

**STATUS
UPDATE****AUTOMATED SUBSTITUTE FOR RETURN: The IRS Has Revised the Selection Criteria for Its Reinstated Automated Substitute for Return Program, But Some Concerns Remain Unaddressed****RESPONSIBLE OFFICIAL**

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TAXPAYER RIGHTS IMPACTED¹

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

PROBLEM

The Automated Substitute for Return (ASFR) program assists the IRS in enforcing filing compliance for taxpayers who have not filed individual income tax returns but appear to owe a tax liability.² In the National Taxpayer Advocate's 2015 Annual Report to Congress, TAS identified the administration of the ASFR program as one of the most serious problems encountered by taxpayers in their dealings with the IRS.³

Specifically, we noted that the ASFR program yielded a poor return on investment, as the IRS collected less than one-third of the amount assessed, and it abated 29 percent of all ASFR assessments.⁴ TAS found that the criteria used to select cases for the ASFR program and determine liabilities were deficient, imposing undue burden on taxpayers and creating rework for the IRS.

Citing resource constraints, the IRS temporarily suspended the ASFR program in the fall of 2015.⁵ The IRS resumed selecting cases for the ASFR program on May 21, 2019, and selected 380,348 cases to work in fiscal year (FY) 2019.⁶ For FY 2019, the IRS had just over 100 full-time equivalent employees assigned to the ASFR program.⁷

1 See Taxpayer Bill of Rights (TBOR), 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 Internal Revenue Manual (IRM) 5.18.1.2, Automated Substitute for Return (ASFR) Program Overview (Apr. 6, 2016).

3 See National Taxpayer Advocate 2015 Annual Report to Congress 188-195 (Most Serious Problem: *Automated Substitute for Return (ASFR) Program: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*).

4 *Id.* at 189.

5 The IRS halted new inventory into the ASFR program from September 15, 2015, to May 10, 2016, and again from November 8, 2016, to October 24, 2017. See IRS email to TAS (Mar. 6, 2019).

6 IRS responses to TAS information requests (July 3, 2019 and Oct. 30, 2019).

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

Upon reinstatement of the ASFR program in 2019, TAS found that the IRS:

- Adopted TAS’s recommendation to consider third-party information that supports exemptions and deductions before selecting cases for the ASFR program;
- Adopted TAS’s recommendation to adjust the ASFR selection process by implementing modeling that takes into consideration taxpayers’ prior filing history; and
- Declined to adopt TAS’s recommendation to improve the accuracy of ASFR abatement reason codes.

IMPACT ON TAXPAYERS

Background

If a taxpayer with a filing requirement fails to file a tax return, the IRS is authorized to use third-party information to determine and assess a tax liability.⁸ In such situations, the IRS may prepare a Substitute for Return and assess the liability based on information reporting documents (such as Forms W-2 and 1099) filed by employers, banks, and other third parties.⁹

The ASFR program uses an algorithm that makes assumptions designed to maximize a taxpayer’s liability. It assumes that the taxpayer is single (or married filing separately where there is evidence the taxpayer is married) and has no dependents, and allows one exemption and only the standard deduction, even where the IRS possesses third-party documentation that shows the taxpayer has allowable deductions that exceed the standard deduction amount.¹⁰ As a result, the ASFR program often computes a liability that exceeds what the taxpayer owes because it fails to take into account the taxpayer’s actual filing status, dependency exemptions, and deductions.

Beginning with the 2018 tax year, the Tax Cuts and Jobs Act (TCJA) increased the standard deduction substantially.¹¹ In addition, personal and dependency deductions have been suspended for tax years 2018 to 2025.¹² It is unclear what impact these changes will have on how the IRS selects cases for its ASFR program and how frequently the IRS will need to abate ASFR assessments.

⁸ IRC § 6020(b).

⁹ IRM 5.18.1.2, Automated Substitute for Return (ASFR) Program Overview (Apr. 6, 2016). To meet ASFR processing criteria, the proposed tax liability must meet or exceed a predetermined dollar threshold established by the IRS for the ASFR program.

¹⁰ IRM 5.18.1.3.6, Taxpayer Delinquency Investigation (TDI) Supplement Information (Apr. 6, 2016); IRM 5.18.1.6.2, Computing Taxable Income (Oct. 1, 2005); IRM 5.18.1.6.3, Computing Tax Due, Penalties and Interest (Apr. 6, 2016). ASFR programming determines the filing status, taxable income, tax, interest, and penalties “systemically” (*i.e.*, without employee review).

¹¹ Tax Cut and Jobs Act (TCJA) increased the standard deduction from \$6,500 to \$12,000 for individual filers, from \$13,000 to \$24,000 for joint returns, and from \$9,550 to \$18,000 for heads of household in 2018. As before, the amounts are indexed annually for inflation. TCJA, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

¹² See IRC § 151(d)(5).

The IRS Has Agreed to Consider Third-Party Information When Selecting Cases for the Automated Substitute for Return Program

In its 2015 Annual Report to Congress, TAS noted that the ASFR program's rate of abatement was significant.¹³ For FYs 2011 to 2014, the IRS abated 29 percent of the amount assessed by the ASFR program.¹⁴

As we noted in 2015, the high abatement rate is attributable, at least in part, to assumptions built into the ASFR program's algorithm that generally overstate a taxpayer's tax liability. For example, the IRS already possesses third-party documentation regarding the mortgage interest deduction and many other itemized deductions. The IRS may also receive documentation regarding state tax payments. These items can have a significant impact on the taxpayer's liability, yet the IRS to date has failed to take them into account.

In TAS's 2015 annual report, for example, we published an analysis of ASFR assessments issued to taxpayers who had received a Form 1098, Mortgage Interest Statement. TAS found that more than 60 percent of ASFR accounts with a Form 1098 showed mortgage interest expense amounts higher than the applicable standard deduction (indicating these taxpayers would generally itemize), yet the IRS calculated the assessment based on the standard deduction.¹⁵

To address this problem, TAS recommended that the IRS develop a selection algorithm that incorporates mortgage interest paid and education expenses.¹⁶ The IRS recently informed TAS that its Strategic Analysis and Modeling (SAM) group has revised its modeling to include third-party information for ASFR case selection and will test the model to select cases from tax year 2017.¹⁷

The IRS Has Adjusted the Automated Substitute for Return Selection Process by Implementing Modeling That Takes Into Consideration Taxpayers' Prior Filing Information

The use of taxpayers' historical data in the selection algorithm may also improve the accuracy of the ASFR selection process. For example, the IRS may have data from prior-year returns regarding the taxpayer's filing status or the number of exemptions for dependents claimed. The IRS states that the revised modeling by its SAM group for 2019 does take into consideration taxpayers' prior filing information.¹⁸

The IRS's decision to consider taxpayers' prior filing status history, in addition to third-party documentation that support deductions, should improve the accuracy of ASFR determinations and thereby reduce taxpayer burden and IRS rework.

13 National Taxpayer Advocate 2015 Annual Report to Congress 188-195 (Most Serious Problem: *Automated Substitute for Return (ASFR) Program: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*).

14 *Id.* at 189.

15 *Id.* at 192-193.

16 *Id.* at 194-195.

17 IRS response to TAS information request (July 3, 2019).

18 *Id.*

IMPACT ON THE INTERNAL REVENUE SERVICE

Use of Third-Party Documentation Will Save the IRS Time and Resources

When the IRS conducts an ASFR assessment that later results in an abatement, it is inefficiently using its resources. In many instances, the IRS allows an abatement of tax after the taxpayer submits documentation (to which the IRS already has access) to substantiate allowable deductions. Thus, by making use of third-party documentation, the IRS would save time and resources.

The IRS Should Refine Automated Substitute for Return Abatement Reason Codes

When the IRS abates an ASFR assessment, it records the reason for abatement. In TAS's 2015 Annual Report to Congress, we noted that that reason codes used were so vague and nondescript that they often provided little information as to why the liability was abated.¹⁹ For example, the most commonly entered reason code was "reconsideration allowed in full." Another common reason code was the application of itemized deductions, without specifying the particular itemized deduction.

TAS recommended that the IRS refine the ASFR abatement reason codes, making them specific enough to provide useful information to the IRS.²⁰ For example, it would be extremely helpful to know whether mortgage interest is the largest driver of abatement. By continuing to use the broad reason code "itemized deductions," the IRS will not obtain the specific information it needs to improve its algorithm.

The IRS considered this recommendation but declined to create new reason codes for abatement. The IRS responded that it determined the existing reason codes are sufficient, and it will rely on ASFR employees to use their judgment to select the appropriate reason code based on the circumstances.²¹

CONCLUSION

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

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

TAS will continue to review the operation and effectiveness of the ASFR program as more data becomes available regarding assessments, abatement, and collection.

19 See National Taxpayer Advocate 2015 Annual Report to Congress 193 (Most Serious Problem: *Automated Substitute for Return (ASFR) Program: Current Selection Criteria for Cases in the ASFR Program Create Rework and Impose Undue Taxpayer Burden*).

20 See *id.* at 195.

21 IRS response to TAS information request (July 3, 2019).

RECOMMENDATION**Administrative Recommendation to the IRS**

The National Taxpayer Advocate reiterates her recommendation that the IRS:

1. Refine ASFR abatement reason codes, making them specific enough to identify which factors contributed to the abatement.