

## MSP #15 **ECONOMIC HARDSHIP: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process**

### RESPONSIBLE OFFICIAL

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### 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*

### DEFINITION OF PROBLEM

Economic hardship, as defined in Treasury regulations and the Internal Revenue Manual, occurs when an individual is “unable to pay his or her reasonable basic living expenses.”<sup>2</sup> Congress has repeatedly emphasized the importance of protecting taxpayers experiencing economic hardship from collection actions that would exceed their ability to pay. For example, in the collection arena:

- Since 1988, Internal Revenue Code (IRC) § 6343 has required the IRS to release a levy if the IRS determines that “such levy is creating an economic hardship due to the financial condition of the taxpayer;”<sup>3</sup>
- Since 1998, IRC § 6330 has permitted a taxpayer, in a collection due process hearing, to raise the inability to pay due to hardship as a “challenge to the appropriateness of collection action;”<sup>4</sup> and
- Since 1998, IRC § 7122 has required the IRS to develop allowable living expense (ALE) guidelines to determine when an offer in compromise (OIC) is adequate and should be accepted to resolve a dispute.<sup>5</sup>

The IRS has internal data that it can use to identify taxpayers at risk of economic hardship. For example, when a taxpayer calls the IRS stating that he or she cannot pay the tax due, the IRS collection employee is able to verify some or all of the financial information provided by the taxpayer. If the employee determines the taxpayer’s ALEs exceed his income, the employee will place the taxpayer’s

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 § 6343, Treas. Reg. § 301.6343-1, and Internal Revenue Manual (IRM) 5.8.11.2.1 (Aug. 5, 2015).

3 IRC § 6343(a)(1)(D).

4 IRC §§ 6320(c), 6330(c)(2)(A)(ii).

5 IRC § 7122(d). If the allowable living expense (ALE) standards exceed the taxpayer’s income, the taxpayer is unable to pay his or her necessary living expenses. Statutory protections of taxpayers who are likely in economic hardship are available in other contexts. See, e.g., IRC § 7526, authorizing funding for the Low Income Taxpayer Clinic (LITC) grant program for taxpayers who cannot afford representation in IRS disputes (generally, those with incomes below 250 percent of the federal poverty level) and are therefore vulnerable to overreaching, and IRC § 6159(f), excusing taxpayers whose incomes do not exceed 250 percent of the federal poverty level from paying user fees to enter into installment agreements (IAs).

account into “currently not collectible (CNC) - hardship” status.<sup>6</sup> As a result, the taxpayer is protected from IRS collection action to ensure he is left with an adequate means to provide for basic living expenses.

However, despite the availability of this information and Congressional guidance to shield these taxpayers from harmful collection activity, the IRS does not *proactively* identify taxpayers likely in economic hardship throughout the collection process.<sup>7</sup> The IRS does not consider ALE guidelines in deciding which collection cases to work, although research by TAS shows that about 93 percent of payments received by the IRS in a sample group came from taxpayers with income exceeding their calculated ALEs or who have assets that can be detected through systemic means.<sup>8</sup> In fact, the IRS does not use internal data at any stage of the collection process to automatically place an indicator that the taxpayer is at risk of economic hardship.<sup>9</sup> This means that the IRS does not have a method to alert collection employees that a taxpayer may be at risk of economic hardship and, when responding to taxpayer inquiries, to ask questions about the taxpayer’s finances to determine an appropriate collection action or alternative.

The IRS’s failure to use information in its databases to consider facts and circumstances that might affect taxpayers’ ability to pay, and respond to them appropriately, violates taxpayers’ *rights to a fair and just tax system* and *to finality*. Many if not most taxpayers who cannot afford to pay their tax liabilities are likely unaware the IRS is required to halt collection action if they are in economic hardship. Thus, they may enter into payment agreements they cannot afford, including streamlined installment agreements (IAs) that do not require financial information from the taxpayer.<sup>10</sup> Furthermore, this approach causes IRS to expend resources attempting to collect from taxpayers who cannot afford to pay, and creates unnecessary rework when those taxpayers default on IAs. TAS’s research shows:

- In fiscal year (FY) 2018, about 40 percent of taxpayers who entered into streamlined IAs within the Automated Collection System (ACS) had incomes at or below their ALEs;<sup>11</sup>

6 IRM 5.16.1.2.9 (Sep. 18, 2018).

7 The IRS has internal data available to provide an initial indicator of whether a taxpayer may be at risk of economic hardship, but uses this information in very limited circumstances, such as the Low Income Indicator (LII) used to determine whether taxpayers entering into an IA are eligible for a reduced waived user fee. The LII is placed on the IRS’s internal Masterfile system, and is determined by reviewing the taxpayer’s income and exemptions on the taxpayer’s most recent tax return and comparing them with the poverty level charts created by the Department of Health and Human Services (HHS). IRM 5.14.1.2 (July 16, 2018); see also IRS response to TAS information request (Sept. 14, 2018).

8 See Research Study: *Further Analyses of “Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens (NFTL) and Alternative IRS Letters on Individual Tax Debt Resolution,”* *infra*. The National Taxpayer Advocate persuaded the IRS to conduct a study to determine if the NFTL or one of three alternative collection letters were more effective in reducing the balances owed by taxpayers. The IRS selected a random sample of about 13,000 taxpayers within ACS who generally owed between \$10,000 and \$25,000 whose liabilities were being transferred to the collection queue. TAS Research’s analysis of these cases showed that taxpayers with income exceeding their calculated ALE or who have systemically detected assets account for about 93 percent of the payments made over two years regardless of the treatment type.

9 An exception to this approach is the IRS’s automatic Federal Payment Levy Program (FPLP). At the urging of the National Taxpayer Advocate, the IRS adopted 250 percent of the federal poverty level as a proxy for identifying taxpayers likely in economic hardship for purposes of FPLP. Recipients of Social Security Administration (SSA) retirement benefits with incomes below that level are generally excluded from the FPLP program. See IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016).

10 See National Taxpayer Advocate 2016 Annual Report to Congress 230-238 (Most Serious Problem: *Installment Agreements: The IRS Is Failing to Properly Evaluate Taxpayers’ Living Expenses and Is Placing Taxpayers in IAs They Cannot Afford*).

11 Due to the lapse in appropriations, Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process. See also Most Serious Problem: *IRS’s Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS,* *infra*.

- About 39 percent of streamlined IAs within ACS involving taxpayers with income at or below their ALES defaulted in FY 2018;<sup>12</sup>
- Forty percent of taxpayers who entered into IAs while their debts were assigned to private collection agencies (PCAs) had incomes at or below their ALES;<sup>13</sup> and
- In FY 2018, the IRS placed 155,186 taxpayers in CNC-Hardship status.<sup>14</sup>

## ANALYSIS OF PROBLEM

### For Decades Congress Recognized the Need to Protect Taxpayers Who Are in Economic Hardship

Prior to 1988, IRC § 6343 authorized the release of a levy only if the IRS determined that release would facilitate collection of the tax.<sup>15</sup> Amendments to IRC § 6343 in 1988 set out conditions under which the IRS is *required* to release a levy, including when “the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer.”<sup>16</sup> Economic hardship is present “if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses.”<sup>17</sup>

Prior to 1998, there was no statutory procedure for any independent review of the IRS’s collection decision.<sup>18</sup> In 1998, Congress enacted IRC §§ 6320 and 6330 to provide for a collection due process (CDP) hearing at the administrative level and for Tax Court review of the IRS’s resulting determination—both to take place after the Notice of Federal Tax Lien (NFTL) is filed but before the IRS takes enforced collection action, such as a levy.<sup>19</sup> At the CDP hearing, taxpayers may challenge the appropriateness of the proposed collection action.<sup>20</sup> If they demonstrate they are in economic hardship, the IRS is obliged to consider alternatives, such as CNC Hardship status.<sup>21</sup>

12 TAS Research analysis of the Individual Master File and Individual Returns Transaction File on IAs established in fiscal year (FY) 2018. This figure assumes taxpayers have one IRS-allowed vehicle ownership and operating expense, and a second if they were married filing jointly. As discussed below, if we assume the taxpayers did not have vehicle ownership expenses, the default rate would be about 32 percent.

13 See Most Serious Problem: *Private Debt Collection: The IRS’s Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive PCA Inventory Accumulates*, *infra*.

14 Custom analysis by TAS Research. IRS, IMF, Collection Activity Report NO-5000-149 (Oct. 11, 2018).

15 See Internal Revenue Code of 1954, Pub. L. No. 83-591, 68A Stat. 3 (1954). Section 6334 provided in its entirety: “It shall be lawful for the Secretary or his delegate, under regulations prescribed by the Secretary or his delegate, to release the levy upon all or part of the property or rights to property levied upon where the Secretary or his delegate determines that such action will facilitate the collection of the liability, but such release shall not operate to prevent any subsequent levy.”

16 See Omnibus Taxpayer Bill of Rights, Pub. L. No. 100-647, § 6236(f), 102 Stat. 3342, 3740 (1988), also known as Taxpayer Bill of Rights 1 (TBOR 1), enacting IRC § 6343(a)(1)(D).

17 Treas. Reg. § 301.6343-1(b)(4).

18 See *IRS Restructuring: Hearings on H.R. 2676 Before the S. Finance Comm.*, 105th Cong. 376, 377 (1998) (testimony of Michael Saltzman, tax attorney, White and Case).

19 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, enacting IRC §§ 6320 and 6330.

20 IRC §§ 6320(c), 6330(c)(2)(A)(ii).

21 See *Vinatieri v. Comm’r*, 133 T.C. 392, 400 (Dec. 21, 2009), in which the Tax Court held: “When a taxpayer establishes in a pre-levy collection hearing under section 6330 that the proposed levy would create an economic hardship, it is unreasonable for the settlement officer to determine to proceed with the levy which section 6343(a)(1)(D) would require the IRS to immediately release. Rather than proceed with the levy, the settlement officer should consider alternatives to the levy.”

Prior to 1998, the IRS evaluated taxpayers' abilities to pay their tax liabilities by comparing their incomes to their ALEs.<sup>22</sup> In 1998, Congress codified this practice by amending IRC § 7122 to *require* the IRS to develop ALEs "designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses."<sup>23</sup> The ALE standards, also known as the Collection Financial Standards, include national and local standards, which are guidelines established by the IRS to provide consistency in certain expense allowances.<sup>24</sup> These standards determine how much money taxpayers need for basic living expenses such as housing and utilities, food, transportation, and health care, based on family size and where they live.<sup>25</sup> The National Taxpayer Advocate continues to have concerns that ALE standards fail to reflect what it truly costs to meet necessary living expenses, but ALEs can nevertheless be an important starting point to detect taxpayers at risk of economic hardship.<sup>26</sup>

### The IRS Scores and Routes Collection Cases Using Internal Data About Taxpayers

If a taxpayer continues to have a tax liability after being sent a series of notices from the IRS, the IRS generally assigns the liability to Taxpayer Delinquent Accounts (TDA) status.<sup>27</sup> The case is scored and routed through the IRS's Inventory Delivery System (IDS), which uses analytical scoring models and business rules to manage unresolved cases.<sup>28</sup> IDS is designed to (1) identify and filter out cases that should not be pursued further (*i.e.*, those that should be shelved), (2) categorize some cases as high risk (*e.g.*, those in which the period of limitations on collection will expire soon), and (3) determine whether cases should be routed to either the IRS's ACS or the Collection Field function (the Field) to be worked.<sup>29</sup> In FY 2018, the IDS routed 87 percent of TDA taxpayers to ACS, which is mainly responsible for responding to taxpayers' calls and sending notices, while about one percent of TDA taxpayers were sent to the Field, where a case can be assigned to a specific Revenue Officer.<sup>30</sup>

22 See, e.g., IRM 105.1.3 (Sept. 25, 1996), <http://core.publish.no.irs.gov/irm/p05/pdf/30353i96.pdf>; IRM 57(10)(10).1(4), *Determination of Adequate Offer* (Sept. 22, 1994), cross referencing IRM 5323 on IAs, <http://core.publish.no.irs.gov/irm/p05/pdf/35490e98.pdf>.

23 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3462, 112 Stat. 685, 764 (Jul. 22, 1998), adding subsection (c) (which is now subsection (d)) to IRC § 7122.

24 IRM 5.15.1.8 (Aug. 29, 2018).

25 See IRS, *Collection Financial Standards*, <https://www.irs.gov/businesses/small-businesses-self-employed/collection-financial-standards>. The ALEs are guidelines that "establish the minimum a taxpayer and family needs to live." The IRS may allow additional amounts for basic living expenses if the taxpayer substantiates the need to deviate from the standards. IRM 5.15.1.8 (6), *Financial Analysis Handbook: Allowable Expense Overview* (Aug. 29, 2018). 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, we 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.

26 See Research Study: *A Study of the IRS's Use of the Allowable Living Expense Standards*, *infra*.

27 Taxpayer Delinquent Account (TDA) status applies to balance due accounts when "the taxpayer has an outstanding liability for taxes, penalties and/or interest." IRM 19.16.4 (Oct. 10, 2012).

28 See IRM 5.1.20.2 (Nov. 2, 2016).

29 Government Accountability Office (GAO) GAO-15-647, *Collection Process Is Largely Automated, but Lacks Adequate Internal Controls* 11 (Jul. 2015). For a description of the ACS, see Most Serious Problem: *IRS'S Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS*, *infra*. For a description of field collection, see 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*, *infra*.

30 IRS, *Collection Activity Report NO-5000-2* (Oct. 1, 2018), (showing the cases of 3,048,419 TDA taxpayers were sent to ACS, while the cases of 34,511 TDA taxpayers were sent to the Field).

Shelved cases are those that the IRS sets aside without pursuing enforced collection action (such as levies).<sup>31</sup> They may continue in that status until the period of limitations on collection expires.<sup>32</sup> The liabilities of over 950,000 taxpayers were routed to the Shelf in FY 2018.<sup>33</sup> Shelved cases are still subject to systemic collection action, such as a refund offset, and the IRS is required to assign some shelved cases to a PCA.<sup>34</sup> Shelved cases are closed with a generic closing code, CNC-Unproductive.<sup>35</sup> The IRS may assign a specific reason for designating a case as CNC, such as the taxpayer's economic hardship, only later in the collection process.<sup>36</sup>

### The Models Used by the IRS to Score and Route Cases Do Not Adequately Identify Taxpayers Experiencing Economic Hardship

As discussed above, Congress has repeatedly directed the IRS to protect taxpayers who experience economic hardship or who cannot pay their basic living expenses. This concept is also embedded in the Taxpayer Bill of Rights.<sup>37</sup> In 2014, the Treasury Inspector General for Tax Administration found that IRS case selection criteria did not consider the financial condition of delinquent taxpayers.<sup>38</sup> Similarly, in 2015, the Government Accountability Office reviewed the IRS's case categorizing and routing process and found effectiveness was not routinely monitored.<sup>39</sup> As a result of these reports and a study by the IRS assessing the collection impact of working different types of cases, the IRS redeveloped the models used within IDS to better predict and filter unproductive cases, or cases where no payments are expected.<sup>40</sup>

While the models used in the case scoring process are designed to identify and shelve unproductive cases, they are not designed to specifically identify if a taxpayer is at risk of economic hardship.<sup>41</sup> The models do not incorporate ALEs, developed by the IRS to identify the amount of expenses "necessary to

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- 31 Cases can be shelved by the Inventory Delivery System (IDS) or later on in the collection stream by ACS or the Field if it remains unworked.
- 32 Under IRC § 6502, the IRS must generally collect tax within ten years after assessment. Shelved cases may be reactivated in certain situations, such as when a taxpayer owes a liability in future years. IRS response to TAS information request (Oct. 17, 2018).
- 33 IRS Compliance Data Warehouse, Individual Accounts Receivable Dollar Inventory Module File (current through cycle 2018-37) (data drawn Nov. 8, 2018). The IRS maintains records of individual taxpayers' accounts on the Individual Master File (IMF). Each module on the IMF represents a specific tax liability. Taxpayers may have unpaid liabilities with respect to more than one tax year, or module.
- 34 IRC § 6306(c) generally requires the IRS to assign to Private Collection Agencies (PCAs) all "inactive tax receivables," defined as any "tax receivable" that meets any one of three criteria, including if 365 days have passed without taxpayer or third-party interaction to further collection of the account. A "tax receivable" for purposes of the statute is an account the IRS includes in "potentially collectible inventory" (PCI), a term not defined in the statute or in Treasury regulations. See also Most Serious Problem: *Private Debt Collection: The IRS's Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive PCA Inventory Accumulates*, *infra*.
- 35 IRS response to TAS information request (Oct. 17, 2018).
- 36 See IRM 5.16.1.2, *Currently Not Collectible Procedures* (Sept. 18, 2018); IRM 5.16.1.2.9, *Hardship* (Sept. 18, 2018); IRM 5.15.1.17, *Making the Collection Decision* (Aug. 29, 2018).
- 37 Taxpayers' *right to a fair and just tax system* includes the right to expect the IRS consider facts and circumstances that might affect their ability to pay.
- 38 See Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2014-30-068, *Field Collection Could Work Cases With Better Collection Potential*, (Sept. 12, 2014).
- 39 See GAO, GAO-15-647, *IRS Case Selection: Collection Process Is Largely Automated, but Lacks Adequate Internal Controls* (July 2015).
- 40 Erik Miller, Stacy Orlett, and Alex Turk, IRS, *Uncollectible Versus Unproductive: Compliance Impact of Working Collection Cases That Are Ultimately Not Fully Collectible*, (2014). See also IRS response to TAS information request (Oct. 17, 2018).
- 41 IRS response to TAS information request (Oct. 17, 2018).

provide for a taxpayer's and his or her family's health and welfare and/or production of income."<sup>42</sup> Thus, taxpayers meeting the IRS's own definition of economic hardship may go undetected at the scoring phase.

### **Failing to Identify Taxpayers at Risk of Economic Hardship and Appropriately Manage Their Liabilities Throughout the Collection Process May Exacerbate Their Financial Struggles and Jeopardize Their Ability to Become Compliant**

#### *Taxpayers Experiencing Economic Hardship May Enter Into Payment Agreements They Cannot Afford*

Because economic hardship cases are not flagged at the onset of the collection process, there is no indicator to alert IRS employees that a taxpayer may be unable to pay and to consider collection alternatives. For example, if a taxpayer calls ACS in response to a threatening collection notice, a telephone assistor may not be alerted to consider collection alternatives or take a full look at the taxpayer's financial situation.<sup>43</sup> Thus, many anxious or intimidated taxpayers may enter into payment agreements they cannot afford, even though additional financial analysis would show that other collection alternatives, such as an OIC, a Partial Pay IA, or CNC-Hardship status, would be more appropriate.<sup>44</sup>

The IRS routinely undertakes collection treatments that do not require any financial analysis, including entering taxpayers into streamlined IAs. Over the last six years, nearly 4.3 million IAs have been arranged for cases assigned to ACS and about 84 percent of those IAs were streamlined—that is, entered into with no financial analysis.<sup>45</sup> Figure 1.15.1 shows a breakdown of alternative collection arrangements entered into by taxpayers in FY 2018 by all collection units, showing OICs were the least used collection alternative.

42 IRM 5.15.1.7(1) (Oct. 2, 2012). The National Taxpayer Advocate continues to have concerns over how the IRS applies ALEs in other collection activities, and believe that ALE standards should be based on costs rather than expenditures, and cover a wider range of expenses. See Research Study: *Further Analyses of "Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens and Alternative IRS Letters on Individual Tax Debt Resolution,"* *infra*; National Taxpayer Advocate 2016 Annual Report to Congress 192-202 (Most Serious Problem: *Allowable Living Expense (ALE) Standard: The IRS's Development and Use of ALEs Does Not Adequately Ensure Taxpayers Can Maintain a Basic Standard of Living for the Health and Welfare of Their Households While Complying With Their Tax Obligations*). Still, ALEs can be an important starting point to detect taxpayers that may be experiencing economic hardship.

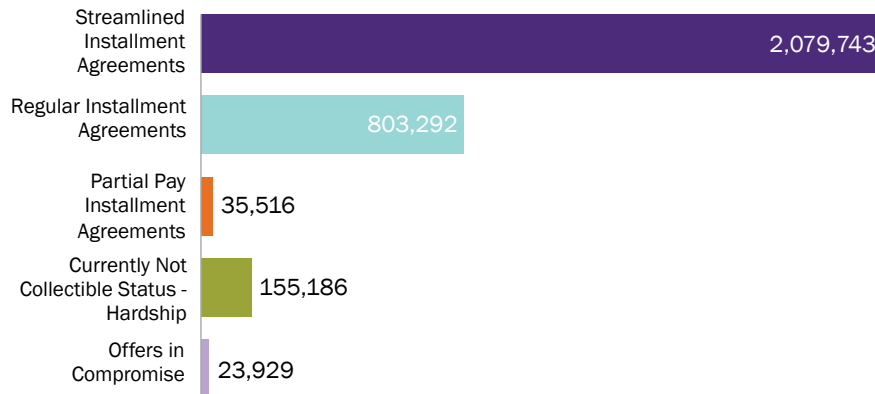
43 Failing to identify economic hardship cases is particularly a problem for cases with delinquencies assigned to ACS. See Most Serious Problem: *IRS'S Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS,* *infra* ("Taxpayers are further frustrated when talking to ACS because they may be talking to an employee who is unfamiliar with their geographic circumstances, and because they may have to explain the conditions in their region over and over since ACS provides no single point of contact.").

44 A Partial Pay IA is a type of IA in which the taxpayer makes payments over the length of time remaining on the collection statute, even though these payments will not fully pay the liability. For additional discussion of concerns regarding the types of collection arrangements taxpayers enter into in ACS, see Most Serious Problem: *IRS'S Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS,* *infra*.

45 There are instances where IAs maybe arranged by other Collection units than ACS. In FY 2018, streamlined IAs made up about 72 percent of total installment agreements. IRS, Collection Activity Report NO-5000-6 (Oct. 1, 2018).

FIGURE 1.15.1<sup>46</sup>

## Alternative Collection Arrangements in FY 2018



Forty percent of taxpayers who entered into a streamlined IA in ACS in FY 2018 had incomes at or below their ALEs.<sup>47</sup> These taxpayers agreed to pay their tax debts while, even by the IRS's own standards, they could not pay for their basic living expenses. These taxpayers may default on their IAs, or continue to make payments but be unable to meet what the IRS has determined are basic living expenses.<sup>48</sup> TAS research shows the default rate for streamlined IAs of taxpayers whose income was at or below their ALEs within ACS in FY 2018 was about 39 percent.<sup>49</sup>

As discussed above, shelved cases that are not designated as CNC-Hardship may be eligible for assignment to a PCA.<sup>50</sup> PCAs do not have the authority to assist taxpayers in resolving their accounts, *e.g.*, by designating the account as CNC-Hardship. PCAs may only request full payment of the liability or, if the taxpayer cannot immediately pay in full, the PCA may propose a streamlined IA.<sup>51</sup> Forty percent of taxpayers who entered into IAs while their debts were assigned to PCAs had incomes at or below their ALEs.<sup>52</sup> This result shows the grave consequences faced by taxpayers when economic hardship cases are not detected and flagged in the case scoring stage, or later as part of the process of determining which cases are sent to the PCAs.

46 IRS, Collection Activity Report NO-5000-6 (Oct. 1, 2018) (showing number of IAs); IRS, Collection Activity Report NO-5000-108 (Oct. 2, 2018) (showing number of OICs); IRS, Collection Activity Report NO-5000-149 (Oct. 11, 2018) (showing number of cases closed as CNC-Hardship).

47 See Most Serious Problem: *IRS'S Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS*, *infra*.

48 The IRS does not track why IAs default, so it has no way to know how many taxpayers in streamlined IAs could no longer afford to pay.

49 TAS Research analysis of the IMF and Individual Returns Transaction File on IAs established in FY 2018. This figure assumes taxpayers have one IRS-allowed vehicle ownership and operating expenses, and only a second one if the taxpayer filed jointly with his or her spouse. As discussed below, if we assume the taxpayers did not have vehicle ownership expenses, the default rate would be about 32 percent.

50 IRC § 6306(c). Liabilities in Currently Not Collectible (CNC)-Hardship status are not selected for assignment to PCAs. An account that is assigned to a PCA and then placed in CNC-Hardship status is recalled from PCA inventory. IRS response to TAS information request (Dec. 19, 2017).

51 See IRC § 6306(b).

52 See Most Serious Problem: *Private Debt Collection: The IRS's Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive PCA Inventory Accumulates*, *infra*.

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Over the last six years, about 4.3 million Installment Agreements (IAs) have been arranged for cases assigned to Automated Collection System (ACS) and about 84 percent of those IAs were streamlined—that is, entered into with no financial analysis.

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### *Shelving Economic Hardship Cases Does Not Help Taxpayers Resolve Their Liabilities and Can Harm Future Compliance*

Taxpayers with cases shelved by the IRS receive no further communications from the IRS to resolve the liability other than an annual balance due reminder.<sup>53</sup> This means that penalties and interest will continue to accrue on the taxpayer's liability unless the taxpayer reaches out on his or her own to make a payment. Yet without any nudges from the IRS, many taxpayers may not understand the significance of their balance due and not prioritize paying it off.<sup>54</sup> This can lead to the accumulation of interest and penalties, which make the balance more difficult to pay off down the road.

Furthermore, working a case, even when it is not likely to produce full payment, produces downstream benefits by helping taxpayers become more compliant in the future. The IRS currently does not have any established measures to identify a change in compliance behavior after contact with ACS, although it intends to include behavioral tracking of how taxpayers respond to notices in its notice redesign process.<sup>55</sup> However, the 2014 “Uncollectible Versus Unproductive” study relied on by the IRS to update IDS scoring found that while working CNC cases would produce smaller payments than other types of cases, “the estimated subsequent compliance impact of working CNC cases is relatively large compared to cases without a CNC determination.”<sup>56</sup> While the National Taxpayer Advocate does not believe the IRS should pursue collection enforcement activity against taxpayers with a CNC determination, engaging these taxpayers through additional correspondence could be effective at bringing them back into compliance and should be studied in greater detail by the IRS.<sup>57</sup>

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53 IRS response to TAS information Request (Oct. 17, 2018). See also CP 71A, *Annual Reminder of Balance Due Taxes*. TAS has previously recommended that the IRS send notices at least quarterly to taxpayers with delinquent tax liabilities to collect more revenue and remind taxpayers of the accumulation of interest and penalties. See National Taxpayer Advocate Purple Book 46 (*Amend IRC § 7524 to Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities*) (Dec. 31, 2017). This recommendation was adopted in the Protecting Taxpayers Act introduced by Senators Portman and Cardin. S. 3278, 115th Cong. § 201 (2018).

54 See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

55 IRS response to TAS information Request (Oct. 17, 2018).

56 Erik Miller, Stacy Orlett, and Alex Turk, IRS, *Uncollectible Versus Unproductive: Compliance Impact of Working Collection Cases That Are Ultimately Not Fully Collectible*, (2014) (“Overall, 12 percent of the individual taxpayers in our study acquired an additional module with an average unpaid assessment of \$804. Cases routed to ACS with a subsequent CNC determination had the lowest percentage of subsequent modules at 8 percent.”).

57 For a discussion of the impact of additional correspondence, see Research Study: *Further Analyses of “Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens and Alternative IRS Letters on Individual Tax Debt Resolution,”* *infra*.



## The IRS Should Better Identify Taxpayers at Risk of Economic Hardship and Develop a Communications Strategy to Work With These Taxpayers Rather Than Taking Automated Collection Action

### *The IRS Should Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Prior to Undertaking Collection Action*

TAS's research shows that an algorithm using internal data about a taxpayer's income and assets, and comparing that information to ALEs, can be a reliable way to predict taxpayers at risk of economic hardship. TAS evaluated a sample of 278 cases in which a taxpayer's account was closed by ACS or the Field with an IA in FY 2018—all cases in which the IRS obtained financial information from the taxpayer which showed ability to pay—and analyzed whether filtering those cases based on systemic information about a taxpayer's income and ALEs would arrive at the same result.<sup>58</sup> Only 14 cases, or five percent of the sample group, showed no ability to pay by the algorithm—meaning that TAS's algorithm arrived at the same result as the IRS employee in 95 percent of the cases. In five of the 14 cases where TAS's algorithm indicated the taxpayer had no ability to pay, the IRS employee initiated a back-up CNC determination in case the IA defaulted. This suggests that even in cases where TAS's algorithm arrived at a different result than on the financial information statement, it didn't miss by much and the IRS recognized these taxpayers could still be at risk of economic hardship.<sup>59</sup> Thus, these results indicate that the IRS could use internal data as an effective starting point in financial analysis of a taxpayer's ability to pay.<sup>60</sup>

Using an automated algorithm to proactively identify taxpayers at risk of economic hardship would allow the IRS to address these cases more appropriately, and could be used in several scenarios:

- **Case Scoring:** The algorithm could apply a marker during case scoring to show the case is at risk of economic hardship and route it a new specific group within ACS, or the “Economic Hardship Shelter.”
- **Telephone Correspondence:** The algorithm could be used to create a template for telephone assistors to view a comparison of the taxpayer's income to ALEs upon inputting the taxpayer's Social Security number. This way, if a taxpayer calls in about his or her tax liability, the assistor would be automatically alerted to ask more questions about the taxpayer's finances prior to setting the taxpayer up on an IA.<sup>61</sup>

58 TAS excluded two cases from the sample because we could not find additional information on the two cases because of an error in the data collection instrument. TAS Research estimated the income for taxpayers in these cases using the Total Positive Income (TPI) reported on the taxpayer's FY 2017 tax return. To evaluate taxpayers that may not have filed a prior-year return, TAS also considered information from third party Information Reporting Program (IRP) documents, including Forms 1099 interest, 1099 dividends, 1099 R (retirement income), 1099 B (stocks and bonds), 1099 MISC, 1099 SSA, and W-2. To incorporate assets, TAS Research looked at Form 1098 (Mortgage Interest), and real estate tax or mortgage interest paid on Schedule A. TAS calculated the amount of ALEs for each case by using the National Standards (with household size determined based on the number of exemptions claimed on the return), Local Standards (determined by the zip code on the return), Vehicle Ownership Expense, and Out of Pocket Healthcare Expenses (determined by the taxpayer's age). If the taxpayer did not file a return in a previous year, TAS allocated the lower amount.

59 The filter's computed ALE amount did not exceed the IRS's computed amount in 82 percent of the cases in our sample.

60 The IRS has expressed concern regarding the ALE determination methodology and how to address income when no income tax return is found. However, the results of TAS's research highlight the need for the IRS to study the feasibility of using internal data further and in which situations the algorithm could be beneficial.

61 While the National Taxpayer Advocate believes the flag indicating a case is at risk of economic hardship should trigger this discussion, using this template would update the information and help ensure the taxpayer's financial situation has not changed since initial case scoring.

- **Online Installment Agreements:** The algorithm could provide a warning for taxpayers entering into streamlined IAs online that they have been flagged as at risk of economic hardship, and could provide the contact number to call if they believe they cannot pay the tax debt without incurring economic hardship.
- **Automated Collection Treatments:** The algorithm could screen out taxpayers with income below their ALEs from automated collection treatments such as the Federal Payment Levy Program, selection for referral to PCAs, or for passport certification unless and until the IRS makes a direct personal contact with the taxpayer to verify the information.<sup>62</sup>
- **CNC-Hardship Review:** The algorithm could be incorporated into the IRS's systemic follow-up review of hardship cases to determine whether the taxpayer's current financial situation has positively changed and the taxpayer's case can be put back into the active inventory.<sup>63</sup>

Systemically flagging cases as at risk of economic hardship would not automatically place these taxpayers in CNC-Hardship status, but it would protect these taxpayers from further collection action until the IRS gathers sufficient financial information to make a determination.<sup>64</sup>

*The IRS Should Contact Taxpayers Likely at Risk of Economic Hardship by Letter and Create a Dedicated Phonenumber to Discuss Potential Collection Alternatives With Those Taxpayers*

Rather than leaving the case neglected while penalties and interest continue to accrue as on the shelf, the IRS should take steps to facilitate communication with taxpayers identified as at risk of economic hardship. Identified cases should be routed to a specific group within ACS, or the “Economic Hardship Shelter.” From that group, the IRS could provide:

- **Hardship Help Line:** A dedicated help line would help the IRS work with taxpayers at risk of economic hardship and collect any other information needed to make the determination that the taxpayer should be placed in CNC-Hardship status.
- **Hardship Notice:** TAS's research shows that additional, targeted contact with taxpayers can help them understand their obligations and avoid future mistakes.<sup>65</sup> The IRS should send a specific notice to educate flagged taxpayers on potential collection alternatives and resources available,

62 The House of Representatives included a provision to exclude taxpayers whose incomes are less than 250 percent of the federal poverty level from referral to a PCA in the bipartisan Taxpayer First Act, H.R. 5444, which passed the House with a recorded vote of 414-0 on April 18, 2018. A recent proposal in Congress would exclude taxpayers whose incomes are at or below 200 percent of the federal poverty level from having their debts assigned to a PCA. See House Amendment to the Senate Amendment to H.R. 88, Division B, § 1205 *Taxpayer First Act of 2018* (Nov. 26, 2018). The IRS should also continue to take steps to incorporate using TAS's retirement income calculator for FPLP. See National Taxpayer Advocate 2018 Objectives Report to Congress 80-87 (Area of Focus: *The IRS Has Improved Its Internal Guidance for Retirement Levies But More Can Be Done*).

63 IRM 5.16.1.6 (Dec. 8, 2014) (describing the two-year review process for CNC cases).

64 In FY 2018, the IRS placed 155,186 taxpayers in CNC-Hardship status in FY 2018. Custom analysis by TAS Research, IRS, IMF, Collection Activity Report NO-5000-149 (Oct. 11, 2018). About 60 percent of these cases involved taxpayers with income less than ALEs and no indication of an asset, which could have been flagged by the economic hardship algorithm at the outset of case scoring. TAS Research analysis of the IMF and Individual Returns Transaction File on IAs established in FY 2018. While taxpayers can be placed in CNC-Hardship even with income above ALEs, this data indicates that using ALEs as a filter can be an effective baseline indication of taxpayers likely to experience economic hardship.

65 See Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*; see also IRS, *Behavioral Insights Toolkit* 13, 27 (2017) (“Feedback and reminders highlight a specific piece of information to increase the chances that recipients will act on or respond to the information in a desired way.”).

including TAS and the Low Income Taxpayer Clinic (LITC).<sup>66</sup> The letter should encourage taxpayers to call the Hardship Help Line, and clearly list the number to do so.

This type of communication would show a willingness by the IRS to work with the taxpayers to meet their needs and circumstances, fulfilling taxpayer *rights to be informed* and *to quality service*, and could improve taxpayer trust in the agency.<sup>67</sup>

These communications should be *resolution-oriented*, explaining to taxpayers the risks of neglecting a tax liability and how penalties and interest can continue to accrue. To better serve taxpayers at risk of economic hardship, the IRS should partner with TAS and the LITCs to develop regular, annual training focusing exclusively on economic hardship to prepare collection employees for how to work with these taxpayers. The training should cover how to help taxpayers develop a plan to resolve the liability through collection alternatives, and highlight the appropriate use of OICs. In drafting IRC § 7211, Congress directed the IRS to make OICs more available to taxpayers to “enhance taxpayer compliance.”<sup>68</sup> The Committee Report reflects the belief that the IRS should be “flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system” and “make it easier for taxpayers to enter into offer in compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.”<sup>69</sup> Pursuing collection alternatives with taxpayers suffering economic hardship would benefit those taxpayers by helping them to resolve their liability in a way that meets their financial situation and fulfills the taxpayer *right to finality*.

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**TAS’s research shows that an algorithm using internal data about a taxpayer’s income and assets, and comparing that information to Allowable Living Expenses (ALEs), can be a reliable way to predict taxpayers at risk of economic hardship.**

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### *Flagging Economic Hardship During Case Scoring Will Allow the IRS to Avoid Rework Caused by Defaulting Installment Agreements*

TAS’s economic hardship algorithm can be an important indicator that a taxpayer *is* able to pay: in a research study by TAS, 93 percent of the payments received by the IRS in our sample group came from taxpayers with income in excess of their ALE or with an indication of an asset.<sup>70</sup> In a time of limited resources, focusing on more productive cases rather than IAs likely to default or to produce no payment

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66 For additional discussion on the impact of sending collection alternative notices, see Research Study: *Further Analyses of “Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens and Alternative IRS Letters on Individual Tax Debt Resolution,”* *infra*. See also Most Serious Problem: *Pre-Trial Settlements in the U.S. Tax Court: Insufficient Access to Available Pro Bono Assistance Resources Impedes Unrepresented Taxpayers from Reaching a Pre-trial Settlement and Achieving a Favorable Outcome.,* *infra*.

67 The National Taxpayer Advocate believes the IRS should assign one ACS employee to a taxpayer’s case who is located in the same geographic region as the taxpayer so that the employee can better understand and relate to the taxpayer’s facts and circumstances. See Most Serious Problem, *IRS’s Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS,* *infra*.

68 S. REP. No. 105-174, at 88 (1998).

69 *Id.* at 88-89.

70 See Research Study: *Further Analyses of “Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens and Alternative IRS Letters on Individual Tax Debt Resolution,”* *infra*.

could help the IRS avoid unnecessary rework, including time and resources to obtain an updated financial statement, reroute the case, or even issue a Notice of Federal Tax Lien determination with additional periods. Thus, proactively flagging taxpayers at risk of economic hardship would benefit taxpayers and the IRS alike. When coupled with the offer of a dedicated phone line to those taxpayers, the resulting future voluntary compliance will increase those benefits.

## CONCLUSION

The IRS must have a different approach to address taxpayers who are *unable*, as opposed to *unwilling*, to pay their tax liabilities and bring them back into compliance. The Congressional mandates for the IRS to consider whether taxpayers can meet basic living expenses in CDP hearings and OICs show a recognition of the need to protect taxpayers who are experiencing economic hardship to prevent collection actions from exacerbating that hardship further. When taxpayers enter into payment agreements they cannot afford, it violates their *right to a fair and just tax system*. Similarly, neglecting taxpayers experiencing economic hardship by simply shelving their case or potentially routing them to a PCA violates the *rights to quality service* and *to finality*.

Using internal data to compare a taxpayer's financial status to their ALEs would allow the IRS to identify taxpayers at risk of economic hardship and shield those taxpayers from potentially harmful collection actions without further financial analysis. The IRS could use this algorithm to identify cases with higher collection potential and identify taxpayers that may be suited for collection alternatives. A notice detailing the options available to the taxpayer would help make the tax liability seem less of an insurmountable obstacle, and could prompt the taxpayer to reach out to the IRS to resolve their liability. In addition, a dedicated phone line for taxpayers at risk of economic hardship would help a taxpayer determine which option is most appropriate and answer any questions. Proactively working to identify and engage taxpayers experiencing economic hardship would be an important step in developing a taxpayer-focused approach to tax administration.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop and utilize an algorithm to compare a taxpayer's financial information to ALEs during IDS case scoring and as a template made available to Revenue Officers and telephone assistants responding to taxpayer inquiries.
2. Apply this algorithm before sending any cases to PCAs, and exclude any case involving a taxpayer at risk of economic hardship from potentially collectible inventory.
3. Route cases identified as at risk of economic hardship to a specific group within ACS and send those taxpayers a specific written notification to educate them on collection alternatives and additional assistance available, including TAS and LITCs.
4. Create a new help line dedicated to responding to taxpayers at risk of economic hardship and helping them determine the most appropriate collection alternative, including OICs.
5. Partner with TAS and LITCs to develop issue-focused training for IRS employees who interact with taxpayers at risk of economic hardship.