

Introduction: Legislative Recommendations

Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The chart immediately following this Introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2011 Annual Reports.¹ The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion details recent developments relating to the National Taxpayer Advocate's proposals.

Taxpayer Bill of Rights

In last year's Annual Report to Congress, the National Taxpayer Advocate recommended that Congress enact the legislative recommendations detailed in previous reports, beginning with her 2007 recommendation to codify a taxpayer bill of rights that would explicitly detail the rights and responsibilities of taxpayers.² On June 28, 2012, Senator Bingaman and Congressman Becerra introduced companion bills entitled the Taxpayer Bill of Rights Act of 2012 (TBOR 2012).³ This legislation would codify a taxpayer bill of rights by amending the Internal Revenue Code (Code) to require the IRS, in consultation with the National Taxpayer Advocate, to publish a summary statement of the rights and obligations of taxpayers under the Code.⁴ The legislation would also codify the National Taxpayer Advocate's authority to issue a Taxpayer Advocate Directive to the IRS.⁵

TBOR 2012 contains many of the National Taxpayer Advocate's proposals. The National Taxpayer Advocate recommended that the IRS create an effective oversight and penalty

¹ An electronic version of the chart is available on the TAS website at www.TaxpayerAdvocate.irs.gov.

² National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*).

³ S. 3355, 112th Cong. (2012); H.R. 6050 112th Cong. (2012).

⁴ The bill lists the following rights to be included: to be informed, to be assisted, to be heard, to pay no more than the correct amount of tax, to appeal, to certainty, to privacy, to confidentiality, to appoint a representative, and to a fair and just tax system. The bill lists five obligations: to be honest, to be cooperative, to provide accurate information and documents on time, to keep records, and to pay taxes on time. S. 3355, 112th Cong. § 101 (2012).

⁵ S. 3355, 112th Cong. § 306 (2012). See National Taxpayer Advocate 2011 Annual Report to Congress 573-81 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*). Taxpayer Advocate Directives mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers or all taxpayers. IRM 13.1.4.2.2.5 (Oct. 31, 2004).

regime for return preparers;⁶ TBOR 2012 requires the IRS to regulate any preparers not already regulated, creates a penalty for unauthorized preparation of returns, and expands and increases current preparer penalties.⁷ The legislation also includes registration and disclosure requirements and new penalties for persons facilitating refund delivery products.⁸

The National Taxpayer Advocate has advocated for numerous changes to the IRS's filing and reporting of federal tax liens.⁹ Under TBOR 2012, the IRS would have to weigh the benefit to the government and the harm to the taxpayer before filing a lien and would have to provide the taxpayer with an opportunity to appeal the lien determination before the lien is filed.¹⁰ Additionally, TBOR 2012 would amend the Fair Credit Reporting Act to require removal of derogatory lien-filing information from credit reports under certain circumstances.¹¹

TBOR 2012 contains the National Taxpayer Advocate's recommendation to provide statutory authority for IRS employees to refer taxpayers to a specific low income taxpayer clinic (LITC) for assistance.¹² In addition, TBOR 12 requires the Department of Treasury to study the accelerated processing of information returns and the effectiveness of collection alternatives.¹³ The legislation also includes the National Taxpayer Advocate's 2011 recommendation to clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.¹⁴

SMALL BUSINESS TAXPAYER BILL OF RIGHTS ACT OF 2012

Senator John Cornyn and Congressman Sam Johnson introduced legislation that would enact a number of the National Taxpayer Advocate's previous recommendations.¹⁵ The legislation would prohibit *ex parte* communications between Appeals officers and other IRS

⁶ See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*), National Taxpayer Advocate 2008 Annual Report to Congress 423-26 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*).

⁷ S. 3355, 112th Cong. §§ 202, 204 (2012). The bill increases the preparer penalty for gross misconduct to 100 percent of the amount of the understatement of tax. *Id.*

⁸ S. 3355, 112th Cong. § 203 (2012).

⁹ See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 357-64 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*).

¹⁰ S. 3355, 112th Cong. § 301 (2012).

¹¹ S. 3355, 112th Cong. § 302 (2012).

¹² S. 3355, 112th Cong. § 201 (2012). See National Taxpayer Advocate 2007 Annual Report to Congress 551-52 (Legislative Recommendation: *Referral to Low Income Taxpayer Clinics*).

¹³ S. 3355, 112th Cong. § 309 (2012). The National Taxpayer Advocate has recommended both of these studies. See National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*), vol. 2, 19-34 (Research Study: *Subsequent Compliance Behavior of Delinquent Taxpayers: A Compliance Challenge Facing the IRS*).

¹⁴ S. 3355, 112th Cong. § 310 (2012). See National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*). The term "de novo" means anew. *Black's Law Dictionary* (9th ed. 2009).

¹⁵ Small Business Taxpayer Bill of Rights Act of 2012, S. 2291, 112th Cong. (2012); H.R. 4375, 112th Cong. (2012).

employees.¹⁶ The bill includes two recommendations relating to collection. The legislation would extend the period in which a third party can bring a suit for return of levied funds or proceeds,¹⁷ and waive the installment agreement fee for taxpayers whose adjusted gross income does not exceed 250 percent of the federal poverty level.¹⁸

The legislation contains two of the National Taxpayer Advocate's recommendations regarding relief from joint and several liability. The bill would allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.¹⁹ The legislation would also clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.²⁰

RELEASE LEVIES CAUSING ECONOMIC HARDSHIP TO BUSINESSES

The National Taxpayer Advocate has advocated for many reforms to the IRS's levy program. Most recently, she recommended that Congress amend the Code to allow the IRS to release levies on business taxpayers that impose economic hardship.²¹ This year, Congressman McDermott introduced legislation that would allow the IRS to release a levy if the levy was causing economic harm to the taxpayer's trade or business.²²

EXTEND THE DUE DATE FOR S CORPORATION ELECTION

The National Taxpayer Advocate has called attention to the harmful consequences of allowing taxpayers to elect S corporation status only if they do so by the 15th day of the third month of their financial year.²³ Senator Franken introduced legislation to allow corporations to elect S corporation status with their first filed returns.²⁴

¹⁶ S. 2291, 112th Cong. § 7 (2012). See National Taxpayer Advocate 2009 Annual Report to Congress 346-50 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*) (noting the IRS Restructuring and Reform Act of 1998 prohibits ex parte communication between Appeals employees and other IRS employees, but recent IRS practices allowing Appeals employees to share office space with other IRS employees foster a perception of a lack of independence).

¹⁷ The bill extends the time for third parties to bring suit from nine months to three years. H.R. 4375, 112th Cong. § 9 (2012). See National Taxpayer Advocate 2001 Annual Report to Congress 202-09 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

¹⁸ S. 2291, 112th Cong. § 10 (2012). See National Taxpayer Advocate 2006 Annual Report to Congress 141-56 (Most Serious Problem: *Collection Issues of Low Income Taxpayers*) (recommending the IRS implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required).

¹⁹ S. 2291, 112th Cong. § 11 (2012). See National Taxpayer Advocate 2004 Annual Report to Congress 490-92 (Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

²⁰ S. 2291, 112th Cong. § 14 (2012). See National Taxpayer Advocate 2011 Annual Report to Congress 531-36 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*).

²¹ See National Taxpayer Advocate 2011 Annual Report to Congress 537-43 (Legislative Recommendation: *Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers that Impose Economic Hardship*).

²² H.R. 4368, 112th Cong. (2012).

²³ See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 410-11 (Legislative Recommendation: *Extend the Due Date for S Corporation Elections to Reduce the High Rate of Untimely Elections*).

²⁴ S. 2271, 112th Cong. (2012).

RESTRICT ACCESS TO THE DEATH MASTER FILE

As one means to stem the growing number of tax related identity theft cases, the National Taxpayer Advocate recommended that Congress restrict access to the Social Security Administration's death master file (DMF).²⁵ Senator Nelson and Congressman Nugent introduced separate identity theft bills that would limit access to the DMF records of individuals who died during the previous two calendar years.²⁶

CONSOLIDATE EDUCATION INCENTIVES

The National Taxpayer Advocate has suggested consolidating and simplifying various provisions in the Code to make compliance less difficult for taxpayers.²⁷ Senator Schumer and Congressman Israel introduced companion bills that include the National Taxpayer Advocate's recommendation to consolidate the education tax credits known as the Hope Scholarship and the Lifetime Learning Credits.²⁸

SUMMARY OF 2012 LEGISLATIVE RECOMMENDATIONS

We continue to advocate for the proposals we have made previously. In this report, we highlight some of the recommendations in prior reports that will protect taxpayer rights. In addition, we present seven new legislative recommendations, summarized below. The first three recommendations concern family status issues, which are part of fundamental tax reform.²⁹ The remaining four involve issues of taxpayer rights.

FAMILY STATUS LEGISLATIVE RECOMMENDATIONS

1. Simplify the National Status and Related Requirements for Qualifying Children.

Confusion arises when similar taxpayers receive different deductions or credits depending on the residence or national status of their children. The dependency deduction, child tax credit (CTC), and Earned Income Tax Credit (EITC), all of which relate to the cost of raising children, have different requirements in terms of where the child must reside, whether the child is an American citizen or national, and whether the child has a social security number. Due to the inconsistency of these requirements, similarly situated taxpayers may fail to claim the correct benefits.

²⁵ See National Taxpayer Advocate 2011 Annual Report to Congress 519-23 (Legislative Recommendation: *Restrict Access to the Death Master File*). The death master file is a database available to the public that includes the full name, SSN, date of birth, date of death, and the county, state, and Zip code of the last address on record of decedents. *Id.*

²⁶ S.1534, 112th Cong. § 9 (2012); H.R. 6205, 112th Cong. § 7 (2012). Both bills also include the National Taxpayer Advocate's administrative recommendation to allow victims of tax related identity theft to turn off the ability to file electronically. See National Taxpayer Advocate 2011 Annual Report to Congress 48, 63 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*).

²⁷ See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 370-72 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*).

²⁸ S. 3267, 112th Cong. (2012); H.R. 6522, 112th Cong. (2012).

²⁹ For a discussion of previous recommendations relating to fundamental tax reform, see National Taxpayer Advocate 2010 Annual Report to Congress 365-72 (Legislative Recommendation: *Enact Tax Reform Now*).

The National Taxpayer Advocate recommends that Congress simplify the three-part children's national status requirements in conformity with overall simplification of the family tax benefits as the National Taxpayer Advocate previously proposed. This includes:

- Consolidating the dependency deduction and CTC (nonrefundable portion) with head of household filing status into a Family Credit;
- Consolidating and modifying the EITC with the refundable portion of the CTC into a Worker Credit not contingent on qualifying children;
- Applying the contiguous country rule encompassing the U.S., Canada, and Mexico for the Family credit;
- Requiring an SSN valid for employment for the Worker Credit; and
- Repealing as obsolete the residence rule that requires the child to be a citizen, national, or otherwise in the U.S.

2. Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married.” Married taxpayers must file joint returns to claim important tax benefits such as the EITC. IRC § 7703, which determines marital status, permits some married taxpayers to be “considered as” not married. So long as these married taxpayers meet the other pertinent statutory requirements, they will be entitled to the tax benefits claimed on their separate returns. IRC § 7703(b), however, prevents taxpayers from being considered “not married” in two ways.

- First, the statute retains an outdated “cost of maintaining a household” test that disproportionately affects members of racial and ethnic minorities who work and have children.
- Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year's end.

The National Taxpayer Advocate recommends that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.”

3. Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes. Between January 1, 2003, and December 31, 2012, a taxpayer adopting a child who has been determined by a state to have special needs could claim an adoption tax credit of \$10,000, plus an inflation adjustment, even if the adoptive parent paid no actual qualified adoption expenses in connection with the adoption. A “child with special needs” is defined as a child whom a state has determined cannot or should not be returned to the home of his parents, and the state has also determined has a specific factor or condition making it reasonable to conclude that placement of the child with adoptive parents requires adoption assistance. Under the IRC, however, a Native American tribal government is treated as a state only

if (a) a particular Code section specifically so provides, or (b) the Code section is listed in § 7871. Neither § 23 nor § 7871 provides that a Native American tribal government can be treated as a state for purposes of the adoption credit. Thus, a determination by a Native American tribal government that a child is a special needs child would not entitle the adoptive parents to a special needs adoption credit. The National Taxpayer Advocate recommends that Congress amend IRC § 7871(a) to include IRC § 23 in the list of Code sections for which a Native American tribal government is treated as a “State.” If a Native American tribal government is treated as a state for purposes of IRC § 23, its determination that a child has special needs would enable adoptive parents to claim the special needs adoption credit, provided that the other requirements of the Code are met.

TAXPAYER RIGHTS LEGISLATIVE RECOMMENDATIONS

4. Amend IRC § 7701 to Provide a Definition of “Last Known Address” and Require the IRS to Mail Duplicate Notices to Credible Alternate Addresses. The IRS informs taxpayers of important statutory rights by sending notices or letters through the United States Postal Service (USPS). For essential notices that advise taxpayers of fundamental rights, such as the statutory notice of deficiency, it does not search beyond its own databases for a taxpayer’s correct address, even when it learns that that address is incorrect. Given the availability of technology and the centrality of “last known address” to fundamental rights that preserve the perception (and actuality) of fairness in our tax system, the small burden of requiring reliable database investigation is more than outweighed by taxpayers’ and the government’s interest in procedural fairness.³⁰ The National Taxpayer Advocate reiterates her recommendation that Congress amend IRC § 7701 to add a definition of “last known address” that incorporates case law and current regulations. She also reiterates her recommendation that Congress direct the Secretary of Treasury to develop procedures for checking third-party databases for credible, alternate addresses prior to sending notices that establish legal rights and require the IRS to mail the notice simultaneously to the last known address and a credible alternate address when the IRS learns its records do not contain a taxpayer’s correct address.

5. Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences. After a taxpayer fails to pay any tax, the federal tax lien arises by operation of law. The IRS may generally commence an administrative seizure when it notifies a taxpayer of the opportunity to be heard in a Collection Due Process (CDP) hearing. After the taxpayer’s hearing (or failure to respond), the IRS may seize the taxpayer’s property, subject to protections provided in the Code. However, after the IRS files a Notice of Federal Tax Lien (NFTL) in the public records and offers a CDP hearing to the taxpayer, the IRS may request that the U.S. Attorney General (AG) direct the filing of a suit to foreclose the tax lien and sell the taxpayer’s principal residence, without reference to the protections

³⁰ For information about the IRS’s inadequate funding of its address systems, see Status Update: *Underfunding of IRS Initiatives to Modernize Its Taxpayer Address Systems Undermines Taxpayers’ Statutory Rights and Impedes Efficient Resource Allocation, supra.*

applicable to seizures. The taking of principal residences without adequate taxpayer protections deprives taxpayers of their homes and the financial resources to acquire new ones.

The National Taxpayer Advocate recommends that Congress amend IRC § 7403 to preclude an IRS employee from requesting that the AG direct the filing of a civil action to foreclose the federal tax lien against a taxpayer's principal residence in U.S. District Court, unless the IRS employee has received executive level approval. This approval could only occur after determining that:

- The taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, including the expenses of the proceedings; and
- The foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer.

6. Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions. While some taxpayers may fraudulently convey their property to friends or relatives to avoid their personal legal obligation to pay taxes, others legitimately divest their property before the IRS assesses tax. The IRS files Notices of Federal Tax Lien (NFTLs) and issues levies against the property of third parties (individuals or entities, known as transferees, nominees, or alter egos) that hold property purportedly belonging to taxpayers subject to collection. However, these third parties are not considered taxpayers for the purposes of Collection Due Process (CDP) rights under IRC §§ 6320 and 6330 and therefore are not entitled to CDP rights. Without the protections afforded by IRC §§ 6320 and 6330, the third party against whom the IRS has taken a collection action has limited remedies, provided only after the collection action has occurred. These remedies are time-consuming, costly, and place an undue burden on those who cannot afford the significant expense of litigating in federal district court. The National Taxpayer Advocate recommends that Congress amend IRC §§ 6320 and 6330 to extend Collection Due Process rights to "affected third parties," known as nominees, alter egos, and transferees, who hold legal title to property subject to IRS collection actions.

7. Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes. The payroll processing industry provides a valuable service to employers, especially small businesses, by helping them comply with complex federal, state, and local employment tax requirements. The industry has created various contractual arrangements with third party payers (TPPs) in which a TPP performs some or all of the employer's federal employment tax withholding, reporting, and payment obligations. While most TPPs are legitimate and trustworthy companies, a few "bad actors" have defrauded their clients and tarnished the image of the industry. Because the IRC does not protect taxpayers from TTP

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failures and employers remain liable for payroll taxes, those victimized in these situations (especially self-employed and small business taxpayers) can experience significant burden.³¹

The National Taxpayer Advocate recommends that Congress amend the IRC to require any person who enters into an agreement with an employer to collect, report, and pay any employment taxes to furnish a performance bond that specifically guarantees payment of federal payroll taxes collected, deducted, or withheld by such person from an employer and from wages or compensation paid to employees. Congress should amend IRC § 3504 to require agents with an approved Form 2678, *Employer/Payer Appointment of Agent*, to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for the failure to file absent reasonable cause. The National Taxpayer Advocate further recommends that Congress amend the U.S. Bankruptcy Code to clarify that IRC § 6672 penalties survive bankruptcy in the case of non-individual debtors.

³¹ For a further discussion of the harms caused by TPP failures, see Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*, *supra*.