocate believes that the IRS should do more to protect taxpayer rights. For example, the IRS does not take sufficient steps to evaluate the quality of the return preparation in the Free File program. The IRS should conduct more quality testing of the software and survey taxpayers on their experiences to protect taxpayers' *right to quality service*.

### Recommendations

The National Taxpayer Advocate recommends that the IRS explicitly prohibit the use of special coding by FFI members to exclude Free File program software from organic searches on search engines; collaborate with the National Taxpayer Advocate and the FFI member companies to determine the best way to eliminate confusion between Free File program products and other non-program free software offered by FFI members; collaborate with the National Taxpayer Advocate as it responds to the MITRE 2019 Free File Report recommendations; conduct research to determine why taxpayers eligible to use the Free File program chose their method of return preparation; develop actionable goals for the Free File program before entering into a new agreement; work with the National Taxpayer Advocate to create measures evaluating taxpayer satisfaction with the Free File program and test each return preparation software's ability to complete various forms, schedules, and deductions; conduct customer satisfaction surveys and routine quality testing of each Free File program software product; redesign the Free File Software Lookup Tool to better direct taxpayers to software providers; provide more Free File program options for English as a Second Language taxpayers; and prepare an advertising and outreach plan to make taxpayers, particularly in underserved communities, aware of the Free File program.

The National Taxpayer Advocate recommends that Congress mandate that the IRS, in consultation with the National Taxpayer Advocate, submit a report to Congress by June 30, 2020, summarizing the actions it has taken to address the recommendations made by the MITRE 2019 Free File report as well as recommendations made by the National Taxpayer Advocate herein to improve the Free File program by Filing Season 2021; and direct the IRS to set a goal of increasing the usage rate of the Free File program to a significantly higher yet attainable level (*e.g.* ten percent of the 70 percent of taxpayers eligible to use the program) and a goal of increasing the retention rate to 75 percent of taxpayers who used Free File in the preceding year and, if those goals are not attained by 2025, to replace Free File with an alternative approach to make tax software available to taxpayers at no or low-cost, including through the use of sole-source or multi-source contracts with tax software companies.

## MSP #6 RETURN PREPARER STRATEGY: The IRS Lacks a Comprehensive Servicewide Return Preparer Strategy

### Problem

Considering that about 80 million tax year 2018 individual tax returns were prepared by return preparers, and preparers interact with most functions of the IRS, the development of a comprehensive return preparer strategy is long overdue. In 2019, the IRS developed a preparer misconduct study in response to a 2018 recommendation by the Treasury Inspector General for Tax Administration. However, preparer misconduct issues are only one component of a truly comprehensive Servicewide return preparer strategy. In addition to addressing misconduct issues, the National Taxpayer Advocate recommends that the IRS develop a comprehensive strategy with the following components:

- Emphasize the taxpayer's *right to retain representation*;
- Encourage return preparer competency within the bounds of its authority;
- Address the current lack of transparency in preparer fees;
- Incorporate a comprehensive taxpayer education campaign;
- Restrict access to confidential taxpayer information on online applications to only those preparers over whom the IRS has oversight authority; and
- Track preparer noncompliance data by type of preparer.

### Analysis

Millions of taxpayers choose to interact with the IRS through their representatives, making them a vehicle for taxpayer compliance. However, currently there are no competency or licensing requirements for federal unenrolled tax return preparers. While the IRS does not have the authority to impose minimum competency requirements, it still has tools to encourage preparers to improve the quality of their return preparation services. In addition, the lack of transparency in preparation and filing fees at the outset of the preparation engagement prevents taxpayers from comparison shopping or even from predicting the cost before entering into the transaction. Further, because the IRS does not have the resources to maintain widespread geographic presence to enforce preparer requirements, it must empower taxpayers to protect themselves through a comprehensive taxpayer education campaign.

### Recommendations

The National Taxpayer Advocate recommends that the IRS develop a comprehensive Servicewide return preparer strategy that addresses the following: reference the taxpayer's *right to retain representation* in the mission of the strategy; increase preparer competency through outreach and education to preparers before any detection of noncompliance; require disclosure of fees and enforce such requirements; include a comprehensive public education campaign; limit access of online applications to only those preparers over whom the IRS has oversight authority; routinely track preparer noncompliance data by type of designation; collaborate with TAS in the development of the strategy; and incorporate service to return preparers into the comprehensive taxpayer service strategy mandated by the Taxpayer First Act. The National Taxpayer Advocate recommends that Congress amend Title 31, § 330 of the U.S. Code to authorize the Secretary to establish minimum standards for federal tax return preparers.

**MSP #7 APPEALS: The Inclusion of Chief Counsel and Compliance Personnel in Taxpayer Conferences Undermines the Independence of the Office of Appeals****Problem**

The Office of Appeals' (Appeals) emphasis on including Counsel and Compliance in certain conferences fundamentally alters the role of Appeals and runs counter to the congressional priority of an independent Appeals process. Currently, Appeals is not gathering sufficient quantitative and qualitative data to adequately evaluate the success of a pilot program to study the effects of this inclusion. However, anecdotal reports of tax practitioners participating in the pilot validate the National Taxpayer Advocate's prior reservations about the involvement of Counsel and Compliance in conferences.

**Analysis**

Appeals is currently in the final year of a pilot program relating to the participation of Counsel and Compliance in Appeals Team Case Leader (ATCL) cases. The involvement of Counsel and Compliance in these cases occurs whether or not taxpayers consent and jeopardizes the independence of Appeals. By definition, Appeals cases arise only when taxpayers and Compliance reach an impasse. Thus, to allow these parties to again make their case in what should be a separate and unbiased proceeding results in the impression, if not the reality, that taxpayers are facing the IRS as an institution. Moreover, Appeals Officers may have difficulty drawing their own independent conclusions at variance with positions advocated by Counsel or Compliance. Some practitioners included in the pilot report chaotic proceedings and a lessening of Appeals' effectiveness. Appeals has issued procedural guidance with respect to pilot cases, but the impact of this guidance remains uncertain. Appeals should gather and consider all available information when assessing the outcome and future of this initiative.

**Recommendations**

The National Taxpayer Advocate recommends that Appeals compile quantitative data regarding the efficiency and outcomes of pilot proceedings and publish that data when the pilot is complete; carefully consider and publish the reactions of taxpayers and tax practitioners who participate in the pilot; regardless of the pilot's outcome, only include Counsel and Compliance in appeals conferences with taxpayers' consent, and, in the absence of consent, offer the parties the possibility of nonbinding mediation; and if the participation of Counsel and Compliance continues after the pilot, restrict this participation to ATCL cases, other than in exceptional circumstances.

## MSP #8 **MULTILINGUAL NOTICES: The IRS Undermines Taxpayer Rights When It Does Not Provide Notices in Foreign Languages**

### Problem

Persons with limited English proficiency (LEP) do not speak English as their primary language and have a limited ability to read, speak, write, or understand English. Although Executive Order 13166 requires all federal agencies to develop and implement a system allowing LEP persons to meaningfully access services, LEP taxpayers frequently do not receive IRS notices in their preferred languages, impairing their *right to be informed*. Even when the IRS has a notice already translated into Spanish, taxpayers often have no simple way to request it or notate their accounts to reflect their preference. This resulted, for example, in the IRS sending in Spanish *only one out of almost a million* notices related to renewing Individual Taxpayer Identification Numbers (ITINs) during the most recent fiscal year, 2019. Additionally, the IRS website fails to include notices and information about those notices in languages other than English.

### Analysis

The IRS only translates some important statutory notices into Spanish and none into languages other than English or Spanish. Of the five most commonly issued versions of the statutory notice of deficiency, only two are available in Spanish and none in any languages other than English or Spanish. Currently, the IRS has programmed its Individual Master File so Spanish notices are only received if the taxpayer has filed a Form 1040PR, which is used by residents of Puerto Rico in certain limited situations. Using U.S. Census data, TAS Research estimated a benchmark for the percentage of LEP Spanish taxpayers who should receive a notice or letter from the IRS and found that the actual percentage of Spanish notices for four key statutory notices was substantially below this benchmark. While IRS employees can manually generate some notices in Spanish upon request, a taxpayer will only receive these notices if he or she knows to request one. The IRS's Spanish webpage for notices provides only general information about understanding any IRS notice or letter, and when one searches by notice number, the results are in English.

### Recommendations

The National Taxpayer Advocate recommends the IRS place a checkbox on Form 1040 to allow taxpayers to choose to receive their notices in Spanish and subsequently expand this option to languages other than Spanish; incorporate information from the ITIN Real Time System in the IRS's account systems so that if a taxpayer files a Form W-7 in Spanish, an indicator is systemically placed on their accounts; translate into the five most common non-English languages the IRS webpages that correspond to the four notices identified in the Most Serious Problem; identify additional notices that provide statutory rights and webpages that specifically pertain to those notices to be translated into the top five LEP languages by using the LEP demographics; create procedures similar to those used by the Social Security Administration to identify taxpayers who may have LEP, instruct employees to ask these taxpayers about language preference, and allow employees to mark a taxpayer's account to reflect this preference; place a note on all correspondence providing taxpayers with instructions for how to receive their notices in languages other than English; and expand the LEP indicator to centrally coordinate and record the issuance of notices in languages other than English.

## **MSP #9 COMBINATION LETTERS: Combination Letters May Confuse Taxpayers and Undermine Taxpayer Rights**

### **Problem**

The IRS uses the Combination Letter, which combines the Initial Contact Letter and the 30-Day Letter, in hundreds of thousands of correspondence audits. In fiscal years (FYs) 2015 to 2019, the IRS used the Combination Letter in approximately 16 percent, or about 500,000, audits. When the IRS combines two letters with very different functions, taxpayers may experience:

- Insufficient time to provide necessary documentation and resolve questionable items;
- Confusion because the inclusion of the audit report in the initial contact gives the appearance that the result of the audit is a foregone conclusion;
- Insufficient understanding of their right to appeal and the related timeframe; and
- A lower likelihood of responding to the letter as compared to taxpayers who received two separate letters.

Despite the problems Combination Letters create for taxpayers, the IRS Wage and Investment Division has plans to expand its use of the letters.

### **Analysis**

In the two-letter process, the IRS mails an Initial Contact Letter to taxpayers at the beginning of the examination to inform them that their return has been selected for examination, to specify the items under examination, and to request documentation to verify the items the IRS is examining. This letter allows taxpayers 30 days to provide support for the examined items. The 30-Day Letter is generally sent to taxpayers to communicate the audit adjustments after the IRS has considered any information that the taxpayers provided, and gives taxpayers 30 days to provide additional documentation, rebut the audit adjustments, or request an appeal of the audit adjustments prior to paying any additional tax due.

The IRS uses Combination Letters to save employee resources and reduce case cycle times (though the IRS does not have statistics to prove this) in cases where it believes the taxpayer is definitely in the wrong. The Combination Letter shortens the timeframe for taxpayers to resolve problems compared to the two-letter process, which can create several problems for taxpayers:

- 1) Taxpayers may miss deadlines to provide documentation or request an appeals conference.
- 2) Taxpayers may be confused and not respond to the IRS, because the audit report enclosed with the Combination Letter gives the appearance that the audit result is a foregone conclusion. Neither the audit report nor the Combination Letter indicate that the adjustments on the enclosed audit report are tentative. Our data found that the non-response rate for taxpayers who receive a Combination Letter was, on average, 29 percentage points higher than taxpayers who received the Initial Contact and 30-Day letters.
- 3) Combination Letters simultaneously tell taxpayers that they are under audit and that they can request an administrative appeal of a determination that the IRS has not yet made. While providing documentation and requesting an appeal is not an either/or situation, the design of the Combination Letter gives the appearance that taxpayers must make a choice between these two options. Regardless, to retain their right to an appeal, taxpayers must request an appeal within 30 days of the letter date, even if they are simultaneously working with the IRS to resolve the

underlying issues, meaning the appeal may be premature or moot, which wastes taxpayer and IRS employee time and resources.

The IRS does not track or analyze data about Combination Letters, and, in fact, is unable to do so. This prevents the IRS from understanding the impact that the Combination Letter has on both IRS administration and taxpayers, and may cause the IRS to continue to use a letter and process that confuses taxpayers while not actually saving any IRS resources.

### Recommendations

The National Taxpayer Advocate recommends that the IRS discontinue the use of Combination Letters and provide all taxpayers undergoing an examination with a separate Initial Contact Letter and 30-Day Letter; work with the Taxpayer Advocate Service on a joint study to track and compare Combination Letter data with Initial Contact Letter data if the IRS chooses to continue use of Combination Letters; refrain from expanding the use of Combination Letters until research is conducted on the impact to taxpayers and the IRS; work with TAS to redesign Combination Letters to clearly communicate important information to taxpayers and protect their rights; and revise IRS Publication 3498-A, The Examination Process (Audits by Mail), to include guidance specific to the Combination Letter.

## **MSP #10 OFFER IN COMPROMISE: The IRS's Administration of the Offer in Compromise Program Falls Short of Congress's Expectations**

### **Problem**

When Congress granted the IRS broad authority to use offers in compromise (OICs) to accept less than the full amount due for some taxpayers, it urged the IRS to educate the public about OICs and adopt a liberal acceptance policy to provide an incentive for taxpayers to continue to file tax returns and pay their taxes. Both taxpayers and the IRS benefit when the IRS accepts an OIC; however, TAS research studies have shown that in 40 percent of returned and rejected OICs, the IRS never collects the amount offered by the taxpayer, much less the reasonable collection potential (RCP) it calculated. The National Taxpayer Advocate remains concerned that the IRS's administration of the OIC program falls short of Congress's expectations because the IRS oftentimes estimates a higher collection potential than the amount a taxpayer offers to compromise the liability, but then never collects that amount, rejecting viable OICs it could accept; the IRS generally fails to consider the effect of bankruptcy when considering an OIC; and the IRS is sending more accounts to its Automated Collection System (ACS) and private collection agencies (PCAs) resulting in less communication with taxpayers about OICs.

### **Analysis**

The IRS will generally accept an OIC if the amount offered reflects the taxpayer's RCP. In a 2017 study of OICs submitted by individuals, TAS concluded that: the IRS never collected the amount offered in 40 percent of the returned and rejected OICs; for rejected OICs, the IRS's calculation of an individual taxpayer's RCP was over 15 times the amount offered but over 40 times the amount actually collected; and taxpayers with accepted OICs have higher rates of future filing and payment compliance. This year, TAS reviewed 250 cases from the 2017 study and found that in 68 percent of the cases reviewed, rejection of the offer was based solely on future income. TAS also reviewed the status of the accounts after rejection and found that although the IRS assigned 82 percent of the accounts to ACS or field collection, as of the end of fiscal year (FY) 2019, the IRS was not able to collect even the amount offered in 65 percent of these cases. Furthermore, as of the end of FY 2019, 50 percent of the taxpayer accounts related to these 250 OICs either remained in the Queue, Currently Not Collectible (CNC) status, or the collection statute expired. TAS also reviewed the status of the 14,420 rejected OICs from the 2017 study where the amount offered exceeded the amount collected and determined that 13 percent of those taxpayers later declared bankruptcy.

Despite rejecting some potentially viable OICs, the IRS OIC program collects approximately 12.5 percent of the liability on accepted OICs. The IRS generally collects on delinquent accounts by assigning inventory to revenue officers and ACS. In FY 2019, 81 percent of collection inventory was assigned to ACS. When ACS cannot resolve the liability, it will either place taxpayers in CNC or shelved status. The delinquent tax dollars in the IRS's shelved inventory has increased 244 percent since 2015, and in FY 2019, 47 percent were later sent to PCAs, who do not have the ability to compromise the liability. In FY 2018, 51 percent of the IRS's aggregate collection revenues were obtained through its notice stream. Before shelving cases or assigning cases to PCAs, the IRS could be contacting these taxpayers with targeted educational notices about the benefits of the OIC program. This would be consistent with Congressional intent and the IRS's policy to educate taxpayers about the OIC program.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS conduct a follow-up study evaluating a statistically valid sample of rejected OICs to determine the accuracy of future income calculations and

why the RCP is not being collected; review rejected OICs where taxpayers later declared bankruptcy and determine whether the policy should be revised to consider the effect of a potential bankruptcy on the RCP on all OICs rather than only those where the taxpayer threatens bankruptcy; and work with the National Taxpayer Advocate to develop a pilot program where the IRS sends educational letters about the OIC program to taxpayers in CNC or shelved status.

## STATUS UPDATES

### Update #1 **PRIVATE DEBT COLLECTION: Forthcoming Changes to the Private Debt Collection Program Will Better Protect Low-Income Taxpayers and Achieve a Program That More Appropriately Respects Taxpayer Rights**

#### Problem

The IRS began assigning accounts to private collection agencies (PCAs) in 2017 after the passage of the Fixing America's Surface Transportation Act in 2015. Although some positive changes to the program will take effect on January 1, 2021, concerns remain: taxpayers who are likely experiencing financial hardship and who had their accounts assigned to a PCA prior to that date will have their accounts remain in PCA inventory; recent assignment of Business Master File (BMF) cases to PCAs adds more complexity to their inventory; accounts that are assigned to PCAs are more likely to linger in inventory without any progress toward resolution; and a new direct debit payment option increases the risk that taxpayers will be subject to scammers mimicking the PCAs.

#### Analysis

The Taxpayer First Act requires that, beginning on January 1, 2021, the IRS excludes from assignment to PCAs those accounts where (1) substantially all of a taxpayer's income is attributable to Social Security Disability Insurance (SSDI) benefits or Supplemental Security Income (SSI); and (2) a taxpayer's adjusted gross income is at or below 200 percent of the Federal Poverty Level. However, the accounts of taxpayers who fall into one of these categories but were assigned to a PCA prior to 2021 will remain in PCA inventory beyond that date. Further, beginning August 2019, the IRS began assigning BMF accounts to PCAs. BMF accounts are generally older than individual accounts assigned to PCAs, making them more difficult to collect on than individual accounts. Adding even more complex accounts to PCA inventory seems unwise considering about 80 percent of the individual accounts assigned to PCAs from the inception of the PDC program through September 12, 2019 have stayed in inventory three months or more without the PCAs receiving any payments or organizing any installment agreements. Finally, a new direct debit payment option makes it more difficult for taxpayers to distinguish between a legitimate PCA employee and an imposter attempting to secure financial information for nefarious purposes.

#### Recommendations

The National Taxpayer Advocate recommends that the IRS begin excluding taxpayers who have adjusted gross income at or below 200 percent of the federal poverty level, or receive SSI or SSDI, as soon as possible, and recall from PCAs cases that currently reside in their inventory and fall into one of these two categories; not assign a BMF employment tax account to a PCA if the taxpayer also has a trust fund recovery penalty that resides with the IRS; reinstate the requirement from the IRS's first PDC program requiring PCAs to return accounts to the IRS when a satisfactory payment plan or full payment has not been established within 12 months from the date the account was assigned to the PCA; and conduct a public outreach campaign informing taxpayers that PCAs will require a signed authorization form prior to accepting direct debit payments.

## **Update #2 AUTOMATED SUBSTITUTE FOR RETURN: The IRS Has Revised the Selection Criteria for Its Reinstated Automated Substitute for Return Program, But Some Concerns Remain Unaddressed**

### **Problem**

The Automated Substitute for Return (ASFR) program assists the IRS in enforcing filing compliance for taxpayers who have not filed individual income tax returns but appear to owe a tax liability. In the National Taxpayer Advocate's 2015 Annual Report to Congress, we noted that the ASFR program yielded a poor return on investment, as the IRS collected less than one third of the amount assessed, and it abated 29 percent of all ASFR assessments. TAS found that the criteria used to select cases for the ASFR program and determine liabilities were deficient, imposing undue burden on taxpayers and creating rework for the IRS. Citing resource constraints, the IRS temporarily suspended the ASFR program in 2015, but resumed selecting cases for the ASFR program on May 21, 2019.

### **Analysis**

After suspending the ASFR program for nearly four years, the IRS has reinstated the ASFR program in 2019, with two significant changes in how it selects cases. It has adopted our recommendation to consider third-party documentation and the prior filing history of taxpayers when determining which cases to select for the ASFR program. By including this information in the selection algorithm, the IRS will minimize the number of abatements, reducing both IRS rework and taxpayer burden.

To date, however, the IRS has declined to refine the ASFR abatement reason codes, making it difficult to pinpoint which business rules are most responsible for the program's inaccurate results. Without more knowledge about the source of the inaccurate results, the ASFR program will continue to impose undue burden on taxpayers and require the IRS to expend its limited resources to correct errors and abate tax.

### **Recommendation**

The National Taxpayer Advocate reiterates her recommendation that the IRS refine ASFR abatement reason codes, making them specific enough to identify which factors contributed to the abatement.

## MOST LITIGATED ISSUES

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Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(XI) requires the National Taxpayer Advocate to include in her Annual Report to Congress the ten tax issues most litigated in the federal courts, classified by the type of taxpayer affected. The cases we reviewed were decided during the 12-month period that began on June 1, 2018, and ended on May 31, 2019.

### MLI #1 Trade or Business Expenses Under IRC § 162 and Related Sections

The deductibility of trade or business expenses has perpetually been among the ten Most Litigated Issues (MLIs) since the first National Taxpayer Advocate's Annual Report to Congress in 1998. We identified 82 cases involving a trade or business expense issue that were litigated in federal courts between June 1, 2018, and May 31, 2019. The courts affirmed the IRS position in 61 of these cases, or about 74 percent, while taxpayers fully prevailed in only two cases, or about two percent of the cases. The remaining 19 cases, or about 23 percent, resulted in split decisions.

### MLI #2 Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

A Collection Due Process (CDP) hearing is an opportunity for a taxpayer to have an independent and meaningful review by the IRS Office of Appeals (Appeals) prior to the IRS's first levy or immediately after its first Notice of Federal Tax Lien (NFTL) filing to enforce a tax liability. At the hearing, the taxpayer has the right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and, under certain circumstances, the underlying tax liability.

Once Appeals issues a determination, a taxpayer has the right to judicial review of that determination if the taxpayer timely requests a CDP hearing and timely petitions the U.S. Tax Court. Generally, the IRS suspends levy actions during a levy hearing and any subsequent judicial review of the Appeals determination that follows the hearing.

CDP has been one of the federal tax issues most frequently litigated in the federal courts since 2001; however, only a small fraction of eligible taxpayers exercise their right to an administrative hearing, and far fewer taxpayers petition the Tax Court to review their case. Between 2003 and 2019, only 1.44 percent of the taxpayers who received a CDP notice requested an administrative hearing (*i.e.*, 426,484 out of 29,614,768) and only 0.08 percent filed a petition in Tax Court (*i.e.*, 24,690 out of 30,726,471).

Our review of litigated issues found 80 opinions on CDP cases during the review period of June 1, 2018, through May 31, 2019, which is an increase of about eight percent since last year's report. Taxpayers prevailed in full in four of these cases (five percent) and, in part, in two others (about three percent). The eight percent success rate for the taxpayers is lower than last year. Of the six opinions where taxpayers prevailed in whole or in part, four taxpayers appeared without a representative authorized to advocate to the court on their behalf (*pro se*), and two were represented by an attorney or other court-approved professional. Cognizant of the distinct disadvantage that *pro se* litigants face, federal courts routinely read their submissions liberally and interpret them to raise the strongest arguments that they suggest. The IRS prevailed fully in 74 cases (about 93 percent) of the opinions, an increase from the 88 percent success rate last year.

**MLI #3 Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)**

Internal Revenue Code (IRC) § 6662(b)(1) and (2) authorizes the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations causes an underpayment of tax required to be shown on a return, or if an underpayment exceeds a computational threshold called a substantial understatement, respectively. IRC § 6662(b) also authorizes the IRS to impose the accuracy-related penalty on an underpayment of tax in six other circumstances. We identified 79 opinions issued between June 1, 2018, and May 31, 2019, where taxpayers litigated the negligence or substantial understatement components of the accuracy-related penalty, which is a notable decrease over recent years.

**MLI #4 Gross Income Under IRC § 61 and Related Sections**

When preparing tax returns, taxpayers must complete the calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress. For this report, we reviewed 72 cases decided between June 1, 2018, and May 31, 2019. The majority of cases involved taxpayers failing to report items of income, including some specifically mentioned in Internal Revenue Code (IRC) § 61 such as wages, interest, dividends, and pensions.

**MLI #5 Summons Enforcement Under IRC §§ 7602, 7604, and 7609**

Pursuant to Internal Revenue Code (IRC) § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability. To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information. If a person summoned under IRC § 7602 neglects or refuses to obey the summons; to produce books, papers, records, or other data; or to give testimony as required by the summons, the IRS may seek enforcement of the summons in a U.S. District Court.

TAS identified 60 federal cases decided between June 1, 2018, and May 31, 2019, involving IRS summons enforcement issues. The government was the initiating party in 35 cases, while the taxpayer was the initiating party in 25 cases. Overall, taxpayers fully prevailed in two cases, while two cases were split. The IRS prevailed in the remaining 56 cases.

**MLI #6 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403**

The United States may file a civil action in U.S. District Court under Internal Revenue Code (IRC) § 7403 to enforce its federal tax lien by subjecting any of the delinquent taxpayer's property, right, title, or interest in property to the payment of the taxpayer's liability. Unlike cases in other Most Litigated Issues, lien enforcement cases are always initiated by the government through the Department of Justice (DOJ) rather than the taxpayer. If the United States succeeds in proving the lien is valid and may be enforced, the court will typically issue an order of sale that (1) authorizes the United States to foreclose on the taxpayer's subject property and (2) describes how the proceeds of sale should be distributed.

During our reporting period from June 1, 2018, to May 31, 2019, we identified 52 opinions that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 48 of these cases, taxpayers prevailed in two cases, and two cases resulted in split decisions in which the IRS and taxpayers or a third party prevailed in part. The 52 cases identified for this reporting period represent a 33 percent increase from the 39 cases reported last year.

**MLI #7 Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654**

We reviewed 34 decisions issued by federal courts from June 1, 2018, to May 31, 2019, regarding additions to tax for:

- 1) Failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1);
- 2) Failure to pay an amount shown as tax on a tax return under IRC § 6651(a)(2);
- 3) Failure to pay installments of the estimated tax under IRC § 6654; or
- 4) Some combination of the three.

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Three cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; 30 cases involved the failure to file and/or failure to pay penalties without the estimated tax penalty; however, the estimated tax penalty was not the sole issue in any of the cases.

A taxpayer can avoid the failure to file and failure to pay penalties by demonstrating the failure is due to reasonable cause and not willful neglect. The estimated tax penalty is imposed unless the taxpayer falls within one of the statutory exceptions. Taxpayers were unable to avoid a penalty in just two of the 34 cases.

**MLI #8 Itemized Deductions Reported on Schedule A (Form 1040)**

For the past two years, itemized deductions reported on Schedule A of IRS Form 1040 have been among the ten Most Litigated Issues. We identified 32 cases involving itemized deductions that were litigated in federal courts between June 1, 2018, and May 31, 2019. The courts affirmed the IRS position in 29 of these cases, or about 91 percent, while taxpayers fully prevailed in one case, or about three percent of the cases. The remaining two cases, or about six percent, resulted in split decisions.

**MLI #9 Charitable Contribution Deductions Under IRC § 170**

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes for contributions of cash or other property to or for the use of charitable organizations. To take a charitable deduction, taxpayers must contribute to a qualifying organization. Taxpayers must also comply with certain substantiation requirements when making a contribution of \$250 or more. Litigation generally occurred in this reporting cycle in the following three areas:

- Substantiation of the charitable contribution;
- Valuation of the charitable contribution; and
- Requirements for a qualified conservation contribution.

We identified and reviewed 17 cases decided between June 1, 2018, and May 31, 2019, with charitable deductions as a contested issue. The IRS prevailed in 13 cases, and four cases resulted in split decisions. Taxpayers represented themselves (appearing *pro se*) in seven of the 17 cases (41 percent). The IRS prevailed in all seven *pro se* cases. The deduction of conservation easement contributions is an emerging issue during this reporting period as the IRS is focused on curtailing abuse in this area by designating syndicated conservation easements as a listed transaction. We expect to see continued litigation on

this issue in the future. Taxpayers must pay close attention to the elements of donating a qualified conservation easement in the absence of safe harbors or other guidance from the IRS on how they may construct a conservation easement deed that satisfies the strict statutory requirements.

#### **MLI #10 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions**

From June 1, 2018, through May 31, 2019, the federal courts issued decisions in at least 16 cases involving the Internal Revenue Code (IRC) § 6673 “frivolous issues” penalty, with one case involving an analogous penalty at the appellate level. Appellate level penalties are imposed for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal. In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future. Nonetheless, we included these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

## TAS RESEARCH AND RELATED STUDIES

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### **Study #1 Study of Subsequent Compliance of Taxpayers Who Received Educational Letters From the National Taxpayer Advocate**

This study expands upon two studies, described in the National Taxpayer Advocate's 2016 and 2017 Annual Reports to Congress, of taxpayers who received educational letters from the National Taxpayer Advocate in January 2016 or January 2017. The National Taxpayer Advocate sent the letters to taxpayers who appeared to have claimed the Earned Income Tax Credit (EITC) in error because they did not meet the relationship or residency requirements, or another taxpayer claimed EITC with respect to the same child. The letters explained the requirements for claiming EITC with respect to a qualifying child and advised which requirement the taxpayer did not appear to meet.

In 2017, a separate group of taxpayers who appeared to have claimed EITC without meeting the residency test received a letter that included an extra help phone number the taxpayer could call to speak with a Taxpayer Advocate Service (TAS) employee about his or her eligibility for EITC. This study considers the effect of the TAS letters on taxpayers' compliance in claiming EITC in the years following the year in which they received TAS's letter.

Among this year's study findings:

- Where the error consisted of not meeting the relationship test, the TAS letter enhanced compliance for all three years following the year the taxpayer received the letter; and
- Where the error consisted of not meeting the residency test, the TAS letter that included an extra help phone number enhanced compliance for both years following the year the taxpayer received the letter.

## **Study #2 Study of Two-Year Bans on the Earned Income Tax Credit, Child Tax Credit, and American Opportunity Credit**

The Internal Revenue Code (IRC) authorizes the IRS to ban taxpayers from claiming certain refundable credits (the Earned Income Tax Credit (EITC), the Child Tax Credit (CTC), or the American Opportunity Tax Credit (AOTC)) for two years if it determines that the taxpayer claimed the credit recklessly or with intentional disregard of rules and regulations. A review of a representative sample of cases in which the bans were imposed as a result of audits of tax year 2016 returns shows the IRS often did not follow its own procedures:

- In 53 percent of the cases, required managerial approval for imposing the ban was not secured;
- In 82 percent of the cases, the IRS did not adequately explain to the taxpayer why the ban was imposed as required;
- In 61 percent of the cases in which the auditor was required to speak to the taxpayer before imposing the ban, no such conversation took place; and
- In 54 percent of the cases in which taxpayers submitted documents, it appeared from the documents submitted that the taxpayer believed he or she qualified for the credit.

These improper bans deprived taxpayers, if they were otherwise eligible for a credit in the ensuing two years, of significant tax benefits. For example, taxpayers who were banned from claiming EITC lost almost \$5,000 on average.

Moreover, the IRS may exercise its summary assessment authority to disallow credits that taxpayers claim while a ban on that credit is in effect. Thus, affected taxpayers may not receive a notice of deficiency that would permit them to file a petition with the Tax Court for review of the disallowance. In other situations, taxpayers may be required to petition the Tax Court multiple times to remove the effect of an erroneously imposed ban.

### Study #3 **Audit Impact Study: The Specific Deterrence Implications of Increased Reliance on Correspondence Audits**

Tax administrations rely on audits as a key tool for promoting and enforcing tax compliance. Since audit resources are costly and scarce, however, they are largely reserved for cases with substantive compliance risks. The overall audit rate for U.S. federal individual income tax returns has decreased over time, from one percent of returns filed in 1990 to six-tenths of one percent of returns filed in 2017. There also has been a substantial change in the composition of audits over this period. Whereas face-to-face audits accounted for the majority (62 percent) of all examinations of returns filed in 1990, the lion's share (81 percent) of all audits of returns filed in 2017 were conducted through correspondence.

An important objective of tax audits is specific deterrence: improving the future compliance behavior of those taxpayers who have been targeted for an audit. Past research on the specific deterrent effect of an audit has largely focused on the impact of random audits, either in a laboratory or a field setting. In contrast, most real-world tax audits are targeted towards returns that are considered to be at substantive risk for noncompliance. To better understand how the population of taxpayers who are targeted for risk-based audits responds to examinations, we focus in this study on the role of operational rather than random audits.

A second limitation of existing studies is that they do not distinguish between audit approaches. In comparison with face-to-face audits, correspondence examinations tend to be more narrowly focused and less costly to undertake. At the same time, they are more impersonal. In fact, a recent survey study commissioned by TAS (Erard *et al.*, 2018) indicates that, while most taxpayers who have received a face-to-face examination are able to recall their audit experience, the majority of those who have received a correspondence examination report that they have not been audited. This suggests that many taxpayers do not perceive a correspondence examination as a genuine audit. In this study, we investigate whether face-to-face audits impact future taxpayer reporting behavior differently than correspondence audits. Given the increasing reliance of the Internal Revenue Service (IRS) on correspondence examinations in response to budgetary pressures, this is a question of significant practical importance.

This study relies on a large and unique database that includes audit and comparison samples covering two different tax years: 2010 and 2014. The tax year 2010 sample includes nearly 53,000 self-employed taxpayers (Schedule C filers) who experienced either a face-to-face or correspondence audit of their tax year 2010 returns as well as a comparison group of approximately 421,000 unaudited Schedule C filers. The sample for tax year 2014 includes about 17,000 audited self-employed taxpayers as well as a comparison group of 377,000 Schedule C filers who were not audited in that year. To estimate the impacts of face-to-face and correspondence examinations on future reporting behavior, we apply an inverse probability weighting methodology. This methodology produces two separate sets of weights for the subsample of unaudited taxpayers. The first set of weights is used to make this subsample representative of taxpayers who received a correspondence audit, while the second set makes it representative of taxpayers who received a face-to-face audit. In this way, the weighted subsample is able to serve as a counterfactual for how the respective groups of audited taxpayers would have behaved in the absence of their audits.

The results indicate that face-to-face audits are consistently effective in promoting future reporting compliance. For tax year 2010, a face-to-face examination is predicted to result in more than a 40 percent increase in reported taxes for the first tax year following the initiation of the audit and a 27 percent increase for the subsequent tax year. For tax year 2014, the estimated pro-deterrent effect is even larger, ranging from 62 to 97 percent, depending on whether the audit takes place later or earlier in the

examination cycle. On the other hand, the impact of correspondence audits on self-employed taxpayers is more nuanced. Correspondence audits that are undertaken shortly after filing (prior to the filing for the subsequent tax year) tend to have a counter-deterrent effect, reducing reported taxes by 6 to 15 percent over the two years following the examination. In contrast, correspondence audits that take place later (after the next year's tax return has been filed) have a pro-deterrent effect, similar in size to that observed for face-to-face examinations. We suspect that these contrary outcomes may reflect differences in the types of issues or taxpayers that are addressed over the correspondence audit cycle. However, more research is needed to understand the reasons underlying this result. More generally, the findings point to a need for further investigation into the proper balance between face-to-face and correspondence examinations.

The remainder of this paper is organized as follows. An overview of the theoretical insights on the specific deterrent effect of an audit is provided in Section 2, while Section 3 describes our estimation methodology. The data are summarized in Section 4, and Section 5 presents the estimation results. Section 6 concludes.

#### **Study #4 Study of the Extent to Which the IRS Continues to Erroneously Approve Form 1023-EZ Applications**

Organizations recognized by the IRS as exempt under Internal Revenue Code (IRC) § 501(c)(3) may be exempt from federal tax, and contributions to them may be tax deductible. For decades, Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, was the IRS form organizations used to request recognition of IRC § 501(c)(3) status. Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, was introduced in 2014. It is a truncated version of Form 1023, consisting mainly of checkboxes, and requires applicants to attest, rather than demonstrate, that they meet the requirements for IRC § 501(c)(3) status.

One of the requirements for IRC § 501(c)(3) status is that the organization satisfy an “organizational test,” which generally means its organizing document (articles of incorporation, for a corporation) must contain adequate purpose and dissolution clauses. Form 1023-EZ applicants are not required to submit their organizing documents to the IRS; they merely attest that the organizational test has been met. Although some states make articles of incorporation available online at no charge, the IRS does not retrieve and review these publicly-available articles of incorporation when it evaluates a Form 1023-EZ application (unless the application is one that is randomly selected for pre-determination review).

In 2015, 2016, and 2017, TAS studied representative samples of articles of incorporation for corporations from 20 states that make articles of incorporation viewable online at no cost and whose Form 1023-EZ had been approved by the IRS during the preceding year. The studies found that between 26 percent and 42 percent of the time, the approved organizations did not meet the organizational test and thus did not qualify for the exempt status the IRS had conferred. In 2019, TAS repeated the study and found that 46 percent of the approved organizations did not qualify for IRC § 501(c)(3) status.

The 2019 study also found that some states provide form, or template, articles of incorporation. Depending on the template, corporations that use the template are virtually guaranteed to meet, or fail to meet, the organizational test. A review of other information that applicants provide on Form 1023-EZ, such as their websites, may provide useful insight about whether the organization qualifies for exempt status.

Form 1023-EZ was revised in 2018 to require applicants to provide a description (in 255 characters or less) of their mission or most significant activities. However, according to IRS procedures, the described mission or activities need only be “within the scope of IRC § 501(c)(3)” to be deemed sufficient. According to the 2019 study results, the IRS made erroneous determinations more frequently after it added the description field.

## NATIONAL TAXPAYER ADVOCATE 2020 PURPLE BOOK: Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration

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Section 7803(c)(2)(B)(ii)(IX) of the Internal Revenue Code requires the National Taxpayer Advocate, as part of the annual report to Congress, to propose legislative recommendations to resolve problems encountered by taxpayers. This year, we present 58 legislative recommendations.

We have taken the following steps to make these recommendations as accessible and user-friendly as possible for Members of Congress and their staffs:

- We have consolidated our recommendations from various sections of this year's report, prior reports, and other sources into this single volume.
- We have grouped our recommendations into categories that generally reflect the various stages in the tax administration process so that, for example, return filing issues are presented separately from audit and collection issues.
- We have presented each legislative recommendation in a format like the one used for congressional committee reports, with "Present Law," "Reasons for Change," and "Recommendation(s)" sections.
- Where bills have been introduced in the past that are generally consistent with a recommendation, we have included a footnote at the end of the recommendation that identifies those bills. (Because of the large number of bills introduced in each Congress, we almost surely have overlooked some. We apologize for any bills we have inadvertently omitted.)
- We have compiled a table, which appears at the end of this volume as Appendix 1, that identifies additional materials relating to our recommendations, where such materials exist. In addition to identifying a larger number of prior bills than we cite in our footnotes, the table provides references to more detailed issue discussions that have been included in prior National Taxpayer Advocate reports.

By our count, Congress has enacted approximately 46 legislative recommendations that the National Taxpayer Advocate has proposed. See Appendix 2 for a complete listing. That total includes approximately 23 provisions from last year's Purple Book that were included as part of the Taxpayer First Act.

The National Taxpayer Advocate has titled this the "Purple Book" because the color purple, as a mix of red and blue, has come to symbolize bipartisanship. The Office of the Taxpayer Advocate is an independent, non-partisan organization within the IRS that advocates for the interests of taxpayers, and historically, tax administration legislation has attracted bipartisan support. Most recently, the Taxpayer First Act was approved by both the House and the Senate on voice votes, with no recorded opposition.

We believe most of the recommendations presented in this volume are non-controversial, common sense reforms that will strengthen taxpayer rights and improve tax administration. We hope the tax-writing committees and other Members of Congress find it useful.

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