

## THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS: Introduction

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Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to submit an annual report to Congress that, among other things, contains a summary of ten “most serious problems” encountered by taxpayers. In previous years, Congress tasked the National Taxpayer Advocate with identifying at least the 20 most serious problems impacting taxpayers. As noted in the Preface, this change was the result of the recent passage of the Taxpayer First Act.<sup>1</sup>

With the change to the number of Most Serious Problems, TAS revisited its method of selecting its list of ten based on multiple factors. While we rank each year’s problems using the same methodology (described below), the list remains inherently subjective in many respects. See Appendix 3 for additional information on how TAS ranked the Most Serious Problems.

### METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

The National Taxpayer Advocate is in a unique position to identify the most pressing problems that taxpayers face. Because TAS is an independent part of the IRS, it can serve as the advocate for the taxpayer and use the experience of its staff to identify taxpayer problems to make recommendations to improve the IRS from within the organization. TAS also works with more than 300,000 taxpayers and practitioners every year through its casework and outreach events so it sees problems from an external perspective as well. On a daily basis, TAS employees interact with taxpayers and IRS employees to try to resolve taxpayers’ individual problems and make systemic fixes to widespread problems.

The National Taxpayer Advocate becomes aware of potential Most Serious Problems through multiple channels. Trends in TAS’s casework, research studies completed by TAS and outside groups, advocacy projects worked by TAS’s Office of Systemic Advocacy, and findings from IRS taskforces and teams on which TAS participates often reveal issues. Additionally, the National Taxpayer Advocate hears directly from individuals, including Taxpayer Advocacy Panel members, IRS employees, taxpayers, tax practitioners, and other external stakeholders, through TAS’s Systemic Advocacy Management System and other channels.<sup>2</sup>

The National Taxpayer Advocate considers several factors in identifying, evaluating, and ranking the Most Serious Problems encountered by taxpayers. The ten issues in this year’s report are ranked largely according to the following criteria:

- Impact on taxpayer rights;
- Number of taxpayers impacted;
- Financial impact on taxpayers;
- Visibility, sensitivity, and interest to stakeholders, Congress, and external indicators (*e.g.*, media, etc.);

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1 Taxpayer First Act, Pub. L. No. 116-25, 133 Stat. 981 (2019).

2 The Systemic Advocacy Management System (SAMS) is a database of systemic issues and information reported online to TAS by IRS employees and members of the public. <https://www.irs.gov/advocate/systemic-advocacy-management-system-sams>. TAS reviews and analyzes the submissions and determines a course of action, which can include information-gathering projects, immediate interventions, and advocacy projects. Internal Revenue Manual (IRM) 1.4.13.4.9.2, Systemic Advocacy Management System (SAMS) (Sept. 17, 2019).

- Barriers to tax law compliance, including cost, time, and burden;
- Taxpayer Advocate Management Information System (TAMIS) inventory data; and
- Emerging issues.

## TAXPAYER ADVOCATE MANAGEMENT INFORMATION SYSTEM LIST

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC but also TAS's integrated approach to advocacy — using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the IRC. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 4, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2019, a period spanning October 1, 2018, through September 30, 2019.

## USE OF EXAMPLES

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

## DATA COMPILATION AND VALIDATION

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 reports, and Treasury Inspector General for Tax Administration reports; (ii) IRS databases to which TAS has access; and (iii) IRS data that IRS operating divisions provide pursuant to TAS information requests. After TAS compiles data, TAS's Office of Research and Analysis confirms it. In accordance with IRC § 7803(c)(2)(B)(ii)(XII), TAS then sends all data included in the Most Serious Problem section of the report to the IRS for final verification prior to publication.

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. This process ensures data integrity and full transparency regarding data sources and reliability.

**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****RESPONSIBLE OFFICIALS**

Charles P. Rettig, Commissioner, Internal Revenue  
 Sunita B. Lough, Deputy Commissioner for Services and Enforcement  
 Jeffrey J. Tribiano, Deputy Commissioner for Operations Support  
 Amalia C. Colbert, Chief of Staff and Project Director, Taxpayer First Act Office

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**PROBLEM**

In 2015, Commissioner Koskinen characterized IRS customer service as “abysmal.”<sup>2</sup> In 2018, the President’s Management Agenda emphasized the importance of high-quality customer service. It said: “Federal customers ... deserve a customer experience that compares to — or exceeds — that of leading private sector organizations,” and it cited data from the American Customer Satisfaction Index (ACSI) and the Forrester U.S. Federal Customer Experience Index as key benchmarks.<sup>3</sup> 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>4</sup> The 2019 Forrester report ranked the IRS 13th out of 15 federal agencies and characterized the IRS’s score as “very poor.”<sup>5</sup>

To address these shortcomings, Congress earlier this year enacted the most comprehensive revisions to IRS procedures since the IRS Restructuring and Reform Act of 1998, and it pointedly titled the new law

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

2 John A. Koskinen, Commissioner of Internal Revenue, Address to National Press Club (Mar. 31, 2015).

3 President’s Management Agenda 7, 28 (Sept. 19, 2019), <https://www.whitehouse.gov/wp-content/uploads/2018/03/Presidents-Management-Agenda.pdf>.

4 American Customer Satisfaction Index, *ACSI Federal Government Report 2018*, at 3-4 (Jan. 2019), <https://www.theacsi.org/images/stories/images/govsatscores/19jan-Gov-report-2018.pdf>.

5 Rick Parrish, *The US Customer Experience Index 2019: How Brands Build Loyalty with the Quality of Their Experience*, Forrester Research 16 (June 2019).

the “Taxpayer First Act (TFA).” Among other things, the law requires the IRS to create and submit a comprehensive customer service strategy to Congress by July 1, 2020.<sup>6</sup>

Although the title and some of the content of the legislation reflect congressional concern about the IRS’s performance, the IRS should view congressional interest as a valuable opportunity to revamp its customer service strategy and engage congressional stakeholders in understanding the type and amount of resources needed to implement its new strategy.<sup>7</sup> 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:

- Improving customer service begins with a cultural shift within the IRS;
- The IRS does not view itself as a service organization first and foremost;
- Customer service decisions are not informed by using multi-disciplined, comprehensive research into customer needs and preferences;
- Taxpayers need assistance navigating the complex tax system, including the agency itself;
- Forcing taxpayers to use digital channels undermines taxpayer rights;
- There is a current absence of meaningful customer service measures to effect desired results;
- Any strategy also needs to address the needs of practitioners who interact with the IRS on behalf of taxpayers; and
- The strategy cannot be merely aspirational — it needs to include an implementation plan complete with cost estimates.

The IRS’s past strategic plans focused on the IRS’s perspective (*e.g.*, cutting costs, pushing taxpayers to use online services without maintaining adequate telephone and in-person service, and aiming for “efficiencies”) without adequately considering the customers’ perspective. For that reason, TAS believes it is critical that TAS be integrally involved in developing and vetting all aspects of the plan.<sup>8</sup> Despite numerous requests, the IRS has failed to include a TAS executive as part of the team leading the Taxpayer First Act Office (TFAO) that will coordinate the IRS’s implementation of the new law.<sup>9</sup> TAS is actively engaging in senior level discussions and all TFAO meetings with IRS points of contact and executives regarding the customer service strategy; however, the TFA implementation team is typically making decisions on major plans without the inclusion of TAS, increasing the risk that the final plan will not adequately address the needs of taxpayers. TAS has made countless recommendations over the past 20 years on ways the IRS can and should enhance customer service. We will not cover each of those

6 See Taxpayer First Act, Pub. L. No. 116-25, § 1101, 133 Stat. 981 (2019) (The provision provides that the strategy shall include “a plan to provide assistance to taxpayers that is secure, designed to meet reasonable taxpayer expectations, and adopts appropriate best practices of customer service provided in the private sector, including online services....”). In addition, the Cross-Agency Priority goals included in the President’s Management Agenda highlighted the need for improved customer experience with federal services, and set the specific goal of providing a modern, streamlined, and responsive customer experience. Office of Management and Budget, *CAP Goal Action Plan: Improving Customer Experience with Federal Services 2*, [https://www.performance.gov/CAP/action\\_plans/FY2018\\_Q1\\_Improving\\_Customer\\_Experience.pdf](https://www.performance.gov/CAP/action_plans/FY2018_Q1_Improving_Customer_Experience.pdf) (last visited Nov. 26, 2019).

7 See Most Serious Problem: *IRS Funding: The IRS Does Not Have Sufficient Resources to Provide Quality Service*, *infra*; Most Serious Problem: *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*, *infra*.

8 TAS has made a number of recommendations related to improving customer service over the years. For a list of recommendations made by the National Taxpayer Advocate over the last seventeen years, see Appendix 1, *Past TAS Recommendations on Taxpayer Service*, *infra*.

9 While an Executive Readiness Candidate from TAS is assigned to the TFAO as Assistant to the Project Director for Taxpayer Experience, this individual is on a developmental detail to the TFAO and is not at the same level as a TAS executive.

recommendations in this discussion but rather will address the larger issues that the IRS must consider as it develops its customer service strategy. Appendix 1 of this report includes a list of all the taxpayer service-related recommendations TAS has made over the years that we believe are still relevant and that the IRS should consider.

## IMPACT ON TAXPAYERS

### Background

Congress has long been concerned with IRS customer service and has required the IRS to train employees in customer service, produce customer service plans detailing its approach to customer service, and implement other requirements aimed at improving service.<sup>10</sup> In 2006 and 2007, in response to a congressional directive, the IRS created a comprehensive service strategy in two phases: the 2006 Taxpayer Assistance Blueprint (TAB I) and the 2007 Taxpayer Assistance Blueprint (TAB II).<sup>11</sup> Congress required the IRS to provide annual updates on its progress toward implementation of the TAB.<sup>12</sup> However, when Congress failed to require the annual update to the TAB in the fiscal year (FY) 2017 appropriations bill, the IRS determined it was no longer required.<sup>13</sup> Accordingly, the updates provided to Congress became mere laundry lists with no comprehensive strategy, no analysis of service gaps that prompted any initiative, and no follow-through to measure the success of initiatives to meet taxpayer needs.<sup>14</sup> Moreover, there was no linkage between the TABs and the annual IRS budget requests.

In April 2019, the IRS issued the IRS Integrated Modernization Business Plan, a “six-year road map for achieving necessary modernization of IRS systems and taxpayer services....” Although the plan states that it addresses multiple service channels, it focuses on information technology rather than the overall customer experience.<sup>15</sup>

### Improving Customer Service Begins With a Cultural Shift Within the IRS

An effective IRS service strategy considers the customer’s perspective from the first interaction with the tax system through full resolution of any enforcement actions. The IRS instead approaches service and enforcement as mutually exclusive rather than understanding that it cannot separate these concepts. It must integrate customer service into all aspects of IRS operations and make it fundamental to ensuring the IRS protects taxpayer rights and promotes voluntary compliance. This requires starting with an overall look at the culture within the IRS and how it interacts with taxpayers. The IRS must look broader than just the type of services it offers to taxpayers and the channels through which it offers them; it must look at the type of employees the agency hires and how they are trained. Is the IRS training employees to be empathetic to customers and to value their interactions with them? Or is the

10 IRS Reform and Restructuring Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1205; H.R. REP. No. 109-307, at 209 (2005).

11 H.R. REP. No. 109-307, at 209 (2005); IRS, The 2006 Taxpayer Assistance Blueprint (2006); IRS, The 2007 Taxpayer Assistance Blueprint (2007).

12 See, e.g., H. Comm. On Appropriations, 111th Cong., *Committee Print on H.R. 1105, Omnibus Appropriations Act, 2009, Division D-Financial Services and General Government*, at 959 (2009).

13 However, the IRS continues to conduct the Taxpayer Experience Survey on an annual basis, which was used to evaluate progress toward the TAB, to gather information on the taxpayer experience and preference. The results from this annual survey are used to inform business decisions. IRS response to TAS fact check (Nov. 15, 2019). See Consolidated Appropriations Act, 2017, Pub. L. No. 115-31. Email from the IRS (May 15, 2017) (on file with TAS).

14 IRS, The 2006 Taxpayer Assistance Blueprint, (Apr. 2006); IRS, The 2007 Taxpayer Assistance Blueprint (2007).

15 IRS Integrated Modernization Business Plan 4-11 (Apr. 2019); See Most Serious Problem: *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, infra.*

IRS training employees to move work as quickly as possible and to try to limit customer interactions? The IRS can undertake an extensive effort to expand digital services and enhance its interactions with taxpayers and practitioners as part of its customer service strategy. However, if at the end of the day the organization is one where employees do not want to engage with taxpayers or where employees negatively view taxpayers who owe money, then an expansion of services will not fundamentally improve the customer service experience.

### Customer Service Is the Responsibility of Every Part of the IRS

An overarching IRS-wide customer service strategy is critical, and each Business Operating Division (BOD) in the IRS must consider how it applies the Servicewide strategy to its particular taxpayer populations and form a plan specific to customer needs during those interactions.<sup>16</sup> The current lack of plans for each taxpayer segment magnifies that the IRS does not first consider itself a service organization. The TFA also requires the IRS to develop a plan to redesign its structure.<sup>17</sup> The IRS should consider using the customer service strategy to inform any potential restructure to avoid the silos that currently cause problems in how the IRS serves customers.

To ensure it incorporates service throughout the organization, the IRS should appoint a Chief Customer Experience Officer (CCEO) who reports directly to the Commissioner or Deputy Commissioner and serves as a liaison to coordinate all service initiatives and strategies across different functions. A CCEO would ensure that IRS senior leadership views decisions through the lens of the taxpayer's experience.<sup>18</sup>

### Customer Services Must Meet Customer Needs and Preferences

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. To provide world class service to customers and protect their *right to quality service*, 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 should conduct research into why taxpayers or their representatives do not use certain service channels for particular tasks so that it can minimize existing barriers and improve services in those areas, if possible. This includes talking with taxpayers and their representatives directly about what they want from the IRS — not just guessing at what the best delivery method might be. Finally, to better understand customer satisfaction with actual usage of each service channel, the IRS should track the subject of taxpayer complaints for each service channel.<sup>19</sup>

While many taxpayers prefer to interact with the IRS electronically in certain transactions, to meet the needs and preferences of all taxpayers, the IRS must maintain an omnichannel service environment. An

16 We acknowledge that the Taxpayer First Act requires the Secretary to submit a plan to redesign the IRS's structure. We are discussing BODs as they are currently structured, but we recognize that the IRS could recommend a reorganization that makes the organization look completely different. Taxpayer First Act, Pub. L. No. 116-25, § 1302, 133 Stat. 981 (2019).

17 *Id.*

18 U.S. General Services Administration, Customer Experience Toolkit (Aug. 8, 2019). The Department of Veterans Affairs, General Services Administration, Export-Import Bank, and Federal Student Aid have all created similar positions. Rick Parrish, *Why Every Federal Agency Should Have a Chief Customer Officer*, GOVLOOP.COM (May 6, 2015), <https://www.govloop.com/why-every-federal-agency-should-have-a-chief-customer-officer/>.

19 National Taxpayer Advocate 2017 Annual Report to Congress 22, 29-30 (Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*).



omnichannel service environment is one that provides taxpayer service in a seamless manner through various channels such as in-person help, phone calls, and online applications. Taxpayers can choose one or several channels to obtain issue resolution, depending on their particular service task, preferences, needs, or access.<sup>20</sup> An omnichannel service environment will ensure that the IRS does not leave behind those taxpayers who do not have access to digital service options due to the lack of broadband access or inability to pass e-authentication requirements for online applications.<sup>21</sup>

A key part of a comprehensive taxpayer service strategy is offering online accounts to share information and enable both taxpayers and practitioners to interact digitally with the IRS. These online accounts contain sensitive taxpayer information and must be safeguarded with strict authentication requirements.<sup>22</sup> However, some taxpayers have difficulty passing strict authentication requirements to access those accounts.<sup>23</sup> For FY 2019, only 43 percent of taxpayers attempting to authenticate their identity were able to pass the strict authentication standards and register for a new online account.<sup>24</sup> As the IRS looks to expand its online service offering, it must make its e-authentication requirements as least burdensome as possible while also satisfying the guidelines issued by the National Institute of Standards and Technology (NIST).<sup>25</sup> We suggest working with NIST and reviewing the methods used by other international taxing authorities. In Canada and the United Kingdom, taxpayers can authenticate through banking partners with links the Canada Revenue Agency and Her Majesty's Revenue and Customs provide.<sup>26</sup> These countries also allow taxpayers to verify in person.<sup>27</sup> Similarly, U.S. taxpayers should have options to authenticate by phone, in person at a Taxpayer Assistance Center (TAC), or via an authentication code sent to their address of record.

**The IRS must integrate customer service into all aspects of IRS operations and make it fundamental to ensuring the IRS protects taxpayer rights and promotes voluntary compliance.**

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- 20 See National Taxpayer Advocate 2017 Annual Report to Congress 22, 22-35 (Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*).
- 21 See, e.g., National Taxpayer Advocate 2017 Annual Report to Congress 36 (Most Serious Problem: *The IRS's Focus on Online Service Delivery Does Not Adequately Take into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population*).
- 22 For a detailed description of the information required to pass Secure Access requirements, see IRS, *Secure Access: How to Register for Certain Online Self-Help Tools*, <https://www.irs.gov/individuals/secure-access-how-to-register-for-certain-online-self-help-tools> (last visited Oct. 26, 2019).
- 23 See National Taxpayer Advocate Fiscal Year 2020 Objectives Report 108 (Area of Focus: *Facilitate Digital Interaction Between the IRS and Taxpayers While Still Maintaining Strict Security of Taxpayer Information*).
- 24 IRS response to TAS fact check (Nov. 26, 2019).
- 25 National Institute of Standards and Technology, Special Publication 800-63-3, *Digital Identity Guidelines* (June 2017). The IRS must also comply with Office of Management and Budget, M-04-04, *E-Authentication Guidance for Federal Agencies* (Dec. 16, 2003).
- 26 The Canada and United Kingdom tax authorities provide additional ways for taxpayers to verify their identities, such as through financial institutions, in person, telephone, and video calls. See Government of Canada Revenue Agency, *My Account for Individuals*, <https://www.canada.ca/en/revenue-agency/services/e-services/e-services-individuals/account-individuals.html> (last visited Oct. 10, 2019); United Kingdom, *Government Digital Service*, <https://www.gov.uk/government/publications/introducing-govuk-verify/introducing-govuk-verify> (last visited Oct. 10, 2019).
- 27 See Government of Canada Revenue Agency, *My Account for Individuals*, <https://www.canada.ca/en/revenue-agency/services/e-services/e-services-individuals/account-individuals.html> (last visited Oct. 10, 2019); United Kingdom, *Government Digital Service*, <https://www.gov.uk/government/publications/introducing-govuk-verify/introducing-govuk-verify> (last visited Oct. 10, 2019).

### Taxpayers Need Assistance Navigating the Complex Tax System

To address various taxpayer communication preferences and assist taxpayers in better navigating the agency itself, the IRS should establish a 311-type phone system, as TAS has previously recommended.<sup>28</sup> The 311 system would provide the taxpayer the option to connect with an operator who would ask questions to understand why a taxpayer is calling. The operator would then match the taxpayer with the specific office within the IRS that handles the taxpayer's issue or case. Such a channel would facilitate increased efficiencies, diminished wait times, and improved interactions between taxpayers and appropriate IRS personnel. It would also fit within a more comprehensive omnichannel environment that utilizes customer experience mapping and customer journey analytics already employed in private industry.<sup>29</sup>

### Reducing Levels of Service on Personal Service Channels Forces Taxpayers Into Using Digital Channels

Although in-person assistance is the most costly service channel, TAS research into taxpayer needs and preferences has clearly indicated a demand for personal services by certain populations and certain types of interactions or tasks.<sup>30</sup> The IRS's reduction in staff and the number of TACs, the switch to appointments-only in the TACs, and the low percentage of telephone calls answered by live assistors leave taxpayers with little choice but to attempt to complete tax-related tasks on the internet (where the taxpayer often does not get issue resolution)<sup>31</sup> or to spend money for professional assistance. If the IRS steers taxpayers toward digital channels when they require or prefer a more personal channel, it is undermining the taxpayers' *rights to be informed* and *to quality service*. It is also causing a downstream impact as the IRS may have to handle multiple requests from the same taxpayer or deal with an exam or collection issue if taxpayers do not get the response they need and are unable to meet their tax obligations.

### Low Percentage of Telephone Calls Actually Answered by Live Assistors

As illustrated in Figure 1.1.1, IRS phone service has fallen short in recent years for taxpayers who chose that service channel expecting to receive personal assistance.<sup>32</sup> Phone assistors only answered about 29 percent of calls enterprisewide in FY 2019. On the Consolidated Automated Collection System line, live assistors answered only about 31 percent of the calls, and the average speed of answer was about 38 minutes. Even worse, for taxpayers calling the Installment Agreement/Balance Due line to make payment arrangements because they could not pay in full, live assistors only answered about 26 percent of the calls, and wait times averaged about 45 minutes. While the IRS touts relatively high levels of service (LOS)

28 See National Taxpayer Advocate 2018 Annual Report to Congress 52 (Most Serious Problem: *Navigating the IRS: Taxpayers Have Difficulty Navigating the IRS, Reaching the Right Personnel to Resolve Their Tax Issues, and Holding IRS Employees Accountable*).

29 National Taxpayer Advocate 2017 Annual Report to Congress 22 (Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*); National Taxpayer Advocate FY 2019 Objectives Report to Congress 41 (Area of Focus: *IRS's Failure to Create an Omnichannel Service Environment Restricts Taxpayers' Ability to Get Assistance Using the Communication Channels That Best Meet Their Needs and Preferences*); Maxie Schmidt-Subramanian and Andrew Hogan, *How to Measure Digital Customer Experience*, Forrester Research 3 (June 21, 2016).

30 National Taxpayer Advocate 2017 Annual Report to Congress, vol. 2, at 61 (Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*); National Taxpayer Advocate Public Forums, <https://taxpayeradvocate.irs.gov/public-forums> (last visited Aug. 19, 2019); National Taxpayer Advocate 2015 Annual Report to Congress, vol. 2, at 101 (Research Study: *Understanding the Hispanic Underserved Population*); National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, at 9 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help From the Clinics*).

31 IRS response to TAS information request (July 1, 2019), from the IRS Customer Satisfaction Survey, FY 2018 Accounts Management (AM) Toll-Free Annual Report, W&I Strategies and Solutions Research Group 1 (Jan. 2019).

32 IRS, JOC, Snapshot Reports: Enterprise Snapshot and Product Line Detail (weeks ending Sept. 30, 2015; Sept. 30, 2016; Sept. 30, 2017; Sept. 30, 2018; Sept. 30, 2019).



for its Accounts Management (AM) line — 65 percent in FY 2019 — live assistors really only answered about 28 percent of the calls made to that line.<sup>33</sup> We are not suggesting that the IRS only served 28 percent of callers as we recognize that some are adequately served through automation and some quickly hang up for personal reasons (*e.g.*, a call-waiting notification is received just after the start of the call).

**FIGURE 1.1.1, Levels of Service for Total Enterprise, Accounts Management, Consolidated ACS, and Installment Agreement Telephone Lines for Fiscal Years 2015–2019<sup>34</sup>**

	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
<b>Total Enterprise Net Attempts</b>	116.7 mil	117.5 mil	95.6 mil	98.5 mil	99.3 mil
<b>Total Enterprise Assistor Calls Answered</b>	26.1 mil (22%)	32.2 mil (27%)	32.6 mil (34%)	34.7 mil (35%)	28.6 mil (29%)
<b>Total Enterprise Level of Service (LOS)</b>	44%	56%	68%	69%	56%
<b>Total Enterprise Average Speed of Answer (ASA) (minutes)</b>	25.9 mins	17.4 mins	12.8 mins	11.3 mins	16.2 mins
<b>Accounts Management (AM) Net Attempts</b>	101.5 mil	104.3 mil	74.5 mil	77.7 mil	76.8 mil
<b>AM Assistor Calls Answered</b>	18.2 mil (18%)	25.5 mil (25%)	23.2 mil (31%)	25.3 mil (33%)	21.3 mil (28%)
<b>AM ASA (minutes)</b>	30.5 mins	17.8 mins	8.4 mins	7.5 mins	11.3 mins
<b>AM LOS</b>	38%	53%	77%	76%	65%
<b>Consolidated ACS Net Attempts</b>	N/A	4.9 mil	13.1 mil	12.1 mil	15 mil
<b>Consolidated ACS Assistor Calls Answered</b>	N/A	2.8 mil (58%)	5.7 mil (44%)	5.9 mil (49%)	4.7 mil (31%)
<b>Consolidated ACS ASA (minutes)</b>	N/A	17.9 mins	30.6 mins	24.4 mins	38.1 mins
<b>Consolidated ACS LOS</b>	N/A	70%	47%	53%	34%
<b>Installment Agreement/Balance Due (IA/Bal Due) Net Attempts<sup>35</sup></b>	11.1 mil	10.4 mil	8.6 mil	7.6 mil	9.3 mil
<b>IA/Bal Due Assistor Calls Answered</b>	4.1 mil (37%)	4.6 mil (44%)	3.7 mil (42%)	3.6 mil (48%)	2.4 mil (26%)
<b>IA/Bal Due ASA (minutes)</b>	34.8 mins	22.5 mins	32.7 mins	27.5 mins	44.5 mins
<b>IA/Bal Due LOS</b>	37%	44%	42%	48%	26%
<b>Practitioner Priority Service (PPS) Net Attempts</b>	2.1 mil	2 mil	2.4 mil	3.1 mil	3.5 mil
<b>PPS Calls Answered</b>	0.9 mil (41%)	1.3 mil (62%)	1.7 mil (73%)	2.2 mil (72%)	2.1 mil (61%)
<b>PPS ASA (minutes)</b>	46.6 mins	10.5 mins	8.9 mins	7.5 mins	8.8 mins
<b>PPS LOS</b>	48%	71%	82%	85%	78%

33 The Accounts Management line has the highest call volume and is used for account inquiries and tax law questions, among other things.

34 IRS, JOC, Snapshot Reports: Enterprise Snapshot and Product Line Detail (weeks ending Sept. 30, 2015; Sept. 30, 2016; Sept. 30, 2017; Sept. 30, 2018; Sept. 30, 2019).

35 The IRS moved the Installment Agreement line from Accounts Management to Consolidated ACS in October 2016 (FY 2017).

To better understand taxpayer interaction with the phone tree system, the IRS should conduct research into why a significant number of taxpayers who call the various IRS phone lines hang up either before or after they are placed in a queue for a particular phone line. The IRS refers to these hang-ups as “primary abandonments” (*i.e.*, when the taxpayer hangs up before they are placed in the queue, such as when a call-waiting notification is received just after the start of the call) and “secondary abandonments” (*i.e.*, when the taxpayer hangs up after they are placed in the queue and before they receive any service).<sup>36</sup> In FY 2019, of the approximate 99 million calls to the IRS enterprisewide, about 25 million (about 25 percent) were primary abandonments, and 11 million (about 11 percent) were secondary abandonments.<sup>37</sup> Research into the reasons for these abandonments will aid the IRS’s understanding of the taxpayer experience to help improve telephone service overall and protect the taxpayer’s *right to quality service*.

In addition, telephone callback technology would address the poor levels of service on the phones. In fact, the TFA mandates the IRS to include callback services as part of the customer service strategy.<sup>38</sup> This technology would enable the caller to request a callback instead of waiting on hold. If the IRS cannot keep up with call volumes on the phone lines and taxpayers experience long hold times, this technology will prevent the IRS from losing the taxpayer who is presumably contacting the IRS in an effort to comply with the tax laws. The IRS tested the technology during the 2019 filing season but has yet to fully roll out the capability. By implementing this technology, the IRS will provide phone service with a taxpayer-centric approach.<sup>39</sup>

### *Reduction in Service at Taxpayer Assistance Centers*

The IRS continues to reduce service at its TACs, the main vehicle for in-person interaction with the IRS. Since 2011, the IRS has closed 43 TACs (over ten percent of its total TACs).<sup>40</sup> As of October 2019, of the remaining 358 TACs, 34 (over nine percent) have no staff and no circuit riders (employees who work at multiple TACs) or seasonal employees and are effectively closed; one is only open seasonally; and eight are staffed by circuit riders and were open less than 35 hours per week.<sup>41</sup> Staffing in TACs has declined over 40 percent since FY 2011.<sup>42</sup> The IRS implemented an appointment-only-based system in the TACs by the end of calendar year 2016.<sup>43</sup> In the first two full fiscal years of the appointment system, TAC visits declined by 38 percent.<sup>44</sup> While an appointment-only system would naturally lead to a decline in TAC visits, this does not mean that fewer taxpayers demand face-to-face service. Rather, it means less face-to-face service is available to taxpayers. The IRS needs to make decisions based on what taxpayers need as opposed to current usage because current usage does not capture taxpayer demands. Figure 1.1.2 shows the steady decline in TAC visits since FY 2014.

36 IRS response to TAS information request (July 2, 2019).

37 IRS, JOC, Snapshot Reports: Enterprise Snapshot (week ending Sept. 30, 2019).

38 Taxpayer First Act, Pub. L. No. 116-25, § 1101(a)(1), 133 Stat. 981, 986 (2019).

39 For more information on callback technology, see Most Serious Problem: *IRS Funding: The IRS Does Not Have Sufficient Resources to Provide Quality Service*, *infra*; Most Serious Problem: *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*, *infra*.

40 Effective July 1, 2019, the Taxpayer First Act, Pub. L. No. 116-25, § 1403, 133 Stat. 981 (2019), imposed new notification and reporting requirements on the IRS before it can close TACs. IRS response to TAS information request (Dec. 23, 2014; July 2, 2019); IRS response to TAS fact check (Nov. 15, 2019).

41 IRS response to TAS information request (July 2, 2019); IRS response to TAS fact check (Nov. 15, 2019).

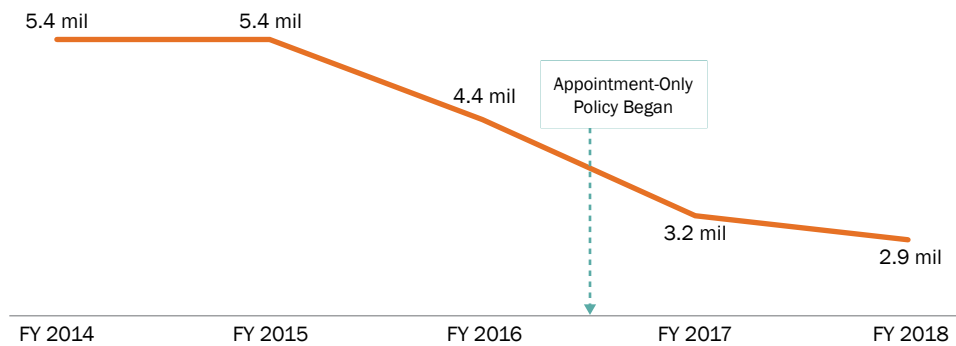
42 IRS response to TAS information request (Sept. 3, 2017; July 2, 2019); IRS response to TAS fact check (Nov. 15, 2019).

43 Memorandum from Debra Holland, Commissioner, Wage & Investment (W&I) to All W&I Employees (Dec. 13, 2016).

44 IRS response to TAS information request (Sept. 2, 2017; July 2, 2019); IRS response to TAS fact check (Nov. 15, 2019).

FIGURE 1.1.2

## Taxpayer Assistance Centers Taxpayer Visits by Fiscal Year



### *The IRS Should Increase Access to Personal Service Channels for Interactions Associated With High Anxiety Levels*

Forcing taxpayers into digital services for transactions associated with high anxiety levels might be counterproductive. Such forced migration may just create delays, greater taxpayer anxiety, and more IRS rework. Even worse, it could create anger and distrust on behalf of taxpayers, which could lead to increased noncompliance.<sup>45</sup> TAS has previously recommended creating a taxpayer anxiety index to understand how taxpayers respond in certain situations.<sup>46</sup> Once established, the IRS should conduct periodic surveys to determine the level of anxiety associated with different interactions with the IRS and track taxpayer complaints for each service channel to gauge the associated level of anxiety. Based on survey findings and taxpayer complaints, the IRS would better understand which types of interactions cause more anxiety and require more personal services. The IRS could also provide dedicated helplines for interactions or tasks associated with particularly high anxiety levels.<sup>47</sup>

### Improved Measures Will Identify Performance Gaps

The Taxpayer First Act requires the IRS to identify metrics and benchmarks to measure its progress in implementing the service strategy.<sup>48</sup> It is often said “you get what you measure.” If the IRS is focused on the speed of its interactions with taxpayers and not on ensuring it resolves all of the taxpayers’ issues, employees will naturally focus on working quickly instead of spending the time needed to resolve the issue. It is crucial that the IRS develop measures that ensure the IRS is truly focusing on taxpayer service. This includes measures such as the rate of first contact resolution for each service channel. In

45 See National Taxpayer Advocate FY 2020 Objectives Report to Congress 1, 5-8 (Introduction: *The National Taxpayer Advocate’s Remarks on the Role of Trust and Taxpayer Advocate Service in Fostering Tax Compliance*); Michelle A. Shell and Ryan W. Buell, *Why Anxious Customers Prefer Human Customer Service* (Apr. 15, 2019), <https://hbr.org/2019/04/why-anxious-customers-prefer-human-customer-service>.

46 TAS has previously suggested the “Taxpayer Anxiety Index” (TAI) as a methodology to analyze how the IRS should design its service strategy, especially the digital component thereof. For a detailed discussion of the TAI and an illustration of its application to the tax return processing roadmap, see National Taxpayer Advocate FY 2020 Objectives Report to Congress 1, 5-8 (Introduction: *The National Taxpayer Advocate’s Remarks on the Role of Trust and Taxpayer Advocate Service in Fostering Tax Compliance*).

47 National Taxpayer Advocate 2015 Annual Report to Congress 240 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility*).

48 Taxpayer First Act, Pub. L. No. 116-25, § 1101(a)(5), 133 Stat. 981 (2019).

addition, the strategy should revisit existing telephone LOS measures to improve transparency and enable the IRS to identify gaps in performance and serve as the basis for funding requests to meet taxpayers' needs.<sup>49</sup>

### *First Contact Resolution*

Achieving a high level of service on the phones does not mean much if the IRS is unable to answer taxpayers' questions or guide them to an appropriate solution to resolve their issues. To more thoroughly evaluate its telephone service and service on other communication channels, the IRS should incorporate additional measures aimed at assessing taxpayer satisfaction. According to researchers, the "single biggest driver of customer satisfaction" is First Contact Resolution.<sup>50</sup> Taxpayers want to be able to resolve all of their issues the first time they contact the IRS, not make multiple attempts to get an answer. Almost 40 percent of taxpayers calling the IRS felt one call did not fully resolve their problems.<sup>51</sup> In FY 2018, approximately 77 percent of callers to the AM lines said they used other resolution methods prior to calling the IRS, with 44 percent visiting IRS.gov prior to calling.<sup>52</sup> The data shows that many taxpayers still need to speak to a live representative even after reviewing many of the non-telephone resources available to them. Incorporating this measure into the plan will more accurately gauge taxpayer satisfaction.

### *Telephone Level of Service Measures Need More Transparency*

Telephone LOS measures must be transparent and capture what is truly happening with service. For example, the IRS received approximately 99 million telephone calls enterprisewide and reported an LOS of about 65 percent on its AM telephone lines during FY 2019.<sup>53</sup> This level marks a significant decline from the IRS's performance during FY 2018, when the IRS reported a 76 percent LOS.<sup>54</sup> However, this measure is narrow and does not reflect the full taxpayer experience. The current LOS measure does not capture all calls to the IRS and insufficiently gauges what the taxpayer actually experiences when using this service channel.<sup>55</sup> The IRS, in collaboration with TAS, should determine a more transparent measure for telephone service.

49 See National Taxpayer Advocate 2017 Annual Report to Congress, vol. 2, at 230 (Literature Review: *Improve Telephone Service Through Better Quality Measures*).

50 Jeff Rumburg & Eric Zbikowski, *The Seven Most Important Performance Indicators for the Service Desk*, METRICNET, [https://www.thinkhdi.com/~media/HDI/Corp/Files/Library-Archive/Rumburg\\_SevenKPIs.pdf](https://www.thinkhdi.com/~media/HDI/Corp/Files/Library-Archive/Rumburg_SevenKPIs.pdf) (last visited Dec. 30, 2019).

51 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, at 62, 85 (Research Study: *A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*).

52 IRS response to TAS information request (July 1, 2019), from the IRS Customer Satisfaction Survey, FY 2018 AM Toll-Free Annual Report, W&I Strategies and Solutions Research Group 1 (Jan. 2019). A study by the Harvard Business Review suggests an even higher percentage, finding that 57 percent of inbound calls to commercial call centers come from customers that attempted to use web resources first. Matthew Dixon, Karen Freeman, & Nicholas Toman, *Stop Trying to Delight Your Customers*, HARVARD BUSINESS REVIEW (July-Aug. 2010), <https://hbr.org/2010/07/stop-trying-to-delight-your-customers>.

53 *Id.* IRS, JOC, Snapshot Reports: Enterprise Snapshot (week ending Sept. 30, 2019). The IRS reports the AM Customer Service Representative LOS as its benchmark measure of telephone performance.

54 IRS, JOC, Snapshot Reports: Enterprise Snapshot (week ending Sept. 30, 2019).

55 The LOS measure only captures calls directed to the AM lines. About 77 million calls (about 77 percent) are routed to AM lines. The reported benchmark LOS accounts only for these calls, not the remaining twelve million calls (such as the compliance phone lines). Further, the denominator in the LOS computation is derived from calls routed to telephone assistants, rather than from all calls to that phone line. As a result, while the IRS is reporting a benchmark LOS of 65 percent, IRS employees answered only 28 percent of the calls received on the AM lines and 29 percent of calls received on all lines. IRS, JOC, Snapshot Reports: Enterprise Snapshot (week ending Sept. 30, 2019); See National Taxpayer Advocate FY 2020 Objectives Report to Congress 15, 24-28 (*Review of the 2019 Filing Season*).

### A Service Strategy Is Not Comprehensive Unless It Addresses Practitioners

Considering that millions of taxpayers choose to interact with the IRS through their representatives, making them a vehicle for taxpayer compliance, the development of a comprehensive customer service strategy would be incomplete without addressing the service needs and preferences of practitioners.<sup>56</sup> Because practitioner needs and preferences are different than those of taxpayers, the IRS should conduct research to determine which service channels practitioners prefer for various service tasks. The IRS should also conduct customer satisfaction surveys to determine how to improve service offerings for this population.

As the IRS develops the customer service strategy, it should coordinate with the team developing the Servicewide return preparer strategy to ensure consistency and avoid duplication of efforts. In this report, we have provided a list of items we believe the IRS should include in the Servicewide return preparer strategy, some of which involve online application access for practitioners, outreach and education, and a public education campaign to taxpayers on what they should expect from their return preparers.<sup>57</sup>

## IMPACT ON THE INTERNAL REVENUE SERVICE

### Strategy Must Include an Implementation Plan

If the IRS wants to change the way it interacts with taxpayers, the customer service strategy cannot be merely aspirational. The IRS must couple the strategy with an implementation plan that lays out the obstacles and challenges for each stage of implementation. Many of the items the IRS will include in the strategy cannot be accomplished without information technology upgrades and the requisite funding. Accordingly, the implementation plan must provide cost estimates for the various initiatives in the strategy.<sup>58</sup>

## CONCLUSION

In the Taxpayer First Act, Congress has given the IRS a directive to revamp the ways in which they serve taxpayers. This challenges the IRS to change how it views taxpayers and their representatives, what they need from the IRS, and how the IRS can best provide those services to meet their needs. Customer service touches every facet of IRS operation and must be a primary consideration as the IRS implements new programs and retires or retrofits current ones to address changing needs and goals. Robust research into taxpayer and practitioner needs and preferences as well as meaningful customer service measures should inform all IRS service decisions. Throughout the development of a comprehensive customer service strategy, the IRS should leverage the wealth of knowledge and experience TAS has acquired through decades of interacting with and assisting taxpayers and their representatives.

56 Over 80 million tax year (TY) 2018 individual tax returns were prepared and filed by return preparers. IRS, Compliance Data Warehouse, Individual Return Transaction File Entity file (data updated Oct. 24, 2019); IRS response to TAS fact check (Nov. 8, 2019). See also Most Serious Problem: *Return Preparer Strategy: The IRS Lacks a Comprehensive Servicewide Return Preparer Strategy*, *infra*.

57 See Most Serious Problem: *Return Preparer Strategy: The IRS Lacks a Comprehensive Servicewide Return Preparer Strategy*, *infra*.

58 See Most Serious Problem: *IRS Funding: The IRS Does Not Have Sufficient Resources to Provide Quality Service*, *infra*; Most Serious Problem: *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*, *infra*.

## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Ensure that each taxpayer segment and BOD are part of the overall customer service strategy to ensure the IRS is addressing the needs of all customers and responsibility is not falling on any one part of the IRS.
2. Appoint a Chief Customer Experience Officer, reporting to the Commissioner or Deputy Commissioner, to unify all taxpayer initiatives across different functions.
3. Work with NIST to determine how to make e-authentication requirements as least burdensome as possible and review the e-authentication methods used by other international taxing authorities.
4. Conduct research into why taxpayers and practitioners do not use certain service channels for particular tasks to enable the IRS to minimize any existing barriers and improve services in that area.
5. Establish a 311-type phone system to provide the taxpayer or practitioner the option to connect with an initial operator who would ask questions to understand the reason for the call. The operator would then match the caller with the specific office within the IRS that handles that particular issue or case.
6. 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 (primary and secondary abandonments).
7. Work with TAS to create a Taxpayer Anxiety Index.
8. Track the subject of taxpayer and practitioner complaints for each service channel to better understand the customer's satisfaction with actual usage of each service channel.
9. 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.
10. Coordinate the team developing the Servicewide return preparer strategy to ensure consistency of strategies.
11. Collaborate with TAS throughout the development of the comprehensive customer service strategy required by the Taxpayer First Act.
12. Couple the customer service strategy with an implementation plan, complete with cost estimates for various initiatives.

### Legislative Recommendations to Congress

The National Taxpayer Advocate recommends that Congress:

1. Provide the necessary funding to the IRS for the adequate staffing, budget, and technology needed to provide a robust, world class customer service experience.<sup>59</sup>

<sup>59</sup> For more details on this legislative recommendation, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 6 (Provide The IRS With Sufficient Funding to Meet Taxpayer Needs and Improve Federal Tax Compliance)*.



## 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

### RESPONSIBLE OFFICIALS

Nancy A. Sieger, Acting Chief Information Officer  
Amalia C. Colbert, Chief of Staff and Project Director, Taxpayer First Act Office

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

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

### PROBLEM

Aging IRS information technology (IT) infrastructure continues to plague the IRS and directly impact taxpayers.<sup>2</sup> For example, equipment added to support the IRS’s IT infrastructure in 2017 crashed during the 2018 filing season, temporarily preventing taxpayers from electronically filing their tax returns and payments.<sup>3</sup> To address the IRS’s failing IT infrastructure and need for updated technology, the IRS developed an Integrated Modernization Business Plan (Plan). The Plan aims to improve “the taxpayer experience, by modernizing core tax administration systems, IRS operations and cybersecurity.”<sup>4</sup> 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.<sup>5</sup>

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

2 See, e.g., Jeff Stein, Damian Paletta & Mike DeBonis, *IRS to Delay Tax Deadline by One Day After Technology Collapse*, WASH. POST, Apr. 17, 2018, [https://www.washingtonpost.com/business/economy/irs-electronic-filing-system-breaks-down-hours-before-tax-deadline/2018/04/17/4c05ecae-4255-11e8-ad8f-27a8c409298b\\_story.html](https://www.washingtonpost.com/business/economy/irs-electronic-filing-system-breaks-down-hours-before-tax-deadline/2018/04/17/4c05ecae-4255-11e8-ad8f-27a8c409298b_story.html).

3 See Aaron Boyd & Frank Konkel, *IRS’ 60-Year-Old IT System Failed on Tax Day Due to New Hardware*, NEXTGOV (Apr. 19, 2018) (citing an IRS official), <https://www.nextgov.com/it-modernization/2018/04/irs-60-year-old-it-system-failed-tax-day-due-new-hardware/147598>.

4 IRS Pub. 5336, *IRS Integrated Modernization Business Plan* (Apr. 2019).

5 See *id.*

## IMPACT ON THE INTERNAL REVENUE SERVICE

The National Taxpayer Advocate has previously discussed the urgent need to modernize the IRS's IT systems.<sup>6</sup> Current IRS IT capabilities substantially limit the IRS's ability to carry out effective tax administration and negatively impact taxpayers and practitioners.<sup>7</sup> The IRS currently operates about 60 separate case management systems, many of which are aged and do not fully integrate with each other.<sup>8</sup> These systems lack basic functionality such as digital communication and recordkeeping, making it difficult for IRS and TAS employees to perform their jobs efficiently and provide quality service to taxpayers.<sup>9</sup>

In April 2019, the IRS released the IT Modernization Plan and a related Companion Document to address various components of the IRS IT strategy for the near future.<sup>10</sup> The six-year plan seeks to improve the taxpayer experience and taxpayer service by modernizing the IRS's information technology.<sup>11</sup> The Companion Document lays out the implementation timeline for IT components and details how the agency intends to measure the success of modernization efforts.<sup>12</sup> The National Taxpayer Advocate commends the IRS for focusing its Plan in large part on updates to its systems to improve taxpayer experience and service.

In fiscal year (FY) 2019, the IRS implemented 18 of the 20 planned capabilities of the Plan.<sup>13</sup> The Plan became even more important after the Taxpayer First Act (TFA) became law on July 1, 2019. The TFA seeks to modernize and improve the IRS's IT and requires the IRS to develop and implement a multi-year strategic plan for its information technology needs.<sup>14</sup> The plan must be reviewed and updated on an annual basis and must consider the development of new IT.<sup>15</sup> The TFA also requires the IRS to create and submit a comprehensive customer service strategy to Congress by July 1, 2020.<sup>16</sup> As the IRS's existing Plan is merged into the plan required by TFA, the Plan will need to be further updated after the

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- 6 See, e.g., National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 47 (Area of Focus: *The IRS's Enterprise Case Management Project Shows Promise, But to Achieve 21st Century Tax Administration, the IRS Needs an Overarching Information Technology Strategy With Proper Multi-Year Funding*).
- 7 For a discussion about how taxpayers and practitioners are negatively impacted by current IRS information technology, see National Taxpayer Advocate 2018 Annual Report to Congress 351 (Legislative Recommendation: *IT Modernization: Provide the IRS with Additional Dedicated, Multi-Year Funding to Replace Its Antiquated Core IT Systems Pursuant to a Plan That Sets Forth Specific Goals and Metrics and Is Evaluated Annually by an Independent Third Party*).
- 8 *Id.*; National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 47 (Area of Focus: *The IRS's Enterprise Case Management Project Shows Promise, But to Achieve 21st Century Tax Administration, the IRS Needs An Overarching Information Technology Strategy With Proper Multi-Year Funding*).
- 9 See National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 1, 6-7 (Preface: *National Taxpayer Advocate's Introductory Remarks*).
- 10 IRS Pub. 5336, IRS Integrated Modernization Business Plan (Apr. 2019).
- 11 *Id.*
- 12 IRS Pub. 5336-A, IRS Integrated Modernization Business Plan: Companion Document (Apr. 2019).
- 13 IRS Integrated Modernization Business Plan Treasury Monthly Briefing 3 (Sept. 26, 2019). A nineteenth capability planned for FY 2019 was completed in October 2019. Only Electronic Case Management was not implemented, due to Government Accountability Office (GAO) protest. IRS response to TAS fact check (Nov. 22, 2019).
- 14 TFA, Pub. L. No. 116-25, §§ 2101-2103, 133 Stat. 981 (2019).
- 15 TFA, Pub. L. No. 116-25, § 2101, 133 Stat. 981, 1009 (2019) (codified as amended at 26 U.S.C. § 7803(f)(4)(B)).
- 16 See TFA, Pub. L. No. 116-25, § 1101, 133 Stat. 981 (2019) (providing that the strategy shall include "a plan to provide assistance to taxpayers that is secure, designed to meet reasonable taxpayer expectations, and adopts appropriate best practices of customer service provided in the private sector, including online services...."). See Most Serious Problem: *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*, *supra*, for a discussion on the plan and IRS taxpayer and customer service.

development of the customer service strategy, as many aspects of improving customer service are likely to be technology-related.

### The Plan Is a Good Step Toward Information Technology Modernization But May Never Be Fully Implemented Unless It Is Adequately Funded

In the Plan, the IRS explains that “overall success will depend on several special legislative proposals and regulatory authorities that we believe are appropriate for an effort of this scope and importance.”<sup>17</sup> Success will require receiving funding and authority to hire IT staff and adequate, predictable funding to pay for the IT upgrades — both of which are outside of the IRS’s control.<sup>18</sup> TAS has previously advocated for multi-year funding and clear independent oversight of progress for IRS IT modernization.<sup>19</sup> Although the TFA extended pay authority for the IRS to hire critical IT personnel to aid in its IT modernization,<sup>20</sup> Congress has not yet allocated IT funding for multiple years, which the IRS requires to execute its Plan.<sup>21</sup>

#### *Full Funding Is Needed for Complete Implementation of the Plan*

The IRS estimates that full implementation of its Plan over six years — with Phase 1 being FYs 2019-2021 and Phase 2 being FYs 2022-2024 — will cost \$2.3 to \$2.7 billion.<sup>22</sup> In FY 2019, the IRS spent \$289.7 million in implementing its Plan.<sup>23</sup> However, it will likely need more than \$2 billion for the remaining years to meet its estimated cost for total implementation.<sup>24</sup> Without full funding, the IRS will fall short of its goals to modernize its systems and enhance taxpayer service.

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.<sup>25</sup> 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.<sup>26</sup> Through ECM the IRS plans to create a simplified infrastructure, hopefully eliminating the need to maintain or rebuild older IT systems.<sup>27</sup> ECM is not a project that the IRS can stop and start as funding becomes available. The project is currently estimated to take six years

17 IRS Pub. 5336, IRS Integrated Modernization Business Plan 15 (Apr. 2019).

18 *Id.*

19 See National Taxpayer Advocate 2018 Annual Report to Congress 351 (Legislative Recommendation: *IT Modernization: Provide the IRS with Additional Dedicated, Multi-Year Funding to Replace Its Antiquated Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and Is Evaluated Annually by an Independent Third Party*). TFA requires the IRS to submit a multi-year strategic plan for the information technology needs of the IRS and requires the IRS to enter into a contract with an independent reviewer to verify and validate the implementation plans. TFA, Pub. L. No. 116-25, § 2101, 133 Stat. 981, 1008-1009 (2019) (codified as amended at 26 U.S.C. § 7803(f)).

20 TFA, Pub. L. No. 116-25, § 2103, 133 Stat. 981, 1009 (2019) (codified as amended at 26 U.S.C. § 7812).

21 See TFA, Pub. L. No. 116-25, 133 Stat. 981 (2019).

22 IRS Pub. 5336-A, IRS Integrated Modernization Business Plan: Companion Document 3 (Apr. 2019). The IRS anticipated IT modernization costs of \$300 million for FY 2019 and an additional \$300 million for FY 2020. *Id.*

23 IRS Integrated Modernization Business Plan Treasury Monthly Briefing 22 (Oct. 24, 2019). In FY 2019, the IRS allocated \$201 million from the Business Systems Modernization appropriations account, which includes the FY 2019 appropriations and carryover balances and \$99 million in user fees. See IRS Pub. 5336-A, IRS Integrated Modernization Business Plan: Companion Document 3 (Apr. 2019).

24 IRS Pub. 5336-A, IRS Integrated Modernization Business Plan: Companion Document 3 (Apr. 2019).

25 National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 6 (Provide The IRS With Sufficient Funding to Meet Taxpayer Needs and Improve Federal Tax Compliance)*.

26 IRS Pub. 5336, IRS Integrated Modernization Business Plan 26 (Apr. 2019).

27 *Id.*

to develop and implement, so absent continued multi-year funding, the IRS will be unable to make progress in its ECM efforts.<sup>28</sup>

The TFA requires the IRS to develop a strategic plan for the IT needs of the IRS.<sup>29</sup> While the current Plan satisfies several requirements of the TFA, the IRS is currently in the process of updating the Plan to fully conform to the TFA requirements.<sup>30</sup> However, Congress did not provide additional funding to the IRS in the TFA, including funding for the modernization efforts.<sup>31</sup>

### *The IRS Also Requires Adequate Funding for Ongoing Information Technology Costs While It Modernizes*

In FY 2018, the IRS spent approximately \$2.5 billion on Information Services, which included telecommunications and information technology development, enhancement, operations, maintenance, and security.<sup>32</sup> Between FYs 2017 to 2019, the IRS spent about \$2 billion per year on “IT spending [to] maintain current capability and performance levels.” However, the cost to operate the IRS technology infrastructure annually now exceeds \$2.2 billion and is expected to exceed \$3 billion by FY 2026 if current trends continue.<sup>33</sup> “Capital asset acquisitions” of IT systems, *i.e.*, the IRS modernizing its IT systems, are separately funded and budgeted in the Business Systems Modernization account.<sup>34</sup>

While the IRS needs the separate funding for its modernization efforts, at the same time it also needs adequate funding to maintain and update existing systems. As noted previously, modernization efforts take time, and the IRS cannot sacrifice maintaining its existing systems to devote all of its resources to implementing new systems. As evidenced by the crash during the 2018 filing season, the IRS needs to be able to reliably deliver existing capabilities even as it looks

**While the IRS needs the separate funding for its modernization efforts, at the same time it also needs adequate funding to maintain and update existing systems. As noted previously, modernization efforts take time, and the IRS cannot sacrifice maintaining its existing systems in order to devote all of its resources to implementing new systems.**

28 IRS Pub. 5336-A, IRS Integrated Modernization Business Plan: Companion Document 9 (Apr. 2019). “The initial foundation for ECM will be established in FY 2020. By FY 2022, the ECM’s target platform and core capabilities [should be] in use for case management, with most major business organizations having an operational footprint on the target platform and demonstrating value to the taxpayer.” IRS response to TAS fact check (Nov. 22, 2019).

29 TFA, Pub. L. No. 116-25, § 2101(a), 133 Stat. 981, 1008-009 (2019) (codified as amended at 26 U.S.C. § 7803(f)(4)).

30 IRS response to TAS information request (Oct. 21, 2019).

31 See TFA, Pub. L. No. 116-25, 133 Stat. 981 (2019).

32 IRS, 2018 Data Book 65. In FY 2017 Operations Support spending was almost \$4.1 billion. Of that, about \$2.2 billion was for Information Services. Approximately \$315 million was spent on Business Systems Modernization. *Id.* IRS, 2018 Data Book 65.

33 IRS response to TAS fact check (Nov. 22, 2019).

34 In FY 2018 the Business Systems Modernization account received about \$247 million in funding, a small amount compared to the total Operations Support budget. IRS, 2018 Data Book 65.

to develop new ones.<sup>35</sup> Failure to fund existing operations and maintenance could result in even more problems with existing technology.

While this ongoing maintenance comes at a cost, the Treasury Inspector General for Tax Administration has noted that “some unfunded IT requests would actually result in the IRS achieving overall cost savings by replacing alternative inefficient manual workarounds.”<sup>36</sup> Therefore, a current investment in the IRS’s IT future could reduce costly maintenance efforts in the future.

### **Congress Should Hold the IRS Accountable for Meeting Certain Milestones and Conduct an Independent Review of Modernization Efforts, Similar to Enterprise Case Management**

Asking Congress to provide consistent, multi-year funding to the IRS in support of its modernization efforts is not without risk. The IRS is preparing a monthly briefing for the Department of Treasury on its implementation progress and costs incurred to show its dedication to the project. The IRS should prepare a similar document to update Congress on modernization efforts and to address related congressional concerns.<sup>37</sup> However, to further mitigate risk, Congress should take an approach similar to ECM. The TFA requires the IRS to have an independent reviewer verify and validate the ECM implementation plans, which includes performance milestones and cost projections of the ECM system.<sup>38</sup> Congress should require the same independent review of the IRS’s modernization efforts at critical performance milestones to monitor how the IRS is spending funds.<sup>39</sup>

### **The Plan Does Not Result in the Modernization of the IRS’s Business Master File, Which May Continue to Hinder Business Taxpayers**

The IRS uses the Individual Master File (IMF) and Business Master File (BMF) information systems, both of which it implemented in the 1960s and are the oldest systems in the entire federal government.<sup>40</sup> The IMF is the central repository of all tax data pertaining to individual taxpayers, and it maintains a continuously updated and current record of all individual taxpayer’s accounts, while BMF serves the same purpose for business taxpayers.<sup>41</sup> For the fiscal year period ending September 30, 2018, there were approximately 175 million returns and other forms filed in the IMF system and approximately 75 million returns and other forms filed in the BMF system.<sup>42</sup>

35 IRS, IRS Provides Additional Day to File and Pay for Taxpayers Through Wednesday, April 18; IRS Processing Systems Back Online, IR-2018-100 (Apr. 17, 2018), <https://www.irs.gov/newsroom/irs-provides-additional-day-to-file-and-pay-for-taxpayers-through-wednesday-april-18-irs-processing-systems-back-online>; Jeff Stein, Damian Paletta & Mike DeBonis, *IRS to Delay Tax Deadline By One Day After Technology Collapse*, WASH. POST, Apr. 17, 2018, [https://www.washingtonpost.com/business/economy/irs-electronic-filing-system-breaks-down-hours-before-tax-deadline/2018/04/17/4c05ecae-4255-11e8-ad8f-27a8c409298b\\_story.html](https://www.washingtonpost.com/business/economy/irs-electronic-filing-system-breaks-down-hours-before-tax-deadline/2018/04/17/4c05ecae-4255-11e8-ad8f-27a8c409298b_story.html).

36 *IRS Oversight: Treasury Inspector General for Tax Administration*, Hearing Before the H. Comm. on Appropriations, Subcomm. on Financial Services and General Government, 116th Cong., (Sept. 24, 2019) (statement of the Honorable J. Russell George, Treasury Inspector General for Tax Administration).

37 See, e.g., IRS Integrated Modernization Business Plan Treasury Monthly Briefing (Oct. 24, 2019).

38 TFA, Pub. L. No. 116-25, § 2101(b), 133 Stat. 981, 1009 (2019) (requiring independent verification of Electronic Case Management system). A similar requirement exists for the IRS’s Customer Account Date Engine 2 (CADE 2) plans. *Id.*

39 National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 6 (Provide The IRS With Sufficient Funding to Meet Taxpayer Needs and Improve Federal Tax Compliance)*.

40 GAO, GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* 28 (May 2016).

41 *Id.*

42 IRS Pub. 55B, 2018 Internal Revenue Service Data Book: Oct. 1, 2017 to Sept. 30, 2018 (May 2019). IMF returns include all individual returns. BMF returns include corporate, partnership, employment tax, estate tax, gift tax, excise tax, and tax-exempt organization returns. See IRM Exhibit 25.7.1-5 (Jan. 1, 2018).

The Plan's efforts are largely focused on IMF, while complete modernization of the BMF infrastructure, which would greatly help the IRS and business taxpayers, is not included.<sup>43</sup> Without a plan for modernization of BMF, the IRS will not be able to provide the same level of service to business taxpayers that it will provide to individual taxpayers.<sup>44</sup> Assuming the IRS is able to fully achieve the modernization of IMF by 2024, then certain services the modernization efforts establish may only be available to individual taxpayers. For example, TAS is aware of situations where, after a taxpayer submits a payment to the IRS, the computer systems do not update for several weeks, preventing a taxpayer or the IRS from knowing if a taxpayer has successfully paid a tax debt. After the IRS fully implements the Plan, this should no longer be a concern for individual taxpayers. However, since the Plan is not modernizing the BMF, business taxpayers will continue to see these types of delays. It is critical that the IRS expand its modernization efforts to include BMF and ensure it can adequately meet the needs of all taxpayers.

## IMPACT ON TAXPAYERS

### If the IRS Does Not Receive Adequate Information Technology Modernization Funding, Taxpayers Will Not Receive the Improved Taxpayer Service That Modern Products and Services Would Provide

The IRS has been rolling out numerous services to improve taxpayer service in the past several years with additional improvements included in the Plan.<sup>45</sup> These new and planned services can help to address current issues with taxpayer services.<sup>46</sup> For example, customer callback is a feature that could address many of the issues taxpayers experience trying to get through to the IRS. This technology allows callers to elect to receive a call back when the next customer service representative is available rather than waiting on hold. When the IRS previously proposed acquiring customer callback technology in its FYs 2015 and 2016 budgets, it estimated the total cost would be \$3.3 million.<sup>47</sup> However, the IRS later revealed that to actually use the callback technology, it would need to upgrade its entire phone system, which would cost an estimated \$48.5 million.<sup>48</sup> While the IRS did eventually upgrade the phone system and is working to roll out the callback technology, this is an example of how aging core systems are prohibiting the implementation of critical new technologies.

43 See IRS Pub. 5336, IRS Integrated Modernization Business Plan 24 (April 2019). While modernization of BMF is not in the Plan, the Plan is largely focused on initiatives that support critical initiatives the IRS could accomplish with sufficient funding. The "taxpayer experience" initiatives benefit many types of customers, including individuals, businesses, and third parties. IRS response to TAS fact check (Nov. 22, 2019).

44 See *IRS Legacy Information Technology Systems*, Hearing Before the House Comm. on Oversight and Government Reform, 114th Cong. (2016) (statement of Terence Milholland, Chief Technology Officer, IRS).

45 See IRS Pub. 5336, IRS Integrated Modernization Business Plan (Apr. 2019); IRS Pub. 5336-A, IRS Integrated Modernization Business Plan: Companion Document (Apr. 2019).

46 See Most Serious Problem: *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*, *supra*.

47 See IRS, Congressional Justification for Appropriations Accompanying the President's FY 2015 Budget IRS-20 (2014); IRS, Congressional Justification for Appropriations Accompanying the President's FY 2016 Budget IRS-22 (2015). The IRS IT division also requested funding of \$3.3 million in FY 2018, which was the first time the IT division requested callback funding. IRS response to TAS fact check (Nov. 22, 2019).

48 See Lisa Rein, *IRS Customer Service Will Get Even Worse This Tax Filing Season, Tax Chief Warns*, WASH. POST, Nov. 3, 2015, <https://www.washingtonpost.com/news/federal-eye/wp/2015/11/03/irs-customer-service-will-get-even-worse-this-tax-filing-season-tax-chief-warns/?noredirect=on>.



The IRS is looking at similar improvements to enhance customer service in the near term. Some taxpayers in pilot programs with certain issues requiring only 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.<sup>49</sup> The IRS is trying to roll out Secure Messaging, which allows taxpayers and IRS employees to exchange documentation safely, securely, and quickly and offers an alternative to traditional channels like mail and fax.<sup>50</sup> An enhanced online taxpayer account can provide information on amount of taxes owed, payment options, and payment history, in addition to access to tax transcripts.<sup>51</sup>

The forthcoming customer service strategy should include a number of recommendations that will involve technology enhancements, as discussed in the Most Serious Problem on Customer Service Strategy.<sup>52</sup> However, these enhancements will come at a price. Without extensive IT modernization, the IRS cannot implement a comprehensive taxpayer service strategy. Without the required multi-year funding, taxpayers will continue to suffer from customer service that fails to meet their needs and is not supported with real-time data updates and now-industry standard methods of interaction. The TFA requires the IRS to examine how to improve customer service, but those improvements cannot become reality without additional funding. Improved customer service resulting from funding the IRS's modernization plans is likely to improve taxpayer trust of the IRS and, in turn, increase voluntary compliance, increasing overall revenue for the federal government.<sup>53</sup>

## CONCLUSION

Taxpayers, the IRS, and TAS all face problems due to the IRS's aging and outdated IT infrastructure. While the IRS's Plan may help to fix many of the issues, lack of consistent funding raises questions as to whether the IRS will successfully implement all the capabilities outlined in its Plan or upgrade its core systems. If the IRS does not receive all of the requested funding or otherwise allocate necessary funding from other sources, it may be unable to adopt some of the new technology underlined in the Plan and may need to continue to spend resources to maintain and patch its aging systems. This may result in increased costs over time and postpone upgrades of the IRS core systems, preventing the IRS from adequately managing cases and providing improved taxpayer service, ultimately harming both taxpayers and the IRS.

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49 See IRS.gov (Webchat is an available option piloted on several pages across the website).

50 See, e.g., IRS, TEBConnect, <https://www.irs.gov/help/tebconnect> (last visited Nov. 20, 2019).

51 See IRS, View Your Account Information, <https://www.irs.gov/payments/view-your-tax-account> (last visited Oct. 28, 2019).

52 See Most Serious Problem: *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*, *supra*. See also TFA, Pub. L. No. 116-25, § 1101, 133 Stat. 981 (2019).

53 See National Taxpayer Advocate 2016 Annual Report to Congress 50 (Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called "Enforcement" Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*). See also GAO, GAO-12-652T, *Opportunities to Improve the Taxpayer Experience and Voluntary Compliance* (Apr. 2012).

## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Modify the Plan to conform to the requirements of the TFA, by itemizing the anticipated project costs and potential risks if the Plan is not fully funded.
2. Conduct independent verification and validation of the updated plan to verify that it will result in complete modernization of IRS IT systems, similar to the independent verification and validation required in the TFA of the CADE 2 and ECM systems. The IRS should 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.
3. Include in future modernization plans the modernization of the BMF system.

### Legislative Recommendations to Congress

The National Taxpayer Advocate recommends that Congress:

1. 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.<sup>54</sup>

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54 For more details on this legislative recommendation, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 6 (Provide The IRS With Sufficient Funding to Meet Taxpayer Needs and Improve Federal Tax Compliance)*. National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 47 (Area of Focus: *The IRS's Enterprise Case Management Project Shows Promise, But to Achieve 21st Century Tax Administration, the IRS Needs An Overarching Information Technology Strategy With Proper Multi-Year Funding*).

**MSP  
#3****IRS FUNDING: The IRS Does Not Have Sufficient Resources to Provide Quality Service****TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**PROBLEM**

Between fiscal years (FYs) 2010 and 2019, the IRS budget was cut by 20.4 percent after adjusting for inflation.<sup>2</sup> Mostly because of antiquated technology, a smaller workforce, and an increasing workload, the IRS cannot afford to provide the quality of service that taxpayers deserve. With the IRS developing a comprehensive taxpayer service strategy<sup>3</sup> and much of that strategy likely dependent on technology modernization,<sup>4</sup> it will be nearly impossible for the IRS to improve service without additional funding.

**IMPACT ON TAXPAYERS****Background**

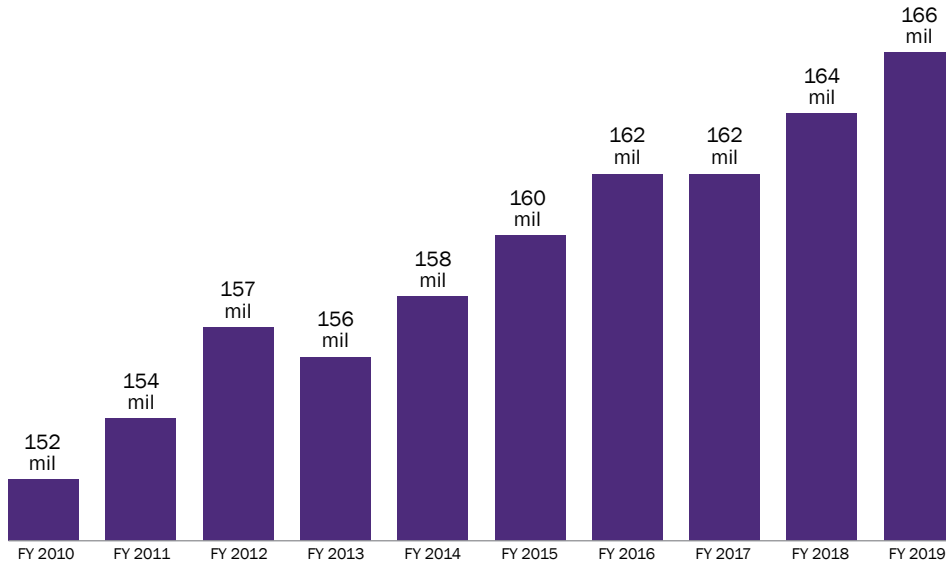
While no single data point provides a perfect measure of the IRS's workload, the number of income tax returns the IRS receives is probably the best general indicator. Most of the IRS's core work (*e.g.*, answering calls and letters, conducting audits, and taking collection actions) increases with the number of filers. Between FYs 2010 and 2019, the number of income tax returns increased by about nine percent. At the same time, the IRS's appropriation (after adjusting for inflation) and number of employees both declined by more than 20 percent, respectively, as shown in Figures 1.3.1-1.3.3.

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 IRS response to TAS information request (Oct. 2, 2019). Data is re-based to FY 2010 using the Gross Domestic Product Chained Price Index (GDP Index). See Office of Management and Budget, *Fiscal Year 2020 Budget of the U.S. Government, Historical Tables*, Table 10.1 (showing year-to-year increases in the GDP index), <https://www.whitehouse.gov/omb/historical-tables/> (last visited Dec. 13, 2019).
- 3 For further discussion, see Most Serious Problem: *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*, *supra*.
- 4 For further discussion, see Most Serious Problem: *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*, *supra*.

**FIGURE 1.3.1<sup>5</sup>**

**Individual and Business Income Tax Returns, Fiscal Years 2010-2019**

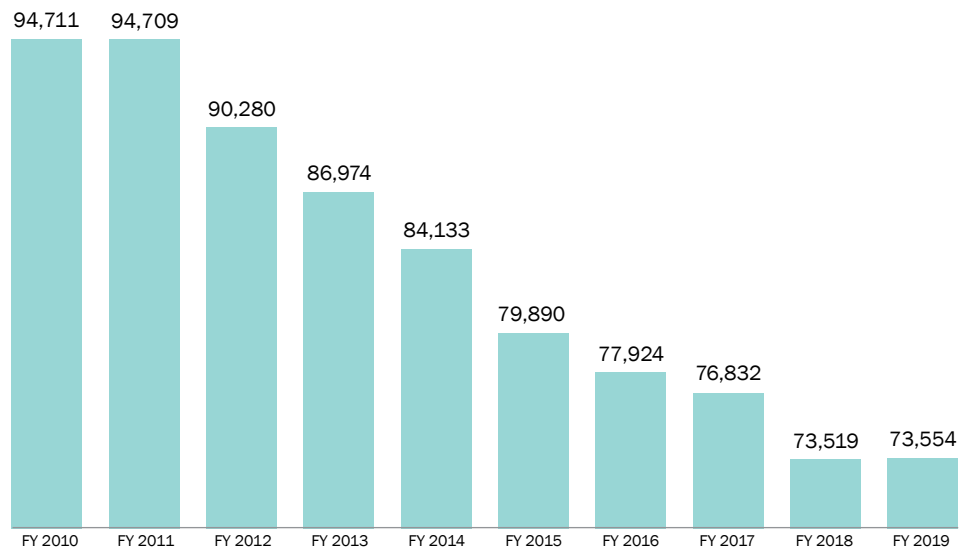
Between FYs 2010 and 2019, the number of income tax returns increased by about 9%



**FIGURE 1.3.2<sup>6</sup>**

**Average Full-Time Equivalent IRS Employees, Fiscal Years 2010-2019**

Between FYs 2010 and 2019, the number of IRS employees decreased by more than 20%



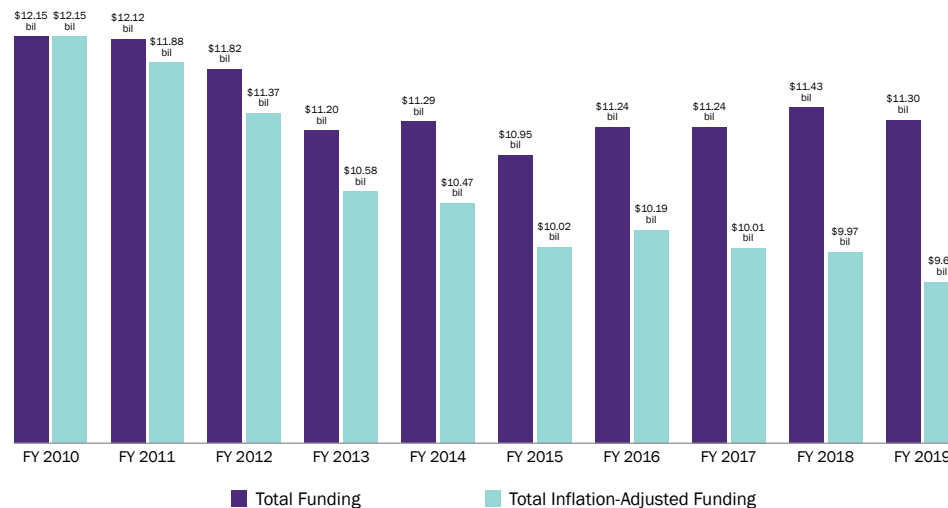
5 IRS, 2018 Data Book, Table 2, Numbers of Returns Filed by Type of Return & Fiscal Year: 2010-2018 (May 2019); IRS, Pub. 6292, Fiscal Year Return Projections by State: 2019–2026 3 (Sep. 20, 2019) (table 1).

6 IRS response to TAS information request (Oct. 2, 2019); IRS response to TAS fact check (Nov. 15, 2019) (excludes full-time equivalents (FTEs) attributable to overtime, terminal leave, and those funded by reimbursable agreements and private debt collection funds).

FIGURE 1.3.3<sup>7</sup>

### IRS Funding in Nominal and Inflation-Adjusted 2010 Dollars

The IRS's inflation-adjusted appropriation has declined by more than 20% since FY 2010



In addition, legislative changes sometimes divert resources. For example, over the last decade the IRS spent more than \$2.6 billion to implement the Patient Protection and Affordable Care Act, more than \$500 million to implement the Foreign Account Tax Compliance Act, and more than \$600 million to implement the Tax Cuts and Jobs Act (TCJA).<sup>8</sup> These responsibilities combine with a steadily increasing workload and a declining appropriation to make it nearly impossible for the IRS to provide good service.

### High Quality Customer Service Is Important

The taxpayers who pay our nation's bills deserve high quality service. In 1998, Congress directed the IRS to “restate its mission to place a greater emphasis on serving the public and meeting taxpayers’ needs.”<sup>9</sup> More recently, Congress enacted the Taxpayer Bill of Rights, which makes “quality service” a right, directed the IRS to make service a priority, and directed it to come up with a plan to improve service.<sup>10</sup>

Service is also a critical investment because it contributes to voluntary tax compliance. In FY 2018, the IRS collected nearly \$3.5 trillion on an appropriated budget of about \$11.43 billion, producing an overall return on investment (ROI) of more than 300:1.<sup>11</sup> Less than two percent of this revenue is

<sup>7</sup> IRS response to TAS information request (Oct. 2, 2019). These budget figures include rescissions and supplemental funds. The inflation adjustment is computed using the GDP Index.

<sup>8</sup> *Id.* Although Congress sometimes allocated supplemental funds to implement these changes (e.g., the TCJA), any such funding is included in the figures above.

<sup>9</sup> IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 722, Title I, § 1002 (1998).

<sup>10</sup> IRC § 7803(a)(3)(B) (providing the right to “quality service”). The Consolidated Appropriations Act, 2018 (Pub. L. No. 115-141, Division E, Title I, § 104) directed the IRS to make improvements to the “help line service a priority...” and section 1101 of the Taxpayer First Act (Pub. L. No. 116-25) required the Secretary of the Treasury to provide Congress with a comprehensive customer service strategy for the IRS.

<sup>11</sup> IRS, 2018 Data Book, Table 1: Collections and Refunds, by Type of Tax (May 2019).

collected through direct enforcement action.<sup>12</sup> The remaining 98 percent is paid timely and voluntarily as a result of taxpayer service and the potential for enforcement.<sup>13</sup>

Because taxpayers pay both taxes and the costs of tax compliance, the government has a responsibility to answer their calls and letters and meet with them when necessary. As former Commissioner Rossotti observed:

Some critics argue that the IRS should solve its budget problem by reallocating resources from customer support to enforcement. In the IRS, customer support means answering letters, phone calls, and visits from taxpayers who are trying to pay the taxes they owe. Apart from the justifiable outrage it causes among honest taxpayers, I have never understood why anyone would think it is good business to fail to answer a phone call from someone who owed you money.<sup>14</sup>

### Taxpayers Have Difficulty Reaching the IRS

When taxpayers contact the IRS, whether by phone, by letter, or in person, they often have difficulty reaching a person or getting a timely response.

- Enterprisewide, the IRS received about 99 million calls in FY 2019, but telephone assistors answered only about 29 percent of them — and only after those callers waited an average of 16.2 minutes on hold.<sup>15</sup>
- The IRS’s Accounts Management function received about 6.9 million pieces of correspondence from taxpayers during FY 2019, including letters responding to proposed adjustments and other notices.<sup>16</sup> About 52.3 percent of the correspondence in open inventory had not been answered within the IRS’s timeframes (generally 45 days).<sup>17</sup>

12 Enforcement revenue accounted for \$59.4 billion (or 1.7 percent) of the \$3.5 trillion the IRS collected in FY 2018. Government Accountability Office (GAO), GAO-19-150, *IRS’s Fiscal Years 2018 and 2017 Financial Statements* 23 (Nov. 2018).

13 Some services (e.g., updating forms, establishing procedures, clarifying the rules, and accepting returns and payments) make it possible, or at least more convenient, for taxpayers to pay their taxes. When paying taxes is inconvenient, fewer are likely to pay voluntarily. Other services (e.g., reviewing and responding to certain submissions) make it possible for the IRS to assess and collect taxes using “enforcement” resources without violating procedural requirements. Still other services (e.g., access to the Taxpayer Advocate Service) probably also bring in revenue by improving goodwill and trust for the agency (or diminishing distrust) because trust is correlated with voluntary compliance. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, at 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

14 Charles O. Rossotti, *Many Unhappy Returns: One Man’s Quest to Turn Around the Most Unpopular Organization in America* 285 (2005).

15 IRS, Joint Operations Center (JOC), Snapshot Reports: Enterprise Snapshot (week ending Sept. 30, 2019).

16 IRS, JOC, Adjustments Inventory Reports: FY 2019 July–September Fiscal Year Comparison (Oct. 19, 2019).

17 IRS, Customer Account Services, Weekly Enterprise Adjustments Inventory Report (week ending Sept. 28, 2019); Internal Revenue Manual (IRM) 1.4.16.4.9(2), Managing Inventory Timeliness and Quality (Dec.17, 2018) (defining “overage” correspondence).



- The IRS provided face-to-face assistance at 324 Taxpayer Assistance Center (TACs) to over 2.3 million taxpayers during fiscal year 2019.<sup>18</sup> When taxpayers called to schedule a visit to a TAC, the IRS answered only about 57 percent of their calls in FY 2019.<sup>19</sup>

The IRS generally does not assist taxpayers who visit a TAC without an appointment.<sup>20</sup> In-person visits to a TAC declined by 38 percent in the first two full fiscal years after 2016 when the IRS adopted its appointment-only policy.<sup>21</sup>

Moreover, IRS employees may not be as well trained as they were in 2010.<sup>22</sup> The IRS spent \$616 per employee on training in FY 2019, down from \$1,775 per employee in FY 2010.<sup>23</sup>

### Taxpayers Have Difficulty Responding to Compliance Contacts

Revenue Agents (RAs) and Revenue Officers (ROs) audit returns and collect tax in the field. While most taxpayers do not want to hear from RAs and ROs, they provide more personalized service than the IRS's automated systems.<sup>24</sup> However, the IRS employed 38.6 percent fewer RAs and 50.4 percent fewer ROs in FY 2019 than in FY 2010.<sup>25</sup> When the IRS relies instead on its automated systems, it is often

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- 18 See *IRS Oversight: TIGTA: Hearing Before the Subcomm. on Financial Services and General Government of the H. Comm. on Appropriations*, 116th Cong. (Sept. 26, 2019) (statement of J. Russell George, Treasury Inspector General for Tax Administration (TIGTA)) (“Although the IRS reports having 358 TACs for the 2019 Filing Season, 33 TACs were not open because they had not been staffed as of April 15, 2019”); W&I, *Business Performance Review 16* (Nov. 7, 2019) (number of taxpayers). As of October 2019, 34 TACs were unstaffed. IRS response to TAS fact check (Nov. 14, 2019).
- 19 IRS, JOC, Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total (week ending Sept. 30, 2019).
- 20 GAO, GAO-18-471, *2018 Tax Filing Season: IRS Managed Processing Challenges and Enhanced Its Management of Tax Law Changes* 15 (Sept. 2018), <https://www.gao.gov/assets/700/694403.pdf>. In FY 2019, the IRS assisted about 270,000 taxpayers who did not have appointments. Wage and Investment (W&I), *Business Performance Review 16* (Nov. 7, 2019). Appointments are not required to drop off non-cash payments or current-year 1040-series returns, or to obtain forms or publications. See IRM 21.1.1.3(18), *Customer Service Representative (CSR) Duties* (Oct. 1, 2018).
- 21 IRS response to TAS fact check (Nov. 14, 2019). Over half of the taxpayers calling to make a TAC appointment in FY 2018 had their questions answered by the IRS employee on the appointment line and no longer needed an appointment. GAO, GAO-18-471, *2018 Tax Filing Season: IRS Managed Processing Challenges and Enhanced Its Management of Tax Law Changes* 15 (Sept. 2018). Nonetheless, this policy makes it more difficult for taxpayers to visit in person and some probably give up in frustration.
- 22 In light of Congress' focus on service, on October 1, 2019 the IRS reversed a policy adopted in 2014 that sharply limited the period within which the IRS could answer tax law questions on the phones and in the TACs. Email from W&I to TAS (Sept. 30, 2019). For a more detailed discussion on telephone and TAC service, see, e.g., National Taxpayer Advocate 2017 Annual Report to Congress 22-35 (Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*); National Taxpayer Advocate 2017 Annual Report to Congress 117-127 (Most Serious Problem: *Taxpayer Assistance Centers (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance*); National Taxpayer Advocate 2018 Annual Report to Congress 19 (Most Serious Problem: *Tax Law Questions: The IRS's Failure to Answer the Right Tax Law Questions at the Right Time Harms Taxpayers, Erodes Taxpayer Rights, and Undermines Confidence in the IRS*). IRS employees will need to be trained to answer more questions.
- 23 IRS response to TAS information request (Oct. 2, 2019); IRS response to TAS fact check (Nov. 15, 2019) (providing employee and training figures, which TAS used to compute training dollars per employee). For further discussion of training issues, see National Taxpayer Advocate 2017 Annual Report to Congress 84-92 (Most Serious Problem: *Employee Training: Changes to and Reductions in Employee Training Hinder the IRS's Ability to Provide Top Quality Service to Taxpayers*).
- 24 Providing personalized service to taxpayers who are subject to compliance contacts is consistent with the National Taxpayer Advocate's recommendation that the IRS provide personalized service to taxpayers in situations where they are likely to have the most anxiety. See National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress 1-14 (Introduction: *The National Taxpayer Advocate's Remarks on the Role of Trust and Taxpayer Advocate Service in Fostering Tax Compliance*).
- 25 IRS response to TAS information request (Oct. 2, 2019) (between FY 2010 and 2019 the average number of ROs declined from 6,042 to 2,995 and the average number of RAs declined from 13,879 to 8,526).

difficult for it to address the resulting calls, letters, and visits from taxpayers — so difficult, in fact, that the IRS sometimes curtails its enforcement efforts.<sup>26</sup> For example:

- The Automated Collection System (ACS) stopped issuing systemic levies between January 2016 and July 2018 because the IRS did not have sufficient resources to answer the resulting calls.<sup>27</sup>
- Due to resource constraints between FYs 2013 and 2017, the IRS virtually stopped using its authority to automatically create a substitute return for certain businesses that had failed to file.<sup>28</sup> Although the Treasury Inspector General for Tax Administration (TIGTA) recommended the IRS reinstate the program, the IRS said it was concerned about “any downstream effects that will result from the reallocation of resources.”<sup>29</sup> The IRS may have been concerned about answering the resulting calls and letters.

Customer service suffers the most, however, when the IRS makes automated compliance contacts even if it does not have the resources to adequately address the downstream consequences. For example:

- The IRS has recently been delaying more refunds to ensure they are not fraudulent (using the Return Integrity Verification Operation (RIVO)), draining service resources.<sup>30</sup> In calendar year (CY) 2019, RIVO delayed more than seven times as many refunds as in 2017 (*i.e.*, increasing from 219,210 to 1,650,999),<sup>31</sup> resulting in a five-fold increase in taxpayers asking TAS for help (from 16,432 in CY 2017 to 89,584 in CY 2019).<sup>32</sup> Overall TAS’s FY 2019 receipts rose by 11 percent as compared with FY 2018 (240,777 compared with 216,792).<sup>33</sup> As a result, the FY 2019 median cycle time for TAS cases increased by 12.2 percent (55 days vs. 49 days in the prior year).<sup>34</sup>
- Between FYs 2018 and 2019, ACS levies increased by 114 percent (from 200,024 to 427,596) and its lien filings increased by 93 percent (from 184,368 to 356,609),<sup>35</sup> even though the IRS did not have the resources to provide adequate phone service to those it contacted. Only about ten percent of the calls to its lien lines reached a telephone assistor, and those that got through waited on hold for an average of 58.1 minutes in FY 2019, as shown in Figure 1.3.4.

26 For further discussion of various error correction procedures (called “unreal” audits) and refund verification procedures, see, e.g., National Taxpayer Advocate 2017 Annual Report to Congress 49-63 (Most Serious Problem: *Audit Rates: The IRS Is Conducting Significant Types and Amounts of Compliance Activities That It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*); Most Serious Problem: *Processing Delays: Refund Fraud Filters Continue to Delay Taxpayer Refunds for Legitimately Filed Returns, Potentially Causing Financial Hardship*, *infra*.

27 See TIGTA, Ref. No. 2018-30-068, *Fiscal Year 2018 Statutory Review Of Compliance With Legal Guidelines When Issuing Levies 7-8* (Sept. 7, 2018).

28 TIGTA, Ref. No. 2019-30-069, *Billions of Dollars of Nonfiler Employment Taxes Went Unassessed in the Automated 6020(b) Program Due Primarily to Resource Limitations 3* (Sept. 16, 2019) (noting “A6020(b) program closures decreased by 92 percent, from 261,582 in FY 2013 to 21,746 in FY 2017. This was caused by a reduction in the FTEs assigned to the program of 84 percent, from 12.11 FTEs in FY 2013 to 1.88 FTEs in FY 2017.”).

29 *Id.* at 12.

30 Over the past three years, the IRS’s refund fraud filters have had false positive rates over 50 percent. W&I, *Business Performance Review 13* (Aug. 14, 2019); W&I, *Business Performance Review 16* (Nov. 8, 2018).

31 IRS response to TAS fact check (Nov. 22, 2019) (data as of Sept. 4, 2019). These figures include non-identity theft cases, those flagged using filters and business rules, and systemically released refunds. *Id.*

32 Taxpayer Advocate Management Information System (TAMIS) (Nov. 1, 2019) (data as of Oct. 1, 2018, and Oct. 1, 2019).

33 *Id.*

34 *Id.*

35 IRS response to TAS fact check (Nov. 15, 2019); Collection Activity Report NO-5000-25, *Lien Source* (Oct. 11, 2018 and Oct. 8, 2019); Collection Activity Report NO-5000-24, *Levies and Seizures Source* (Oct. 2, 2018 and Oct. 1, 2019).

Even small increases in enforcement can have a significant effect on service. Between FYs 2018 and 2019, when Congress increased the IRS appropriation for enforcement by \$50.6 million and increased the appropriation for taxpayer service by \$44 million, it was more difficult for taxpayers to speak to an assistor on nearly all the lines shown in Figure 1.3.4 that taxpayers call to respond to compliance contacts.<sup>36</sup>

**FIGURE 1.3.4, IRS Telephone Service in Response to Compliance Contacts in FYs 2018 and 2019<sup>37</sup>**

Telephone Line	FY	Dialed Attempts	Calls Answered by an Assistor (Number)	Calls Answered by an Assistor (Percent)	Average Speed of Answer
Automated Collection System (ACS)	2018	4,447,277	2,275,544	51.17%	19.3 min
	2019	5,655,228	2,186,446	38.66%	31.2 min
Installment Agreement/ Balance Due	2018	7,622,022	3,646,674	47.84%	27.5 min
	2019	9,270,239	2,425,539	26.16%	44.5 min
Lien Processing	2018	383,142	85,095	22.21%	59.5 min
	2019	543,987	55,403	10.18%	58.1 min
National Taxpayer Advocate <sup>38</sup>	2018	681,738	382,471	56.10%	3.2 min
	2019	960,412	412,633	42.96%	8.8 min
W&I Individual Customer Response	2018	6,120,135	2,691,633	43.98%	7.1 min
	2019	5,882,801	2,025,034	34.42%	12.5 min
Self-Employed Individual Customer Response	2018	3,591,304	1,527,195	42.52%	7.9 min
	2019	3,323,552	1,149,108	34.57%	12.7 min
Business Customer Response	2018	2,418,631	1,544,569	63.86%	12.2 min
	2019	2,377,677	1,113,337	46.82%	20.0 min
Automated Underreporter (AUR)	2018	2,540,241	1,037,719	40.85%	21.2 min
	2019	1,756,130	648,536	36.93%	23.8 min
SB/SE Exam	2018	468,569	165,968	35.42%	22.2 min
	2019	317,737	108,069	34.01%	28.2 min
W&I Exam	2018	1,440,366	458,333	31.82%	31.5 min
	2019	1,098,142	330,394	30.09%	34.7 min

36 IRS response to TAS information request (Oct. 2, 2019) (showing between FYs 2018 and 2019 the post-transfer allocation to enforcement increased from \$4.6270 billion to \$4.6776 billion and the allocation to service increased from \$2.512554 billion to \$2.556554 billion). The IRS CFO's figures reported in this discussion (and in Figure 1.3.5) do not match the Treasury Department's public figures because the CFO's figures show enacted budgetary authority net of any inter-appropriation transfers and rescissions, and including supplemental funds with the appropriation into which they were transferred.

37 IRS, JOC, Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total (week ending, Sept. 30, 2019). This table focuses on number and percentage of calls answered by an assistor. Some taxpayers hang up quickly and others are routed to a recording and disconnected. Both types of callers are excluded from the denominator when the IRS computes its "level of service" (LOS) metric, even though most people probably call the IRS because they want to speak to a person. *Id.*

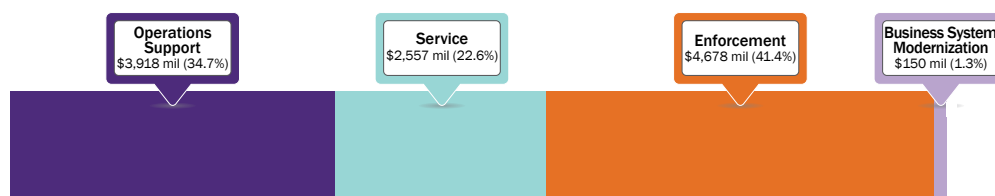
38 The National Taxpayer Advocate line is staffed by the IRS. Several of the lines (e.g., the National Taxpayer Advocate and the Customer Response lines) receive calls in response to compliance contacts as well as other calls.

### Enforcement Can Deplete Resources for Service

Congress funds the IRS’s service and enforcement accounts separately, as shown in Figure 1.3.5. However, enforcement contacts deplete service resources. In response to compliance contacts, taxpayers call the IRS, write letters, and ask TAS for assistance. Thus, any increase in funding for enforcement not coupled with an increase in funding for services is likely to make it more difficult for taxpayers to communicate with the IRS.

**FIGURE 1.3.5**<sup>39</sup>

#### Components of IRS’s FY 2019 Budget (in Millions)



For the same reason, a “program integrity cap” (PIC) adjustment can deplete resources for service. The Administration’s FY 2020 budget proposed to increase the baseline funding for enforcement by about five percent while reducing funding for taxpayer services by about seven percent.<sup>40</sup> To increase enforcement funding, it proposed an additional \$362 million using a PIC adjustment — an exception to the spending cap rules. This exception applies only where additional enforcement expenditures will generate an ROI of greater than 1:1 (*i.e.*, the additional expenditures will increase federal revenue on a net basis).<sup>41</sup> Under the proposal, PIC adjustments would increase funding for enforcement by \$15 billion over the next ten years.<sup>42</sup>

These adjustments cannot increase funding for services, even though the proposal acknowledges (for purposes of computing the ROI) that enforcement initiatives consume service resources.<sup>43</sup> Yet issuing guidance; updating forms and publications; conducting outreach and education; assisting taxpayers, tax preparers, and tax software providers; and otherwise administering the tax filing season are absolute prerequisites for tax compliance. Thus, the ROI for many of these service activities is probably greater than the ROI for enforcement actions.

Even when used to address specific compliance problems, services can have a greater ROI than enforcement. For example, it is sometimes more cost effective for the IRS to send out soft letters or

<sup>39</sup> IRS response to TAS information request (Oct. 2, 2019). These percentages would be slightly different if the numbers were not rounded.

<sup>40</sup> Department of Treasury and IRS, *Congressional Budget Justification and Annual Performance Report and Plan FY 2020 IRS-89*, <https://home.treasury.gov/system/files/266/02-IRS-FY-2020-CJ.pdf> (last visited Dec. 13, 2019).

<sup>41</sup> Department of Treasury and IRS, *Congressional Budget Justification and Annual Performance Report and Plan FY 2020 IRS-89*; Office of Management and Budget, *Budget of the United States Government: Analytical Perspectives, Supplemental Materials, Fiscal Year 2020 134*, <https://www.whitehouse.gov/omb/analytical-perspectives/> (last visited Dec. 13, 2019).

<sup>42</sup> *Id.*

<sup>43</sup> Department of Treasury and IRS, *Congressional Budget Justification and Annual Performance Report and Plan FY 2020 IRS-93* (noting that increasing audit coverage increases downstream costs for TAS and W&I).

issue guidance to help the vast majority of taxpayers who are willing to comply voluntarily (based on statistics cited above), so that it can reserve its costly enforcement efforts for those few who do not respond by complying. The IRS's Large Business and International Division has launched a series of tax compliance “campaigns” that reflect its view that enforcement is not always the best treatment stream.<sup>44</sup> Accordingly, increased funding for the IRS's enforcement account could waste resources, degrade service to taxpayers, and violate the *right to privacy* (i.e., the right to expect that enforcement “will be no more intrusive than necessary”), unless coupled with appropriate increases to its service account.

For similar reasons, any increase in funding for enforcement or service should be coupled with proportionate increases in operations support so that the IRS can afford the infrastructure needed to support those operations. Operations support includes, among other things, “rent payments; facilities services; printing; postage; physical security; headquarters and other IRS-wide administration activities....”<sup>45</sup> The IRS cannot hire employees for its enforcement or service functions if it cannot afford the infrastructure to support them. For example, in FY 2019, the IRS had such critical information technology (IT) needs, which could only be funded out of operations support, that it requested to transfer appropriations from enforcement to operations support.<sup>46</sup>

### Modern Technology Could Improve Service<sup>47</sup>

According to the Government Accountability Office (GAO), the IRS has “inaccurate tax records ... [which] place an undue burden on taxpayers who may be compelled to respond to IRS inquiries caused by errors in their accounts” due to the IRS's systemic limitations.<sup>48</sup> In addition, the IRS stores account information for individuals and businesses on its Individual Master File (IMF) and Business Master File (BMF) information systems, both of which were established in the 1960s.<sup>49</sup> They are the oldest systems in the federal government.<sup>50</sup>

An IRS system crash, attributed to equipment supporting the IMF, prevented taxpayers from submitting tax returns and payments electronically and prompted the IRS to extend the April 17, 2018, filing deadline.<sup>51</sup> The IRS has been taking steps to replace the core components of the IMF with a system known as the Customer Account Data Engine 2 (CADE 2).<sup>52</sup> However, funding for IRS technology upgrades — provided through the Business Systems Modernization (BSM) account — has been very limited. Congress reduced BSM funding by 48.3 percent between FY 2017 (\$290 million) and FY 2019

44 See, e.g., IRS, IRS Announces Rollout of 11 Large Business and International Compliance Campaigns (Nov. 3, 2017), <https://www.irs.gov/businesses/large-business-and-international-compliance-campaigns> (citing the initial rollout on Jan. 31, 2017).

45 Department of Treasury and IRS, *Congressional Budget Justification and Annual Performance Report and Plan FY 2020* IRS-20.

46 IRS response to TAS fact check (Nov. 15, 2019).

47 For a more detailed discussion, see Most Serious Problem: *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*, *supra*.

48 GAO, GAO-19-150, *IRS's Fiscal Years 2018 and 2017 Financial Statements* 11 (Nov. 2018).

49 GAO, GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* 28-30 (May 2016).

50 *Id.*

51 See Aaron Boyd & Frank Konkel, *IRS' 60-Year-Old IT System Failed on Tax Day Due to New Hardware*, NEXTGOV (Apr. 19, 2018) (citing an IRS official), <https://www.nextgov.com/it-modernization/2018/04/irs-60-year-old-it-system-failed-tax-day-due-new-hardware/147598>.

52 IRS response to TAS fact check (Nov. 15, 2019) (clarifying that if resources are available as planned, the strategy for replacing the IMF “will be developed by 2021 and subsequently independently validated. CADE 2, which is currently in the second of three transition states to completion, will replace only the core components of the IMF.”).

(\$150 million) and it constituted just 1.3 percent of the agency’s overall appropriation in FY 2019, even though the IRS says the success of its modernization plan depends on receiving funding that is “available for multiple fiscal years at somewhat predictable intervals.”<sup>53</sup>

**FIGURE 1.3.6, Business System Modernization Appropriation, FYs 2017–2019**<sup>54</sup>

Fiscal Year	BSM Funding	Total IRS Funding	BSM as Percentage of Total IRS Funding
2017	\$290 M	\$11.24 B	2.6%
2018	\$110 M	\$11.43 B	1.0%
2019	\$150 M	\$11.30 B	1.3%

Modern technology would not only enable the IRS to become more efficient but also would improve taxpayer service. Consider the following examples:

*Customer Callback Technology Could Reduce Time Wasted on Hold.* A customer callback system would enable callers to request a call back from the IRS so they would not have to wait on hold.<sup>55</sup> While the IRS recently tested its callback technology for the balance due line (technically one “application” on the line), it was used for such a small number of calls that the technology did not significantly reduce the time that taxpayers spent on hold.<sup>56</sup> The IRS should fully implement customer callback on all of its major lines as soon as possible.

*E-Filing of Amended Tax Returns Could Reduce Burden.* Taxpayers are expected to file approximately 3.9 million amended returns for 2018 — all on paper.<sup>57</sup> Allowing taxpayers to e-file amended returns would reduce filing burdens and speed up corrections and refunds. It could also reduce processing costs and follow-up calls, and help the IRS address potentially erroneous refunds.<sup>58</sup> This \$5.6 million upgrade could save the IRS \$79.4 million over five years in processing costs alone.<sup>59</sup>

*An Integrated Case Management System Could Reduce Processing Times and Expand Information Available Through Online Accounts.* The IMF and BMF contain account information, whereas case management systems generally track case-related information within each IRS function or process (e.g., the status of the case and the basis for any determination by the function). The IRS has about 60 case management

53 IRS Pub. 5336, IRS Integrated Modernization Business Plan 15 (Apr. 2019).

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

55 Department of Treasury and IRS, *Congressional Budget Justification and Annual Performance Report and Plan FY 2020* IRS-5 (“The technologies provided for in the plan, such as customer callback and online notifications, will simplify taxpayer interactions with the IRS across all service channels and expedite return processing times, allowing taxpayers to comply and receive refunds faster”).

56 IRS Pub. 5336, IRS Integrated Modernization Business Plan 20 (Apr. 2019). As shown on Figure 1.3.4, customer service representatives (CSRs) answered only 26.16 percent of the calls to the balance due application after taxpayers waited on hold for an average of 44.5 minutes in FY 2019. The IRS plans to implement customer callback on four more applications by the second quarter of 2020 and on up to 15 total applications by the third quarter of 2021. IRS Integrated Modernization Business Plan, Treasury Monthly Briefing (Oct. 24, 2019). A lack of funding could derail these plans.

57 See, e.g., IRS, Electronic Tax Administration Advisory Committee, Publication 3115, Annual Report to Congress (June 2019), <https://www.irs.gov/pub/irs-pdf/p3415.pdf>.

58 See TIGTA, Ref. No. 2019-40-042, *Actions Have Not Been Taken to Improve Amended Tax Return Review Procedures to Reduce Erroneous and Fraudulent Refunds* 1 (July 2019).

59 *Id.* at 1 and 9.



systems that are not fully integrated with each other.<sup>60</sup> Each function's employees must transcribe or import information from other electronic systems into their own case management systems, and then mail or fax files and supporting documents to other functions (e.g., quality review, Appeals, and Counsel).

These workarounds can lead to delays, lost files, and data security risks. A single integrated system could improve efficiency and reduce such delays, losses, and risks. Particularly when combined with upgrades to IMF and BMF (and/or CADE 2), an integrated system would expand the information that IRS employees could provide to taxpayers when they call the IRS or visit a TAC. Such upgrades could also expand what taxpayers could access directly through their online accounts.

## CONCLUSION

In FY 2018, U.S. taxpayers paid \$3.5 trillion to finance the operations of the federal government. The IRS, as the federal government's "accounts receivable" department, collected those funds on an appropriated budget of approximately \$11.43 billion, producing an ROI of over 300:1. Both to improve service and to enhance its ability to collect taxes, the IRS requires additional funding. In particular, it requires additional funding to ensure taxpayers can reach an IRS employee more easily. It also requires additional funding to modernize its aging IT systems, which will help employees to both assist taxpayers and collect revenue.

## RECOMMENDATIONS

### Legislative Recommendations to Congress

The National Taxpayer Advocate recommends that Congress:

1. Provide the IRS with sufficient additional funding to improve taxpayer service and modernize its IT systems over a predictable multi-year period.<sup>61</sup>
2. Ensure that any increase in funding for enforcement (including program integrity cap adjustments) is coupled with a commensurate increase in funding for service and operations support so that taxpayers seeking to respond to the IRS can do so easily.<sup>62</sup>

60 See National Taxpayer Advocate 2018 Annual Report to Congress 351-358 (Legislative Recommendation: *IT Modernization: Provide the IRS with Additional Dedicated, Multi-Year Funding to Replace Its Antiquated Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and Is Evaluated Annually by an Independent Third Party*); National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress 47-51 (Area of Focus: *The IRS's Enterprise Case Management Project Shows Promise, But to Achieve 21st Century Tax Administration, the IRS Needs an Overarching Information Technology Strategy With Proper Multi-Year Funding*).

61 For more detailed recommendations, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 6-8 (*Provide The IRS With Sufficient Funding to Meet Taxpayer Needs and Improve Federal Tax Compliance*).

62 *Id.*



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

Ken Corbin, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**PROBLEM**

The IRS has designed a number of filters to assist in the detection and prevention of identity theft (IDT) and non-IDT refund fraud. These fraud detection filters are an essential component of combating refund fraud, and from January 1 through September 30, 2019, have protected the IRS from issuing about \$2.7 billion in improper refunds.<sup>2</sup> However, the filters have also created problems for taxpayers, most notably delays in obtaining their refunds, creating a financial hardship for hundreds of thousands of taxpayers. Predictably, this resulted in more taxpayers seeking Taxpayer Advocate Service (TAS) assistance. Specifically, these problems include:

- A new non-IDT refund fraud filter (Filter X) suspended nearly double the returns than projected, and about a quarter of these returns took 40 days or longer to be processed;<sup>3</sup>
- The IRS received most W-2 information timely, but the transmittal of paper W-2s was delayed;<sup>4</sup>
- Other non-IDT refund fraud filters had false positive rates (FPRs) of 71 percent;<sup>5</sup>
- Refund delays were nearly three weeks beyond normal processing times, causing economic hardship for a large number of taxpayers;<sup>6</sup>
- The IRS often provides taxpayers little information regarding the precise reason for refund delays and what steps they can take to expedite the process; and

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

2 IRS response to TAS consolidated end of year information request (Nov. 22, 2019). Filter X also protected about \$1.6 million in revenue after June 15, 2019 (the date that Filter X was retired). The information on these returns was verified after this date. IRS, Identity Theft (IDT) and Integrity and Verification Operations (IVO) Performance Report, Slide 7 (Oct. 9, 2019).

3 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File (IRTF) Form 1040 (Oct. 23, 2019); IRS CDW, Individual Master File (IMF) Transaction History File (Oct. 23, 2019).

4 By the end of filing season (FS) 2019, the IRS had received information on 2.6 million paper Forms W-2 from the Social Security Administration (SSA), compared to information on 6.2 million paper Forms W-2 during the same period in FS 2018. Generalized Mainline Framework (Jan. 2 through Apr. 26, 2019).

5 IRS response to TAS consolidated end of year information request (Nov. 22, 2019).

6 *Id.*

- The issues with the new Filter X, in conjunction with high FPRs and processing delays, 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.<sup>7</sup>

## IMPACT ON TAXPAYERS

### Background

The IRS's efforts to detect and prevent refund fraud are managed by the Return Integrity Verification Operations (RIVO) of Wage and Investment (W&I), which oversees both the IDT refund fraud program in the Taxpayer Protection Program (TPP) and non-IDT refund fraud in the Pre-Refund Wage Verification Hold Program (PRWVH).<sup>8</sup>

These programs rely primarily on two systems to detect and prevent fraud: the Dependent Database (DDb) to detect IDT, and the Return Review Program (RRP) to detect IDT *and* non-IDT refund fraud. The DDb contains filters comprised of rules that are binary in nature (*i.e.*, if the rule is broken, the return will be selected for further analysis; if the rule is not broken, the return will continue through normal processing).

The RRP, on the other hand, contains filters comprised of both rules and models.<sup>9</sup> Once the models complete their analysis, each return is given a risk score. That score is fed into RRP filters, which will select returns based on whether the score exceeds a specified threshold while considering other information in the system. If the score exceeds the threshold and other conditions are met, the IRS will route the return to either the TPP or PRWVH, whichever is most appropriate.

Figure 1.4.1 provides a simplified flowchart of the complicated processes the IRS uses to screen returns where a taxpayer has claimed a refund and the IRS suspects either IDT or non-IDT refund fraud.

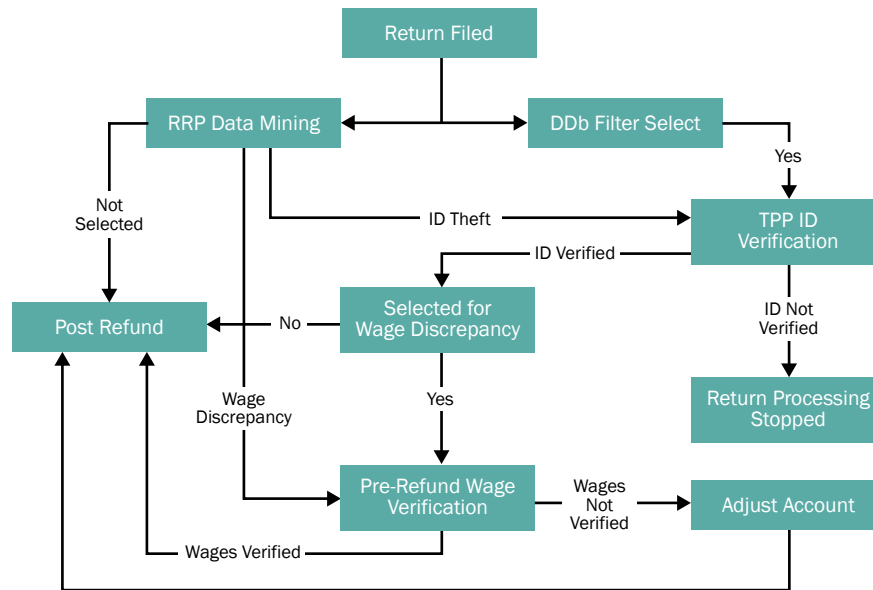
7 Data obtained from Taxpayer Advocate Management Information System (TAMIS). TAS extracts data on the day following the last day of the month.

8 See Internal Revenue Manual (IRM) 25.25.6.1(1) and (3), Program Scope and Objectives (Aug. 20, 2019); IRM 25.25.3.1(1), Program Scope and Objectives (Aug. 30, 2019). For purposes of this Most Serious Problem, we have used "TPP" and "IDT refund fraud program" interchangeably, as well as the terms, "pre-refund wage verification hold program" and "non-IDT refund program."

9 National Taxpayer Advocate 2018 Annual Report to Congress 79-90 (Most Serious Problem: *False Positive Rates: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers*). The filter models use techniques such as predictive models, business rules, and clustering.

FIGURE 1.4.1<sup>10</sup>

## Refund Return Screening for Identity Theft and Non-Identity Theft Refund Fraud



Once the IRS selects a taxpayer's return into the TPP program, it asks the taxpayer to authenticate his or her identity either over the phone, online, or by visiting a Taxpayer Assistance Center.<sup>11</sup> For taxpayer returns selected into the PRWVH program, the IRS matches the information on the return with third-party information provided by the taxpayer's employer(s) and payor(s) to the Social Security Administration (SSA) or the IRS. Beginning in Filing Season (FS) 2017, employers and other specified payers were required to submit third-party reporting information (Forms W-2 and 1099-MISC-Nonemployee Compensation) no later than January 31 to the SSA or the IRS.<sup>12</sup> The purpose of this change in the law was to get information to the IRS earlier so it could have more time to match the wage and tax information reported on the taxpayer's return against information submitted by third parties; however, the IRS does not receive all third-party information from SSA by January 31.<sup>13</sup> Once the SSA receives third-party information from employers, it begins the process of transmitting this information to the IRS in accordance with an agreement entered into between both agencies. This transmittal process is efficient for third-party information submitted to the SSA electronically. For paper

10 For a more detailed roadmap of IRS processes, see IRS Pub. 5341, *The Taxpayer Roadmap 2019: An Illustration of the Modern United States Tax System* (Sept. 2019).

11 IRM 25.25.6.1.7(3), *Taxpayer Protection Program Overview* (Aug. 20, 2019). International taxpayers can mail in documentation to authenticate their identity. Letter 5447C, *Potential Identity Theft during Original Processing; Foreign Address* (Sept. 2018).

12 Section 201 of the Protecting Americans From Tax Hikes (PATH) Act of 2015 amended IRC § 6071 to require that certain information returns be filed by January 31, generally the same date as the due date for employee and payee statements and are no longer eligible for the extended filing date for electronically filed returns under IRC § 6071(b). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015). However, the January 31 deadline for submitting W-2 information does not apply to other reporting requirements of income sources. For example, state and local refunds are required to be reported to the IRS on or before February 28 (March 31 if filed electronically). 26 C.F.R. § 1.6050E-1.

13 See 42 U.S.C. 432 § 232, *Processing of Tax Data*; 20 C.F.R. § 422.114, *Annual Wage Reporting Process*. "Under the authority of section 232 of the Act, SSA and IRS have entered into an agreement that sets forth the manner in which SSA and IRS will ensure that the processing of employee wage reports is effective and efficient."

information though, the SSA administers a laborious manual process, resulting in backlogs in processing paper W-2s, which keeps the SSA from transmitting some data to the IRS until August or September.<sup>14</sup>

In calendar year (CY) 2019, the IRS made several changes to improve the efficiency and effectiveness of the refund fraud program, namely reducing processing times and increasing the accuracy of filter selections. The changes include:

- During the filing season, the IRS modified its new non-IDT refund fraud filter (Filter X) to systemically check for the posting of third-party information daily instead of weekly;
- When the return was selected due to a mismatch between the information on the return and the third-party information, the IRS conducted additional analysis. If the third-party information had no impact on the amount of the refund, the refund was released immediately; and
- When a return carried with it both an IDT and non-IDT refund fraud concern, IRS systems had the capability to systemically verify income and withholding information upon successful authentication of the taxpayer's identity, thereby compressing the processing time.

During FS 2020, the IRS intends to expand the number of non-IDT refund fraud filters that will check for posting of third-party information daily instead of weekly and release the refunds systemically once the IRS verifies the information on the return.<sup>15</sup> TAS anticipates that this additional automation of the IRS's fraud detection filters will further reduce processing times. These improvements are in addition to a change this year in the IRS's ability to verify returns without third-party information from certain employers' submissions. More specifically, for FS 2019, the IRS identified employers who historically filed late income information. If a taxpayer's return was selected and the information was largely consistent with prior year returns, the IRS presumed the return was legitimate and released the refund.<sup>16</sup> The National Taxpayer Advocate applauds the IRS for implementing these improvements to its filters to help expedite the process while also protecting revenue.

### **A New Non-Identity Theft Refund Fraud Filter (Filter X) Suspended Nearly Double the Returns Projected, and About a Quarter of These Returns Took 40 Days or Longer to Be Processed**

While the IRS has made a number of improvements in its filters, issues remain. For FS 2019, the IRS added Filter X to assist in identifying returns suspected of non-IDT refund fraud. Filter X selects returns where Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC) is claimed on the return; where there is either no or only some W-2 information available, and thus the information and withholding on the return cannot be verified; and where other criteria programmed into the filter have been met (*i.e.*, the returns that do not meet the programmed criteria will proceed through normal processing channels).<sup>17</sup>

The IRS originally projected that Filter X would suspend about 500,000 returns annually,<sup>18</sup> this projection was a significant understatement, as it ultimately suspended about 1.1 million returns from

14 Government Accountability Office (GAO), GAO-14-633, *Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud* 21 (Aug. 2014).

15 IRS response to TAS information request (July 16, 2019).

16 IRS, IDT and IVO Performance Report, Slide 8 (Oct. 9, 2019). The IRS released 223,515 refunds as a result of the Information Return Processing (IRP) Release Plan.

17 IRS response to TAS information request (Sept. 23, 2019).

18 IRS Processing Year 2019 Treatment Process Update (Dec. 5, 2018).

January 1 through September 26, 2019.<sup>19</sup> Of the returns held by Filter X, about half (590,384) had the original refund claimed on the return released after February 15, 2019, the earliest date under the law that the IRS could release these refunds.<sup>20</sup> The IRS held half of these, or about a quarter of all returns selected by Filter X, for 40 days or longer from the time the return was selected.<sup>21</sup> These delays caused hardship for a number of taxpayers who were relying on their refunds and had to come to TAS for assistance.

### The IRS Received Most W-2 Information Timely, But the Transmittal of Some Paper W-2s Was Delayed

The IRS's daily posting of third-party information resulted in it posting a large amount of W-2 data to IRS systems sooner. For instance, the IRS received 219 million W-2s through February 4 in FS 2019, compared with 101 million for the same period in FS 2018 — an increase of about 117 percent.<sup>22</sup> The receipt of significantly more W-2s earlier in the filing season helps speed up the processing of returns. As part of the Taxpayer First Act, Congress amended Internal Revenue Code (IRC) § 6011 authorizing the IRS, beginning in 2022, to issue regulations that require employers to file electronic information returns when filing more than ten documents annually.<sup>23</sup> This will continue the earlier receipt of W-2 information, allowing the IRS filters to verify wage information earlier. However, the IRS will continue to struggle with the delays caused by paper W-2s. The IRS should work with SSA to speed up the transmission of paper W-2 data.

### Other Refund Fraud Filters Had False Positive Rates of 71 Percent

Problems persist for the IRS's remaining set of refund fraud filters. Specifically, these filters had an FPR of 71 percent for January 1 through October 2, 2019.<sup>24</sup> The FPR is the number of returns that turned out to be legitimate divided by the number of returns selected by the filter.<sup>25</sup> As Figure 1.4.2 illustrates, this FPR is lower than last year's by about ten percent, but is higher than 2017.

19 IRS, IDT and IVO Performance Report, Slide 8 (Oct. 9, 2019). This filter was retired beginning in June because it is believed that at this point, all the W-2 information that SSA has should have been transmitted to IRS.

20 IRS, CDW, IRTF Form 1040 (Oct. 23, 2019); IRS CDW, IMF Transaction History File (Oct. 23, 2019). Out of the 1,072,192 returns, 419,885 were released shortly after February 15, the earliest date the IRS could release these returns under the law. Of the remaining 652,307 returns, 590,384 had the refunds released because the IRS had received W-2 data from SSA. The remaining 61,923 returns (652,307–590,384) are still being held by Filter X and are not yet resolved, have been sent to a treatment stream such as Exam, or the taxpayer received a partial refund or no refund.

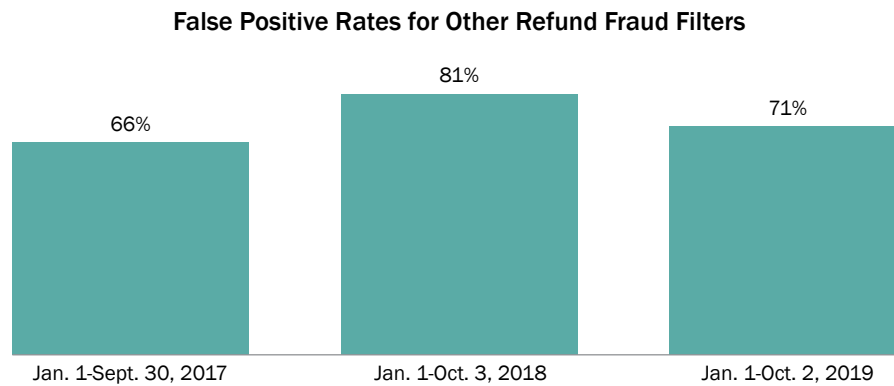
21 IRS, CDW, IRTF Form 1040 (Oct. 23, 2019); IRS CDW, IMF Transaction History File (Oct. 23, 2019).

22 IRS, IDT and IVO Performance Report, Slide 10 (Feb. 6, 2019).

23 Taxpayer First Act of 2019, H.R. 1957, § 2301, 116th Cong. The National Taxpayer Advocate has previously made a similar recommendation. See National Taxpayer Advocate 2017 Annual Report to Congress 267, 276 (Legislative Recommendation: *Timing of Refunds: Direct the IRS to Study the Impact of Delaying the Issuance of Refunds to Allow Sufficient Time to Process Information Returns and Perform Document-Matching*). Treas. Reg. § 301.6011-2(b). This regulation, in certain situations, requires the following to be submitted electronically: Form 1042-S, 1094 series, 1095-B, 1095-C, 1098, 1098-E, 1098-T, 1099 series, 5498, 8027, W-2G, and Form W-2 and other forms treated as Form W-2.

24 IRS, IDT and IVO Performance Report Appendix, Non-IDT Refile Rate, Slide 1 (Oct. 9, 2019).

25 *Id.*

**FIGURE 1.4.2**<sup>26</sup>

Additionally, the returns that comprise the 71 percent FPR took the IRS, on average, 38 days to process.<sup>27</sup> However, the IRS processed the returns that turned out to be legitimate quicker when compared to the 2018 filing season. The IRS needs to continue to learn from the returns that were part of the FPR to further refine the filters and continually work to lower the FPR.

### Refund Delays Were Nearly Three Weeks Beyond Normal Processing Times, Causing Economic Hardship for a Large Number of Taxpayers

For non-IDT refund fraud, the IRS tracks how long it takes to release legitimate returns selected by fraud detection filters. This is referred to as the “operational performance rate” (OPR).<sup>28</sup> This figure represents the number of legitimate returns the non-IDT refund fraud filters selected that took more than four weeks for the IRS to release from the time of selection.<sup>29</sup> From January 1 through October 2, 2019, the OPR was 34 percent compared to a 64 percent rate for the same time period in the prior year – nearly half last year’s rate.<sup>30</sup> This means it took the IRS more than four weeks to release 34 percent of the returns these filters selected from the time of selection.<sup>31</sup> However, as discussed in last year’s Annual Report to Congress, the Operational FPR, which is the number of returns that comprise the FPR that took more than four weeks from the time of selection to process, better illustrates how many legitimate

26 IRS, IDT and IVO Performance Report, Slides 19 and 32 (Oct. 10, 2018) (showing rate for 2018); IRS response to TAS information request (Oct. 19, 2017) (providing rates for 2017).

27 IRS response to TAS information request (Sept. 23, 2019). W&I response to TAS consolidated end of year information request (Nov. 22, 2019).

28 The IRS defines the OPR as returns that are selected and not released by the pre-wage verification program within two weeks of selection (prior to selection, these returns are screened for an additional two weeks). The National Taxpayer Advocate believes the OPR is not an accurate measure of the post-screening/selection FPR.

29 National Taxpayer Advocate 2018 Annual Report to Congress 79, 84 (Most Serious Problem: *False Positive Rates: The IRS’s Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers*). The OPR retains the same denominator as the FPR (the total number of returns selected by the IRS), but the numerator is decreased by the number of returns that the IRS clears as legitimate within two weeks of selection. See also IRS, IDT and IVO Performance Report Appendix, Non-IDT OPR Calculation, Slides 1-2 (Oct. 9, 2019).

30 IRS, IDT and IVO Performance Report Appendix, Non-IDT OPR Calculation, Slides 1-2 (Oct. 9, 2019); IDT and IVO Performance Report, Slide 32 (Oct. 10, 2018).

31 *Id.*

returns selected by the non-IDT refund fraud filters were delayed more than four weeks.<sup>32</sup> This Operational FPR rate has also improved, dropping to 55 percent for January 1 through October 2, 2019, compared to 72 percent for the same time period in the prior year.<sup>33</sup>

Although this drop is an improvement, the IRS still took more than four weeks from the time of selection to release nearly half of the returns that comprise the FPR.<sup>34</sup> The IRS should continue to take steps to reduce the Operational FPR if FPRs are to remain at the same level. Alternatively, the IRS should take steps to reduce the FPR, if it cannot further reduce the Operational FPR.

Additionally, TAS found there were delays in sending returns to the necessary treatment stream where the information on the returns could not be otherwise verified.<sup>35</sup> An analysis of TAS cases showed that out of 309 TAS case receipts with PRWVH indicators received between August 25 and August 31, 2019, 236 waited an average of 141 days from the return filing date for the IRS to screen and determine that it could not verify the information on the returns.<sup>36</sup> Further, as of October 1, 2019, the IRS had assigned only 36 percent of the 236 returns to a particular treatment stream. By October, the IRS should have received all W-2 information, and the fact that it had not yet released or sent to a treatment stream over 60 percent of these cases is concerning.

While it is essential for the IRS to prevent fraud and protect revenue, these processing delays, accompanied with the processing delays experienced by returns selected by Filter X due to the SSA's delays in transmitting paper W-2 data, caused a financial hardship for many taxpayers. These delays have a significant impact on low-income taxpayers. This is especially true for selected returns where EITC or ACTC is claimed. Often, low-income taxpayers are waiting on their refunds to pay day-to-day living expenses such as rent, car repairs, or healthcare, and any delay can cause taxpayers significant hardship. To address these processing delays, the IRS should look to increase staffing for the manual validation process so it can verify returns and assign them to the appropriate treatment stream quickly.

32 National Taxpayer Advocate 2018 Annual Report to Congress 79-91 (Most Serious Problem: *False Positive Rates: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers*). The Operational FPR is the ratio of the legitimate returns resolved after the four-week period (the numerator) and the number of returns left after the four-week period (the denominator). This formula is a more accurate depiction of the number of legitimate returns that took more than two weeks to be resolved from the time of selection than the OPR because, unlike the OPR, the numerator and denominator mirror one another. Specifically, both numbers exclude the number of returns resolved within two weeks of selection. On the other hand, the OPR does not exclude the number of returns resolved within two weeks of selection from the formula's denominator, which distorts the percentage and gives an inaccurate appearance of improved performance.

33 IRS, IDT and IVO Performance Report Appendix, Non-IDT Extended Refile Rate Calculation, Slide 3 (Oct. 9, 2019); the IRS did not track this data until FS 2019, but TAS calculated its own rate for FS 2018. See National Taxpayer Advocate 2018 Annual Report to Congress 79-91 (Most Serious Problem: *False Positive Rates: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers*). The IRS refers to this as the extended refile rate, but for purposes of this discussion, we will refer to it as the Operational FPR.

34 IRS, IDT and IVO Performance Report Appendix, Non-IDT Extended Refile Rate Calculation, Slide 3 (Oct. 9, 2019).

35 If the information on returns cannot be verified through a verification process, the returns will then be referred to one of three treatment streams: CPO5A/WOW, wage and withholding only issues (no refundable credits to be addressed); Automated Questionable Credit (AQC) Program, for wage and withholding issues where a refundable credit is claimed; or Correspondence Examination, selections by the Examination Department and not eligible for another IVO treatment stream (refund tolerances and the availability of budget resources will affect how many returns are selected).

36 Case receipts data obtained from TAMIS on September 13, 2019. The sample was based on a 95 percent confidence level with a 4.2 percent margin of error rate.



### The IRS Generally Provides Taxpayers Little Information Regarding the Precise Reason for Refund Delays and What Steps They Can Take to Expedite the Process

In prior Annual Reports to Congress, TAS has pointed out that taxpayers who call the IRS because their refunds have been held as part of the non-IDT refund fraud program receive little information regarding the cause of the refund delay.<sup>37</sup> Specifically, prior to April 2019, IRS assistors were advised to tell taxpayers that “...no further action is required.”<sup>38</sup>

As a result of TAS’s successful advocacy, the Accounts Management IRM has been updated to instruct assistors to provide taxpayers with the following information:

Advise the taxpayer that we select some returns to determine if income, expenses, and credits are being reported accurately. Recommend the taxpayer review their return and all income information statements (*e.g.*, Form W-2) to ensure all income and withholding matches the information reported on the return. If they determine they have made an error, file an amended return.<sup>39</sup>

Although the IRS has made improvements regarding the information it gives taxpayers while holding their refunds, communication regarding the status of the taxpayer’s return falls short in several instances and does not fully observe the taxpayer’s *right to be informed*. Specifically:

- Letter 4464C, Questionable Refund 3rd Party Notification Letter, instructs taxpayers that the IRS is holding their refund, but does not provide any guidance as to what they can do to expedite the process (*i.e.*, review their return to ensure the income and withholding reported is accurate, and if it is not, file an amended return);<sup>40</sup>
- Not all taxpayers whose refunds are held as part of the non-IDT refund fraud program receive the same periodic update notices. The IRS sends out Notice CP05, We’re Holding Your Refund Until We Finish Reviewing Your Return, and follows up with a subsequent interim letter it sends every 60 days if it is still holding the refund.<sup>41</sup> Conversely, taxpayers whose returns the IRS selected for verification by other non-IDT refund fraud filters receive Letter 4464C, Questionable Refund 3rd Party Notification, and no other subsequent interim letter while the IRS reviews the return;<sup>42</sup> and
- When an account is transferred by RIVO to a different IRS treatment stream such as Exam, taxpayers receive no notification, and the taxpayer won’t hear from the IRS again until an employee in that treatment stream begins working the account.

37 National Taxpayer Advocate 2017 Annual Report to Congress 219, 225 (Most Serious Problem: *Fraud Detection: The IRS Has Made Improvements to Its Fraud Detection Systems, But a Significant Number of Legitimate Taxpayers Are Still Being Improperly Selected by These Systems, Resulting in Refund Delays*).

38 IRM 21.5.6.4.35.3.1.2(2), -R Freeze with IVO Involvement - No IVO Letter or Notice Issued (Oct. 1, 2018).

39 IRM 21.5.6.4.35.3.1.2(2), -R Freeze with IVO Involvement - No IVO Letter or Notice Issued (Oct. 1, 2019).

40 Letter 4464C, Questionable Refund 3rd Party Notification Letter (“What you need to do: If you filed the tax return: You don’t need to do anything at this time. We understand your tax refund is very important to you and we’ll work to complete our review as quickly as possible.”). TAS received several submissions on this issue to its Systemic Advocacy Management System (SAMS). TAS SAMS issues 40219, 41107, and 41114.

41 IRM 21.5.6.4.35.3.1.4(2), -R Freeze with IVO Involvement - IVO Letter 2645C/2644C Issued (Oct. 1, 2019); Notice CP 05, We’re Holding Your Refund Until We Finish Reviewing Your Return. Although an interim letter is manually issued for accounts where a Letter 4464C is issued and the return review has not been completed, it has been TAS’s experience that this manual issuance of the interim letter is done inconsistently.

42 Although an interim letter is manually issued for accounts where a Letter 4464C is issued and the return review has not been completed, it has been TAS’s experience that this manual issuance of the interim letter is done inconsistently.

Understandably, the IRS needs to be very careful about the amount of information it releases to prevent supporting fraud. However, when taxpayers are provided information regarding the status of their refunds, including what actions they can take to expedite the process, they may be less likely to call the IRS inquiring about their refunds and take steps to help identify if there is an issue with their return. Recently, RIVO has agreed to work with TAS on piloting notices that have more information about why the IRS is holding the taxpayer's return and what they can do to address the problem.<sup>43</sup> TAS looks forward to working with RIVO on this pilot to test the impact on taxpayer behavior and better observe the taxpayer's *right to be informed*.

TAS is also currently working with the e-file industry to ensure that preparation and filing software include sufficient alerts on (1) the importance of accurately reporting on the return information from third-party information reports and (2) when the law allows the IRS to release refunds. For example, taxpayers may not know the importance of information on the return matching other third-party documentation. In an effort to obtain their refunds as early as possible, some taxpayers may use their last paystub of the year to fill in the income and withholding on their return. However, a discrepancy between the year's last paystub and the W-2 may result in the refund fraud filter identifying the return, which will delay the processing of the refund. Additionally, if the taxpayer's refund includes EITC or ACTC, this early filing is futile as, by law, the IRS cannot release their refund until after February 15.<sup>44</sup>

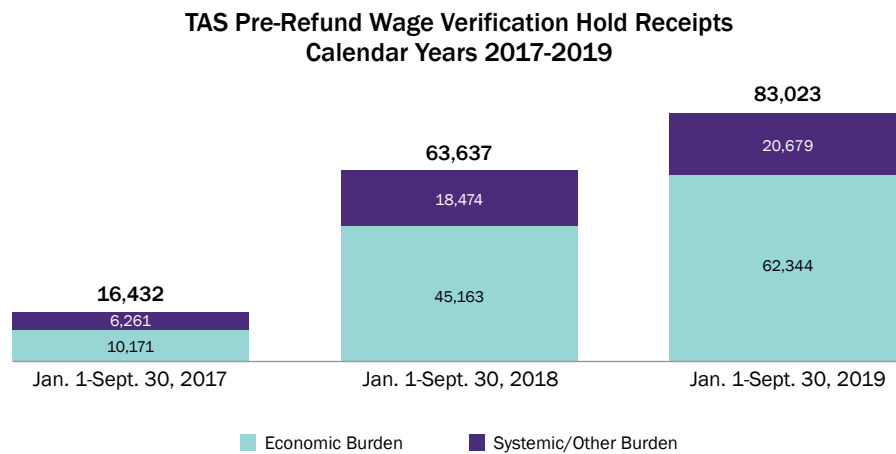
## IMPACT ON THE TAXPAYER ADVOCATE SERVICE

### Issues With the New Filter X, in Conjunction With High False Positive Rates and Processing Delays, Contributed to a 405 Percent Increase in TAS Non-Identity Theft Refund Fraud Cases

As discussed above, IRS challenges with PRWVH cases have resulted in a large number of taxpayers seeking TAS assistance. As shown in Figure 1.4.3, TAS PRWVH case receipts have increased over five times over the past three years, from over 16,000 cases in CY 2017 to over 83,000 in CY 2019, and about 75 percent of the case receipts for CY 2019 were accepted under TAS's economic hardship criteria.

43 TAS/Return Integrity and Compliance Services (RICS) Executive Meeting (Sept. 9, 2019).

44 See PATH Act of 2015, Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015).

FIGURE 1.4.3<sup>45</sup>

The increase in cases — significantly more than TAS anticipated — resulted in delays in TAS’s ability to timely respond to and work cases.

To more precisely identify the root of this increase, TAS Research reviewed nearly 32,000 TAS closed cases involving PRWVH, received between January 28 and June 30, 2019, where the taxpayers ultimately received the refund claimed on their original returns. A majority of these involved the new Filter X.<sup>46</sup> As discussed above, a number of returns selected by Filter X were delayed due to the slow transmittal of paper W-2 data by SSA. Additionally, there were also a subset of cases where delays in sending cases to the necessary treatment stream resulted in taxpayers seeking TAS assistance. These issues, which the IRS can take steps to improve, delayed the processing of returns and were the primary factors behind TAS’s significant increase in PRWVH case receipts. For a more in-depth discussion of TAS’s non-IDT refund fraud case receipts, see the Case Advocacy section in this report.<sup>47</sup>

## CONCLUSION

When taxpayers file their tax returns, they anxiously await the receipt of their refunds and actively monitor their status. Taxpayers who have filed on time and done everything right do not understand why the IRS holds their refunds for more than a month and why it does not explain exactly what is happening and how to fix the issue. The IRS has made significant improvements to its refund fraud program and plans to continue making improvements in the upcoming filing season. However, refund delays and high false positive rates continue, harming significant numbers of taxpayers. These delays create anxiety and frustration for taxpayers, infringe on taxpayers’ rights, and result in more requests for TAS assistance. The IRS needs to take additional steps to improve its filters, improve communications with taxpayers, and improve the time in which it processes legitimate returns.

<sup>45</sup> Data obtained from TAMIS (Oct. 1, 2019; Oct. 1, 2018; Oct. 1, 2017).

<sup>46</sup> TAMIS cases for tax year 2018, Master File Tax Code (MFT) 30, received between January 28, 2019, and June 30, 2019, with primary core issue code 045 or secondary core issue code 045 and other specifications and exclusions matched to selection tables 2019\_SV\_Selection and 2019\_IW\_Selection.

<sup>47</sup> National Taxpayer Advocate 2019 Annual Report to Congress TAS Case Advocacy section, *infra*.

## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Work with SSA to speed up the transmission of paper W-2 data to earlier in the year.
2. Identify acceptable FPR and Operational FPR ranges each year as part of its refund fraud projections.
3. 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.
4. Increase RIVO staffing to improve the processing time for validating information on returns and assigning returns to a compliance stream for further treatment.
5. Send an interim letter every 60 days to all taxpayers whose returns it is holding in the PRWVH program.
6. Revise the Letter 4464C initial contact notice instructing taxpayers to review their returns to verify the income and withholding reported is accurate and correct, and if a mistake is identified, to file an amended return.
7. Instruct RIVO to send Letter 86C, Referring Taxpayer Inquiry/Forms to Another Office, informing taxpayers that it has referred their return to another IRS function and providing them 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****RESPONSIBLE OFFICIALS**

Charles Rettig, Commissioner, Internal Revenue  
 Sunita Lough, Deputy Commissioner for Services and Enforcement  
 Ken Corbin, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**PROBLEM**

To fulfill its statutory duty 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.<sup>2</sup> While the rate of electronic filing approached 90 percent for tax year (TY) 2018 individual returns, less than two percent of all individual returns filed (or about 2.5 million returns) were filed using Free File program software products.<sup>3</sup> 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.<sup>4</sup>

During 2019, after ProPublica alleged that FFI was engaging in deceptive marketing practices and Congress submitted inquiries, the IRS engaged MITRE Corporation to conduct an independent assessment of the program.<sup>5</sup> The MITRE 2019 Free File Report, issued on October 3, 2019, confirmed

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

2 See IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105–206, § 2001, 112 Stat. 685, 723. The FFI products must be available to 70 percent of all taxpayers, particularly focusing on economically disadvantaged or underserved taxpayers. Eighth Memorandum of Understanding (MOU) on Service Standards and Disputes Between the Internal Revenue Service and Free File, Inc. 3 (effective as of Oct. 31, 2018) (hereinafter 2018 Free File MOU), <https://www.irs.gov/pub/irs-utl/Eight%20Free%20File%20MOU.pdf>.

3 IRS response to TAS fact check (Dec. 20, 2019).

4 *Id.*

5 To access the MITRE 2019 Free File Report, see IRS, IRS Statement on Free File Program (Oct. 11, 2019), <https://www.irs.gov/newsroom/irs-statement-on-free-file-program>. ProPublica published a series of investigative reports. See ProPublica, *The TurboTax Trap: How Tax Prep Industry Makes You Pay*, <https://www.propublica.org/series/the-turbotax-trap> (last visited Oct. 20, 2019).

the accusations on deceptive marketing practices but also concluded that IRS oversight was generally adequate and effective.<sup>6</sup>

Based on the MITRE 2019 Free File Report findings, the public response, as well as Taxpayer Advocate Service's (TAS) 2018 review of the Free File program,<sup>7</sup> the National Taxpayer Advocate believes that the current program is not promoting the best interests of taxpayers for the following reasons:

- FFI member companies are steering eligible taxpayers away from their Free File program software products and toward their commercial products;
- Cross-marketing of fee-based services on Free File program software products can confuse taxpayers and gives the impression of IRS endorsement;
- The Free File program is not meeting the needs and preferences of eligible taxpayers, as illustrated by its low usage rate; and
- The IRS does not perform routine quality testing of the Free File program software.

## IMPACT ON TAXPAYERS

### Background

#### *The Free File Program*

The IRS Restructuring and Reform Act of 1998 (RRA 98) directed the IRS to set a goal of increasing the e-file rate to at least 80 percent by 2007.<sup>8</sup> In 2002, the IRS entered into an agreement with a consortium of tax software companies under which the companies would provide free online return preparation services on an IRS.gov webpage to 60 percent of taxpayers during the tax filing season, and in exchange, the IRS would not compete with these companies by providing its own software to taxpayers.<sup>9</sup> The agreement allows the software providers to determine the scope of their offerings but obligates the IRS to take oversight action, such as implementing usability performance measures and notifying the consortium if services are not being properly performed.<sup>10</sup> The IRS also has the authority to terminate the agreement if the consortium fails to provide appropriate coverage, taking into account “the extent to which actual usage of Free Services has increased.”<sup>11</sup>

The IRS intended the Free File partnership to be the “best method” to “promote higher quality Free Services by utilizing the existing expertise of the private sector, maximize consumer choice, promote competition for such Free Services, and thereby meet the objectives in the least costly manner.”<sup>12</sup>

6 MITRE 2019 Free File Report at vi-ix. The press questioned the independence of MITRE and criticized the review as too narrow and lacking meaningful proposals for reform. See, e.g., ProPublica, *IRS-Funded Review Confirms TurboTax Hid Free Filing From Search Engines, but Says There's No Need for Major Changes* (Oct. 9, 2019), <https://www.propublica.org/article/irs-funded-review-confirms-turbotax-hid-free-filing-from-search-engines-but-says-theres-no-need-for-major-changes>.

7 National Taxpayer Advocate 2018 Annual Report to Congress 65-78 (Most Serious Problem: *Free File: The IRS's Free File Offerings Are Underutilized, and the IRS Has Failed to Set Standards for Improvement*).

8 Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998).

9 Free On-Line Electronic Tax Filing Agreement Entered Into Between the IRS and the Free File Alliance, LLC (effective as of Oct. 30, 2002), <https://www.irs.gov/pub/irs-utl/2002-free-online-electronic-tax-filing-agreement.pdf> (hereinafter 2002 Free File Agreement); IRS, Free File: About the Free File Alliance, <https://www.irs.gov/e-file-providers/about-the-free-file-alliance> (last visited Oct. 20, 2019) (provides links to each Free File program agreement and MOU).

10 2002 Free File Agreement at 3-4.

11 *Id.* at 2.

12 *Id.* at 1. Dept. of Treas., *Treasury, IRS Announce New Efforts to Expand E-Filing* (Jan. 30, 2002), <https://www.treasury.gov/press-center/press-releases/Pages/po964.aspx>.

Beginning with the 2006 Free File Memorandum of Understanding (MOU), the IRS has “pledged to not enter the tax preparation software and e-filing services marketplace.”<sup>13</sup>

The IRS has renewed its agreement multiple times, including the most recent agreement with FFI, signed on October 31, 2018.<sup>14</sup> FFI currently consists of 11 private-sector companies.<sup>15</sup> Amendments to the agreement have included broadening the scope of eligibility for the Free File program to 70 percent of all taxpayers, heightening security and privacy requirements, and requiring members to provide an electronic Free File indicator on returns to allow the parties to track usage.<sup>16</sup> During the 2019 filing season, taxpayers with adjusted gross incomes (AGIs) of less than \$66,000 were eligible to use Free File software.<sup>17</sup>

### *IRS Engaged MITRE to Assess Free File Program*

In 2019, ProPublica issued a series of articles accusing the FFI of not acting in the best interests of taxpayers by steering them away from free preparation software options.<sup>18</sup> In response, the IRS engaged MITRE to independently assess the program. Among the many findings and recommendations included in the MITRE report, the National Taxpayer Advocate believes the following are the most significant:

- **Search Engine Avoidance:** Five of the FFI member companies used a coding device to prevent taxpayers from finding their Free File program page when searching the internet for the program.<sup>19</sup>
- **Program Oversight:** The public-private partnership has room for improvement, but current compliance processes are “adequate and effective to support the integrity of the program.”<sup>20</sup>
- **Taxpayer Participation:** The often-cited low participation numbers are misleading because they do not factor in taxpayer choice and behavior.<sup>21</sup>

### **Deceptive Marketing Practices Steer Taxpayers Away From Free File Program Options**

The MITRE 2019 Free File Report confirmed that five of the FFI member companies used a coding device to exclude their Free File landing page from organic searches on search engines such as Google or Bing.<sup>22</sup> The members took the position that such practice keeps them in compliance with the MOU language requiring the program software to be accessible only through IRS.gov.<sup>23</sup> In addition, seven members bought ads for keywords relating to free tax filing that directed traffic toward their fee-based software products.<sup>24</sup> As result, MITRE recommended that the next negotiated MOU address the IRS position on this issue.

13 2006 Free File MOU at 4.

14 2018 Free File MOU.

15 At the date of execution of the 2018 Free File MOU, there were 12 members of FFI. However, one member (Drake) dropped out of the group in July 2019. Therefore, herein, we refer to 11 member companies. MITRE, IRS, Wage and Investment, IRS Free File Program, *Independent Assessment of the Free File Program: Free File Program Assessment Final Report*, iii n.2 (Oct. 3, 2019).

16 2006 Free File MOU at 4.

17 It is our understanding that taxpayers with adjusted gross income of \$69,000 or less will be eligible to use Free File software to prepare and e-file returns during the 2020 filing season. IRS, Draft Instructions to Tax Year 2019 Form 1040 and 1040-SR (Oct. 10, 2019). See Free File: Do Your Federal Taxes for Free, <https://www.irs.gov/filing/free-file-do-your-federal-taxes-for-free> (last visited Oct. 23, 2019).

18 ProPublica, *The TurboTax Trap: How Tax Prep Industry Makes You Pay*, <https://www.propublica.org/series/the-turbotax-trap> (last visited Oct. 20, 2019).

19 MITRE 2019 Free File Report at vii.

20 *Id.* at viii-ix.

21 *Id.* at x.

22 *Id.* at vi-vii.

23 *Id.* at vi.

24 MITRE 2019 Free File Report at vi-vii.



These intentionally deceptive practices by FFI members violate the intent of the MOU, which is to provide Free File options for economically disadvantaged and underserved taxpayers in exchange for the IRS agreeing to not provide such services. While the IRS attempts to protect these taxpayers by ensuring free services through the MOU, FFI is capitalizing on the confusion and potential unsophistication of these taxpayers by purposefully directing them to fee-based services in lieu of the free services they are required to provide. The National Taxpayer Advocate believes that the IRS should explicitly prohibit this practice in the MOU to protect taxpayers' *right to be informed* and *to quality service*. Further, the IRS should collaborate with the National Taxpayer Advocate and the industry to determine the best way to eliminate confusion between Free File program products and other free software offered by FFI members.

### Cross-Marketing of Other For-Fee Services on Free File Program Software Products Can Confuse Taxpayers and Gives the Impression of IRS Endorsement

Despite the fact that all Free File program software products are accessed through the official IRS.gov website, marketing of fee-based products and services through the program platform still occurs. The National Taxpayer Advocate commends the IRS for including important amendments to strengthen taxpayer protections and limit the marketing of paid services by FFI members in the 2018 Free File MOU. The new MOU includes language requiring software providers to automatically return taxpayers to the IRS Free File page if they don't qualify for an offer, preventing software providers from upselling their other products through "value-add" buttons on landing pages.<sup>25</sup> The MOU also contains provisions for limiting email solicitations of taxpayers in subsequent years and requiring Free File software providers to offer returning taxpayers Free File program software products as a first option in subsequent years.<sup>26</sup>

While the 2018 MOU amendments are an improvement, the National Taxpayer Advocate continues to be concerned over the marketing of paid state tax filing services on Free File program software products. While some states offer free filing independent of the Free File program, the 2018 Free File MOU prohibits the IRS from making taxpayers aware of these services.<sup>27</sup> By providing links on the Free File program software to software providers marketing paid state-return options and not advertising the other free state options available, the IRS is in effect endorsing these for-fee products. Thus, rather than providing a service that meets taxpayers' needs, Free File program software has the potential to mislead taxpayers and ensnare them in for-fee product offerings. This behavior impinges taxpayers' *rights to be informed*, *to quality service*, and *to confidentiality* as well as undermines the purpose of the Free File program.

- 25 IRS News Release IR-2018-213, IRS, Free File Alliance Announce Changes to Improve Program; Improved Taxpayer Options Available for 2019 Free File Program (Nov. 2, 2018), <https://www.irs.gov/newsroom/irs-free-file-alliance-announce-changes-to-improve-program-improved-taxpayer-options-available-for-2019-free-file-program>. See also 2018 Free File MOU § 4.32.2 (requiring Members to "provide, as a first option, a prominent hyperlink for the taxpayer to return to the IRS Free File Landing Page" if the taxpayer "enters a Member's Free File Landing Page and begins to complete a return but ultimately cannot qualify for the Member's free offer."); § 4.32.6 ("Members shall not include a "value-added" button (i.e., an icon, link or any functionality that provides a taxpayer with access to a Member's commercial products or services) on the Member's Free File Landing Page.").
- 26 See also 2018 Free File MOU § 4.14 (A returning taxpayer must "be given a first option to return to the Member's Free File offer before receiving any other alternative choices for the Member's publicly available commercial tax preparation products or services."); 2018 Free File MOU § 4.32.4 ("Free File Members shall communicate not less than once annually via email with their taxpayer customers who used Free File services and completed their returns through Free File in the immediately preceding tax year prior to the opening of the following tax season. The content of this email(s) shall only remind the taxpayer about the availability of the Member's Free File offer and invite them to return to the Member's Free File Landing Page. Free File Members shall not use these communications to communicate with the taxpayer about any non-Free File commercial products or services. No marketing, soliciting, sale or selling activity, or electronic links to such activity, will be permitted in these email(s).").
- 27 See 2018 Free File MOU § 4.21. The 2018 Free File MOU specifies that providing links from "the IRS Free File Website to Non-Free File State Department of Revenue websites is grounds for FFI to immediately dissolve its obligations in this MOU." 2018 Free File MOU § 4.22.

### Less Than Two Percent of Tax Year 2018 Individual Tax Returns Were Prepared Using Free File Program Software

The Free File program was created to help the IRS reach the 80 percent statutory e-file goal included in RRA 98.<sup>28</sup> However, with a current e-file rate of about 89 percent, and less than two percent (approximately 2.5 million returns) of total filers using Free File program software, the IRS has surpassed its goal with minimal contribution from the program.<sup>29</sup> The MITRE 2019 Free File report argues that many taxpayers prefer to use other return preparation methods, leaving the true pool of Free File eligible taxpayers at about 30 million, which is substantially lower than the roughly 105 million taxpayers the National Taxpayer Advocate believes are eligible to use the program (70 percent of all individual taxpayers).<sup>30</sup> However, the National Taxpayer Advocate disagrees with the report's assessment because it does not consider the reasons why eligible taxpayers chose other preparation methods. For example, some eligible taxpayers could have used paid return preparers or fee-based commercial software products because they were unaware of the Free File program, while others are unable to use the program due to its eligibility restrictions and language limitations. Taxpayers who do use the program have little guidance in the Free File Software Lookup Tool about the strengths and weaknesses of each software package's offering prior to selection and may begin preparing a return only to find the program lacks the capability to prepare the return or to fully capture the deductions and credits available to the taxpayer.<sup>31</sup> Moreover, 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.<sup>32</sup>

Since 2006, all Free File MOUs specifically highlight economically disadvantaged and underserved populations as the targeted groups for Free File services.<sup>33</sup> Taxpayers in vulnerable groups typically have limited disposable income and free time to spend on tax return preparation. In addition, age restrictions sharply curtail the number of Free File Program software options available to elderly taxpayers.<sup>34</sup> While the IRS offers the Tax Counseling for the Elderly program to assist taxpayers age 60 or older with return preparation, this program is not designed to serve every taxpayer in this age range.<sup>35</sup> Free on-demand electronic tax preparation service is still a valuable resource for taxpayers in this demographic. However, only four of the 11 FFI providers offer services to taxpayers of all ages, and even these have use restrictions based on the taxpayer's state of residence, income, or eligibility for the Earned Income Tax Credit.<sup>36</sup> In addition, four of the 11 FFI providers have age limitations that start before the age of 60.<sup>37</sup>

28 See RRA 98, Pub. L. No. 105–206, § 2001, 112 Stat. 685, 723.

29 IRS response to TAS fact check (Dec. 20, 2019).

30 The report concludes that the pool of eligible taxpayers should only include taxpayers who prefer “do-it-yourself” preparation methods; thereby excluding taxpayers who chose paid or volunteer return preparers. MITRE 2019 Free File Report at x.

31 See IRS, Free File Software Lookup Tool, <https://apps.irs.gov/app/freeFile/jsp/wizard.jsp> (last visited Oct. 20, 2019); MITRE 2019 Free File Report at 73.

32 IRS response to TAS fact check (Dec. 20, 2019).

33 2006 Free File MOU at 4.

34 MITRE 2019 Free File Report at 8. Seven of the 11 FFI members prevent taxpayers ranging from ages 53-70 from using their Free File program. MITRE 2019 Free File Report at 8.

35 IRS, Tax Counseling for the Elderly, <https://www.irs.gov/individuals/tax-counseling-for-the-elderly> (last visited Oct. 20, 2019); IRS Pub. 3676-B, IRS Certified Volunteers Providing Free Tax Help (Oct. 2015).

36 For example, one FFI software provider makes its services available to all ages, but the taxpayer must have AGI of less than \$34,000 or be eligible for the Earned Income Tax Credit. See Free File Software Offers, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited Oct. 15, 2019); MITRE 2019 Free File Report at 8.

37 See Free File Software Offers, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited Oct. 15, 2019); MITRE 2019 Free File Report at 8.

These age restrictions make it more difficult for elderly taxpayers to choose a preparation method suited to their needs and preferences and affects their *right to a fair and just tax system*.

Moreover, English as a Second Language (ESL) taxpayers face difficulty navigating and using Free File software. In the 2018 Free File MOU, the IRS chose making tax filing easier for underserved populations a key objective and even required members to provide a Spanish Free File indicator to show how many taxpayers took advantage of such services.<sup>38</sup> However, during Filing Season 2019, only one Free File option was available in a language other than English (Spanish), and the offer was not available to taxpayers over age 50.<sup>39</sup> A 2015 TAS study showed that because of language barriers and less education, Spanish-speaking taxpayers may be especially vulnerable to unscrupulous return preparers who promote high-interest loans and charge high fees.<sup>40</sup> Thus, there is a great need for the IRS to make available several options for free tax return preparation assistance that it has vetted for Spanish-speaking taxpayers, as well as other ESL taxpayers. Limitations in service can drive these taxpayers to costly paid preparer options.

The MOU limits the IRS's ability to provide free file services in exchange for FFI filling the void and providing those services to the majority of taxpayers (*i.e.*, 70 percent with emphasis on economically disadvantaged and underserved populations). However, the poor usage numbers indicate that the void still exists. Free File is a critical service to this group of vulnerable taxpayers, most of whose only contact with the IRS will be the filing of the return. Thus, the IRS should ensure that the MOU provides an easy, assessable free file platform for these taxpayers.

To achieve a discernible increase in Free File participation, the National Taxpayer Advocate recommends that before entering into a new agreement with FFI, the IRS conduct research studies, develop actionable goals, create measures evaluating taxpayer awareness and satisfaction, test each member's software, provide options for ESL taxpayers, and conduct more outreach.<sup>41</sup> Taking these steps before negotiating a new MOU will protect taxpayers' *rights to be informed, to quality service, and to a fair and just tax system*. However, if the Free File program cannot attain (1) a significantly higher usage rate (*e.g.*, ten percent of the 70 percent of taxpayers eligible to use the program) and (2) a retention rate of 75 percent of taxpayers who used Free File in the preceding year by filing season 2025, it is in the best interests of taxpayers to replace the program with an alternative approach to make the tax software available to taxpayers at no or low cost.<sup>42</sup>

### The IRS Does Not Conduct Routine Quality Testing of the Program Software

The IRS has not taken sufficient steps to evaluate the quality of the return preparation in the Free File program. To ensure program standards are being met, the 2018 Free File MOU emphasizes the “in-place

38 2018 Free File MOU at 5, 18; 2015 Free File MOU at 5, 16.

39 See IRS, Free File: Ofrece el Software en Español, <https://www.irs.gov/es/filing/free-file-ofrece-el-software-en-espanol> (last visited Oct. 12, 2019).

40 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, at 102 (Research Study: *Understanding the Hispanic Underserved Population*). TAS research has shown that only six percent of Hispanic taxpayers used a free tax preparation service by a trained volunteer, while 60 percent used a paid tax return preparer other than an attorney, CPA, or enrolled agent. *Id.*

41 See MITRE 2019 Free File Report at 79-88.

42 Among taxpayers who used Free File software in 2017, nearly half (47 percent) did not use Free File software again in 2018. IRS response to TAS fact check (Dec. 20, 2019).

review process” for the program rather than adding any new initiatives.<sup>43</sup> The “in-place review process” occurs once prior to filing season and once during filing season. This review is mainly to ensure the software providers’ technical compliance with the Free File MOU and does not evaluate the quality of the offerings from Free File software providers.<sup>44</sup> Thus, the National Taxpayer Advocate is concerned that merely reemphasizing the current limited reviews in the 2018 MOU will not adequately gauge the experiences of taxpayers using the program. The 2018 MOU does specifically assign the FFI members the responsibility to “provide the necessary support to accomplish a customer satisfaction survey.”<sup>45</sup> The National Taxpayer Advocate believes customer satisfaction surveys coupled with routine quality testing are necessary to provide effective oversight by enabling the IRS to evaluate whether the software programs are meeting the needs of taxpayers and accurately preparing returns. The IRS and FFI should work together to collect data through customer satisfaction surveys.

Conducting robust demographics analysis and satisfaction surveys, along with testing of taxpayer scenarios, would help the IRS determine why particular groups use or do not use the Free File offerings, which providers are offering inadequate services, and how it can improve its agreement with FFI to better meet the needs of taxpayers.<sup>46</sup> By neglecting to measure and evaluate the Free File program, the IRS is missing a valuable opportunity to fulfill its promises in the 2018 Free File MOU to make the program more taxpayer-friendly. The IRS should work with the National Taxpayer Advocate to develop meaningful measures and better oversight, including routine quality testing, to better ensure the offerings provided on Free File fulfill the *right to quality service*.

## CONCLUSION

The IRS’s Free File program in its current format has become an ineffective relic of early efforts to increase e-filing. Rather than being a beneficial program providing free return preparation services, it provides limited services and is used by only a small percentage of eligible taxpayers. To increase participation, the IRS must first understand why eligible taxpayers choose their particular method of return preparation, including fee-based options. Further, before the IRS negotiates another agreement with the FFI, it must set actionable goals that address issues currently faced by taxpayers and establish measures to assess whether those goals are being met. The IRS must monitor and perform quality testing of the products and present taxpayers with more information so they can make an informed choice about whether to use each product. When the services provided by FFI fail to meet the needs and preferences of taxpayers, particularly in underserved communities, it reflects poorly on the IRS and can further erode taxpayers’ trust in fair tax administration.

43 IRS News Release IR-2018-213, Free File Alliance Announce Changes to Improve Program; Improved Taxpayer Options Available for 2019 Free File Program (Nov. 2, 2018). <https://www.irs.gov/newsroom/irs-free-file-alliance-announce-changes-to-improve-program-improved-taxpayer-options-available-for-2019-free-file-program>.

44 These reviews accomplish the following: validate that the software has acquired the appropriate security and privacy certifications; test that a filer can easily prepare, file, print, download and save a tax return using the Free File software; ensure ancillary services/products, Refund Anticipation Checks and Refund Anticipation Loans are not being offered; ensure third party security and privacy certifications have been acquired to assure industry security and privacy standards and practices are being used; validate a guarantee of calculations is provided by each company. IRS response to TAS information request (Sept. 7, 2018). See also MITRE 2019 Free File Report at 55-58.

45 2018 Free File MOU at 19.

46 For example, the most recent Free File demographics report from 2015 does not show how many Spanish speaking taxpayers used its services. See Demographics of TY 2015 Traditional Free Filers, Free File Fillable Form Users, True Paper Filers, V-code Filers, and Form 1040 Series Filers, included in IRS response to TAS information request (Sept. 7, 2018).

## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Explicitly prohibit the use of special coding by FFI members to exclude Free File program software from organic searches on search engines.
2. 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.
3. Collaborate with the National Taxpayer Advocate as it responds to the recommendations made in the MITRE 2019 Free File Report.
4. Conduct research to determine why taxpayers eligible to use the Free File program, particularly economically disadvantaged and underserved populations, chose their method of return preparation, including fee-based methods.
5. Develop actionable goals for the Free File program before entering into a new agreement that, among other things, provide targeted use percentages aimed to substantially increase taxpayer usage and increase the percentage of taxpayers who continue to use the program from year to year.
6. 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.
7. Conduct customer satisfaction surveys and routine quality testing of each Free File program software product to determine clarity of prompts, accuracy of preparation, ease of navigation, and coverage of forms and schedules.
8. Redesign the Free File Software Lookup Tool to better direct taxpayers to software providers that best meet their circumstances.
9. Provide more Free File program options for ESL taxpayers.
10. Prepare an advertising and outreach plan to make taxpayers, particularly in underserved communities, aware of the Free File program.

### Legislative Recommendations to Congress

The National Taxpayer Advocate recommends that Congress:

1. 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.<sup>47</sup>
2. Direct the IRS to set a goal of increasing the usage rate of the Free File program to 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.<sup>48</sup>

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<sup>47</sup> For more details on this legislative recommendation, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 19 (Direct the IRS to Set Goals of Substantially Increasing the Usage Rate and the Retention Rate of the Free File Program by Filing Season 2025 and to Replace Free File With An Alternative Approach If Those Goals Are Not Attained)*.

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

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

Carol Campbell, Director, Return Preparer Office  
 Eric Hylton, Commissioner, Small Business/Self-Employed Division  
 Ken Corbin, Commissioner, Wage and Investment Division  
 Elizabeth Kastenber, Acting Director, Office of Professional Responsibility

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Confidentiality*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

**PROBLEM**

With over 80 million tax year (TY) 2018 individual tax returns prepared by return preparers, and preparers interacting on a regular basis with most functions of the IRS, the development of a comprehensive return preparer strategy is long overdue.<sup>2</sup> As the IRS works to develop a comprehensive taxpayer service strategy, it is critical that the needs of return preparers are included in this effort.<sup>3</sup> However, a return preparer strategy needs to address more than just service to preparers. During 2019, in response to a recommendation by the Treasury Inspector General for Tax Administration (TIGTA) that the IRS develop a “preparer misconduct strategy,” the Small Business/Self-Employed (SB/SE) Operating Division led a cross-functional effort to develop a “coordinated Servicewide Return Preparer Strategy.”<sup>4</sup> The resulting strategy focuses on return preparer misconduct issues, which are only one component of a truly comprehensive servicewide return preparer strategy.<sup>5</sup> In addition to addressing misconduct issues,

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

2 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File (IRTF) Entity file (data updated Oct. 24, 2019); IRS response to TAS fact check (Nov. 8, 2019).

3 See Most Serious Problem: *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*, *supra*.

4 TIGTA, Ref. No. 2018-30-042, *The Internal Revenue Service Lacks a Coordinated Return Preparer Strategy to Address Unregulated Return Preparer Misconduct* (July 25, 2018).

5 IRS, SB/SE, *Servicewide Preparer Strategy: Taxpayer Advocate Team Member Overview* (Mar. 25, 2019). The National Taxpayer Advocate has long proposed the need for the IRS to develop a servicewide return preparer strategy. See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*).



the National Taxpayer Advocate recommends that the IRS develop a comprehensive return preparer 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.

## IMPACT ON TAXPAYERS

### Background

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. Attorneys, certified public accountants (CPAs), and enrolled agents (EAs) must pass competency examinations and satisfy continuing education requirements. In addition, the IRS requires volunteer preparers to pass competency examinations as part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs.<sup>6</sup> However, most paid preparers are non-credentialed and are not required to pass any competency tests or take any educational courses on tax return preparation.<sup>7</sup> The evolution of the commercial tax return preparation and filing industry has made it easier for inexperienced and untrained preparers to enter into the business without having any knowledge of tax law.<sup>8</sup>

Figure 1.6.1 provides information on total TY 2018 Forms 1040 and Forms 1040 filed with Schedule EIC (Form 1040), Earned Income Credit, prepared by different types of preparers.

6 IRS Pub. 5166, IRS Volunteer Quality Site Requirements 5 (Oct. 2018); IRS Pub. 5101, Intake/Interview & Quality Review Training, 2019 Filing Season (Oct. 2018); IRS Pub. 4961, VITA/TCE Volunteer Standards of Conduct – Ethics Training, 2018 Returns (Oct. 2018).

7 As of September 3, 2019, the IRS has issued approximately 779,000 Preparer Tax Identification Numbers (PTINs) in calendar year (CY) 2019, of which over 30,000 are attorneys, 211,000 are CPAs, 218 are enrolled actuaries, 56,000 are enrolled agents, 684 are enrolled retirement plan agents, and 60,000 are Annual Filing Season Program (AFSP) Record of Completion Holders. IRS Return Preparer Office, Return Preparer Office Federal Tax Return Preparer Statistics (Oct. 1, 2019).

8 For a detailed discussion of the participants in the tax preparation industry, see Government Accountability Office (GAO), GAO-19-269, *Tax Refund Products: Product Mix Has Evolved and IRS Should Improve Data Quality* 4-9 (Apr. 2019).

**FIGURE 1.6.1, Tax Year 2018 Forms 1040 and Forms 1040 Filed With Schedule Earned Income Credit by Type of Preparer (Through September 26, 2019)<sup>9</sup>**

Type of Preparer	Forms 1040	Percentage of Total Forms 1040	Forms 1040 with Schedule EIC	Percentage of Total Forms 1040 with Sched. EIC
Unenrolled Preparer	38,419,176	53%	9,613,511	76%
Attorney	824,042	1%	46,574	0%
Certified Acceptance Agent	504,596	1%	118,646	1%
Certified Public Accountant	20,433,903	28%	1,092,920	9%
Enrolled Agent	9,120,259	13%	1,040,972	8%
Enrolled Actuary	12,709	0%	3,594	0%
Enrolled Retirement Plan Agent	137	0%	64	0%
State-Regulated Tax Preparer	3,531,971	5%	711,408	6%
<b>Total</b>	<b>72,846,793</b>	<b>100%</b>	<b>12,627,689</b>	<b>100%</b>

As the figure indicates, unenrolled preparers prepared about 53 percent of all TY 2018 Forms 1040 and about 76 percent of all Forms 1040 filed with a Schedule EIC through September 26, 2019.

### *Pre-Loving Return Preparer Program*

Since 2002, the National Taxpayer Advocate has recommended that Congress authorize the IRS to conduct preparer oversight.<sup>10</sup> The proposals included a program to register, test, and certify unenrolled preparers as well as increase preparer penalties and improve due diligence requirements. The National Taxpayer Advocate also recommended that the IRS mount a comprehensive taxpayer education campaign to inform taxpayers how to choose a competent preparer and remind them to obtain a copy of the tax return with the preparer's signature.<sup>11</sup> Such proposed oversight has received widespread support from various practitioner groups and members of Congress.<sup>12</sup> In 2011, the IRS began to implement a program that included minimum competency standards.<sup>13</sup> However, the program was enjoined in 2013 when a U.S. district court held in *Loving v. IRS* that the IRS does not have the authority to impose preparer standards without statutory authorization.<sup>14</sup> Subsequent to *Loving*, the IRS has failed to develop a truly comprehensive servicewide return preparer strategy separate from the competency standards.

- 9 IRS CDW Return Preparer Providers (RPP), PTIN Table; IRS CDW, Individual Returns Transaction File (IRTF), Form 1040 Table (through Sept. 26, 2019).
- 10 See, e.g., National Taxpayer Advocate 2002 Annual Report to Congress 216-230 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).
- 11 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2002 Annual Report to Congress 216-230 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*); *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. On Oversight of the H. Comm. on Ways and Means, 109th Cong. (2005)* (statement of Nina E. Olson, National Taxpayer Advocate).
- 12 See National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 16 (Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers)*.
- 13 See IRS Pub. 4832, *Return Preparer Review* (Dec. 2009).
- 14 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. 2013), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

### *The IRS's Voluntary Annual Filing Season Program*

In the absence of mandatory minimum competency standards, the IRS created the voluntary Annual Filing Season Program (AFSP) to encourage the accurate preparation of individual income tax returns by unenrolled preparers. In addition to satisfying annual continuing education requirements and annually renewing their preparer tax identification number (PTIN), participating preparers must consent to adhere to the duties, restrictions, and sanctions relating to practice before the IRS in Circular 230.<sup>15</sup> Upon completion of these requirements, preparers receive a Record of Completion, which enables them to represent taxpayers before the IRS during an examination of a tax return or claim for refund they prepared.<sup>16</sup> In addition, they are included in a public database of return preparers on the IRS website.<sup>17</sup> As of October 1, 2019, the IRS had issued approximately 60,000 AFSP Records of Completion in calendar year (CY) 2019.<sup>18</sup>

### *As the IRS Develops a Comprehensive Customer Service Strategy, It Must Address Service to Return Preparers*

The Taxpayer First Act requires the IRS to create and submit a comprehensive customer service strategy to Congress by July 1, 2020.<sup>19</sup> Considering that millions of taxpayers choose to interact with the IRS through their preparers, the customer service strategy would be incomplete without including service to those preparers.<sup>20</sup> Accordingly, the teams developing the return preparer and customer service strategies should coordinate to ensure both strategies are consistent and comprehensive.

### *The IRS Is Developing a Return Preparer Misconduct Strategy in Response to a 2018 TIGTA Report*

In July 2018, TIGTA issued a report criticizing the IRS for not having a coordinated preparer strategy, despite the availability of significant information about preparer misconduct.<sup>21</sup> In response to a recommendation in TIGTA's report, the IRS formed a cross-functional team, headed by SB/SE, to develop a draft servicewide return preparer strategy to address preparer misconduct. However, the forthcoming preparer misconduct strategy is only one component of a truly comprehensive strategy. Addressing return preparer misconduct is important, but the IRS needs to address the needs and actions of return preparers holistically.

### **Emphasize the Taxpayer's Right to Retain Representation**

Pursuant to the Taxpayer Bill of Rights (TBOR), taxpayers have the *right to retain representation*. Specifically, TBOR provides that taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. In addition, this right provides that taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford

15 31 C.F.R. Part 10; IRS, Requirements for Annual Filing Season Program Record of Completion, <https://www.irs.gov/tax-professionals/general-requirements-for-the-annual-filing-season-program-record-of-completion> (Sept. 4, 2019); Rev. Proc. 2014-42, I.R.B. 2014-29 (July 14, 2014).

16 Rev. Proc. 2014-42, I.R.B. 2014-29 (July 14, 2014).

17 IRS, Directory of Federal Tax Return Preparers with Credentials and Select Qualifications, <https://irs.treasury.gov/rpo/rpo.jsf> (last visited Sept. 4, 2019).

18 IRS Return Preparer Office, Return Preparer Office Federal Tax Return Preparer Statistics (Oct. 1, 2019).

19 See Taxpayer First Act, Pub. L. No. 116-25, § 1101, 133 Stat. 981 (2019).

20 See Most Serious Problem: *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*, *supra*.

21 TIGTA, Ref. No. 2018-30-42, *The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct* (July 25, 2018).

representation.<sup>22</sup> Emphasizing this taxpayer right in the high-level return preparer strategy would send a strong message to all IRS employees that they must respect, support, and vigorously protect this fundamental right as they develop and implement strategies and procedures throughout the agency. Representation helps both taxpayers and the IRS resolve disputes. In addition, taxpayers' representatives play an important role in obtaining fair and equal treatment of taxpayers and access to justice.

### Encourage Preparer Competency

An effective return preparer strategy should take a proactive approach by encouraging preparer competency within the bounds of the IRS's authority post-*Loving*. While the IRS does not have the authority to impose minimum competency requirements after *Loving*, it still has tools to encourage preparers to improve the quality of their return preparation services. For example, the IRS could likely increase preparer compliance by incorporating robust outreach and education initiatives into its preparer strategy. The strategy should include initiatives to educate preparers through several forms of media — not solely through the internet — such as by mail, email, or face-to-face meetings. Most importantly, the strategy should aim to touch preparers *before* the detection of any preparer misconduct. In fact, the IRS should attempt to reach new unenrolled preparers before they even start preparing returns. The IRS could identify these new preparers through the PTIN registration system.

In addition, the strategy should address the low participation in the IRS's AFSP, with approximately 60,000 record of completion holders for the AFSP in CY 2019.<sup>23</sup> The National Taxpayer Advocate previously raised concerns about the lack of an official examination component of this voluntary program.<sup>24</sup> The IRS Return Preparer Office responded by noting adding an official exam requirement would potentially increase the costs of the program to prohibitive levels and reduce participation even further.<sup>25</sup> However, the IRS could counter this effect by increasing the incentives to participate, such as granting access to certain online applications.<sup>26</sup>

**The Taxpayer First Act requires the IRS to create and submit a comprehensive customer service strategy to Congress... Considering that millions of taxpayers choose to interact with the IRS through their preparers, the customer service strategy would be incomplete without including service to those preparers.**

22 IRC § 7803(a)(3); TAS, *Taxpayer Bill of Rights*, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

23 IRS Return Preparer Office, Return Preparer Office Federal Tax Return Preparer Statistics (Oct. 1, 2019).

24 National Taxpayer Advocate 2017 Annual Report to Congress 46, 36-48 (Most Serious Problem: *Online Accounts: The IRS's Focus on Online Service Delivery Does Not Adequately Take Into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population*). There is no official exam component for AFSP participation. However, there is a test administered by the continuing education (CE) provider at the conclusion of the Annual Federal Tax Refresher (AFTR) course about the course material. The participant must pass the test in order to receive credit for the six-hour course. There are no tests associated with the other 12 hours of CE courses needed for AFSP participation. IRS response to TAS fact check (Nov. 8, 2019).

25 Telephone Meeting Between TAS and the IRS Return Preparer Office (June 17, 2019).

26 See National Taxpayer Advocate FY 2020 Objectives Report, vol. 3 (Special Report: *Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*).

### Address the Current Lack of Transparency in Preparer Fees

Taxpayers have the *right to be informed*, and this includes receiving a detailed breakdown of fees charged for the preparation and filing of their federal income tax returns. The National Consumer Law Center (NCLC) recently noted that it is common practice among unenrolled preparers to refuse to provide upfront fee information to taxpayers. The Government Accountability Office confirmed the NCLC's statements when it conducted undercover preparer visits during a recent investigation on refund products.<sup>27</sup>

The lack of transparency in fees at the outset of the preparation engagement prevents taxpayers from comparison shopping or even from predicting the cost before entering into the transaction. Not allowing the taxpayer to predict the cost of preparation and filing also sets the stage for the preparer to sell the taxpayer ancillary refund products, such as Refund Anticipation Checks (also known as Refund Transfers), to pay the unpredicted preparation fees.<sup>28</sup> IRS Publication 1345, Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns, provides that all authorized e-file providers should “[a]dvise taxpayers of all fees and other known deductions to be paid from their refund and the remaining amount the taxpayers will receive.”<sup>29</sup> However, this language is located in the refund products section of the publication and only seems to apply to returns claiming refunds. Further, it is unclear if the IRS actually enforces this provision in its administrative guidance. The IRS needs a strategy to ensure compliance with fee requirements and provide appropriate sanctions, including suspension of status as an authorized IRS e-file provider.

### Incorporate a Taxpayer Education Campaign on What to Expect From Return Preparers

Because the IRS does not have the resources to maintain widespread geographic presence to enforce preparer requirements, it must empower taxpayers to protect themselves. Taxpayer communications are just as important as preparer communications in a return preparer strategy. Failure to incorporate taxpayer communications into the preparer strategy could result in a less effective or disjointed communications strategy on preparer-related topics. Accordingly, the strategy should include a comprehensive taxpayer education campaign, particularly to low-income, immigrant, and other taxpayer populations that are vulnerable to unskilled and unethical preparers.<sup>30</sup> The education campaign should provide information on preparer roles, responsibilities, and requirements (such as signing the return, entering their PTIN on the return, and providing a copy of the completed and signed return to the taxpayer).<sup>31</sup> The campaign should also inform taxpayers how to report preparer misconduct.

27 Mandi Matlock and Chi Chi Wu, NCLC, *2019 Tax Season: The Return of the Interest-Bearing Refund Anticipation Loan and Other Perils Faced by Consumers* 11 (Apr. 2019); GAO, GAO-19-269, *Tax Refund Products: Product Mix Has Evolved and IRS Should Improve Data Quality* 36-40 (Apr. 2019).

28 A RAC or Refund Transfer is the most common refund product whereby the preparer receives the refund in a temporary bank account, deducts the preparer and ancillary fees, and pays the remainder to the taxpayer. See also, GAO, GAO-19-269, *Tax Refund Products: Product Mix Has Evolved and IRS Should Improve Data Quality* 40 (Apr. 2019). In 2017, the National Taxpayer Advocate recommended that the IRS require all Electronic Return Originators to prepare a “truth-in-lending” statement if they offered a Refund Anticipation Loan (RAL) product. National Taxpayer Advocate 2017 Annual Report to Congress 233 (Most Serious Problem: *Refund Anticipation Loans: Increased Demand for Refund Anticipation Loans Coincides with Delays in the Issuance of Refunds*).

29 IRS Publication 1345, Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns 35.

30 National Taxpayer Advocate 2015 Annual Report to Congress 261-283 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*).

31 IRC § 6695.

### Limit Access to Confidential Taxpayer Information Through Online Applications to Only Those Preparers Over Whom the IRS Has Oversight Authority

The National Taxpayer Advocate has recommended that the IRS limit access to the future online account application for tax professionals. Only tax professionals who are subject to IRS oversight under Circular 230 should have access to this application.<sup>32</sup> If Circular 230 professionals misuse information from the application, the IRS has authority to take action. It is TAS's understanding that the IRS has not made a policy decision to limit access to the application.<sup>33</sup> To safeguard confidential taxpayer information, the IRS must ensure it is limiting those who can access its systems. The online account will provide a service to return preparers and the IRS can and should place restrictions on those who can access this service. If the IRS ignores this important consumer protection issue, it could inadvertently perpetuate preparer misconduct.

### Address the Need to Routinely Track Preparer Noncompliance Data by Type of Designation

There is no current IRS initiative to track preparer noncompliance data by type of preparer designation.<sup>34</sup> The IRS already has the ability to track this data if it validates the PTINs entered on returns accepted for processing. Resulting analysis of the noncompliance data will assist the IRS in determining the appropriate level of oversight as well as any necessary preparer treatments. Maintaining this type of data would also potentially support the need for Congress to authorize the IRS to impose minimum competency requirements on unenrolled return preparers. Accordingly, TAS strongly recommends that a return preparer strategy include initiatives to routinely track and analyze noncompliance data by preparer type.

## CONCLUSION

Despite the important role tax return preparers play in the tax system, the IRS has failed to develop a truly comprehensive return preparer strategy. It is vital that such strategy emphasize the taxpayer's *right to retain representation*. It must also focus on improving preparer competency, increasing the transparency of preparer fees, and addressing taxpayer communications on what to expect from preparers. Further, the IRS must safeguard taxpayer information by limiting access to the online account for professionals.

An effective strategy would provide for the routine tracking and analysis of preparer noncompliance by preparer type. We strongly believe that TAS participation in the development of such strategy is vital given our wealth of knowledge gained from TAS's decades of experience in assisting taxpayers impacted by incompetent and unscrupulous preparers, as well as our extensive interactions with return preparers.<sup>35</sup> Finally, because representatives are also customers of the IRS and their needs are often different than those of taxpayers, we believe that the development of the return preparer strategy must coincide with the development of the comprehensive taxpayer service strategy mandated by the Taxpayer First Act.<sup>36</sup>

32 National Taxpayer Advocate 2017 Annual Report to Congress 36-48 (Most Serious Problem: *Online Accounts: The IRS's Focus on Online Service Delivery Does Not Adequately Take Into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population*).

33 National Taxpayer Advocate FY 2019 Objectives Report to Congress, vol. 2, at 36-37 (*IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2017 Annual Report to Congress: IRS Response to TAS Recommendation 3-34*).

34 IRS response to TAS information request (July 12, 2019).

35 See National Taxpayer Advocate 2018 Annual Report to Congress 105 (Most Serious Problem: *Return Preparer Oversight: The IRS Lacks a Coordinated Approach to Its Oversight of Return Preparers and Does Not Analyze the Impact of Penalties Imposed on Preparers*).

36 See Taxpayer First Act, Pub. L. No. 116-25, § 1101, 133 Stat. 981 (2019).



## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS develop a comprehensive servicewide return preparer strategy that:

1. References the taxpayer's *right to retain representation* in the mission of the strategy.
2. Increases preparer competency through outreach and education to preparers before any detection of noncompliance.
3. Requires disclosure of fees charged in connection with the preparation and filing of tax returns and enforce such requirements.
4. Includes a comprehensive public education campaign, particularly to low-income and other taxpayer populations that are vulnerable to unskilled and unethical preparers. Such a campaign should provide information to taxpayers about preparer roles, responsibilities, requirements, and reporting misconduct.
5. Limits access to confidential taxpayer information through online applications to only those preparers over whom the IRS has oversight authority.
6. Routinely tracks preparer noncompliance data by type of designation.
7. Collaborates with TAS in the development of the comprehensive servicewide return preparer strategy.
8. Incorporates service to return preparers into the comprehensive taxpayer service strategy mandated by the Taxpayer First Act, because return preparers are customers of the IRS and important vehicles of taxpayer compliance.

### Legislative Recommendation to Congress

The National Taxpayer Advocate recommends that Congress:

1. Amend Title 31, § 330 of the U.S. Code to authorize the Secretary to establish minimum standards for federal tax return preparers.<sup>37</sup>

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<sup>37</sup> For more details on this legislative recommendation, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 16 (Authorize the IRS to Establish Minimum Competency 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

### RESPONSIBLE OFFICIAL

Andrew Keyso, Jr., Acting Chief, Office of Appeals

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

### 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.<sup>2</sup> 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.<sup>3</sup>

### IMPACT ON TAXPAYERS

#### The Participation of Counsel and Compliance in Certain Appeals Conferences Fundamentally Alters the Role of Appeals and Runs Counter to an Independent Appeals Process

Beginning in October 2016, Appeals undertook a concerted effort to expand the participation of IRS Counsel and Compliance personnel in appeals conferences.<sup>4</sup> In May 2017, Appeals expanded this approach with a pilot initiative designed to make the inclusion of representatives from the Large Business and International (LB&I) examination audit team a matter of "routine," without requesting taxpayer

- 1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465(b) (July 22, 1998). This priority was recently reinforced by Congress when it established Appeals as an independent organization within the IRS. Taxpayer First Act, Pub. L. No. 116-25, §1001, 133 Stat. 981 (2019). As stated by one member of Congress, "I am proud that the Taxpayer First Act also includes a provision that I had in my bill that I introduced with a Republican colleague, Jason Smith, the Preserving Taxpayers' Rights Act. This provision establishes an independent office of appeals within the IRS and gives taxpayers a legal right to impartial, timely, and efficient dispute resolution." H.R. REP. Vol. 165, No. 61 (2019) (statement of Rep. Sewell). See also H.R. REP. No. 116-39, pt. 1, at 29 (2019).
- 3 These reservations, which were shared by the National Taxpayer Advocate, were discussed in the National Taxpayer Advocate 2017 Annual Report to Congress 203-210 (Most Serious Problem: *Appeals: The IRS's Decision to Expand the Participation of Counsel and Compliance Personnel in Appeals Conferences Alters the Nature of Those Conferences and Will Likely Reduce the Number of Agreed Case Resolutions*).
- 4 Internal Revenue Manual (IRM) 8.6.1.5.4, Participation in Conferences by IRS Employees (Oct. 1, 2016).

consent.<sup>5</sup> This pilot, which applies to large cases run by Appeals Team Case Leaders (ATCLs), negatively impacts affected taxpayers and does not give taxpayers the ability to object to the inclusion of others in the Appeals conference.<sup>6</sup> Currently, smaller cases are excluded from the pilot, and Appeals has indicated that it has no plans to expand coverage of the program to these cases.<sup>7</sup> Nevertheless, Appeals will not rule out inclusion of Counsel or Compliance in specific smaller cases if Appeals believes that such participation will be beneficial.<sup>8</sup>

By definition, Appeals cases arise only when taxpayers and Compliance reach an impasse.<sup>9</sup> Appeals' mission is to facilitate resolution of these cases on a basis that is fair and impartial to both taxpayers and the IRS.<sup>10</sup> In order to minimize litigation and maximize future tax compliance, taxpayers must feel that they have had the opportunity to effectively present their cases in an independent and unbiased venue.<sup>11</sup>

Prior to the 2016 guidance changes, Counsel and Compliance were typically granted their say via the case file and a pre-conference, if the case was particularly large or complex.<sup>12</sup> The Appeals conference itself generally was devoted to presentation of the taxpayer's case and settlement negotiations between the taxpayer and the Appeals Technical Employee (ATE). Counsel and Compliance rarely attended such conferences, leaving taxpayers and ATEs free to develop rapport, seek common ground, and pursue case resolution.<sup>13</sup>

Appeals' new emphasis on including third parties, however, allows Counsel and Compliance to reiterate and even expand their positions, converts Appeals to a more adversarial forum, and limits negotiation between taxpayers and ATEs.<sup>14</sup> As one practitioner observed, "Adding IRS employees to the Appeals conference turns the Appeals conference into more of a trial setting as opposed to the historic conduct of most Appeals conferences."<sup>15</sup> Appeals finds authority for this approach within the Internal Revenue Manual — guidance that Appeals itself created.<sup>16</sup>

Counsel and Compliance are not technically a party to the actual settlement discussions, which occur near the conclusion of the conference.<sup>17</sup> Nevertheless, when Counsel and Compliance are given an opportunity to present an oral argument setting forth their case, this inevitably drives taxpayers and

5 IRS, Appeals Team Cases: All Parties Conferences, <https://www.irs.gov/pub/irs-utl/atclfaqs.pdf> (last visited Nov. 20, 2019).

6 ATCLs manage a team of Appeals Officers who together conduct an appeal for the often-complex cases that originate in the LB&I operating division. IRM 8.7.11.3, Appeals Team Case Leader (ATCL) Position (Sept. 4, 2018).

7 Appeals response to TAS fact check (Oct. 18, 2019).

8 *Id.*

9 Appeals response to TAS information request (June 9, 2017), Tab 3. This category of cases is known as nondocketed Appeals. The other category, docketed Appeals, consists of cases that bypass Appeals on their way to the U.S. Tax Court and then are remanded to Appeals for further consideration.

10 IRM 8.1.1.1, Accomplishing the Appeals Mission (Oct. 1, 2016).

11 Congress recently reaffirmed the importance of an unbiased and objective administrative appeal for taxpayers and enacted provisions to facilitate and protect this independence. See Taxpayer First Act, Pub. L. No. 116-25, §1001, 133 Stat. 981 (2019).

12 Michael I. Saltzman & Leslie Book, *IRS PRACTICE AND PROCEDURE* 9.06 (2016); IRM 8.7.11.8.1, Purpose of Pre-Conference Meeting (Mar. 16, 2015).

13 Chelsea Looper-Stockwell, *Sitting Down with Appeals Chief, Donna Hansberry*, APPEALS QUARTERLY NEWSLETTER, Feb. 2017, at 1-2.

14 Under the pilot, Compliance can raise additional arguments or present new information no later than 45 days prior to the conference. *IRS Outlines Procedures for Appeals Conference Program*, 2019 TNT 175-27 (Sept. 9, 2019).

15 Marie Sapirie, *IRS Appeals Chief Clarifies Policy Changes in Open Letter*, 2016 TNT 215-5 (Nov. 14, 2016).

16 See IRM 8.6.1.5.4, Participation in Conferences by IRS Employees (Oct. 1, 2016).

17 Appeals response to TAS information request (June 19, 2019).

their representatives to respond in kind.<sup>18</sup> This dynamic fundamentally changes the role of appeals conferences and runs the risk of poisoning the environment for the meaningful dialogue between taxpayers, representatives, and ATEs, which can facilitate resolution.

Further, as TAS cautioned when the pilot was first initiated, inviting Counsel and Compliance to attend conferences makes it difficult for Appeals to serve as an unbiased participant in the case resolution process.<sup>19</sup> Compliance is placed in a position to put pressure on ATEs to adopt and sustain the prior asserted outcome and has an opportunity to directly counter the arguments of taxpayers. Additionally, ATEs may be reluctant to override the views of Counsel when Counsel actually has a seat at the table.<sup>20</sup> An ATE may lack the personal confidence or the institutional support necessary to stand firm in exercising independent judgment in the face of opposition from Compliance regarding the strengths and weaknesses of a case, or the assessment of Counsel regarding hazards of litigation.<sup>21</sup> By inviting these parties to conferences as a routine matter, Appeals is undermining its own independent mechanisms for case resolution.

**In order to minimize litigation and maximize future tax compliance, taxpayers must feel that they have had the opportunity to effectively present their cases in an independent and unbiased venue.**

Additional IRS participants cannot help but alter taxpayers' perceptions of the proceedings and the fairness of the outcomes. Taxpayers may not feel they are going before an objective and unrelated party to seek a resolution to their cases; instead, it may seem that they are simply continuing their disagreements with the IRS as an institution, this time with an extra party or two added to the conversation. Such an appearance is a far cry from the independent arbiter envisioned by the IRS Restructuring and Reform Act of 1998: "With this legislation, we require the agency to establish an independent Office of Appeals — one that may not be influenced by tax collection employees or auditors."<sup>22</sup>

Congress reiterated this desire and created the institutional structure necessary to safeguard the availability of objective appeals for taxpayers when it passed the Taxpayer First Act, which was signed into law in July 2019.<sup>23</sup> In establishing Appeals as an independent function within the IRS reporting directly to the Commissioner, Congress recognized that Appeals is taxpayers' last, and sometimes best,

18 Nina E. Olson, *Appeals Should Facilitate Mutual Respect and Trust by Allowing Taxpayers a Choice in the Expanded Participation of Counsel and Compliance in Appeals Conferences*, NTA BLOG, (June 21, 2017), <https://taxpayeradvocate.irs.gov/news/appeals-should-facilitate-mutual-respect-and-trust-by-allowing-taxpayers-a-choice-in-the-expanded-participation-of-counsel-and-compliance-in-appeals-conferences?category=Tax%20News>.

19 National Taxpayer Advocate 2017 Annual Report to Congress 203-210 (Most Serious Problem: *Appeals: The IRS's Decision to Expand the Participation of Counsel and Compliance Personnel in Appeals Conferences Alters the Nature of Those Conferences and Will Likely Reduce the Number of Agreed Case Resolutions*).

20 Rev. Proc. 2012-18, § 2.02(3)(b), 2012-10 I.R.B. 455.

21 The National Taxpayer Advocate has previously suggested steps that would enhance Appeals' independence, such as locating at least one Appeals Officer and Settlement Officer in every state, the District of Columbia, and Puerto Rico, and maintaining separate office space and communication facilities from other IRS personnel. National Taxpayer Advocate 2009 Annual Report to Congress 348, 346-350 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*). This independence could be further strengthened if, as also recommended for TAS, Appeals were provided with an independent Counsel to help Appeals evaluate positions adopted by IRS Counsel. National Taxpayer Advocate 2002 Annual Report to Congress 198 (Legislative Recommendation: *The Office of the Taxpayer Advocate*).

22 RRA 98, Pub. L. No. 105-206, Title III, Subtitle E, § 3465(b) (July 22, 1998); 144 CONG. REC. S7622 (1998) (statement of Sen. Roth).

23 Taxpayer First Act, Pub. L. No. 116-25, §1001, 133 Stat. 981 (2019).

hope to resolve their cases within the IRS.<sup>24</sup> Such case resolutions, however, depend on the ability of taxpayers to receive unbiased and objective case reviews from Appeals. Despite this strong affirmation of the need for Appeals' independence, Appeals continues to conduct business as usual and, by emphasizing the inclusion of Counsel and Compliance in conferences, is disregarding the intention of Congress.

### The Anecdotal Reports of Tax Practitioners Included in the Pilot Validate Prior Reservations About the Inclusion of Counsel and Compliance in Conferences

Often, parties bring hard feelings developed during the examination into Appeals and they spill over into the proceedings. "Counsel and Compliance just end up arguing across the table with taxpayers and the debate only muddies the waters."<sup>25</sup> The impressions and experiences of practitioners participating in the Appeals pilot confirm this contentious relationship. Under the pilot, conferences have become increasingly adversarial and ATEs appear to lack either the ability or the willingness to rein in Counsel and Compliance.<sup>26</sup>

According to Appeals, a primary goal of the pilot is to increase the efficiency of the proceedings.<sup>27</sup> However, the opposite may be occurring. Even though the IRS is hampered by limited resources, conferences conducted under the pilot are extremely large, often involving multiple representatives of Counsel, Compliance, and Appeals, sometimes outnumbering taxpayers and their representatives by a ratio of five to one.<sup>28</sup> Moreover, the proceedings are anything but smooth: "Exam often keeps interrupting the taxpayer's presentation and pushing its own points... Counsel and Compliance say whatever they want and stay as long as they want. The ATE looks helpless, like a parent refereeing a fight."<sup>29</sup> According to one practitioner, some time savings did occur in a case when a discouraged taxpayer walked out in the middle of an appeal and took the case directly to court.<sup>30</sup> Otherwise, some practitioners report that conferences conducted under the pilot are taking longer.<sup>31</sup>

Further, these cases are being resolved in ways that trouble practitioners and that should worry Appeals. According to one practitioner who had several cases in the pilot, "I was not able to reach settlement on a single case where Counsel and Compliance were involved."<sup>32</sup> Multiple practitioners report taking pilot cases to both the U.S. Tax Court and the Court of Federal Claims, where they enjoyed significant success in resolving those cases, typically via pretrial settlement.<sup>33</sup>

In large part, this failure to resolve cases is attributable to the circumstance that, under the pilot, Appeals loses actual and perceived independence. One practitioner related a scenario in which Counsel, Compliance, and Appeals representatives all had breakfast together immediately before the conference commenced and then went out for lunch together, leaving the taxpayer to wonder about the nature of

24 H.R. REP. NO. 116-39, pt. 1, at 29 (2019).

25 TAS conference call with participants from the American Bar Association (ABA) (May 23, 2019).

26 Stephanie Cumings, *IRS Open to Appeals Pilot 'Ground Rules' Checklist*, 2018 TNT 188-6.

27 Chelsea Looper-Stockwell, *Sitting Down with Appeals Chief, Donna Hansberry*, APPEALS QUARTERLY NEWSLETTER, Feb. 2017, at 1-2.

28 Stephanie Cumings, *Appeals Process Getting Crowded Under New Procedures*, 2018 TNT 150-1; TAS conference call with participants from the ABA (May 23, 2019).

29 TAS conference call with participants from the ABA (May 23, 2019).

30 *Id.*

31 *Id.*

32 *Id.*

33 *Id.* While these favorable outcomes are beneficial for taxpayers, they demonstrate that the cases should have been resolved administratively in the first instance. Moreover, such cases subject both taxpayers and the IRS to unnecessary expenditures and case delays.

the relationships and what was being discussed. Another described a Counsel representative begging the ATE not to provide a favorable settlement.<sup>34</sup> Likewise, practitioners have observed that ATEs are unwilling to challenge Counsel's assertions regarding hazards of litigation. Instead, as was explicitly admitted in one case, they seek "buy-in" from Counsel and Compliance regarding the proposed resolution.<sup>35</sup> Given this lack of independence, some practitioners included in the pilot are losing confidence in Appeals. "Previously I found Appeals to be very important in helping to avoid Tax Court. Now these conferences are a waste of time and money."<sup>36</sup>

Appeals has issued guidance that it hopes will reduce these negative experiences and alleviate the continuing concerns of taxpayers and practitioners.<sup>37</sup> This guidance outlines the processes, procedures, and general expectations surrounding pilot conferences. While the procedural clarity provided by these guidelines is welcome, the guidelines do not, in and of themselves, guarantee the preservation of Appeals' independence or the protection of taxpayer rights, and only time will tell the extent to which they are effective.

## IMPACT ON THE INTERNAL REVENUE SERVICE

### Appeals Is Not Gathering Sufficient Data to Adequately Evaluate the Pilot

The pilot was originally designed to run for two years, until May 2019. However, it was extended for a third year through May 2020.<sup>38</sup> The primary quantitative datapoints used to evaluate the pilot will be cycle time and average hours per case.<sup>39</sup> Given that the pilot has already been running for over two years, TAS sought to obtain an initial look at the efficiency of pilot proceedings by requesting a limited amount of data from Appeals. TAS planned to compare cycle times and hours per case in pilot cases against those measures in traditional ATCL cases. Appeals refused to provide this data, stating, "The ATCL pilot is in process and expected to run through May 2020. At this point, it would be premature to provide the data requested... Appeals will evaluate the results of the pilot following its completion."<sup>40</sup>

Currently, cycle times and case hours are the only quantitative measures that Appeals intends to use to evaluate the effectiveness of the pilot.<sup>41</sup> In order to fully gauge the impact of Counsel and Compliance participation, Appeals should also compare outcome data from pilot cases against the results of traditional ATCL cases. Appeals states that it does not track this information, as, in its view, every case is different and comparisons could be misleading.<sup>42</sup> Nevertheless, to adequately evaluate the pilot, Appeals, taxpayers, and their representatives must have some way of verifying that taxpayers are not significantly disadvantaged by the inclusion of Counsel and Compliance in conferences.

34 Andrew Velarde, *Appeals May Seek Taxpayer Feedback on Conference Procedures*, 2018 TNT 121-7.

35 TAS conference call with participants from the ABA (May 23, 2019).

36 *Id.*

37 *IRS Outlines Procedures for Appeals Conference Program*, 2019 TNT 175-27 (Sept. 9, 2019).

38 Appeals response to TAS information request (June 19, 2019).

39 Appeals response to TAS fact check (Oct. 18, 2019). Cycle time is defined as the period between when a case is opened in Appeals and when it is closed out of Appeals. "Average hours per case" reflects the time spent on a case by Appeals personnel. Appeals indicates that it also will be considering the results of the Customer Satisfaction Survey distributed to pilot participants. Although potentially valuable, TAS views these results and the data they generate as qualitative, rather than quantitative.

40 Appeals response to TAS information request (June 19, 2019).

41 Appeals response to TAS fact check (Oct. 18, 2019).

42 Appeals response to TAS information request (June 19, 2019).

Notwithstanding Appeals' reluctance to compile and publish even high-level outcome data, this comparative information can be developed and circulated in a way that is meaningful and helpful to taxpayers and their representatives. For example, TAS tracks outcome data from a taxpayer perspective by measuring the percent of cases receiving full or partial relief based on the type of assistance requested by the taxpayer. If taxpayers and their representatives reach the conclusion that Counsel and Compliance participation makes it unduly difficult to obtain relief in their cases, they likely will begin to bypass Appeals and go directly to court, resulting in delayed case resolutions and increased costs for the IRS.

As one way of gaining insight into the impact of Counsel and Compliance participation in appeals conferences, TAS attempted to compare the ratio of statutory notices of deficiency (SNODs) issued in pilot cases versus SNODs issued in ATCL cases between fiscal years 2014 and 2016. While this inquiry does not directly analyze outcome data on an individual case basis, it would provide a useful snapshot of how case resolutions are potentially affected by Counsel and Compliance participation. If, for example, a high proportion of pilot cases conclude with the generation of a SNOD, this data would correspond with and tend to confirm the anecdotal experiences of tax practitioners, discussed above. Appeals has refused to provide TAS with the requested SNOD data.<sup>43</sup> Moreover, it does not intend to consider such data when evaluating the pilot.<sup>44</sup>

If the pilot study is to be meaningful, Appeals must rely on quantitative data to assess its results. This means looking not only at efficiency data, such as cycle time and hours per case, but also at statistical measures that would allow taxpayers to know whether they are advantaged, disadvantaged, or unimpacted when Counsel and Compliance attend appeals conferences.

Additionally, the reports received from tax practitioners underscore the need for Appeals to systematically obtain evaluations and comments from taxpayers and tax practitioners whose cases are included in the pilot. Appeals is collecting such comments via a survey, but the information to be sought in that survey and whether the results will be made public have not been disclosed.<sup>45</sup>

Appeals must define its constituency, not just as the IRS and Appeals employees, but also as taxpayers and their representatives. Appeals should take very seriously the opinions of taxpayers and practitioners included in the pilot and distribute the results of the follow-up survey. Doing so would evidence willingness to engage with the tax community and understand all aspects of the current pilot; failure to do so would raise the question of whether Appeals is more concerned with cycle time than with its independence and would run the risk of eroding the foundations of objectivity and trust on which Appeals' success depends.

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43 Appeals response to TAS information request (June 19, 2019).

44 Appeals response to TAS fact check (Oct. 18, 2019).

45 Cumings, Stephanie, *IRS Guidelines Provide Insight on Appeals Conference Initiative*, 2019 TNT 175-7 (Sept. 9, 2019); Appeals response to TAS information request (June 19, 2019).

## CONCLUSION

The credibility of Appeals hinges on its ability to undertake direct and unbiased settlement negotiations with taxpayers and their representatives. This credibility and the independence of Appeals, bolstered by the recently passed Taxpayer First Act, are undermined by the participation of Counsel and Compliance in appeals conferences. The ATCL pilot is reportedly giving rise to conferences that are contentious, chaotic, lengthier, and that impact taxpayers' ability to resolve their cases without going to court. This hurts taxpayers by forcing them to incur extra costs and delays, and likewise damages the IRS in the long run by generating additional litigation and associated resource burdens. Appeals should carefully consider the negative impact of these unintended consequences potentially flowing from the inclusion of Counsel and Compliance in conferences. Further, when evaluating the pilot, Appeals should examine a range of data and pay careful attention to the comments and experiences of taxpayers and their representatives.

## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that Appeals:

1. Compile quantitative data regarding the efficiency and outcomes of pilot proceedings and publish that data when the pilot is complete.
2. Carefully consider and publish the reactions of taxpayers and tax practitioners who participate in the pilot.
3. Regardless of the pilot's outcome, only include Counsel and Compliance in appeals conferences with taxpayers' consent. To the extent taxpayers do not agree to this participation, offer the parties the possibility of nonbinding mediation as a means of resolving or narrowing their differences through collaborative exploration of factual and legal disputes prior to an appeals conference.
4. 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****RESPONSIBLE OFFICIALS**

Ken Corbin, Commissioner, Wage and Investment Division  
 Eric Hylton, Commissioner, Small Business/Self-Employed Division  
 Nancy Sieger, Acting Chief Information Officer

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**PROBLEM**

Taxpayers with limited English proficiency (LEP) frequently do not receive notices in their preferred languages, impairing their *right to be informed*. Even when the IRS has a notice already translated into Spanish, taxpayers 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 fiscal year (FY) 2019.<sup>2</sup> Additionally, the IRS website fails to include notices and information about those notices in languages other than English.<sup>3</sup>

**IMPACT ON TAXPAYERS**

LEP persons do not speak English as their primary language and have a limited ability to read, speak, write, or understand English.<sup>4</sup> The United States has an estimated 5.3 million LEP households.<sup>5</sup> Over 22 percent of Spanish-speaking households and over a quarter of Asian and Pacific island language households are LEP households.<sup>6</sup> Pursuant to the Civil Rights Act of 1964,<sup>7</sup> Executive Order 13166 requires all federal agencies to examine their service and develop and implement a system allowing LEP

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

2 During FY 2019, the IRS issued CP 48, Renew Your ITIN, 969,863 times. Yet, during this same period, the IRS issued CP 748, the Spanish version of this letter, only once. IRS, Servicewide Notice Information Program (SNIP) Database (Sept. 18, 2019).

3 While this piece is focused on IRS notices, a similar problem exists for other IRS communications, including IRS Forms, Publications, and website content.

4 67 Fed. Reg. 41459 (June 18, 2002).

5 U.S. Census Bureau, *2013-2017 American Community Survey 5-Year Estimates* (Dec. 2018), [https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS\\_17\\_5YR\\_S1602&prodType=table](https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_17_5YR_S1602&prodType=table).

6 *Id.* Estimates for 2013-2017 are 3,191,985 Spanish speaking LEP households and 1,084,682 Asian and Pacific Island languages LEP households.

7 "No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance." Pub. L. N. 88-352, 78 Stat. 252 § 601.

persons to meaningfully access those services.<sup>8</sup> The Department of Justice issued guidance providing four factors to be considered in ensuring meaningful access:

1. The number or proportion of LEP persons eligible to be served or likely to be encountered by the program or grantee;
2. The frequency with which LEP individuals come in contact with the program;
3. The nature and importance of the program, activity, or service provided by the program to people's lives; and
4. The resources available to the grantee/recipient and costs.<sup>9</sup>

Meeting one's legal tax filing and payment obligations or claiming one of the many federal benefits administered through the tax code is fundamentally important to taxpayers' lives. From objecting during an examination, to claiming appeal rights, to demonstrating a hardship caused by collection, taxpayers must be able to understand what the correct amount of tax should be, why the IRS is taking an action, and what rights they can exercise. Balancing the other factors such as the number of LEP taxpayers, the frequency of taxpayer contacts, and resource requirements, the IRS should provide notices in languages other than English in order to provide meaningful access to IRS services.

### Many IRS Notices Providing Statutory Rights or Fulfilling Statutory Directives Are Not Translated Into Languages Other Than English

The IRS only translates some important statutory notices into Spanish and none into languages other than English or Spanish.<sup>10</sup> For example, the statutory notice of deficiency (SNOD), which the law requires the IRS to issue, provides taxpayers with the statutory right to appeal the liability in U.S. Tax Court, the only opportunity the taxpayer has to challenge the liability in court prior to paying it.<sup>11</sup> The notice provides a deadline by which the taxpayer must exercise this right and is accompanied by a waiver, which allows a taxpayer to choose to give up the important right of appealing the decision in court. However, of the five most commonly issued versions of this notice, only two are available in Spanish and none are available in any languages other than English or Spanish.<sup>12</sup> The offer in compromise rejection letter, which provides the taxpayer with the statutory right to receive an independent review of the rejection by the IRS Office of Appeals, is only available in English.<sup>13</sup>

8 65 Fed. Reg. 50121 (Aug. 16, 2000).

9 70 Fed. Reg. 6069 (Feb. 4, 2005).

10 IRS response to TAS information request (June 28, 2019).

11 IRC §§ 6212(a), 6213(a).

12 The five English versions are Letter 3219, Notice of Deficiency; Notice CP 3219A, Automated Under Reporter (AUR) Statutory Notice of Deficiency; Letter 3219B, Business Master File (BMF) AUR Statutory Notice of Deficiency - 90 Day Letter; Letter 3219C, Statutory Notice of Deficiency; and Notice CP 3219N, Automated Substitute for Return (ASFR) 90-Day Letter. The two Spanish versions are Letter 3219(SP), Notice of Deficiency (Spanish) and Notice CP 3219N(SP), Automated Substitute for Return (ASFR) 90-Day Letter (Spanish). See IRS Product Catalog Information and SNIP for copies of these letters. See also National Taxpayer Advocate 2018 Annual Report to Congress 198, 201-202 (Most Serious Problem: *Statutory Notices of Deficiency: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making It Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution*).

13 See Letter 238, Offer in Compromise Rejection Letter, in the Automated Offer in Compromise system. See also IRC § 7122(e).

### Even When Notices Are Available in Spanish, the IRS Does Not Track Taxpayers Who Want to Receive Notices in Spanish or Provide Simple Options for These Taxpayers to Request Spanish Notices

Although the IRS has an LEP indicator on its electronic account system, the Integrated Data Retrieval System, it is unclear how this indicator is placed on taxpayers' accounts and whether it has any effect.<sup>14</sup> Currently, the IRS has programmed its Individual Master File (IMF) 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.<sup>15</sup> Given only about 104,000 Form 1040PRs were filed in FY 2019, this programming severely limits the eligible Spanish-speaking LEP taxpayers who might automatically receive Spanish notices.<sup>16</sup> If a taxpayer who previously filed a Form 1040PR subsequently files a Form 1040 in a later year, then the taxpayer will no longer receive Spanish notices.

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 each time a notice is issued.<sup>17</sup> Furthermore, even when taxpayers know to call the IRS and request the Spanish version of the notice they received, it may be too late. Often the important statutory letters carry strict deadlines for providing information or requesting an appeal, and by the time the taxpayer receives the new notice, he or she may have forfeited his or her rights. Additionally, some notices for which the IRS has Spanish versions cannot be manually generated.<sup>18</sup>

Taxpayers who file the Spanish version of Form W-7, Application for Individual Taxpayer Identification Number (ITIN), will receive notices related to the Form W-7 in Spanish, but they will not automatically receive other notices in Spanish unless they also file a Form 1040PR.<sup>19</sup> This occurs because the IRS does not transmit language preference from the ITIN Real Time System to the IMF, even though it transmits other information such as the name and address components of an ITIN application. Figure 1.8.1 demonstrates how the IRS handles Spanish notices for taxpayers in the different situations discussed.

14 IRS response to TAS information request (June 28, 2019) states, "Since there is no requirement to input a [LEP indicator] TC 971 AC 192, it would not appear in the Compliance Data Warehouse or any other data source."

15 Form 1040PR, U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico) (2018) is used by Puerto Rico residents to report self-employment income and claim the additional child tax credit. In addition to filing a Form 1040PR, a taxpayer must also have a collection location code indicating the Philadelphia Service Center, which handles international returns, and have a universal location code indicating Puerto Rico in order to receive Spanish notices. IRS response to TAS information request (June 28, 2019). See Form 1040PR, U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico) (2018).

16 TAS Research used Compliance Data Warehouse (CDW), Individual Returns Transaction File, F1040 Table.

17 For example, the Automated Collection System (ACS) can accommodate taxpayers' requests to manually generate a notice in Spanish. See Internal Revenue Manual (IRM) Exhibit 5.19.5-5, ACS History Codes Reference IRM 5.19.5.4 (Nov. 21, 2019).

18 IRS response to TAS subsequent information request (Sept. 25, 2019).

19 Taxpayers who are ineligible for a Social Security number but who have a tax filing obligation must apply for an ITIN using Form W-7(SP), Application for IRS Individual Taxpayer Identification Number (Spanish Version), Solicitud de Número de Identificación Personal del Contribuyente del Servicio de Impuestos Internos.

FIGURE 1.8.1<sup>20</sup>

## Examples of How the IRS Currently Handles Spanish Notices for Taxpayers With Limited English Proficiency



<sup>20</sup> IRS response to TAS subsequent information request (Sept. 25, 2019).

### The Percentage of Spanish Notices Sent to Taxpayers Is Substantially Lower Than the Estimated Percentage of Limited English Proficiency Spanish Taxpayers

Given the IRS has not programmed its LEP markers for use,<sup>21</sup> TAS Research used the latest U.S. Census Five-Year Estimates data to estimate a benchmark for the percentage of all U.S. taxpayers who are Spanish-speaking, working age, and LEP taxpayers.<sup>22</sup> TAS Research used IRS data to generate the numbers of all IRS notices and letters issued in English and Spanish for FYs 2017 to 2019.<sup>23</sup> From these numbers, TAS contrasted the percentage of the relevant U.S. population who are LEP Spanish-speaking, working age taxpayers (almost four percent)<sup>24</sup> with the percentage of the notices and letters sent in Spanish (about a third of one percent). Given that the population of LEP Spanish-speaking taxpayers identified by TAS does not include taxpayers who speak English well but who would prefer to receive their notices in Spanish, the actual population of taxpayers who would choose Spanish notices if given a choice is likely higher than four percent. Figure 1.8.2 shows that the actual percentage of Spanish notices is substantially lower than TAS's conservative benchmark of four percent.

**FIGURE 1.8.2, Total Notices and Letters and Spanish Notices and Letters, FYs 2017–2019<sup>25</sup>**

	FY 2019		FY 2018		FY 2017	
	Count	% of All Letters	Count	% of All Letters	Count	% of All Letters
<b>All Notice and Letter Volumes Less Spanish Notice and Letter Volumes</b>	146,483,794	99.67%	153,347,519	99.67%	157,093,912	99.63%
<b>Spanish Notice and Letter Volumes</b>	486,831	0.33%	503,473	0.33%	587,739	0.37%
<b>Total</b>	<b>146,970,625</b>		<b>153,850,992</b>		<b>157,681,651</b>	

TAS Research further examined specific notices and letters that provided important statutory rights or fulfilled a statutory directive from Congress for taxpayers. Figure 1.8.3 shows the results for these four notice/letter groups, with the share of Spanish notices and letters at less than one percent, in contrast to TAS's conservative benchmark of approximately four percent for the relevant population of Spanish-speaking LEP taxpayers.

21 IRS response to TAS fact check (Oct. 25, 2019).

22 The relevant Spanish speaking, working-age taxpayers are described as Spanish speaking persons who speak English not well or not at all and are employed out of the total number of persons age 18 and over. TAS Research used the U.S. Census Bureau, *Age by Language Spoken at Home by Ability to Speak English for the Population 5 Years and Over*, B16004, and U.S. Census, *Employment Status*, S2301, for 2013-2017.

23 TAS Research used data information from IRS systems, SNIP and CDW Notice Delivery System Database (NDS).

24 The estimate was derived using the Spanish Population age 18 & over, who speak English "not well" or "not at all," the Spanish employment ratio, the U.S. Population age 18 & over, and U.S. employment ratio, which produced 3.8 percent. U.S. Census 2013-2017 American Community Survey 5-Year Estimates Tables, B16004 and S2301.

25 TAS Research used data information from IRS systems, SNIP Annual Correspondex (C-Letter) Volumes by Letter number and Center for FYs 2017-2019 and Annual Notice Volumes by CP number and Center for FYs 2017-2019; and CDW NDS, NDS NOTICE Table for FYs 2017-2019.

FIGURE 1.8.3, Selected Notices and Letters in English and Spanish, FYs 2017-2019<sup>26</sup>

	FY 2019		FY 2018		FY 2017	
	Count	% of CP11 & CP711	Count	% of CP11 & CP711	Count	% of CP11 & CP711
CP11 – English Error on Return – Balance Due	488,078	99.30%	613,093	99.40%	580,746	99.30%
CP711 – Spanish Error on Return – Balance Due	3,668	0.70%	3,485	0.60%	4,092	0.70%
<b>Total</b>	<b>491,746</b>		<b>616,578</b>		<b>584,838</b>	
	Count	% of CP105C & CP105(C-SP)	Count	% of CP105C & CP105(C-SP)	Count	% of CP105C & CP105(C-SP)
Letter 105C – English Claim Disallowed	305,061	99.90%	350,211	99.93%	375,592	99.90%
Letter 105(C-SP) – Spanish Claim Disallowed	226	0.10%	259	0.07%	342	0.10%
<b>Total</b>	<b>305,287</b>		<b>350,470</b>		<b>375,934</b>	
	Count	% of CP106C & CP106(C-SP)	Count	% of CP106C & CP106(C-SP)	Count	% of CP106C & CP106(C-SP)
Letter 106C – English Claim Partially Disallowed	57,375	99.90%	50,281	99.77%	56,657	99.80%
Letter 106(C-SP) – Spanish Claim Partially Disallowed	46	0.10%	114	0.23%	88	0.20%
<b>Total</b>	<b>57,421</b>		<b>50,395</b>		<b>56,745</b>	
	Count	% of Letter 845C & 845(C-SP)	Count	% of Letter 845C & 845(C-SP)	Count	% of Letter 845C & 845(C-SP)
Letter 854C – English Penalty Waiver or Abatement Disallowed/ Appeals Procedure Explained	74,067	99.90%	79,292	99.88%	104,201	99.90%
Letter 854(C-SP) – Spanish Penalty Waiver or Abatement Disallowed/ Appeals Procedure Explained	63	0.10%	93	0.12%	89	0.10%
<b>Total</b>	<b>74,130</b>		<b>79,385</b>		<b>104,290</b>	

These numbers demonstrate that in terms of important notices, the IRS is only meeting the needs of very few of the Spanish-speaking LEP population and none of the LEP population speaking other languages.

26 TAS Research used data information from IRS systems, SNIP Annual Correspondence (C-Letter) Volumes by Letter number and Center for FYs 2017-2019 and Annual Notice Volumes by CP number and Center for FYs 2017-2019.

### The IRS Could Do More to Identify Taxpayers Who Should Receive Notices in Spanish

If the IRS began using its existing LEP indicator to generate notices in Spanish, it could place a simple checkbox on Form 1040 to allow taxpayers to indicate their preference for receiving notices in Spanish. In response to TAS's information request, the IRS stated: "At this time the check box option has not been considered, therefore, there are no technological barriers identified."<sup>27</sup> The IRS could also create a checkbox on its online accounts system to allow taxpayers to record a preference for Spanish notices. Additionally, the IRS could transmit the language preference automatically from the ITIN Real Time System and prompt the LEP indicator to be placed on a taxpayer's account. This could prevent situations such as what has been occurring with the CP 48, Renew Your ITIN, notice. Despite the prevalence of Spanish-speaking taxpayers within the ITIN population, in FY 2019, only *one out of almost a million* copies of the ITIN renewal notice sent to taxpayers was sent in Spanish.<sup>28</sup>

The IRS could also consider other factors that would lead to marking a taxpayer's account with a preference for another language. The Social Security Administration (SSA) considers several criteria to determine whether an individual should receive a notice in Spanish:

- The application shows the claimant was born in a country or territory where Spanish is the predominant language (*e.g.*, Mexico, Puerto Rico);
- The claimant has a Hispanic surname;
- The claimant lives in a known Spanish-speaking area (*e.g.*, "Little Havana" or "East Los Angeles");
- The interview is conducted in Spanish or with the assistance of a Spanish translator;
- The claimant has difficulty speaking English but is fluent in Spanish;
- The claimant requests notification in Spanish; or
- The claimant meets none of the criteria, but there are circumstances which indicate that Spanish notices would be helpful, and the claimant would like to receive them.<sup>29</sup>

If one of these criteria is met, the SSA tells those individuals they may receive Spanish notices and asks them if they want to receive them.<sup>30</sup> In addition, the SSA manual states: "If an individual files a Request for Hearing (HA-501-U5), or Request for Review of Hearing Decision/Order (HA-520-U5), and meets any of the criteria listed above, state whether the individual wants to receive Spanish notices in the section of the form that gives the reason for filing a hearing or a review."<sup>31</sup> The IRS could adopt similar criteria to proactively identify taxpayers who may need to receive their notices in Spanish and allow taxpayers to easily communicate this when filling out certain forms.

### The IRS Website Fails to Include Notices and Related Information About Those Notices in Languages Other Than English

The IRS is increasingly relying on its website to inform taxpayers, and to its credit, it has created individual pages to help taxpayers understand the specific notice that they have received. For example, the IRS has a page titled, *Understanding Your CP 3219N Notice*, which explains the CP 3219N, one

27 IRS response to TAS information request (June 28, 2019).

28 During FY 2019, the IRS issued CP 48, Renew Your ITIN, 969,863 times. Yet, during this same period, the IRS issued CP 748, the Spanish version of this letter, only once. IRS SNIP Database (Sept. 18, 2019).

29 SSA, Program Operations Manual System (POMS) NL 00801.025 Spanish Language Notices (2007).

30 *Id.*

31 *Id.*



of the IRS's statutory notices of deficiency that provides the taxpayer with his or her only opportunity to challenge the liability in U.S. Tax Court prior to paying it if he or she timely files a petition.<sup>32</sup> The webpage has seven sections: What the notice is about; What you need to do; If you want to file a petition with the Tax Court; You may want to...; Helpful Information; Frequently asked questions; and Tips for next year.<sup>33</sup> Although the IRS has a Spanish translation of Notice 3219N, it does not have a similar webpage in Spanish for taxpayers. The 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.<sup>34</sup>

The IRS touts that with its Spanish website and at least five other non-English websites, “potentially 85 percent of the U.S. LEP population can be serviced through the online channel.”<sup>35</sup> However, this service is inadequate when LEP taxpayers do not have similar access to the explanations and instructions for key notices that provide taxpayer rights. Eighty-nine percent of Spanish LEP taxpayers report having internet access at home,<sup>36</sup> and IRS research indicates that one of the most frequently cited activities that Spanish LEP taxpayers reported as being likely to use on the IRS website was responding to a notice.<sup>37</sup>

Although translating every page into another language may be onerous, the IRS could create some general explanations in each of the top five foreign languages that would apply to different groups of notices. For example, instead of having an individual foreign language page for every SNOD or every single Collection Due Process (CDP) letter, the IRS could at minimum create some standard language for how to petition Tax Court after receiving a SNOD or when a taxpayer must request a CDP hearing. While the IRS has a webpage, *Understanding a federal tax lien*, translated into at least five languages other than English, there is no cross-reference to the notices that taxpayers receive, such as the Notice of Federal Tax Lien, and there is no mention of CDP hearing rights on this page.<sup>38</sup> The IRS could translate the page *Letters and Notices Offering an Appeal Opportunity*, which provides a brief description of each notice that provides appeal rights, and link to this page from the main notice page for each of the five foreign languages.<sup>39</sup>

The majority of our discussion has been focused on Spanish because it is by far the most frequent primary language for LEP taxpayers and the only language the IRS has chosen for translating its notices. However, by only translating notices in Spanish, the IRS is leaving out literally millions of other LEP

32 IRS, Understanding Your CP3219N Notice, <https://www.irs.gov/individuals/understanding-your-cp3219n-notice>.

33 *Id.*

34 IRS, Understanding Your IRS Notice or Letter, <https://www.irs.gov/individuals/understanding-your-irs-notice-or-letter> (English) and IRS, Entendiendo sus cartas o avisos del IRS, <https://www.irs.gov/es/individuals/understanding-your-irs-notice-or-letter> (Spanish).

35 IRS, Limited-English Proficient (LEP) Customer Base Report, FY 2012–2015, 211 (Jan. 2018).

36 IRS, Taxpayer Experience Survey (TES) 2017 Spanish Limited English Proficient (LEP) Report 8 (Apr. 30, 2018).

37 Spanish LEP respondents reported they were likely to use the IRS website to find an answer to a tax law question (67 percent); respond to a notice or letter received from the IRS (65 percent); and get an IRS form or publication (64 percent). *Id.* at 21 (Apr. 30, 2018).

38 IRS, Understanding a Federal Tax Lien, <https://www.irs.gov/businesses/small-businesses-self-employed/understanding-a-federal-tax-lien>, is translated into six different languages, specifically Spanish, Chinese, Korean, Russian, Vietnamese and Haitian Creole.

39 IRS, Letters and Notices Offering an Appeal Opportunity, <https://www.irs.gov/appeals/letters-and-notices-offering-an-appeal-opportunity>. See also Most Serious Problem: *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*, *supra*.

taxpayers.<sup>40</sup> In 2015, there were an estimated 1.8 million LEP persons in the United States speaking Chinese, Vietnamese, Korean, Cantonese, or Russian, which are the five most popular foreign languages for LEP persons after Spanish.<sup>41</sup> Focusing on the top five foreign languages in addition to Spanish and translating the notices that have the most importance in terms of taxpayer rights would show the IRS is committed to serving multilingual taxpayers. TAS commends the IRS for translating publications, such as its new Publication 5307, Tax Reform Basics for Individuals and Families, into languages other than English and Spanish.<sup>42</sup> Still, by focusing on publications taxpayers will use on the front end when filing their taxes, and not translating key notices that are sent to taxpayers when they have a problem related to their taxes, the IRS impairs taxpayers' *right to be informed*.

## IMPACT ON THE INTERNAL REVENUE SERVICE

### *The IRS Overlooks the Positive Impact When Determining Which Documents to Translate*

In FY 2017, the IRS had 323 translated vital documents, meaning they were required by law or critical for taxpayers to receive a benefit or service.<sup>43</sup> The IRS's Standard Translation Process requires, among other items, that a document must (1) be important to LEP taxpayers, (2) be unavailable by alternate means, and (3) have an acceptable level of downstream adverse impact (such as staffing to handle additional calls).<sup>44</sup> Certainly, notices required by law to be issued to taxpayers or those which provide statutory rights are "important to LEP taxpayers." One might argue that if the IRS translates one SNOD, then the information is available to taxpayers by alternate means. However, because the IRS does not post the translated notices on its webpage, and it would not issue the similar translated notice to the taxpayer, then the document is not available by alternate means.

In considering downstream adverse impacts, the IRS should weigh these with the positive benefits. For example, issuing an exam notice in another language may lead the taxpayer to call the IRS to ask questions using an interpreter, which would be an adverse downstream effect in terms of resources. However, this same event may be positive for the IRS in that the taxpayer is responding to the notice, participating in the exam, and possibly learning from the exam to avoid repeating mistakes on future returns. The IRS's LEP Customer Base Report notes the costs for not only publishing LEP written materials but also the postage costs when sending these materials.<sup>45</sup> The IRS should not consider these costs a downstream consequence because regardless of what language the taxpayer prefers, the IRS must send the taxpayer the notice, and postage costs are the same for translated notices. In FY 2015, the IRS spent \$877,087 on over-the-phone interpretation services for Spanish speakers.<sup>46</sup> It is possible that issuing a greater number of notices in Spanish and providing more detailed information about the notices on the IRS's Spanish webpages could reduce some of the need for taxpayers to call the IRS.

40 LEP persons speaking one of the top 10 languages in addition to Spanish numbered 2.5 million in 2015. IRS, LEP Customer Base Report, FY 2012–2015, 28 (Jan. 2018).

41 IRS, LEP Customer Base Report, FY 2012–2015, 28 (Jan. 2018).

42 IRS.gov, Tax Reform Tax Tip 2019-140, Tax Reform Publication Translated Into Different Languages (Oct. 8, 2019), <https://www.irs.gov/newsroom/tax-reform-publication-translated-into-different-languages>.

43 IRS, LEP Customer Base Report, FY 2012–2015, 10 (Jan. 2018).

44 IRS response to TAS information request (June 28, 2019).

45 IRS, LEP Customer Base Report, FY 2012–2015, 104 (Jan. 2018).

46 *Id.*

### *The IRS Should Use Its Limited English Proficiency Demographic Assessment to Identify Documents to Translate*

According to the IRS, the document business owner has the program responsibility for the technical content of the document and is the only one who can request a document be translated.<sup>47</sup> Placing the onus on the document owner to identify whether taxpayers need a document translated is misguided, considering the document owner may be an expert on the technical content but have little knowledge of what demographic, geographic, or ethnic group is receiving the document.

A better approach would be for the IRS to start with data from its LEP Demographic Assessment and use this data to make recommendations to program owners as to which documents the IRS should translate. The IRS gathers thorough data on the LEP population and publishes a useful document detailing this data in the LEP Demographic Assessment.<sup>48</sup> When asked for an explanation of how it uses the LEP demographic assessment, the Wage and Investment Division responded that it uses the data to determine the top five languages the IRS will serve and to “learn where these potential customers are located, industry they are employed in, education levels and other socio-economic and behavior information like computer use to determine how and where to serve taxpayers.”<sup>49</sup> Yet, it is not clear whether the IRS is using this data to select which notices it will translate. The most recent LEP Demographic Assessment states:

The IRS would benefit from further analysis into document translation demand, particularly in light of the success of the non-English website pages. Overall requests for document translation (internal requests from employees) have been increasing but is not that high a number, peaking at 2,422 in 2015, primarily for Spanish translation. What percent ‘share of the need’ this represents is not clear, *i.e.*, are there many others who would benefit from this who didn’t ask?<sup>50</sup>

Some program owners may not think to ask for a translation, which could cause a discrepancy in which notices are translated. Currently, only two of the five most commonly issued versions of the statutory notice of deficiency are translated into Spanish.<sup>51</sup> Furthermore, IRS leadership could identify some primary notices to translate into one of the top five identified foreign languages other than Spanish because the notices are so fundamental to taxpayer rights.

In addition to not leveraging the LEP Customer Data, the IRS misses the opportunity to evaluate whether it is meeting the notice needs of LEP taxpayers. The IRS appears to lack central coordination of when Spanish letters are issued, how they are accounted for, and how a taxpayer is notated as an LEP taxpayer. As the IRS prepares to implement Enterprise Case Management, now is an ideal opportunity to build in LEP indicators that will help the IRS communicate effectively across the organization.<sup>52</sup>

47 The business document owner is an IRS individual who is responsible for the technical content, publishing and edits of specific letters. If a person other than the business document owner requests a letter translation, then the person must contact the business document owner and receive their concurrence. See IRS response to TAS information request (June 28, 2019).

48 IRS, LEP Customer Base Report, FY 2012–2015, 23-81 (Jan. 2018).

49 IRS response to TAS information request (June 28, 2019).

50 IRS, LEP Customer Base Report, FY 2012–2015, 20 (Jan. 2018).

51 The two Spanish versions are Letter 3219(SP), Notice of Deficiency (Spanish) and Notice CP 3219N(SP), Automated Substitute for Return (ASFR) 90-Day Letter (Spanish). IRS Product Catalog Information.

52 Enterprise Case Management (ECM) solution provides an IRS-wide solution for streamlining case and workload management processes. The solution digitizes case information, automates work selection, and improves resource alignment. See IRS Integrated Modernization Business Plan 23 (Apr. 2019). See also National Taxpayer Advocate FY 2019 Objectives Report to Congress 47-51; Most Serious Problem: *Information Technology Modernization: The IRS Modernization Plan’s Goal to Improve Taxpayer Experience Is Commendable, But the IRS Needs Additional Multi-Year Funding to Bring It to Fruition, supra.*

## CONCLUSION

A tax agency dedicated to taxpayer rights should take a proactive approach to LEP taxpayers by identifying potential taxpayers who may want notices in other languages and allowing them to check a box to easily request notices in foreign languages. The IRS has identified no information technology barriers to placing a checkbox on its Form 1040 to allow taxpayers to receive notices in other languages. As the IRS relies more on its website to answer taxpayers' questions about notices and how to exercise their rights, it should translate webpages that explain the key notices. Until the IRS makes these changes, LEP taxpayers will continue to face difficulty in responding to IRS notices, exercising their rights, and coming into compliance.

## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Place a checkbox on Form 1040 to allow taxpayers to choose to receive their notices in Spanish and, as more notices are translated, expand the 1040 checkbox to languages other than Spanish.
2. Incorporate language 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 his or her accounts.
3. Translate into the five most common non-English languages the IRS webpages that correspond to the four notices identified above (CP 11 – English Math Error on Return – Balance Due; Letter 105C – English Claim Disallowed; Letter 106C – English Claim Partially Disallowed; Letter 854C – English Penalty Waiver or Abatement Disallowed/Appeals Procedure Explained), along with other IRS webpages that correspond to other statutory notices and taxpayer rights.
4. Develop a plan to 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. The plan should include options to create a hyperlink or scannable code on the notices that would direct an LEP taxpayer to a webpage providing alternate language templates of the notice.
5. Create procedures similar to those used by the SSA 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.
6. Place a note on all correspondence providing taxpayers with instructions explaining how to receive their notices in languages other than English.
7. Expand the LEP indicator and use the 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****RESPONSIBLE OFFICIALS**

Ken Corbin, Commissioner, Wage and Investment Division  
Eric Hylton, Commissioner, Small Business/Self-Employed Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**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.<sup>2</sup> In fiscal years (FYs) 2015-2019, the IRS used the Combination Letter in approximately 16 percent, or about 500,000, correspondence audits.<sup>3</sup> 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.<sup>4</sup>

Despite the problems Combination Letters create for taxpayers, the IRS Wage & Investment (W&I) Division has plans to expand its use of the letters to additional issues.<sup>5</sup>

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

2 Audits conducted through the mail are also referred to as “correspondence” audits.

3 In this Most Serious Problem (MSP), we focus solely on Combination Letters sent by the IRS Wage and Investment (W&I) and Small Business/Self-Employed (SB/SE) divisions. All data and procedural analysis referenced in this MSP is based on W&I and SB/SE data and procedures. Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started after September 30, 2014. This is an estimate based on project codes where a Combination Letter could have been sent. IRS response to TAS fact check (Nov. 25, 2019).

4 See Figure 1.9.2, *infra*. IRS response to TAS fact check (Nov. 25, 2019).

5 IRS response to TAS information request (July 2, 2019) (W&I is considering expanding use of the Combination Letter to “[Premium Tax Credit] within project code 1300 for specific error codes” and “Unallowable Project Code 0000 with Source Code 03 (for those items that are truly unallowable by law).”

## IMPACT ON TAXPAYERS

The Combination Letter combines the Initial Contact Letter and the 30-Day Letter into a single letter.<sup>6</sup> The use of the Combination Letter is usually limited to correspondence audits, the most common type of IRS examination.<sup>7</sup> While the IRS generally uses a two-letter process for the majority of its examinations, it began using Combination Letters in 1999 to shorten the time required for correspondence exams and to maximize employee resources.<sup>8</sup> Prior to 2006, the Combination Letter was most often used in examinations of the Earned Income Tax Credit (EITC).<sup>9</sup> In response to the National Taxpayer Advocate's concerns surrounding the IRS's use of the Combination Letter,<sup>10</sup> the IRS stopped using the Combination Letter in EITC exams.<sup>11</sup> However, the Combination Letter still impacted approximately 16 percent of the three million correspondence examinations opened by the IRS W&I and Small Business/Self-Employed (SB/SE) divisions between FYs 2015-2019.<sup>12</sup>

### The IRS Uses Combination Letters to Fast-Track Certain Examinations, Shortening the Timeframe for Taxpayers to Resolve Problems When Compared to the Two-Letter Process

In the two-letter process, the IRS mails an Initial Contact Letter to the taxpayer at the beginning of the examination to inform him or her that the IRS has selected his or her return for examination, to specify the items under examination, and to request documentation to verify the items the IRS is examining.<sup>13</sup> This letter allows taxpayers 30 days to provide support for the examined items.<sup>14</sup> The 30-Day Letter is sent to a taxpayer to communicate the audit adjustments after the IRS has considered any information that the taxpayer provided.<sup>15</sup> This letter 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 30-Day Letter is critical because it is the only way the taxpayer can appeal the IRS's determination in an independent forum prior to going to Tax Court. For many taxpayers, it is the only appeal right they will get because many cannot afford legal representation, or they find the idea of going to court intimidating.

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- 6 See, e.g., Letter 566B. See also National Taxpayer Advocate 2003 Annual Report to Congress 87 (Most Serious Problem: *Combination Letter*).
- 7 In FY 2018, the IRS conducted 741,400 audits via correspondence, and 74.8 percent of all audits conducted were via correspondence. The remaining 25.2 percent were conducted in the field by revenue agents, tax compliance officers, tax examiners, and revenue officer examiners. IRS Pub. 55B, IRS Databook 2018, 23 (May 2019) (Table 9a).
- 8 See National Taxpayer Advocate 2003 Annual Report to Congress 87 (Most Serious Problem: *Combination Letter*).
- 9 At the time, EITC examinations made up approximately three quarters of all correspondence audits. In FY 2001, Correspondence Examination units on IRS campuses conducted 401,448 EITC examinations, 9,624 non-filer examinations, and 129,830 other examinations for a total of 540,902 examinations. See National Taxpayer Advocate 2003 Annual Report to Congress 89 (Most Serious Problem: *Combination Letter*).
- 10 See National Taxpayer Advocate 2003 Annual Report to Congress 87 (Most Serious Problem: *Combination Letter*).
- 11 *Id.*; IRS response to TAS information request (July 2, 2019). See also Internal Revenue Manual (IRM) 4.19.1.5.2, RPS Examination Process (Jan. 1, 2006).
- 12 Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started after September 30, 2014. This is an estimate based on project codes where a Combination Letter could have been sent. IRS response to TAS fact check (Nov. 25, 2019).
- 13 IRM 4.19.13., Initial Contact (Mar. 10, 2016). See, e.g., Letter 566; Letter 566D. See also National Taxpayer Advocate 2008 Annual Report to Congress 243 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures, and Assessments*).
- 14 See, e.g., Letter 566D.
- 15 IRM 4.19.13.12, No Response and Unagreed Cases (Feb. 9, 2018). See also Letter 525 (sent as 30-Day Letter and also as a Combination Letter).

In the Combination Letter process, taxpayers receive only one letter that both informs them that their tax return is under audit and serves as a letter transmitting the audit report reflecting the audit outcome should the taxpayer fail to substantiate the items under examination. The letter date not only starts the 30-day timeframe in which the taxpayer must respond and provide substantiation for examined items, it also starts the clock on the taxpayer's 30-day window to request an appeal. While the Combination Letter refers the taxpayer to IRS Publication 3498-A, *The Examination Process (Audits by Mail)*, for more information on the audit process, including appeal rights, it does not fully discuss the taxpayer's options within the body of the letter.<sup>16</sup>

The IRS sends Combination Letters for examinations where the taxpayers were previously contacted by the IRS and subsequently selected for examination.<sup>17</sup> The IRS also uses Combination Letters when it “can clearly determine the taxpayers are not entitled to the credits or there is a clear mathematical computation”<sup>18</sup> or “if the item is clearly unallowable.”<sup>19</sup> In essence, the IRS is fast-tracking certain correspondence exams where it believes taxpayers are definitely in the wrong.

Because the IRS cannot provide data showing the number of Combination Letters it sends in a given year or show the outcome of cases in which it used the Combination Letter,<sup>20</sup> the IRS is unable to track data or analyze the effects of using Combination Letters on the IRS or taxpayers.<sup>21</sup> To understand when the IRS uses Combination Letters, Figure 1.9.1 details the issues for which such letters might be used. By reviewing the examination results for these issues, we have estimated the impact of the Combination Letter by comparing these examination results to other correspondence examination results as shown in Figures 1.9.2 and 1.9.3.

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16 See, e.g. Letter 566B; see also National Taxpayer Advocate 2008 Annual Report to Congress 243 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures, and Assessments*).

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

18 *Id.* (this is the procedure for W&I).

19 *Id.* (this is the procedure for SB/SE).

20 *Id.*

21 See IRS response to TAS information request (July 2, 2019). Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started. Estimates are based on project codes where a Combination Letter could have been sent. IRS response to TAS fact check (Nov. 25, 2019).



**FIGURE 1.9.1, Project Codes Where a Combination Letter May Be Issued<sup>22</sup>**

Project Code	Issue Description	Combination Letter Number
0	Unallowable Program	525
44	Erroneous Refunds	566B
59	Related Pickup Non-EITC Duplicate TIN	566B
124	SE Tax	718
125	Math Error Non-EITC	566B
133	Criminal Investigation - CI - Non-EITC Referral	566B
277	Substitute for Returns (SFR)	1862
385	Criminal Investigation - Non-EITC Credits	566B
394	Child & Dependent Care - Child turned 13 the first half of the year	566B
400	Child & Dependent Care - Child over 12 the entire year	566B
406	Hope Education Credit Greater Than 2 years for same student	566B
420	General Business Credit, No Business Indicators	566S*
505	Health Coverage Tax Credit	525
628	Child & Dependent Care - Duplicate Dependent for Child Tax Credit, Child and Dependent Care Credit or Education Credit	566B
631	Alternative Minimum Tax	2194
1521	Automated Underreporter With Greater Than 100 Information Returns	2625C, 2626C, Computer Paragraph Notice (CP) 2000 or CP 2501

<sup>22</sup> These are the project codes that the IRS informed us a Combination Letter may be issued, as well as additional project codes we found independently in the IRM. IRS response to TAS information request (July 2, 2019) (identifying that Combination Letters may be issued in project codes 0000, 0124, 0394, 0400, 0420, 0631, and 1521). Please note that the IRS identified project code 0420 as one that the IRS used Combination Letters for. However, the IRS did not provide an associated Combination Letter with this project code, nor could TAS find one, so we included in Figure 1.9.1 Letter 566S, the initial contact letter associated with the 0420 project code. See also IRM 4.19.15.17(8), Erroneous Refunds (Nov. 4, 2019) (0044); IRM 4.19.15.11.1(2), Initial Contact (Dec. 1, 2017) (0059); IRM 4.19.15.10(4), Math/Clerical Error (Dec. 1, 2017) (0125); IRM 4.19.15.3(4), Education Tax Benefits - General Requirements and Exam Programs (Nov. 4, 2019) (0406, beginning on March 14, 2016, the IRS no longer used Combination Letters for this project code); IRM 4.19.15.2(6), Child and Dependent Care Credit (Nov. 4, 2019) (0628). The IRS informed us that a Combination Letter was no longer use in project code 0000 cases after November 1, 2016. IRS response to TAS follow-up request (Nov. 25, 2019).

### Taxpayers May Miss Deadlines Because the Combination Letter Reduces Response Time and Taxpayer Contacts

The IRS gives taxpayers who receive both an Initial Contact Letter and a 30-Day Letter two separate opportunities to provide documentation — one 30-day period upon receiving the initial contact requesting documentation and another 30-day period upon receiving the audit report at the conclusion of the exam.<sup>23</sup> The Combination Letter can cut the time taxpayers have to provide documentation to a single 30-day period.<sup>24</sup> This compressed timeframe may be insufficient for taxpayers to properly gather and provide the necessary documentation needed to resolve any questionable items.

Taxpayers may be so focused on the news that they are under audit and the tasks necessary to gather the requested documents that they may overlook that the 30-day period provided by the Combination Letter is also their opportunity to request an Appeals conference. Taxpayers will likely believe that their exam is not yet final and will not realize that, even if they provide supporting information that the IRS deems insufficient, the IRS may not provide the taxpayer additional time beyond the 30-day period to request an Appeals conference,<sup>25</sup> thereby effectively losing the *right to appeal in an independent forum*.

### The Combination Letter Gives the Appearance the Audit Result Is a Foregone Conclusion, Causing Taxpayer Confusion and Failure to Respond

Enclosed with the Combination Letter is an audit report showing the items in question as disallowed. However, neither the audit report<sup>26</sup> nor the Combination Letter indicate that the adjustments on the enclosed audit report are tentative. Additionally, one Combination Letter begins, “If you don’t agree with the proposed changes...”<sup>27</sup> This can give the appearance that the IRS has already determined the outcome of the audit and any input from the taxpayer would be superfluous. Data shows that the non-response rate for taxpayers identified as being potentially subject to the issuance of the Combination Letter is, on average, 29 percentage points higher<sup>28</sup> than taxpayers who received the Initial Contact and 30-Day letters. (See Figure 1.9.2)

23 See, e.g., Letters 566D & 525. See also National Taxpayer Advocate 2008 Annual Report to Congress 243 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures, and Assessments*).

24 In some circumstances the taxpayer can have longer than 30 days to respond, depending on the IRS response. The IRS also generally gives 15 days for mail processing, though taxpayers are not made aware of this “extra” time. W&I response to TAS fact check (Nov. 14, 2019). The time given, however, is still shorter than the 60 days from the two-letter process. IRM 4.19.13.10.1, Taxpayer Responses – Additional Information Needed (Apr. 3, 2017), instructs examiners to update cases to status code 25, thereby suspending the case for 30 days prior to the issuance of the Statutory Notice of Deficiency. See also IRM 4.19.10.1.5.2, Standard Suspend Periods for Correspondence Examination (Dec. 8, 2017). Taxpayers are not informed of this suspension period. Examiners typically give taxpayers a response date of 15 days from the date the L692 was sent, giving taxpayers the impression that the response date is the final date they can submit information for the audit.

25 IRM 4.19.13.10.1, Taxpayer Responses – Additional Information Needed (Apr. 3, 2017) (instructing examiners who receive insufficient information from a taxpayer to: 1) attempt calling the taxpayer to explain why the information sent is not sufficient and what is still needed, no Letter 692 is sent, or 2) send Letter 692 with an explanation of why the information received is insufficient and what information is still needed if attempt to reach taxpayer was unsuccessful).

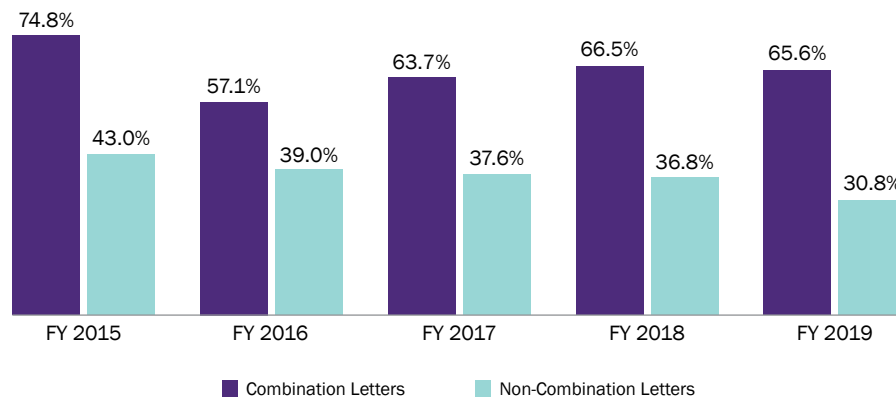
26 Usually Form 4549, Report of Income Tax Examination Changes.

27 See, e.g., Letter 566B.

28 The average non-response rate between FYs 2015-2019 for W&I and SB/SE correspondence examinations is 43 percent. IRS response to TAS fact check (Nov. 25, 2019). The non-response rate for W&I and SB/SE correspondence cases subject to combination letter procedures is 67 percent. IRS response to TAS fact check (Nov. 25, 2019).

FIGURE 1.9.2<sup>29</sup>

**Comparison of Non-Response Closure Rates for Correspondence Audits  
by Type of Initial Contact Letter, FYs 2015-2019**



Unfortunately, this failure to respond to the IRS may cause taxpayers to pay more tax than required, jeopardizing their *right to pay no more than the correct amount of tax*. Alternatively, the Combination Letter may cause taxpayers to make an appeal prematurely, thinking they have no choice but to appeal something the IRS has already decided against them. Since a taxpayer cannot appeal without having provided substantive support, Appeals will almost always send these cases back, wasting both the taxpayer's time and the IRS's resources.

Considering the confusion the Combination Letter may cause, a taxpayer's *right to a fair and just tax system* is inadvertently violated by the IRS's use of this letter. Furthermore, when taxpayers decline to participate in an examination, future compliance is impacted because the IRS misses an opportunity to educate these taxpayers during an audit about reoccurring errors they may be making. Despite these risks to taxpayers' rights, the IRS has not conducted research studies on the effect design (or redesign) of Combination Letters has on taxpayer responsiveness.<sup>30</sup>

<sup>29</sup> Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams. Estimates are based on project codes where a Combination Letter could have been sent for audits starting after September 30, 2014. IRS response to TAS fact check (Nov. 25, 2019).

<sup>30</sup> Neither W&I nor SB/SE have conducted behavioral research studies on these Combination Letter issues. IRS response to TAS information request (July 2, 2019). The IRS Research, Applied Analytics and Statistics Division (RAAS) has also not conducted any behavioral research studies on Combination Letters. IRS Response to TAS Information Request (Sept. 24, 2019).

### The Combination Letter's Current Design May Limit Taxpayers' Ability to Understand and Exercise Their Appeal Rights

Cognitive science and behavioral psychology both inform us that, for better understanding, there should not be too many or conflicting messages in one communication.<sup>31</sup> Yet, 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.

For an example of how one Combination Letter deemphasizes appeal rights by relegating them to a single sentence, Letter 525 states the enclosed "Publication 3498-A describes the audit process and explains other options, including your appeal rights, if you disagree with our proposed changes."<sup>32</sup> Moreover, in the same paragraph the taxpayer is told if he or she disagrees with the IRS's proposed changes, he or she must "[r]eturn a copy of this letter along with your explanation and any supporting documents."<sup>33</sup> Nowhere does the letter state that to protect their option to appeal at a later point in the audit, taxpayers must request an appeal within 30 days of the letter's date.

**Considering the confusion the Combination Letter may cause, a taxpayer's right to a fair and just tax system is inadvertently violated by the IRS's use of this letter.**

Behavioral science also shows that if a document requires readers to look elsewhere for information, they are much less likely to retrieve it.<sup>34</sup> The IRS merely mentioning Publication 3498-A, The Examination Process (Audits by Mail), in the Combination Letter does not fulfill the IRS's obligation to fully inform taxpayers of their appeal rights. The eight-page Publication 3498-A discusses the audit process but does not specifically address scenarios in which taxpayers receive an audit report with the initial contact letter (*i.e.*, Combination Letter).

The rate at which taxpayers request an Appeals conference is historically low in correspondence examinations (less than one percent).<sup>35</sup> Because appeal rates are so low, it is difficult to draw a definitive conclusion as to why affected taxpayers are not requesting an appeal, however taxpayers who receive Combination Letters request appeals at a rate consistently lower when compared to all correspondence examinations, as shown in Figure 1.9.3.

31 See National Taxpayer Advocate 2018 Annual Report to Congress vol. 2, at 193 (Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*).

32 See Letter 525.

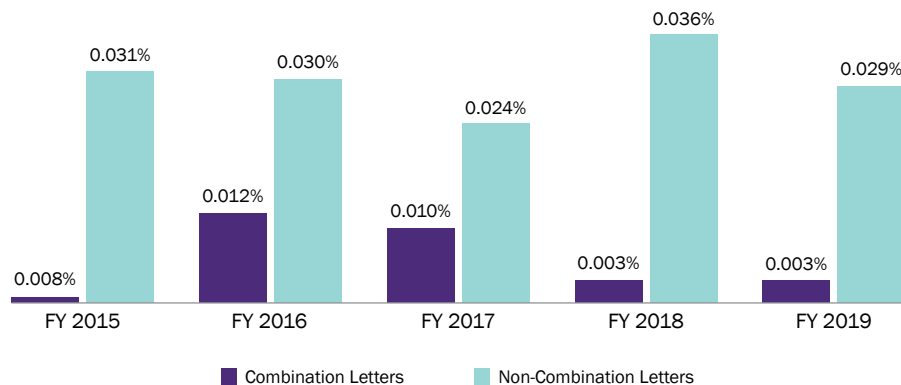
33 *Id.*

34 See National Taxpayer Advocate 2018 Annual Report to Congress vol. 2, at 193 (Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*).

35 Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started after September 30, 2014. IRS response to TAS fact check (Nov. 25, 2019).

FIGURE 1.9.3<sup>36</sup>

### Comparison of Appealed Closure Rates for Correspondence Audits by Type of Initial Contact Letter, FYs 2015-2019



## IMPACT ON THE INTERNAL REVENUE SERVICE

The IRS uses Combination Letters because it believes they reduce the number of contacts with taxpayers, thereby reducing the cycle time for these cases. However, the IRS should want to positively engage with taxpayers rather than limiting interactions. The examination process should not only be used to resolve the issues under examination but also as an opportunity for the IRS to educate taxpayers. While reducing cycle time may be a valid goal to keep audits from unnecessarily dragging out, focusing solely on cycle times and limiting the number of interactions are potentially harmful to taxpayers. The IRS's aim should be to get to the correct answer, not just reduce case cycle times.

Regardless of its claim of the benefits of using the Combination Letter (namely saving employee resources by reducing taxpayer contacts and shortening case cycle times), the IRS can neither accurately identify the number and type of interactions it has with taxpayers who received the Combination Letter versus an Initial Contact Letter, nor can it accurately measure the cycle time for these same groups.<sup>37</sup> Thus, there is no evidence that taxpayer contacts or cycle times are notably better when the IRS uses Combination Letters rather than the two-letter process.<sup>38</sup> Despite the lack of data supporting its effectiveness, W&I is considering expanding the use of the Combination Letter to two additional project codes, which is concerning given the above issues.<sup>39</sup>

<sup>36</sup> IRS response to TAS fact check (Nov. 25, 2019).

<sup>37</sup> IRS response to TAS information request (July 2, 2019).

<sup>38</sup> *Id.* Phone call with W&I and SB/SE on May 30, 2019.

<sup>39</sup> IRS response to TAS information request (July 2, 2019) (W&I is considering expanding use of the Combination Letter to “[Premium Tax Credit] within project code 1300 for specific error codes” and “Unallowable Project Code 0000 with Source Code 03 (for those items that are truly unallowable by law).”

## CONCLUSION

Combination Letters negatively impact taxpayers because of the short timeframe taxpayers have to gather documentation, respond to the examiner, and request an appeal. Combination Letters may confuse taxpayers by giving the impression that the audit is a foregone conclusion. The design and wording of the Combination Letters may lead taxpayers to overlook or misunderstand their ability to request an appeal. Without considering the impact on taxpayers, the IRS is considering expanding the use of the Combination Letter.<sup>40</sup> The IRS can and should address these issues by using two separate notices, the Initial Contact Letter and the 30-Day Letter, in all audits, thereby reducing taxpayer confusion and protecting taxpayer rights.

## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Discontinue the use of Combination Letters and provide all taxpayers undergoing an examination with a separate Initial Contact Letter and 30-Day Letter, providing taxpayers with sufficient time to submit documentation and explanations before issuing the 30-Day Letter.
2. If the IRS chooses not to discontinue use of Combination Letters, it should work with the Taxpayer Advocate Service (TAS) on a joint study to track and compare Combination Letter data with Initial Contact Letter data to identify the causes of significant discrepancies between the two populations, as well as analyze potential issues and areas for improvement.
3. Refrain from expanding the use of Combination Letters until research is conducted on the impact to taxpayers and the IRS.
4. If the IRS continues to use Combination Letters, work with TAS to redesign them to clearly communicate to taxpayers:
  - a. Their tax return is under examination;
  - b. The possible outcomes of the audit, including what happens if the taxpayer provides documentation the IRS deems inadequate;
  - c. The timeframe in which they have to request an appeal and the factors that impact this timeframe; and
  - d. The steps they must take to request an appeal.
5. Revise IRS Publication 3498-A, The Examination Process (Audits by Mail), to include guidance specific to the Combination Letter.

<sup>40</sup> IRS response to TAS information request (July 2, 2019) (W&I is considering expanding use of the Combination Letter to “[Premium Tax Credit] within project code 1300 for specific error codes” and “Unallowable Project Code 0000 with Source Code 03 (for those items that are truly unallowable by law).”

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

Eric Hylton, Commissioner, Small Business/Self-Employed Division  
Andrew Keyso, Jr., Acting Chief, Appeals

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

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

**PROBLEM**

Congress has granted the IRS broad authority to use offers in compromise (OICs) to accept less than the full amount due for some taxpayers. It has 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.<sup>2</sup> 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.<sup>3</sup> 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, 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.

**IMPACT ON TAXPAYERS**

The goal of the OIC program is to reach a compromise that is in the best interest of both the taxpayer and the IRS while achieving collection of what is potentially collectible at the earliest possible time and at the least cost to the government.<sup>4</sup> Therefore, the IRS's policy is to accept an OIC when it is unlikely the tax liability can be collected in full and the amount offered reasonably reflects collection potential.<sup>5</sup>

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

2 See IRC § 7122; H.R. REP. No. 105-599, at 287 (1998) (Conf. Rep.); S. REP. No. 105-174 at 88 (1998).

3 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, at 42, 60 (Research Study: *A Study of the IRS Offer in Compromise Program*).

4 Internal Revenue Manual (IRM) 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992).

5 *Id.*



The IRS recognizes that the success of the program relies on taxpayers making adequate compromise proposals consistent with their ability to pay and on the IRS making prompt and reasonable decisions.<sup>6</sup> It is also the IRS's longstanding policy to educate and assist taxpayers who make a good faith effort to comply and to discuss OIC alternatives and assist taxpayers in preparing required forms when it has determined that an OIC is a viable solution to tax delinquency.<sup>7</sup> The IRS benefits from accepting an OIC because it immediately secures a payment and requires the taxpayer to remain in filing and payment compliance for the five-year period following acceptance.<sup>8</sup> The taxpayer benefits from receiving a fresh start and the finality of settling a debt that cannot be satisfied in full.<sup>9</sup>

**The National Taxpayer Advocate remains concerned that the IRS's administration of the Offer in Compromise program falls short of Congress's expectations.**

Acceptance of an OIC generally depends upon whether the amount offered reflects the taxpayer's RCP, which is calculated by evaluating a taxpayer's equity in assets and expected future income after allowing for the payment of necessary living expenses.<sup>10</sup> The IRS has developed national and local allowances for determining necessary living expense amounts but is required to deviate from these amounts to ensure taxpayers can still provide for their basic living expenses.<sup>11</sup> Accordingly, in determining a taxpayer's RCP, the IRS will consider the taxpayer's overall situation, which requires the examiner to use judgment to evaluate the facts and circumstances of each case.<sup>12</sup>

When calculating RCP, the IRS may also consider the effect of a bankruptcy on the collectibility of the tax debt.<sup>13</sup> In bankruptcy, income taxes may be discharged if certain conditions are met.<sup>14</sup> However, the IRS will consider the effect of filing for bankruptcy on the RCP only if the taxpayer indicates he or she may file for bankruptcy.<sup>15</sup>

6 IRM 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992).

7 IRM 1.2.1.6.1, Policy Statement 5-1, Enforcement Is a Necessary Component of a Voluntary Assessment System (Aug. 18, 1994); IRM 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992).

8 IRM 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992).

9 While an OIC is being considered, the IRS is generally prohibited from levying against the taxpayer. IRC § 6331(k). Once the OIC is accepted and the taxpayer has paid the compromised liability amount, the IRS will release any federal tax liens. IRS, Form 656, Offer in Compromise 6 (Aug. 2019).

10 IRM 5.8.4.3(2), Doubt as to Collectibility (Jan. 18, 2018); IRM 5.8.4.3.1 Components of Collectibility (Apr. 30, 2015).

11 IRC § 7122(d)(2); IRM 5.8.5.22.1, Necessary Expenses (Oct. 22, 2010).

12 IRM 5.8.4.3(2), Doubt as to Collectibility (Jan. 18, 2018). *But see* National Taxpayer Advocate 2018 Annual Report to Congress vol. 2, at 39, 41 (Research Study: *A Study of the IRS's Use of the Allowable Living Expense Standards*) (finding IRS employees do not always exercise judgment to allow statutorily authorized deviation from the tables).

13 IRM 5.8.10.2.2, Offers in Compromise Before Bankruptcy (Feb. 14, 2017).

14 Income taxes are generally dischargeable if they become due three years before the taxpayer files for bankruptcy as long as it has been at least two years since the taxpayer filed the tax return and 240 days since the taxes were assessed. 11 U.S.C. §§ 507(a)(8)(A) and 523(a)(1)(B)(ii).

15 IRM 5.8.10.2.2, Offers in Compromise Before Bankruptcy (Feb. 14, 2017).

### Reasonable Collection Potential Calculations Result in the IRS Rejecting Offers in Compromise on Accounts for Which They Then Do Not Collect the Tax or Amount Offered

TAS conducted a research study in 2017 on individual OICs processed from 2009 to 2013, which showed 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.<sup>16</sup>

In the 2018 Annual Report to Congress, the National Taxpayer Advocate recommended that the IRS “conduct a study to analyze the OIC amount offered and collected amounts to understand why the IRS is rejecting OICs that have an offered amount greater than the dollars collected. For instance, the IRS should look at how it is applying the Allowable Living Expense (ALE) standards and where the taxpayer is obtaining the payment for the OIC.”<sup>17</sup> The IRS agreed to conduct a study reviewing the collection results for OICs that were rejected between 2014 and 2019, but failed to review how it had calculated RCP in individual cases to understand why it was rejecting these OICs.<sup>18</sup> Based on the study results of amounts collected, the IRS responded to TAS that a change to the OIC program was unwarranted.<sup>19</sup>

In its study reviewing rejected OICs, the IRS found that in 29 percent of the lump sum payment OICs and in 34 percent of the periodic payment OICs that were not accepted, the IRS did not later collect the offered amount within 48 months of the OIC closure.<sup>20</sup> Similar to the 2017 TAS study results, the IRS study also shows that in a sizeable amount of cases, the IRS never collected the amount offered.<sup>21</sup> Furthermore, the IRS did not analyze why it is rejecting OICs that have an offered amount greater than the dollars collected. The IRS should review how it is applying ALE standards and calculating RCP to determine if these amounts are factors in rejecting potentially viable offers, consequently collecting lower amounts after the rejection. Therefore, the IRS's response to the 2018 Annual Report to Congress that a change to the OIC program is unwarranted is based on incomplete information.

This year, TAS conducted its own study to determine how the IRS was applying ALE standards and calculating RCP.<sup>22</sup> TAS took a statistically valid sample of individual OICs that were included in the 2017 study (250 cases) and reviewed the IRS's calculations of RCP in each case. TAS determined what financial factors were primary in the decision to reject the offer<sup>23</sup> and found that in 68 percent (171 of

16 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, at 42, 44, 60 (Research Study: *A Study of the IRS Offer in Compromise Program*).

17 National Taxpayer Advocate 2018 Annual Report to Congress 266, 276 (Most Serious Problem: *Offer in Compromise: Policy Changes Made by the IRS to the Offer in Compromise Program Make It More Difficult for Taxpayers to Submit Acceptable Offers*).

18 IRS, Draft Response to MSP #18 OIC (Aug. 8, 2019).

19 *Id.*

20 See *Id.* and attachment Enforcement Revenue Information System OIC – Stakeholder Analysis Brief – 20190612 – Final 7.

21 The TAS study reviewed cases four or more years after OIC closure, and the IRS study reviewed cases 48 months after closure.

22 The statistical information in this research study was not provided or reviewed by the Secretary under IRC § 6108(d). See IRC § 7803(c)(2)(B)(ii)(XII).

23 The TAS Data Collection Instrument for the case review considered the amount of the calculated future income potential, the calculated equity in assets, and the percentage of each attributable to the total RCP. It also considered the percentage of total asset equity attributable to retirement assets, life insurance, real property, dissipated assets, investment assets or other assets.

250) of the cases, the rejection was based solely on the calculation of future income.<sup>24</sup> The TAS study found that the IRS may be miscalculating taxpayers' future income potential in determining their RCP and recommends the IRS review additional cases to verify this finding.<sup>25</sup>

Of the 250 cases it reviewed, TAS also reviewed the status of the accounts after rejection. In 82 percent of the 250 cases TAS reviewed this year, the IRS attempted to collect the debt after rejecting the OIC by assigning the accounts to ACS or field collection.<sup>26</sup> 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 post-OIC referrals.<sup>27</sup> Furthermore, as of the end of FY 2019, 50 percent of the taxpayer accounts related to these 250 OICs either remained in the Queue or Currently Not Collectible (CNC) status, or the collection statute expired.<sup>28</sup> This emphasizes the need for the IRS to further study why it could not collect the calculated RCP on these accounts. Rejecting viable OICs impacts a taxpayer's *right to finality, to quality service, and to a fair and just tax system* as well as reducing dollars collected and losing the opportunity to bring the taxpayer into compliance.

### The IRS Fails to Calculate the Potential Impact of Bankruptcy in Reviewing Offers in Compromise

The IRS acknowledges that there are benefits to both the IRS and the taxpayer when accepting an OIC instead of the taxpayer filing for bankruptcy. For example:

- The IRS can negotiate for assets that may not be collectible if the taxpayer declares bankruptcy;
- The IRS may be able to collect the offer amount more quickly; and
- The taxpayer's credit will not reflect a bankruptcy, improving the taxpayer's ability to comply with future tax obligations.<sup>29</sup>

24 The TAS Data Collection Instrument for the case review considered the rejection based solely on the calculation of future income when there was a positive monthly ability to pay and there was either no asset equity or the total asset equity accounted for less than 25 percent of the total RCP. The margin for the 95 percent confidence interval is plus or minus 5.7 percent.

25 The 2017 study was based on OICs that were rejected or returned between 2009 and 2013, years during which the IRS took into account projected income for 48 months or longer when calculating the future income for RCP purposes. IRM 5.8.5.23, Calculation of Future Income (Oct. 22, 2010); IRM 5.8.5.6.6, Calculation of Future Income (Sept. 23, 2008). The IRS's method for calculating future income changed in 2018, and now the IRS generally bases the calculation on 12 months of future income for a lump sum cash OIC and 24 months for a periodic payment OIC. IRM 5.8.5.29, Payment Terms (Mar. 23, 2018). TAS applied the current calculation method to the reviewed cases and found that in almost 90 percent of the cases the 24-month future income calculation also exceeded the amount offered. IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File (Tax Years (TYs) 2009-2013). The margin for the 95 percent confidence interval is plus or minus 4.5 percent. The collection statute could only be determined in 138 of the 171 cases. Of those 138 cases, 24 cases went to collection status code 12 due to abatement of the tax or full payment after the study. In about 90 percent of the remaining 114 cases, the 24-month future income calculation exceeded the amount offered. The margin for the 95 percent confidence interval is plus or minus 5.5 percent.

26 IRS CDW, Individual Returns Transaction File (TYs 2009-2013). For this purpose, TAS considered the IRS attempted to collect if the account went into Collection Status 22 (ACS) or 26 (Field Collection) after leaving Status 71 (OIC). The margin for the 95 percent confidence interval is plus or minus 4.7 percent.

27 *Id.* The margin for the 95 percent confidence interval is plus or minus 5.9 percent.

28 *Id.* The margin for the 95 percent confidence interval is plus or minus 6.1 percent. The Queue holds taxpayer balance due accounts awaiting assignment based on IRM 5.1.20.2, Inventory Delivery System Overview (July 8, 2019). See IRM 5.16, Currently Not Collectible (Sept. 18, 2018) for an explanation of CNC status.

29 IRM 5.8.10.2.2, Offers in Compromise Before Bankruptcy (Feb. 14, 2017).

Of the 14,420 OICs reviewed in the 2017 TAS study, 13 percent (1,922 OICs) later filed for bankruptcy.<sup>30</sup> For the IRS to take into account the effect of a bankruptcy on RCP only in cases where the taxpayer indicates he or she may file for bankruptcy impacts a taxpayer's *right to a fair and just tax system*. This policy also impacts the IRS's ability to collect from the taxpayer after OIC rejection and post-bankruptcy. The IRS should review rejected OICs where the taxpayer subsequently declares bankruptcy to determine if the IRS would have collected more if it had accepted the OIC in the first instance. Then, the IRS should consider whether it should change its policy to consider the effect of a potential bankruptcy filing in calculating every taxpayer's RCP.

## IMPACT ON THE INTERNAL REVENUE SERVICE

The IRS could be more efficient if it accepted viable offers rather than rejecting them and later assigning them to other Collection functions such as field collection, ACS, or shelved status.<sup>31</sup> Despite existing resource constraints, the IRS could potentially increase dollars collected and decrease CNC and shelved inventories by educating taxpayers in these statuses about the OIC program. Encouraging these taxpayers' participation in the OIC program is consistent with both Congress's intent in creating the statute and the IRS's policy to educate and assist taxpayers with OICs.<sup>32</sup>

The IRS collection function consists of field and campus components, such as revenue officers (ROs) and ACS. When the IRS assigns the RO a case, he or she contacts the taxpayer and then attempts to collect the liability and financial information to determine the taxpayer's ability to pay.<sup>33</sup> The RO does a full analysis of the case and resolves the account before closing it. For example, the RO could place the taxpayer into CNC status, enter the taxpayer into a full-pay or partial pay installment agreement, or assist the taxpayer in completing and submitting an OIC.

In contrast, ACS, which automatically sends payment demand notices and notices of federal tax lien and levies, relies upon taxpayers to call ACS employees after receiving a balance due notice. If contacted, then ACS employees will attempt to assist the taxpayer in resolving the liability, but they have less financial analysis training than ROs and do not work with taxpayers from inception to resolution as ROs do.

In recent years the number of ROs has declined by 40 percent, which has resulted in fewer taxpayers working with one employee to resolve their tax debt.<sup>34</sup> Although TAS has supported increased staffing, and the IRS has begun hiring additional ROs, reaching the level of staffing necessary to handle many

30 IRS CDW, Individual Returns Transaction File (TYs 2009-2013). For purposes of determining what percentage of taxpayers later filed for bankruptcy, TAS limited its review to 14,420 rejected OICs where the IRS calculated a RCP higher than the offer amount and did not subsequently collect the amount offered.

31 The IRS uses the term "shelved" to refer to cases that are inactive and unassigned.

32 See IRM 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992).

33 IRM 5.15.1, Financial Analysis Handbook (July 24, 2019).

34 Full-time Revenue Officers declined from 3,752 to 2,239. IRS, Small Business/Self-Employed (SB/SE) Division, Collection Activity Report NO-5000-23, Collection Workload Indicators (FYs 2009-2019).

more accounts may not be possible under the current IRS budget.<sup>35</sup> The IRS is assigning more cases (81 percent in FY 2019) to ACS, as accounts assigned to ROs declined to five percent in FY 2019.<sup>36</sup>

If ACS cannot resolve the liability, then the account is either put into CNC status or shelved. The IRS's CNC inventory has grown from approximately \$61 billion in FY 2009 to approximately \$144 billion in FY 2019.<sup>37</sup> As of the end of FY 2019, IRS shelved inventory reached 8.2 million tax modules, with 47 percent of shelved modules later sent to PCAs.<sup>38</sup> PCAs only have authority to request the taxpayer make a voluntary payment or enter into a full payment installment agreement without assessing a taxpayer's RCP.<sup>39</sup> Currently, more taxpayers' accounts are going from ACS and the Queue to shelved status now that the IRS is required by statute to assign cases to PCAs.<sup>40</sup> With the statutory mandate that the IRS use PCAs, the delinquent tax dollars in IRS's shelved inventory have increased approximately 244 percent.<sup>41</sup> Beginning in 2021, the IRS will be required to withhold certain vulnerable taxpayers' accounts from PCAs, which will likely increase shelved or CNC inventory.<sup>42</sup> Each year unaccepted offers contribute to that total, many with little chance of any future collection because some of these taxpayers are either considered low-income or their allowable living expenses exceed income.<sup>43</sup>

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- 35 The IRS planned to hire 500 to 600 ROs and estimated that 250 ROs would depart during FY 2019. Michael Cohn, *IRS Faces Hiring Shortages Amid Workforce Attrition*, ACCOUNTING TODAY, June 25, 2019, <https://www.accountingtoday.com/news/irs-faces-hiring-shortages-amid-workforce-attrition>. In FY 2019, the total number of ROs increased by 71. IRS, SB/SE Division, Collection Activity Report NO-5000-23, Collection Workload Indicators (FY 2018-2019). See generally 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 ROs).
- 36 IRS, SB/SE Division, Collection Activity Report NO-5000-2, Taxpayer Delinquency Account Cumulative Report (FY 2019).
- 37 IRS, SB/SE Division, Collection Activity Report NO-5000-149, Recap of Accounts Currently Not Collectible (FYs 2009-2019).
- 38 IRS, SB/SE Division, Collection Activity Report NO-5000-149, Recap of Accounts Currently Not Collectible (FY 2019).
- 39 IRS Private Collection Agencies Policy and Procedures Guide, § 10, Individual and Business Payment Options (May 3, 2019). Under IRC § 6306, the IRS is required to enter into qualified collection contracts with private debt collectors to collect inactive account receivables.
- 40 See IRC § 6306. In 2015, the Fixing America's Surface Transportation Act, Pub. L. No. 114-94, § 32102, 129 Stat. 1312, 1733 (2015), mandated the IRS hire private debt collectors to collect inactive inventories. The IRS began implementing the program in April 2017. IRS Servicewide Electronic Research Program Alert #17A0120, Private Debt Collection (Apr. 4, 2017).
- 41 IRS SB/SE Division, Collection Activity Report NO-5000-149, Recap of Accounts Currently Not Collectible (FYs 2015-2019). Shelved inventory was \$11,330,340,718 at the end of FY 2015 and \$38,956,141,758 at the end of FY 2019.
- 42 Taxpayer First Act, Pub. L. No. 116-25, § 1205, 133 Stat. 981 (2019) (amending IRC § 6306(d)(3) to insert subparagraphs (E) and (F) as of December 31, 2020 to prohibit the IRS from sending to PCAs accounts of taxpayers whose income substantially consists of certain social security disability insurance benefits or whose adjusted gross incomes do not exceed 200 percent of the applicable poverty level).
- 43 The total individual OIC receipts for FY 2017, 2018, and 2019 were 141,006, representing 131,528 unique taxpayers. Of those who filed a tax return prior to OIC submission, over 15 percent (20,284) are now in CNC or shelved status (59 percent of these had income below 250 percent of poverty level and 56 percent had projected allowable living expenses greater than income). IRS CDW, Individual Returns Transaction File (TYs 2017-2019). Allowable expenses include transportation expenses, which may consist of ownership expenses (loan or lease payments) and operating expenses (maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking, and tolls). Unless otherwise indicated, in calculating taxpayers' ALEs, TAS allowed operating expenses (two allowances in the case of joint filers and one allowance for all other taxpayers), and all taxpayers were allowed one vehicle ownership expense. TAS used the ALE housing and utility standards published by SB/SE, but some five-digit zip codes may match to more than one county. Note: "A tax return prior to OIC submission" means a tax return was filed for the tax year preceding the fiscal year (e.g., for an offer submitted in FY 2017, TAS reviewed the tax year 2016 return) and some taxpayers may be counted in more than one fiscal year if they submitted offers in more than one fiscal year.

### The IRS Could Affirmatively Identify Cases and Increase Collection Revenues With Targeted Outreach About the Offer in Compromise Program

Despite the fact that the IRS may be rejecting some viable OICs, the OIC program is generally an effective vehicle for collecting revenues and bringing taxpayers into compliance. In FY 2019, the IRS collected approximately 12.5 percent of the total liability on each accepted OIC through the OIC program.<sup>44</sup> The IRS has also been successful at collecting revenue through collection notices, which made up approximately 51 percent of total enforcement revenues in FY 2018.<sup>45</sup> To meet Congress's intent and its own goals of achieving long-term compliance and educating and assisting taxpayers,<sup>46</sup> the IRS should be actively identifying cases that are suitable for the OIC program. Before shelving cases or assigning cases to PCAs, the IRS could be contacting this group of taxpayers with targeted notices about the benefits of the OIC program. This could potentially increase compliance and revenues with little effort while giving taxpayers finality in settling their tax debt. Active outreach may increase collection and compliance, and protect taxpayers' *rights to finality, to be informed, to quality service, and to a fair and just tax system.*

## CONCLUSION

When the IRS rejects an OIC because it overstates RCP, fails to account for its future collection inactivity, or declines to consider the effect of filing bankruptcy in calculating the taxpayer's RCP, it is harmful to both the IRS and the taxpayer. The IRS does not immediately collect on the liability and instead will have to decide whether to expend additional resources to pursue enforced collection. Moreover, taxpayers whose OICs are accepted have a higher tendency to maintain filing and payment compliance for the five-year period following acceptance, which benefits both taxpayers and the IRS.<sup>47</sup> Overstating RCP is not reasonable or consistent with the IRS's current policy in accepting OICs where the amount offered reasonably reflects collection potential.<sup>48</sup> Rejecting otherwise viable OICs and missed opportunities to educate taxpayers on the program infringes on taxpayers' *rights to be informed, to quality service, to finality, and to a fair and just tax system* and may also result in loss of confidence in the program and its ultimate success.

44 IRS, SB/SE Division, Collection Activity Report NO-5000-108, Monthly Report of Offer in Compromise Activity (FY 2019). Contrast this to the 1.34 percent collection rate of the private debt collection (PDC) program from inception through FY 2018. PDC Program Scorecard for FY 2019.

45 Treasury Inspector General for Tax Administration, Ref. No. 2019-30-063, *Trends in Compliance Activities Through Fiscal Year 2018* 7 (Sept. 9, 2019).

46 See IRM 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992) (stating that in cases where an OIC appears to be a viable solution to a delinquency, the employee assigned to the case will discuss the OIC alternative with the taxpayer, and when necessary, assist in preparing the required forms); IRM 1.2.1.6.1, Policy Statement 5-1, Enforcement Is a Necessary Component of a Voluntary Assessment System (Aug. 18, 1994) (recognizing long-term voluntary compliance as an IRS goal).

47 See National Taxpayer Advocate 2018 Annual Report to Congress, vol. 2, at 131, 137 (Research Study: *A Study of the IRS Offer in Compromise Program for Business Taxpayers*) (finding that 70 percent of individual taxpayers remained in filing compliance and 72 percent had no balance due, as opposed to 66 percent and 52 percent, respectively, for individual taxpayers whose OICs were rejected).

48 See IRM 1.2.1.6.17, Policy Statement 5-100, Offers Will Be Accepted (Jan. 30, 1992).



## RECOMMENDATIONS

### Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Conduct a follow-up study evaluating a statistically-valid sample of rejected OICs to determine the accuracy of future income calculations and why the IRS is not collecting the RCP.
2. 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.
3. Work with the National Taxpayer Advocate to develop a pilot program where the IRS sends informative, educational letters about the OIC program to taxpayers in CNC or shelved status.