IMPROVE ASSESSMENT AND COLLECTION PROCEDURES

Legislative Recommendation #11

Continue to Limit the IRS's Use of "Math Error Authority" to Clear-Cut Categories Specified by Statute

PRESENT LAW

Before the IRS may assess a deficiency, IRC § 6213(a) ordinarily requires that it send the taxpayer a "notice of deficiency" that gives the taxpayer 90 days (150 days if addressed to a taxpayer outside the United States) to contest it by filing a petition with the U.S. Tax Court (known as "deficiency procedures"). The taxpayer's ability to appeal a deficiency determination to the Tax Court before paying the tax is central to the taxpayer's *right to appeal an IRS decision in an independent forum*.

As an exception to standard deficiency procedures, IRC § 6213(b)(1) authorizes the IRS to summarily assess and collect tax without first providing the taxpayer with a notice of deficiency or access to the Tax Court, when addressing "mathematical and clerical" errors (known as "math error authority"). If a taxpayer contests a math error notice within 60 days, IRC § 6213(b)(2)(A) provides that the IRS must abate the assessment. If the IRS abates the assessment, it must follow deficiency procedures before reassessing the tax. Taxpayers who do not contest a math error notice within this 60-day period lose the right to do so in court before paying. The IRS may summarily assess 17 types of mathematical or clerical errors, which are codified at IRC § 6213(g)(2) in subparagraphs A-Q.

REASONS FOR CHANGE

Congress generally requires the IRS to follow deficiency procedures, which provide taxpayers with notice and a reasonable opportunity to challenge the IRS's tax adjustment. Math error authority, which provides fewer taxpayer protections, was authorized as a limited exception to regular deficiency procedures. It allows the IRS to make adjustments in cases of clear taxpayer error, such as where a taxpayer incorrectly adds numbers or incorrectly transcribes a number from one form to another. Because taxpayers have fewer protections under math error procedures, the procedures are not intended to be used where a substantive disagreement may exist. When Congress has expanded the IRS's math error authority, it has done so consistent with that principle.

Because math error procedures are cheaper and simpler for the IRS than deficiency procedures, the Department of the Treasury has requested that Congress grant it the authority to add new categories of "correctable errors" by regulation.[1]

The National Taxpayer Advocate is concerned about the impact on taxpayer rights of giving the IRS broad authority to add new categories of math error. In our reports to Congress, we have documented

1 *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals* 245-246 (Feb. 2015); Joint Committee on Taxation, JCS-1-19, *Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal* 62, 64 (July 8, 2019).

circumstances in which the IRS has used math error authority to address discrepancies that have undermined taxpayer rights.[2]

If the IRS uses math error authority to address more complex issues that require additional fact finding, its assessments are more likely to be wrong, and the IRS's computer-generated notices, which confuse many taxpayers in the simplest of circumstances, are likely to become more difficult to understand. Shorter deadlines and confusing notices will prevent some taxpayers from responding timely. As a result, these taxpayers will lose their right to challenge the adjustments in court before paying, undermining the taxpayers' *right to appeal an IRS decision in an independent forum*.

Math error authority may be appropriate to use where required schedules are omitted, or annual or lifetime dollar caps have been exceeded. It also may be appropriate to use where there is a discrepancy between a return entry and data available to the IRS from a reliable government database, such as records maintained by the Social Security Administration. But the IRS should not be the arbiter of that reliability. Rather, Congress should retain full authority to determine whether the administrative "efficiency" of using math error authority in these instances outweighs the loss of the significant taxpayer protections that deficiency procedures provide.

RECOMMENDATIONS

- Do not give the IRS unrestricted authority to summarily assess tax for additional categories of "correctable errors" identified by regulation. Continue to limit the IRS's use of "math error authority" to clear-cut categories specified by statute. Because the standard deficiency procedures created by Congress provide important taxpayer protections, the IRS should not be authorized to add new categories of mathematical or clerical errors by regulation.
- Amend IRC § 6213(g) to authorize the IRS to exercise its existing (and any new) authority to summarily assess a deficiency due to "clerical errors" only where: (i) there is a discrepancy between a return entry and reliable government data; (ii) the IRS's notice clearly describes the discrepancy and how to contest it; (iii) the IRS has researched all information in its possession that could help reconcile the discrepancy; (iv) the IRS does not have to evaluate documentation to make a determination; and (v) there is a low abatement rate for taxpayers who respond.
- Amend IRC § 6213(g) to provide that the IRS is not authorized to use any new criteria or data to make summary assessments unless the Department of the Treasury, in conjunction with the National Taxpayer

2 *See, e.g.*, National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*); National Taxpayer Advocate 2014 Annual Report to Congress 163-171 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 5 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 92-93 (*Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*); National Taxpayer Advocate 2006 Annual Report to Congress 311 (Most Serious Problem: *IRS Implementation of Math Error Authority Impairs Taxpayer Rights*); National Taxpayer Advocate 2003 Annual Report to Congress 113 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 25 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 186 (Legislative Recommendation: *Math Error Authority*); National Taxpayer Advocate 2001 Annual Report to Congress 33 (Most Serious Problem: *Explanations on Math Error Authority*).

Advocate, has evaluated and publicly reported on the reliability of the criteria or data for that intended use.[3]

3 For a more limited recommendation, see National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*).

Legislative Recommendation #12

Require Independent Managerial Review and Written Approval Before the IRS May Assert Multiyear Bans Barring Taxpayers From Receiving Certain Tax Credits and Clarify That the Tax Court Has Jurisdiction to Review the Assertion of Multiyear Bans

PRESENT LAW

IRC §§ 24(g), 25A(b), and 32(k) require the IRS to ban a taxpayer from claiming the Child Tax Credit (CTC), the American Opportunity Tax Credit (AOTC), or the Earned Income Tax Credit (EITC) for two years if the IRS makes a final determination that the taxpayer improperly claimed the credit with reckless or intentional disregard of rules and regulations. The duration of the ban increases to ten years if the IRS makes a final determination that the credit was claimed fraudulently.

IRC § 6214 grants the Tax Court jurisdiction to redetermine a deficiency for the tax year(s) before the court, but it does not grant the Tax Court jurisdiction to redetermine deficiencies for other tax years.

IRC § 6213 authorizes the IRS to disallow credits claimed while a ban is in effect pursuant to its summary assessment procedures (sometimes known as "math error authority").

IRC § 6751(b) prohibits the IRS from assessing certain penalties unless an employee's initial determination to impose a penalty is personally approved (in writing) by his or her immediate supervisor or a higher level official.

REASONS FOR CHANGE

Congress directed the IRS to impose multiyear bans on CTC, AOTC, and EITC eligibility to deter and penalize certain taxpayers who improperly claim these credits. Multiyear bans are highly unusual because they mean taxpayers will be denied credits in future years even if the taxpayers otherwise satisfy all of the eligibility requirements in those years.

These refundable credits, particularly the EITC, account in some cases for 20 percent or more of a taxpayer's annual income. Given the potentially devastating financial impact of multiyear bans, adequate safeguards are critical to ensure both that the IRS imposes a ban only when a taxpayer acts with the requisite state of mind and that a taxpayer has access to meaningful review of an IRS final determination to assert the ban.

Presently, the IRS may disallow an examined year's credit and assert a multiyear ban against claiming the credit in future years when it issues a statutory notice of deficiency at the conclusion of an audit. A taxpayer may contest a notice of deficiency in the Tax Court, but it is uncertain whether the court has jurisdiction to review the IRS's assertion of the ban.[1] Once a ban on claiming a credit in future years takes effect, the IRS

1 Compare *Garcia v. Comm'r*, T.C. Summ. Op. 2013-28 (holding, in a nonprecedential case, that a ban did not apply) *with Ballard v. Comm'r*, No. 03843-15S (T.C. Feb. 12, 2016), (declining to rule on the application of IRC § 32(k), noting that the application of the ban had no effect on the taxpayer's federal income tax liability for the year before it).

will disallow the credit if the taxpayer claims it, and it may do so using its summary assessment process. The IRS would issue a statutory notice of deficiency in that instance only if the taxpayer disputes the summary assessment.

Written Managerial Approval

The IRS's internal rules allow it to impose two-year bans automatically in some EITC cases.[2] In all other ban cases, IRS procedures require a manager to review the case independently and approve the assertion of a ban in writing.[3] IRC § 6751(b), which generally requires managerial approval before the IRS imposes penalties, does not apply to multiyear bans. Significantly, two TAS research studies of two-year ban cases found that this required managerial approval is usually lacking.[4]

The National Taxpayer Advocate does not believe that automatic or systemic imposition of multiyear bans is ever appropriate. The law requires that the two-year ban be imposed only in cases where the IRS determines a taxpayer acted recklessly or with intentional disregard of rules and regulations and that the ten-year ban be imposed only in cases where the IRS determines a taxpayer's claim was fraudulent. The law does not permit the IRS to impose multiyear bans when an improper claim is due to inadvertent error or even due to negligence.

A computer is not capable of assessing a taxpayer's state of mind and therefore cannot determine whether an improper claim was made due to inadvertent error or due to reckless or intentional disregard of rules and regulations. This determination requires an independent facts-and-circumstances investigation by an employee. And in light of the harsh impact of multiyear bans, managerial approval should be required in all cases before they are imposed.

Tax Court Jurisdiction

IRC § 6214 restricts the Tax Court to determining the amount of tax owed in the tax year(s) before the court. Thus, the court may determine whether the taxpayer properly claimed credits for the year that is the subject of a notice of deficiency. By contrast, the court may not have jurisdiction to determine whether the IRS's asserted ban should apply to the future years that are not before it, even if the ban is proposed in the statutory notice of deficiency, because a ban has no effect on a taxpayer's liability in the tax year in which it is imposed (it affects only the following two or ten years).[5] If the Tax Court does not consider whether a ban was properly imposed and the ban is left intact, then if the taxpayer claims the banned credit on a subsequent return, the IRS will disallow the claim, and may do so pursuant to its summary assessment procedures. The taxpayer would then be required to dispute the summary assessment and, once the IRS issues a statutory notice of deficiency for the subsequent year, seek Tax Court review to determine whether the credits were properly claimed. However, the Tax Court has not held that it has jurisdiction to determine whether the ban

2 Internal Revenue Manual (IRM) 4.19.14.7.1.5, Project Codes 0027 and 0028 – EITC Recertification with a Proposed 2 Year EITC Ban (Nov. 2, 2017).

3 IRM 4.19.14.7.1(3), 2/10 year-ban Correspondence Guidelines for Exam Technicians (CET) (Dec. 11, 2019).

4 *See* National Taxpayer Advocate 2019 Annual Report to Congress vol. 2, at 239-256 (Research Study: *Study of Two-Year Bans on the Earned Income Tax Credit, Child Tax Credit, and American Opportunity Tax Credit*); National Taxpayer Advocate 2013 Annual Report to Congress 103 (Most Serious Problem: *Earned Income Tax Credit: The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*).

5 *See* note 1, *supra*.

was properly imposed initially (and if it lacks that jurisdiction, it may conclude that because the ban is intact, the court does not have the authority to allow the credit in the ban years).

Transparency is a critical element of taxpayer rights and fairness, and taxpayers should understand clearly when they may seek Tax Court review of an adverse IRS determination. In most cases, the law is clear. Here, the law is not clear, and there appear to be four possible outcomes: (i) the Tax Court may have jurisdiction to review a ban both for the year in which it is imposed and for the year in which it is effective; (ii) the Tax Court may have jurisdiction to review a ban for the year in which it is imposed but not for the year in which it is effective; (iii) the Tax Court may not have jurisdiction to review a ban for the year in which it is imposed but may have jurisdiction to review it for the year in which it is effective; or (iv) the Tax Court may not have jurisdiction to review a ban at any time. These procedural uncertainties undermine the taxpayer's *rights to appeal an IRS decision in an independent forum* and *to a fair and just tax system* and require clarification.

RECOMMENDATIONS

- Amend IRC §§ 24(g), 25A(b), and 32(k) to require independent managerial review and written approval based on consideration of all relevant facts and circumstances before the IRS asserts a multiyear ban. Alternatively, amend IRC § 6751 to require independent managerial review and written approval based on consideration of all relevant facts and circumstances before the IRS may assert a multiyear ban.
- Amend IRC § 6214 to grant the Tax Court jurisdiction (i) to review the IRS's final determination to impose a multiyear ban under IRC §§ 24(g), 25A(b), or 32(k) in any deficiency proceeding in which the statutory notice of deficiency asserts a multiyear ban or any subsequent deficiency proceeding in which the IRS disallows a claimed credit because a multiyear ban is in effect; and (ii) to allow the affected credit if it finds a multiyear ban was improperly imposed and the taxpayer otherwise qualifies for the credit.

Legislative Recommendation #13

Allow Additional Time for Taxpayers to Request Abatement of a Math Error Assessment Equal to the Additional Time Allowed to Respond to a Notice of Deficiency When the Math Error Notice Is Addressed to a Person Outside the United States

PRESENT LAW

IRC § 6213(b) authorizes the IRS to make a "summary assessment" of tax arising from mathematical or clerical errors as defined in IRC § 6213(g), thus bypassing otherwise-applicable deficiency procedures. A taxpayer has no right to file a petition in the U.S. Tax Court based on a math error notice. Under IRC § 6213(b)(2)(A), however, a taxpayer has 60 days after a math error notice is sent to file an abatement request with the IRS. If the taxpayer submits an abatement request within 60 days, the IRS must abate the summary assessment and then follow deficiency procedures under IRC § 6212 if it wishes to reassess an increase in tax. If the taxpayer does not submit an abatement request within 60 days, the taxpayer forfeits his or her right to file a petition in the Tax Court. No additional time to request an abatement is allowed when the math error notice is addressed to a taxpayer outside the United States.

By contrast, a taxpayer outside the United States who receives a notice of deficiency is given additional time to respond. In general, a taxpayer may file a petition in the Tax Court for a redetermination of a deficiency within 90 days from the date the notice is mailed. However, when the notice of deficiency "is addressed to a person outside the United States," IRC § 6213(a) provides that the taxpayer has 150 days from the date the notice is mailed to file a Tax Court petition. The Tax Court has construed this language broadly, concluding among other things that the 150-day period for filing a petition applies not only when a notice of deficiency is mailed to an address outside the United States but also when a notice of deficiency is mailed to an address within the United States, provided the taxpayer is located outside the United States.[1]

REASONS FOR CHANGE

Approximately nine million U.S. citizens live abroad, along with about 165,000 U.S. military service personnel.[2] In addition, more than 340,000 U.S. students study overseas.[3] Taxpayers living abroad (temporarily or permanently) often require more time to respond to IRS notices than taxpayers living in the United States. Mail delivery takes longer in both directions — in some cases, depending on where the

1 *See, e.g.*, *Levy v. Comm'r*, 76 T.C. 228 (1981) (holding that the 150-day rule is applicable to a U.S. resident who is temporarily outside the country when the notice is mailed and delivered); *Looper v. Comm'r*, 73 T.C. 690 (1980) (holding that the 150-day rule is applicable where a notice is mailed to an address outside the United States); *Lewy v. Comm'r*, 68 T.C. 779 (1977) (holding that the 150-day rule is applicable to a foreign resident who is in the United States when the notice is mailed but is outside the United States when the notice is delivered); *Hamilton v. Comm'r*, 13 T.C. 747 (1949) (holding that the 150-day rule is applicable to a foreign resident who is outside the United States when the notice is mailed and delivered).

2 For Fiscal Year (FY) 2019, the Department of State estimates that about nine million U.S. citizens lived abroad. U.S. Department of State, Bureau of Consular Affairs, *Consular Affairs by the Numbers*, FY 2019 data (Jan. 2020), https://travel.state.gov/content/dam/travel/CA-By-the-Number-2020.pdf. As of the end of 2019, about 165,000 U.S. military service personnel were stationed abroad. *See* Statista, *Deployment of U.S. Active-Duty Military & Civilian Personnel Around the World in 2019, by Selected Regions*, https://www.statista.com/statistics/222920/deployment-of-us-troops-in-selected-world-regions (last visited Sept. 2, 2020).

3 Open Doors, *U.S. Study Abroad: All Destinations*, https://opendoorsdata.org/data/us-study-abroad/all-destinations (last visited Sept. 2, 2020) (showing 341,751 U.S. students studied abroad during the 2017-2018 academic year).

taxpayer is located, substantially longer. In addition, persons temporarily abroad often do not have access to their tax or financial records, making it difficult for them to respond immediately.

By giving taxpayers living abroad 60 additional days to file a petition in the Tax Court in response to a notice of deficiency, Congress recognized that holding overseas taxpayers to the same deadlines as taxpayers located in the United States would be unreasonable. The same logic applies with respect to math error notices. In fact, the need for additional time is arguably greater in the case of math error notices because the standard response deadline is 60 days (as opposed to 90 days for filing a Tax Court petition in response to a notice of deficiency).

RECOMMENDATION

- Amend IRC § 6213(b)(2)(A) to allow taxpayers 120 days to request an abatement of tax when a math error notice is addressed to a person outside the United States.

Legislative Recommendation #14

Require the IRS to Waive User Fees for Taxpayers Who Enter Into Low-Cost Installment Agreements

PRESENT LAW

In cases where a taxpayer is unable to pay the full amount of his or her tax liability in a single lump sum, IRC § 6159(a) authorizes the IRS to enter into an installment agreement (IA) under which the taxpayer will pay the liability in monthly installments. A taxpayer can apply for an IA on paper or by using an online payment agreement (OPA).

The Independent Offices Appropriations Act of 1952 (31 U.S.C. § 9701) and Office of Management and Budget Circular A-25 authorize the IRS to set user fees by regulation. In 2016, the IRS increased the IA fee.[1] Pursuant to Treas. Reg. § 300.1, it now charges $225 for entering into paper IAs and $149 for entering into OPAs. If a taxpayer authorizes the IRS to "direct debit" a bank account each month, the fee is reduced to $107 for paper IAs and $31 for OPAs. These fees are designed to enable the agency to recover the full costs of administering IAs.

For low-income taxpayers (*i.e.*, taxpayers whose incomes do not exceed 250 percent of the Federal Poverty Level), Treas. Reg. § 300.1 caps the IA fee at $43. In addition, IRC § 6159(f)(2)(A) waives the fee for low-income taxpayers who enter into direct-debit IAs. Low-income taxpayers who cannot enter into direct-debit IAs (*e.g.,* because they do not have a bank account) must pay the IA fee, but if they make all payments required under the IA, IRC § 6159(f)(2)(B) requires the IRS to refund the amount of the IA fee to them. In 2018, Congress amended IRC § 6159(f)(1) to prohibit the IRS from increasing the IA user fees.

REASONS FOR CHANGE

Even a modest IA user fee may deter taxpayers from applying for IAs and paying their taxes voluntarily. Taxpayers who require IAs are, almost by definition, experiencing some level of financial hardship. Some taxpayers cannot afford to pay a fee, even if they do not qualify as low-income. Even taxpayers who qualify as low-income sometimes end up paying the full fee.[2] The cost to the IRS of OPAs and direct-debit IAs is so low that if the user fee discourages even a small percentage of taxpayers from paying voluntarily, this reduced compliance is likely to cost the government more in lost tax revenue and increased enforcement costs than the user fee generates.

RECOMMENDATION

- Amend IRC § 6159 to require the IRS to waive the user fee for all direct-debit IAs.[3]

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1 *See User Fees for Installment Agreements (IAs)*, T.D. 9798, 81 Fed. Reg. 86,955 (Dec. 2, 2016).

2 *See* American Bar Association Section of Taxation, *Comments Concerning User Fees for Processing Installment Agreements and Offers in Compromise* 2 (Oct. 1, 2013) ("many low-income taxpayers are charged the full user fee, despite qualifying for the reduced amount").

3 For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 301 (2017); Taxpayer Protection and Assistance Act, S. 1321, 109th Cong. § 301 (2006).

Legislative Recommendation #15

Improve Offer in Compromise Program Accessibility by Repealing the Partial Payment Requirement and Restructuring the User Fee

PRESENT LAW

IRC § 7122(a) authorizes the IRS to settle a tax debt by accepting an offer in compromise (OIC). According to Policy Statement 5-100, the IRS will "accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential." Taxpayers whose offers are accepted must file and pay their taxes for the next five years, as stated on IRS Form 656, Offer in Compromise (2019) (items l and m), or the IRS may seek to collect the amounts it compromised.

IRC § 7122(c)(1)(A) requires a taxpayer who would like the IRS to consider a "lump-sum" offer — payable in five or fewer installments — to include a nonrefundable partial payment of 20 percent of the amount of the offer with the application. IRC § 7122(c)(1)(B) requires a taxpayer who would like the IRS to consider a "periodic payment" offer — an offer payable in six or more installments — to include the first proposed installment with the application and to continue to make installment payments while the IRS is considering it. In addition to these partial payments, Treas. Reg. § 300.3 requires that most offer applications include a $205 user fee. IRC § 7122(c)(3) provides that taxpayers with low incomes (*i.e.*, not more than 250 percent of the Federal Poverty Level) are not subject to the user fee or the partial payment requirement. They may apply for a waiver on Form 656.

REASONS FOR CHANGE

By accepting an offer, the IRS generally collects money it would not otherwise collect and may convert a noncompliant taxpayer into a compliant one by requiring the taxpayer, as a condition of the agreement, to timely file returns and pay taxes for the following five years. The Treasury Department's General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals acknowledged the benefit of offers by proposing to repeal the partial payment requirement, explaining that the requirement "may substantially reduce access to the offer in compromise program. … Reducing access to the offer-in-compromise program makes it more difficult and costly to obtain the collectable portion of existing tax liabilities." The Treasury Department estimated that repealing the requirement would raise revenue.[1]

A 2007 TAS study found that taxpayers above the low-income threshold were no better able to afford to make partial payments than those below it and that those below it frequently did not obtain a waiver. Similarly, a 2005 Treasury Inspector General for Tax Administration report found that when the IRS first imposed a $150 OIC fee in 2003, offer submissions declined by more than 20 percent among taxpayers at every income level, including those who were eligible for a fee waiver. Furthermore, after the partial payment requirement was imposed, the offer acceptance rate did not increase, suggesting that higher up-front costs did not deter bad

1 In the past, the IRS expressed concern that repealing the partial payment requirement or limiting the user fee might have the effect of increasing the number of frivolous offers. To address concerns about frivolous submissions, Congress enacted a frivolous submissions penalty under IRC § 6702(b). In general, it imposes a penalty of $5,000 on any person who submits a frivolous OIC application (among other frivolous submissions).

offers at a higher rate than good ones. Thus, upfront payments such as the user fee and the partial payment requirement likely reduce collections and increase enforcement costs.

RECOMMENDATION

- Amend IRC § 7122(c) to remove the requirement that taxpayers include a partial payment with offer applications and restructure the user fee so that it is collected out of amounts otherwise due on accepted offers.[2]

2 For legislative language generally consistent with this recommendation, see Taxpayer Protection Act, H.R. 2171, 115th Cong. § 206 (2017); Taxpayer Protection Act, H.R. 4912, 114th Cong. § 206 (2015); Taxpayer Assistance Act, H.R. 4994, 111th Cong. § 202 (2010). For additional background, see, *e.g.*, National Taxpayer Advocate 2006 Annual Report to Congress 507-519 (Legislative Recommendation: *Improve Offer in Compromise Program Accessibility*).

Legislative Recommendation #16

Modify the Requirement That the Office of Chief Counsel Review Certain Offers in Compromise

PRESENT LAW

IRC § 7122 authorizes the Secretary to enter into an agreement with a taxpayer that settles the taxpayer's tax liabilities for less than the full amount owed, as long as the taxpayer's case has not been referred to the Department of Justice. Such an agreement is known as an offer in compromise (OIC). Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability or doubt as to collectibility, or to promote effective tax administration. The regulations further define these terms and describe instances when compromise is appropriate.

IRC § 7122(b) requires the Treasury Department's General Counsel to review and provide an opinion in support of accepted OICs in all criminal cases and in all civil cases where the unpaid amount of tax assessed (including any interest, additional amount, addition to tax, and assessable penalty) is $50,000 or more. This authority is exercised by the IRS Office of Chief Counsel.[1]

REASONS FOR CHANGE

The IRS receives tens of thousands of OIC applications every year and must verify that the legal and IRS policy requirements for compromise are met prior to proposing acceptance. The time Office of Chief Counsel employees spend learning the facts of every criminal OIC and civil OIC where the unpaid amount of tax assessed is $50,000 or more and writing supporting opinions creates significant delays in OIC processing and is often duplicative of work the IRS has already performed. It also requires a significant commitment of legal resources on the part of the IRS. The Office of Chief Counsel reports that it spends thousands of hours each year reviewing OICs.[2] Taxpayers would be better served if those resources could be allocated elsewhere.

In addition, delays in OIC processing may impede a taxpayer's ability to make other financial decisions while awaiting a response and may even jeopardize the taxpayer's ability to pay the amount offered if his or her financial circumstances change.

The National Taxpayer Advocate believes the OIC process would be improved if Congress repeals the blanket requirement that Counsel review all OICs in civil cases where the unpaid tax assessed is $50,000 or more and replace it with language authorizing the Secretary to require Counsel review in cases that present significant legal issues.

RECOMMENDATION

- Amend IRC § 7122(b) to repeal the requirement that Counsel review all OICs in civil cases where the unpaid amount of tax assessed (including any interest, additional amount, addition to tax, or assessable

1 *See* Internal Revenue Manual 8.23.4.3.2, Counsel Review of Acceptance Recommendations (Apr. 24, 2020).
2 Emails from IRS Office of Chief Counsel (Sept. 1, 2020 and Aug. 9, 2019).

penalty) is $50,000 or more and replace it with language authorizing the Secretary to require Counsel review of OICs in cases that he determines present significant legal issues.[3]

3 For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 303 (2017); Taxpayer Bill of Rights Enhancement Act of 2015, S. 1578, 114th Cong. § 403 (2015); Tax Administration Good Government Act, S. 882, 108th Cong. § 104 (2003); Tax Administration Good Government Act, H.R. 1528, 108th Cong. § 304 (2004).

Legislative Recommendation #17

Amend IRC § 7122 to Require the IRS to Refund Any Payment Collected Pursuant to a Federal Tax Lien That Exceeds the Amount of an Accepted Offer in Compromise

PRESENT LAW

IRC § 7122 authorizes the Secretary to sign an agreement (an "offer in compromise" or OIC) with a taxpayer to settle the taxpayer's tax liabilities for less than the amount owed. OICs take one of two forms: (i) the taxpayer may pay the agreed amount in a single lump-sum or (ii) the taxpayer may pay the agreed amount through periodic payments, generally monthly. Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability or doubt as to collectibility, or to promote effective tax administration. With respect to offers based on doubt as to collectibility, the Service has a legal basis to compromise when the taxpayer's equity in assets and future income potential are less than the taxpayer's liabilities. The IRS follows guidelines set forth in Internal Revenue Manual (IRM) 5.8.5 to evaluate a taxpayer's equity in assets and future income potential. According to IRS Policy Statement 5-100, an OIC is considered a "legitimate alternative to declaring a case as currently not collectible or to a protracted installment agreement" and the goal is to "achieve the collection of what is potentially collectible at the earliest possible time and at the least cost to the government."

Taxpayers seeking an OIC must complete Form 656, Offer in Compromise. Taxpayers seeking an OIC based on Doubt as to Collectibility must also complete a Collection Information Statement on Form 433. Section 7 of Form 656 includes certain terms and conditions a taxpayer must accept when submitting an OIC. In Paragraph (o) of Section 7, taxpayers agree that failure to meet the terms of an OIC, such as by missing payments, may cause default of the offer, possibly resulting in reinstatement of the full tax liability, plus penalties and interest. In Paragraph (q) of Section 7, taxpayers agree that:

> The IRS may file a Notice of Federal Tax Lien during consideration of the offer or for offers that will be paid over time. If the offer is accepted, the tax lien(s) for the periods and taxes listed in Section 1 will be released within 35 days after the payment has been received and verified. The time it takes to transfer funds to the IRS from commercial institutions varies based on the form of payment. If I have not finished paying my offer amount, then the IRS may be entitled to any proceeds from the sale of my property. The IRS will not file a Notice of Federal Tax Lien on any individual shared responsibility debt.

IRC § 6331(a) authorizes the IRS to "levy upon all property and rights to property," but the IRS generally will not seek to enforce a levy while an offer is pending, for 30 days following the rejection of an offer, or during any period when an appeal is being considered.[1] When an OIC paid through periodic payments is accepted, however, the IRS may maintain a lien on any property owned by the taxpayer until all payments are made.[2]

1 *See* IRC § 6331(k).
2 IRS Form 656-B, Offer in Compromise (Apr. 2020).

REASONS FOR CHANGE

When the IRS accepts an OIC, the IRS contracts to settle a tax liability for less than the full amount of the liability. Prior to accepting an OIC, the IRS carefully reviews and verifies the taxpayer's financial condition.[3] It calculates a taxpayer's "reasonable collection potential" (RCP), accounting for assets, future income, other lienholders, and allowable living expenses.[4] Generally, an OIC is not accepted unless the offer proposed by the taxpayer is equal to or greater than the RCP, as calculated by the IRS.

In certain situations where the IRS has filed a lien on taxpayer property, the IRS may end up collecting more than the amount originally calculated as the taxpayer's reasonable collection potential. IRS internal guidance calls for a lien on property to remain in place until the taxpayer has made all payments.[5] If a taxpayer sells property subject to lien prior to completing payment on the OIC, the IRS may take the net sale proceeds up to the full amount of its original lien, as authorized by Section 7, Paragraph (q), of Form 656. As a result, the IRS may collect more money than was originally determined when the taxpayer's reasonable collection potential was determined and the OIC executed.

RECOMMENDATION

- Amend IRC § 7122 to require the IRS to refund any payment collected pursuant to a federal tax lien that exceeds the amount of an accepted OIC, provided the taxpayer disclosed all material income and assets to the IRS on his or her application and made all payments in accordance with the terms of the agreement.

3 IRM 5.8.5, Financial Analysis (Mar. 23, 2018).
4 IRM 5.8.4.3.1, Doubt as to Collectibility (Apr. 30, 2015).
5 IRM 5.8.10.6, Discharge and Subordination Request (July 20, 2020).

Legislative Recommendation #18

Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities

PRESENT LAW

IRC § 7524 requires the IRS, "[n]ot less often than annually," to send taxpayers with delinquent accounts a written notice that sets forth the amount of the tax delinquency as of the date of the notice.

REASONS FOR CHANGE

The IRS satisfies the IRC § 7524 requirement by sending taxpayers with delinquent accounts Notice CP-71, Reminder Notice, once a year. However, the infrequency of IRS billing notices leaves collectible revenue uncollected and subjects taxpayers who would make payments if they received more frequent reminders to additional penalties and interest charges.

We recognize that sending more frequent notices after the IRS's initial notice stream would entail additional postage and processing costs. However, private sector businesses, including credit card issuers and retailers, face this same trade-off, and they almost uniformly send billing notices more frequently than once a year. Most send delinquency notices on at least a monthly basis. Thus, private businesses that depend on maximizing net revenue have consistently found that the collection costs of mailing more frequent notices more than pay for themselves.

We believe the IRS would similarly collect more revenue, net of costs, if it sends more frequent notices. In addition, taxpayers receiving more frequent notices would be more aware that penalties (up to the maximum allowed by law) and interest charges continue to accrue, causing their balances to increase. This would provide an additional incentive for them to resolve their liabilities.

RECOMMENDATION

- Amend IRC § 7524 to require the IRS to notify taxpayers of delinquent tax liabilities at least quarterly.[1]

1 For legislative language generally consistent with this recommendation, see Protecting Taxpayers Act, S. 3278, § 201, 115th Cong. (2018). The IRS may reach a point in the next few years where it can transmit information to taxpayers with online accounts electronically rather than by snail mail. For that reason, we are phrasing our recommendation broadly to allow that means of communication as an option.

Legislative Recommendation #19

Clarify When the Two-Year Period for Requesting Return of Levy Proceeds Begins

PRESENT LAW

IRC § 6331(a) allows the IRS to levy on a taxpayer's property and rights to property that exist at the time the levy is served. Rights to property include fixed and determinable obligations to which the levy attaches, even if receipt of a payment arising from the obligation is deferred until a later date.

IRC § 6331(e) allows the IRS to serve a levy on the taxpayer's salary or wages that continues from the date the levy is first made until the levy is released under IRC § 6343.

IRC § 6331(h) allows the IRS to serve a levy on federal payments specified under that provision, such as Social Security benefits, which continues from the date the levy is first made until the levy is released. This levy is made by electronic means under the Federal Payment Levy Program (FPLP).

IRC § 6343(b) authorizes the IRS to return money levied upon or money received from the sale of levied property *to third parties* when it determines the levy was wrongful within the meaning of IRC § 7426(a)(1) if the third party requests the return within two years from the "date of levy."

IRC § 6343(d) authorizes the IRS to return money levied upon or money received from the sale of levied property *to the taxpayer* when it determines one of the circumstances specified in IRC § 6343(d)(2) exists if the taxpayer requests the return within two years from the "date of levy."[1] Neither IRC § 6343 nor the Treasury regulations promulgated thereunder define the term "date of levy."

For levies delivered by hand, the IRS takes the position that the "date of levy" is the date of delivery.[2] For mailed levies, Treasury Regulation § 301.6331-1(c) similarly defines the term "date of levy" as the date the levy is delivered to the person in possession of the property. By contrast, for levies imposed by electronic means through the FPLP, the IRS has adopted a policy to return all or a portion of the FPLP proceeds it received during the two-year period preceding the date of request for their return without regard to the date of the initial levy was delivered.[3]

REASONS FOR CHANGE

The IRS may issue levies to attach a taxpayer's assets, such as wages, pension benefits, annuities, or Social Security benefits, that result in multiple payments over many years. The IRS has the authority to return levy proceeds to a third party or the taxpayer if the person requests the proceeds within two years of the date of

1 IRC § 6343(b) & (d) permits the IRS to return specific property levied upon at any time.

2 *Cf. American Honda Motor Co., Inc. v. United States*, 363 F. Supp. 988, 991-992 (S.D.N.Y. 1973) (holding that date of levy for purposes of timely filing suit under IRC § 6532(c)(1) is the date when the notice of levy is served upon the person in possession of the taxpayer's property).

3 The Treasury regulations under IRC § 6331 do not define the term "date of levy" when the levy occurs through electronic means as used in the FPLP. The IRS's policy is set forth in the Internal Revenue Manual (IRM). *See* IRM 5.11.7.2.7, Returning FPLP Levy Proceeds (Oct. 3, 2018); IRM 5.19.9.3.8, Return of FPLP Levy Proceeds (Oct. 3, 2018).

levy. The IRS generally interprets the "date of levy" to mean the date the IRS delivers by mail or by hand a notice of levy to the person in possession of the property levied. In the case of a continuous levy under IRC § 6331(e), the date of levy is the date the notice of levy is first served by hand or by mail on the person in possession of the taxpayer's salary or wages.[4] If the taxpayer requests return of levy payments more than two years after the date the notice of levy was served, the IRS is not authorized to return any payments. In the case of FPLP levies under IRC § 6331(h), however, the IRS will return a levied payment if the payment was made within the two-year period before the date of the request for return. This results in similarly situated persons being treated differently and infringes upon a third party or taxpayer's *right to a fair and just tax system*.

To illustrate, assume the IRS issues a continuous levy under IRC § 6331(e) to the taxpayer's employer in Year One, and the employer withholds and pays over to the IRS a portion of the taxpayer's paychecks for each month of the next four years. Then in Year Four, the taxpayer's dependent becomes ill, and as a result, his living expenses increase significantly due to large medical bills. The levy is now causing an economic hardship to the taxpayer. The taxpayer asks the IRS to release the levy and return a portion of the levy proceeds, and the IRS agrees that it is in the best interests of the taxpayer and the government to do so. However, the IRS is prohibited from returning the levy proceeds to the taxpayer because more than two years have elapsed since the date the levy was served on the employer. Contrast this result with a taxpayer whose Social Security benefits are levied under the FPLP. The IRS may return up to the last two years of levy payments even if the request occurs more than two years after the FPLP levies began.

RECOMMENDATION

- Amend IRC § 6343(b) to strike the term "date of such levy" and substitute "each date the IRS receives money from the levy or the date the IRS receives the money from the sale of levied property."

4 Such a levy is issued via Form 668-W and is generally a "paper" levy. A paper levy is defined as "either a manual or systemic levy on Form 668-A, or Form 668-W, that is prepared and issued by an RO." IRM 5.11.5.1.6, Terms/Definitions/Acronyms (June 13, 2018). This differs from an FPLP levy, which is an automated levy. Automated levies are "levies issued through the Automated Levy Programs. These levies are transmitted electronically. The proceeds are also received electronically." IRM 5.11.5.1.6, Terms/Definitions/Acronyms (June 13, 2018). *See also* IRM 5.11.7.2.5.1, FPLP or Paper Levy (Form 668-A/668-W) (Sept. 23, 2016).

Legislative Recommendation #20

Protect Retirement Funds From IRS Levies, Including So-Called "Voluntary" Levies, in the Absence of "Flagrant Conduct" by a Taxpayer

PRESENT LAW

The IRS has wide discretion to exercise its levy authority. IRC § 6331(a) provides that the IRS generally may "levy upon all property and rights to property," which includes retirement savings. Some property is exempt from levy pursuant to IRC § 6334.

As a policy matter, the IRS has decided not to levy on a taxpayer's retirement savings unless it has determined that the taxpayer engaged in "flagrant conduct."[1] Neither the IRC, the regulations, nor internal IRS guidance defines the term "flagrant conduct" for purposes of this analysis.[2]

REASONS FOR CHANGE

Congress has provided significant tax incentives to encourage taxpayers to save for retirement. There are strong public policy reasons to encourage retirement savings — and to shield retirement savings from IRS levies. Almost all workers eventually retire, and they require retirement savings for support. In addition, retired taxpayers who do not have sufficient savings are more likely to experience economic hardship and qualify for public assistance, which other taxpayers pay to provide.

The IRS has taken certain steps to protect retirement savings by requiring a specialized analysis prior to levy, including a determination of whether the taxpayer engaged in "flagrant conduct." However, recent changes in IRS procedures have eroded these protections. Specifically, the IRS has adopted procedures that allow taxpayers to request or agree to "voluntary" levies on retirement accounts.[3] If a taxpayer agrees to a "voluntary" levy, the IRS bypasses the determination of "flagrant conduct."[4]

Without protection from levy, taxpayers who have not engaged in "flagrant conduct" in their tax matters and who therefore would have been shielded from levies on their retirement accounts in the past may agree to "voluntary" levies out of fear or anxiety, and thus may find themselves in economic hardship during retirement.

Under IRC § 6334, the IRS is prohibited from levying on certain sources of payment, such as unemployment and child support. These exceptions reflect policy determinations. For example, Congress has determined that the IRS should not levy on child support payments because doing so would likely harm the children who rely on those benefits for support. To better protect retirement savings, the National Taxpayer Advocate

1 Internal Revenue Manual (IRM) 5.11.6.3(5), Funds in Pension or Retirement Plans (July 8, 2019).
2 The IRM provides examples of flagrant conduct. *See* IRM 5.11.6.3(6), Funds in Pension or Retirement Plans (July 8, 2019). However, the IRM does not provide a definition of the term and it can be changed at any time.
3 IRM 5.11.6.3(3), Funds in Pension or Retirement Plans (July 8, 2019).
4 The IRS will still verify that the taxpayer has received collection due process rights, consider collection alternatives, and analyze whether the taxpayer relies on funds in the retirement account (or will in the near future) for necessary living expenses. IRM 5.11.6.3(3), (4), & (7), Funds in Pension or Retirement Plans (July 8, 2019).

believes that retirement savings should be added to the list of exempt property absent "flagrant conduct," and that the term "flagrant conduct" should be defined in the statute.

RECOMMENDATIONS

- Amend IRC § 6334(a) to include qualified retirement savings as a category of property exempt from levy unless it is determined that the taxpayer has engaged in "flagrant conduct."
- Amend IRC § 6334 to define "flagrant conduct" as willful action (or failure to act) that is voluntarily, consciously, and knowingly committed in violation of any provision of chapters 1, 61, 62, 65, 68, 70, or 75 and that appears to a reasonable person to be a gross violation of any such provision.[5]

5 For legislative language generally consistent with this recommendation, see Taxpayer Protection Act, H.R. 4912, 114th Cong. § 203 (2016) and Taxpayer Rights Act, S. 2333 and H.R. 4128, 114th Cong. §§ 306 & 307 (2015).

Legislative Recommendation #21

Toll the Time Periods for Requesting the Return of Levy Proceeds While the Taxpayer or a Pertinent Third Party Is Financially Disabled

PRESENT LAW

Under IRC § 6331, the IRS is authorized to collect outstanding tax by levying against a taxpayer's nonexempt property and rights to property. In certain circumstances, under IRC § 6343 and the related regulations, levies must be released, and money already levied upon may, or in some cases must, be returned to its owner. When the IRS has seized tangible property and it is in the IRS's possession, it can be returned at any time. With respect to the return of levied money, however, time limitations apply.

IRC § 6511(h) provides that the running of periods of limitation on claims for refund or credit is suspended during periods when an individual is financially disabled. An individual is considered financially disabled "if such individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death and which has lasted or can be expected to last for a continuous period of not less than 12 months." The use of the term "medically determinable" has been interpreted to require a determination by a licensed physician. *See* Rev. Proc. 99-21.

Return of Wrongfully Levied Money to Third Parties Under IRC § 6343(b)

An administrative wrongful levy claim under IRC § 6343(b) is a request, made by a person other than the taxpayer who owes the taxes being levied upon, for the return of money believed to be wrongfully levied upon or seized. Generally, the basis for a wrongful levy claim is that the third party believes the levied money belongs to him or her and not the taxpayer, or that the third party believes he or she has a superior claim to the money that is not being recognized by the IRS.

There are strict time constraints for third parties to request the return of money upon which the IRS wrongfully levied. The third party may file an administrative claim for the return of the levied money or bring a civil action against the United States in a U.S. district court. If the third party files an administrative claim for the return of levied money, the claim must be made in writing to the appropriate IRS office within two years from the date of the levy. If the third party brings a civil action against the United States without having first filed an administrative claim, the third party has two years from the date of the levy to file suit. If the third party files an administrative claim and the IRS rejects it, the third party may still file suit. In this circumstance, IRC § 6532(c)(2) provides that the deadline for filing suit will be extended for the shorter of the following two periods:

1. A period of 12 months from the date of filing the request, or
2. A period of six months from the date a notice of disallowance is mailed to the third party by registered or certified mail.

Return of Levied Money to the Taxpayer Under IRC § 6343(d)

If a taxpayer (as opposed to a third party) seeks the return of money levied upon, the taxpayer may request return of the levied money under IRC § 6343(d). Generally, the taxpayer making the request believes the

IRS should return the levied money because one of the conditions in IRC § 6343(d)(2) has been met. These conditions include: (A) the levy was premature or otherwise not in accordance with administrative procedures; (B) the taxpayer has entered into an installment agreement to satisfy the liability for which the levy was imposed (unless the agreement provides otherwise); (C) the return of the levy proceeds will facilitate the collection of the tax liability; or (D) with the consent of the taxpayer or the National Taxpayer Advocate, return of the levy proceeds would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.

A taxpayer seeking return of levied money faces the same time constraints as a third party (two years from the date of the levy) to file a written administrative claim. Unlike a third party, however, a taxpayer has no right to seek judicial review if a request for the return of levied money is denied by the IRS under IRC § 6343(d).

REASONS FOR CHANGE

Current law prevents the IRS from returning levied funds in cases where a taxpayer is financially disabled due to a physical or mental impairment and does not file a request for the return of levied money until after the two-year period. Likewise, a district court lacks jurisdiction over a wrongful levy suit filed by a third party if the deadline for filing the suit is missed due to a physical or mental impairment of the third party.

To ensure that an impaired taxpayer or third party (who is an individual) can have his or her request for return of levied money considered by either the IRS or the courts, the two-year period should be tolled if the taxpayer or third party can show that the individual was materially limited in managing his or her financial affairs due to a physical or mental impairment.[1] Without this change, an impaired taxpayer or other third party who is prevented due to the impairment from requesting the return of levied funds in a timely manner will not be able to get back levied money that otherwise would be eligible for return under IRC § 6343(b) and (d), even in cases where the IRS violated the law.

RECOMMENDATIONS

- Amend IRC §§ 6343(b) and 6532(c) to toll the time periods for filing a claim for the return of levied money, a wrongful levy claim, and a wrongful levy suit during any period in which an individual is financially disabled.
- Amend IRC § 6511(h)(2)(A) to provide that an individual is "financially disabled" if the individual is "materially limited" in managing his or her financial affairs by reason of a physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months, as determined by a qualified medical or mental health professional.

1 *See* National Taxpayer Advocate 2013 Annual Report to Congress 302-310 (Legislative Recommendation: *Broaden Relief from Timeframes for Filing a Claim for Refund for Taxpayers With Physical or Mental Impairments*). TAS recommended that IRC § 6511(h)(2) be amended to allow qualified medical and mental health professionals (rather than only licensed medical professionals) to determine whether an individual is physically or mentally impaired and to change the requirement that a physical or mental impairment must render the individual "unable" to manage his or her financial affairs to a requirement that "the individual is materially limited in managing his or her financial affairs." The purpose of this recommendation was to broaden relief to include taxpayers who are financially disabled, but who may be able to manage some, but not all, of their financial affairs. For example, a taxpayer in the early stages of Alzheimer's disease may be unable to consistently manage his or her financial affairs, even if the individual is not at the point of being entirely unable to do so. Relief in this situation may be prudent and should be determinable not only by a licensed physician but also by a licensed mental health professional, such as a psychologist.

Legislative Recommendation #22

Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence

PRESENT LAW

The IRS may follow either of two sets of procedures to seize the principal residence of a taxpayer to satisfy a delinquent tax liability: (i) an administrative seizure or (ii) a lien foreclosure suit. The two cannot be used concurrently.

Administrative Seizure. IRC § 6334(a)(13) provides that the principal residence of a taxpayer is generally exempt from levy, except as provided in subsection (e). IRC § 6334(e) provides that a principal residence shall not be exempt from levy if a judge or magistrate of a U.S. district court "approves (in writing) the levy of such residence." An administrative seizure is generally subject to significant taxpayer protections. Among them, IRC § 6343(a) requires the IRS to release a levy under certain circumstances, including where it determines that the levy "is creating an economic hardship due to the financial condition of the taxpayer."

Lien Foreclosure Suit. IRC § 7403 authorizes the Department of Justice (DOJ) to file a civil action against a taxpayer in U.S. district court to enforce a tax lien and foreclose on a taxpayer's property. There is no exclusion for property consisting of a taxpayer's principal residence. As compared with administrative seizures, statutory taxpayer protections are considerably more limited in lien foreclosure suits. For example, the Supreme Court has held: "We can think of virtually no circumstances … in which it would be permissible to refuse to authorize a sale simply to protect the interests of the delinquent taxpayer himself or herself."[1] A court has some discretion to refuse to authorize a sale that would impact a spouse, children, or other third parties, but even in that circumstance, the discretion is limited.[2]

REASONS FOR CHANGE

In enacting the IRS Restructuring and Reform Act of 1998, the Senate Finance Committee report stated that the "seizure of the taxpayer's principal residence is particularly disruptive to the occupants" and a principal residence therefore "should only be seized to satisfy tax liability as a last resort."[3]

Meaningful taxpayer protections are needed to protect not only the delinquent taxpayer but also family members, including a spouse and minor children, who may live in the house.

As described above, taxpayers have far fewer statutory protections in lien foreclosure suits under IRC § 7403 than in administrative seizures under IRC § 6334(e).

At the recommendation of the Office of the Taxpayer Advocate, the IRS has written procedures into its Internal Revenue Manual (IRM) that provide additional taxpayer protections before a case may be referred to

1 *United States v. Rodgers*, 461 U.S. 677, 709 (1983).
2 *Id.* at 680, 709-710.
3 S. Rep. No. 105-174, at 86-87 (1998).

the DOJ for the filing of a lien foreclosure suit.[4] The IRM prescribes certain initial steps IRS employees must take, such as attempting to identify the occupants of a residence and advising the taxpayer about Taxpayer Advocate Service assistance options. It also sets forth an internal approval process prior to referring a lien enforcement case to the DOJ. However, the IRM is simply a set of instructions to IRS staff. Taxpayers generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time.

Because of the devastating impact the seizure of a taxpayer's principal residence may have on the taxpayer and his or her family, the National Taxpayer Advocate believes taxpayer protections from lien foreclosure suit referrals should be codified and not left for the IRS to determine through IRM procedures.

RECOMMENDATIONS

- Amend IRC § 7403 to codify current IRM administrative protections, including that an IRS employee must receive executive-level written approval to proceed with a lien foreclosure suit referral.
- Amend IRC § 7403 to preclude IRS employees from requesting that the DOJ file a civil action in U.S. district court seeking to enforce a tax lien and foreclose on a taxpayer's principal residence, except where the employee has determined that (1) the taxpayer's other property or rights to property, if sold, would be insufficient to pay the amount due, including the expenses of the proceedings, and (2) the foreclosure and sale of the residence would not create an economic hardship due to the financial condition of the taxpayer.[5]

4 *See, e.g.*, IRM 5.17.4.8.2.5, Lien Foreclosure on a Principal Residence (May 23, 2019); IRM 5.17.12.20.2.2.4, Additional Items for Lien Foreclosure of Taxpayer's Principal Residence (May 24, 2019); IRM 25.3.2.4.5.2(3), Actions Involving the Principal Residence of the Taxpayer (May 29, 2019).

5 For legislative language generally consistent with this recommendation, see Small Business Taxpayer Bill of Rights Act, H.R. 1828, 114th Cong. § 16 (2015); Small Business Taxpayer Bill of Rights Act, S. 949, 114th Cong. § 16 (2015); and Eliminating Improper and Abusive IRS Audits Act, S. 2215, 113th Cong. § 8 (2014).

Legislative Recommendation #23

Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions

PRESENT LAW

Current law authorizes the IRS to file Notices of Federal Tax Lien (NFTLs) and issue levies against a taxpayer's property or rights to property, including property owned jointly, property owned by certain third parties, and property secured by certain creditors. However, third parties generally are not considered "taxpayers" for purposes of the Collection Due Process (CDP) notice and hearing procedures described in IRC §§ 6320 and 6330, and they are therefore not entitled to CDP rights.[1] For that reason, the IRS does not issue CDP lien notices pursuant to IRC § 6320 or provide notice of proposed levies pursuant to IRC § 6330 to these third parties.[2]

REASONS FOR CHANGE

Congress created the CDP notice and hearing procedures to give taxpayers the right to a meaningful hearing before the IRS levies their property or immediately after the IRS files an NFTL against their property. During a CDP hearing, a taxpayer has the right to raise defenses, challenge the appropriateness of collection actions, and propose collection alternatives.

However, affected third parties, such as joint owners, nominees, and alter egos, do not have CDP rights. This may be an oversight.[3] There is apparent inconsistency between the statute and the accompanying regulations. For example, the regulations governing CDP rights relating to levy action explain that a CDP notice is issued to the person described in IRC § 6331(a) (*i.e.,* the person who is liable to pay the tax due after notice and demand and who refuses or neglects to pay) and concludes that a "pre-levy or post-levy CDP Notice therefore will be given only to the taxpayer."[4] However, the applicable Code section refers to "person." IRC § 6330(a) stipulates that "[n]o levy may be made on any property or right to property of any *person* unless the Secretary has notified such person in writing of their right to a hearing under this section before such levy is made." (Emphasis added.)

Affected third parties would benefit from CDP hearings at least as much as liable taxpayers. Indeed, an affected third party may warrant additional protection because the underlying liability is generally not his or hers, and if the property at issue belongs strictly to the third party, the IRS may have no right to take its proposed collection action. Without the benefit of CDP protections, an affected third party against whom the IRS takes a collection action has comparatively limited remedies.

Additionally, current law provides different treatments for different types of third parties. Although third parties generally do not receive CDP rights, transferee assessments are established under the same procedures

1 Treas. Reg. §§ 301.6320-1(a)(2), Q-A1 & A-A1; 301.6330-1(a)(3), Q-A1 & A-A1.
2 *See generally* IRC §§ 6321, 6322, 6323(a), (f) and (h)(6), and 6331(a).
3 In the context of explaining the CDP provisions, the Senate report accompanying its version of the IRS Restructuring and Reform Act of 1998 referred to "[t]he taxpayer (or affected third party)." S. Rep. No. 105-174, at 67 (1998).
4 Treas. Reg. § 301.6330-1(a)(3), Q-A1 & A-A1.

used for taxpayers.[5] Transferees may challenge an assessment in court. Transferees also receive CDP rights when the IRS files an NFTL or issues a notice of intent to levy.[6] However, other types of third parties, such as nominees and alter egos, do not receive these protections.

For these reasons, the National Taxpayer Advocate believes affected third parties should be given the same CDP rights to raise defenses and propose collection alternatives as taxpayers who owe a liability. While current law could be interpreted as allowing the IRS to give CDP rights to third parties, the IRS has not adopted that interpretation.

RECOMMENDATION

- Clarify that IRC §§ 6320 and 6330 extend CDP rights to affected third parties who hold legal title to property subject to IRS collection actions.[7]

5 IRC § 6901.

6 Internal Revenue Manual 5.17.14.4.2, Assessing Liability Under IRC § 6901 (Jan. 24, 2012).

7 For more detail, see National Taxpayer Advocate 2012 Annual Report to Congress 544 (Legislative Recommendation: *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*).

Legislative Recommendation #24

Extend the Time Limit for Taxpayers to Sue for Damages for Improper Collection Actions

PRESENT LAW

IRC § 7433(a) provides that if an IRS employee recklessly or intentionally, or by reason of negligence, disregards any provision of the IRC or any regulation in connection with the collection of federal tax, the taxpayer harmed by the improper collection action may sue the United States for damages. Under IRC § 7433(d)(3) and Treasury Regulation § 301.7433-1(g)(2), the suit must be brought in a U.S. district court within two years from the date on which the taxpayer has had a reasonable opportunity to discover all essential elements of a possible cause of action.

Under IRC § 7433(d)(1), before bringing suit, the taxpayer must file an administrative claim with the IRS. Treasury Regulation § 301.7433-1(d) provides that a taxpayer generally may not file suit in court until the earlier of (i) the date six months after filing an administrative claim or (ii) the date on which the IRS renders a decision on the claim. However, if the claim is filed within the last six months of the two-year period for filing suit, the taxpayer may file suit in court at any time before expiration of the two-year period.

REASONS FOR CHANGE

IRC § 7433(d)(1) reflects a policy decision that it is generally in the best interests of both the taxpayer and the government to allow the IRS to consider and render a decision on a taxpayer's claim before a case is brought to court. If a case is resolved at the administrative level, both parties are spared the time and expense of litigation. Treasury Regulation § 301.7433-1(d) reflects a complementary policy decision that where the IRS does not render a decision on an administrative claim within six months, taxpayers should be able to bring their cases to court without having to wait indefinitely for an IRS decision.

However, the existing rules do not always achieve the goal of allowing the IRS to consider and render a decision before suit is filed. For example, while a claim is pending at the administrative level, the two-year period for filing suit in a U.S. district court continues to run. If a taxpayer files an administrative claim during the final six months of the two-year period, the taxpayer may be forced to file suit in a U.S. district court before the IRS has an opportunity to render a decision on the administrative claim (or forfeit the right to do so).

To give the IRS an opportunity to render an administrative decision while preserving the taxpayer's right to challenge an adverse decision in court, the two-year period that commences when the right of action accrues should be tied to the deadline for filing an administrative claim (rather than the deadline for filing suit). Specifically, if the IRS renders an adverse or partially adverse decision on a timely-filed administrative claim, the taxpayer should be allowed to file suit within two years from the date of the IRS's decision (*i.e.*, similar to the time period allowed for filing suit after a refund claim is denied).

At the same time, to ensure taxpayers do not have to wait indefinitely for an IRS decision, a taxpayer should be permitted to file suit in a U.S. district court if a timely-filed administrative claim goes unanswered for six months. These rules would ensure the IRS has a full six-month period to consider and render a decision on a

taxpayer's damages claim based on an alleged improper collection action, while preserving the taxpayer's right to file suit if the IRS does not render a timely decision.

RECOMMENDATION

- Amend IRC § 7433(d)(3) to allow taxpayers who file an administrative claim with the IRS within two years after the date a right of action accrues to file a civil action in a U.S. district court (i) no earlier than six months from the date on which the administrative claim was filed and (ii) no later than two years from the date on which the IRS mails its decision on the administrative claim to the taxpayer by certified or registered mail.[1]

1 The Taxpayer Bill of Rights Enhancement Act, S. 1793, 115th Cong. § 201(c) (2017), and S. 1578, 114th Cong. § 301 (2015), would have amended IRC § 7433(d)(3) to replace the requirement that taxpayers bring suit within two years of the date the cause of action accrues with a requirement that a suit be commenced by "*the later of the date on which administrative remedies available within the Internal Revenue Service have been exhausted* or the date on which the taxpayer reasonably could have discovered that the actions of the officer or employee were done in disregard of a provision of this title or any regulation promulgated under this title." (Emphasis added.) This proposed change would prevent taxpayers from being forced to file suit before the IRS has had the opportunity to render a decision on the administrative claim and is thus generally consistent with this recommendation. However, the recommendation we are making would also preserve the IRC § 7433(d)(1) requirement that taxpayers must file an administrative claim before they can bring suit in a U.S. district court and is thus more comprehensive.

Legislative Recommendation #25

Direct the IRS to Implement an Automated Formula to Identify Taxpayers at Risk of Economic Hardship

PRESENT LAW

The IRC contains several provisions that protect taxpayers experiencing economic hardship from IRS collection actions. IRC § 6330 authorizes a taxpayer in a collection due process hearing to propose collection alternatives, which may be based on an inability to pay the tax due to economic hardship.

IRC § 6343 requires the IRS to release a levy if the IRS determines that the levy "is creating an economic hardship due to the financial condition of the taxpayer." Under Treasury Regulation § 301.6343-1 and the Internal Revenue Manual, economic hardship exists when an individual is "unable to pay his or her reasonable basic living expenses."

IRC § 7122(d) requires the IRS to develop and publish schedules of national and local allowances (known as allowable living expenses or ALEs) to ensure that taxpayers entering into offers in compromise are left with "an adequate means to provide for basic living expenses."

REASONS FOR CHANGE

In general, the IRS is required to halt collection actions if a taxpayer demonstrates that he or she is in economic hardship. However, the IRS routinely enters into installment agreements (IAs) with taxpayers without undertaking the financial analysis required to make a hardship determination. For example, taxpayers are not required to submit any financial information to qualify for streamlined IAs and may enter into them online without interacting with an IRS employee. Many anxious or intimidated taxpayers seek to resolve their liabilities quickly and do not know the IRS is required to halt collection action if they are in economic hardship. As a result, taxpayers often agree to make tax payments they cannot afford.

TAS estimates that about 27 percent of taxpayers who entered into streamlined IAs through the IRS's Automated Collection System (ACS) in fiscal year (FY) 2019 had incomes at or below their ALEs.[1] To emphasize the point: More than a quarter of taxpayers who agreed to streamlined IAs in ACS would have received the benefit of collection alternatives, such as offers in compromise or currently not collectible hardship (CNC-Hardship) status, if they had known to call the IRS to explain their financial circumstances.

That is not a fair result. Whether a taxpayer is left with sufficient funds to pay for the basic living expenses for himself or herself and family should not depend on the taxpayer's knowledge of the IRS's procedural rules.

1 In FY 2018, TAS estimated that 39 percent of ACS taxpayers who entered into streamlined IAs had incomes at or below their ALEs. This estimate allowed two-vehicle ownership expenses for married taxpayers filing joint returns. TAS is publishing a new study on the feasibility of using an algorithm to identify taxpayers at risk of economic hardship in the main volume of this report. This study uses a more conservative estimate of ALEs, allowing only one vehicle-ownership expense. *See* National Taxpayer Advocate 2020 Annual Report to Congress 249-267 (TAS Research Study: *Economic Hardship Indicator*).

Furthermore, taxpayers with incomes below their ALEs who paid their liabilities are disproportionately likely to have incurred economic hardships to do so. Some of these taxpayers will default on their IAs, which subjects them to additional collection actions and further increases their burden.

To address this problem, the TAS Research function has developed an automated algorithm that we believe can, with a high degree of accuracy, identify taxpayers whose incomes are below their ALEs. If the IRS validates this formula or develops an alternative formula that is reasonably accurate, it could place a "low-income" indicator on the accounts of all taxpayers whom the formula identifies as having incomes below their ALEs.

While the ALE standards represent only average expenses for taxpayers and should not be used to automatically close a case as CNC-Hardship, an ALE-based indicator would be a useful starting point for financial analysis in the collection context. It could be used to alert collection employees speaking with a taxpayer over the phone of the need to request additional financial information so the IRS can analyze the specific facts and circumstances of the taxpayer's case. The indicator could be used to trigger a notification to taxpayers entering into online IAs that informs them of their right to contact the IRS collection function for assistance if they believe they cannot pay their tax debt without incurring economic hardship. The IRS could also use this algorithm to screen out these taxpayers from automated collection treatments such as the Federal Payment Levy Program, from selection for referral to private collection agencies, or for passport certification, unless and until the IRS has made direct personal contact with the taxpayer to verify his or her financial information.

In short, an automated economic hardship screen would benefit taxpayers and the IRS alike. It would help protect low-income taxpayers from agreeing to make payments that would leave them without adequate means to provide for their basic living expenses, and it would help the IRS avoid the rework that occurs when taxpayers default on IAs they cannot afford.

RECOMMENDATION

- Direct the IRS to implement an algorithm to identify taxpayers at high risk of economic hardship and to use it to respond appropriately to taxpayers who contact the IRS regarding a balance due; alert taxpayers at risk of economic hardship who seek to enter into streamlined IAs online of the resources available to them; determine whether to exclude taxpayers' debts from automated collection treatments such as the Federal Payment Levy Program, the private debt collection program, and passport certification; and possibly to rank cases for collection priority.

Legislative Recommendation #26

Revise the Private Debt Collection Rules to Eliminate the Taxpayers Intended to Be Excluded by the Taxpayer First Act

PRESENT LAW

IRC § 6306 directs the Secretary to enter into qualified tax collection contracts with private debt collection agencies (PCAs) to collect certain "inactive tax receivables."[1] Subsection (d) lists categories of collection cases that are not eligible for assignment to PCAs.

The Taxpayer First Act (TFA) added the following category to the list:[2]

> "[A] taxpayer who is an individual with adjusted gross income, as determined for the most recent taxable year for which such information is available, which does not exceed 200 percent of the applicable poverty level (as determined by the Secretary)."

REASONS FOR CHANGE

The IRS has implemented the exclusion for taxpayers with adjusted gross incomes (AGI) that do not exceed 200 percent of the Federal Poverty Level in a manner that fails to identify those taxpayers accurately. While the TFA directed the IRS to not send the accounts of taxpayers with AGIs at or below 200 percent of the Federal Poverty Level to PCAs, it did not specify how the IRS should determine AGI. There are two possible methods. One method is to rely exclusively on a filed tax return, even if it is not recent. The other method is to rely on third-party information reporting documents (*e.g.,* Forms W-2 and 1099) when no recent return has been filed.

The IRS exclusively uses a taxpayer's last-filed tax return to determine AGI — and if there is no recent return, it will reach back up to *ten years* to locate one. Under this approach, the results may be dramatically underinclusive and overinclusive of the population the provision is designed to protect. Liability determinations and collectibility determinations are made at different points in time. For example, if a taxpayer files a tax return for tax year 2012, the liability determination reflects the taxpayer's income, deductions, and credits for that year. By contrast, if a taxpayer still has an unpaid 2012 tax liability today, the determination of whether the taxpayer has sufficient income to pay the liability is made on the basis of the taxpayer's current financial condition, and not the taxpayer's financial condition in the year the liability was incurred.[3]

The TFA underscored this point by directing the IRS to determine an individual's AGI "for the most recent taxable year for which such information is available." Using tax returns going back ten years to make current collection decisions stands the logic of collectibility determinations on its head. A taxpayer who could afford to pay tax in 2012 may not be able to do so today — and these are the cases Congress intended to exclude

1 IRC § 6306(a) & (c).
2 TFA, Pub. L. No. 116-25, § 1205, 133 Stat. 981, 989 (2019) (adding IRC § 6306(d)(3)(F)).
3 See, *e.g.*, IRC § 7122(d), which directs the Secretary, for purposes of evaluating offer-in-compromise submissions, to "develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses."

from assignment to PCAs. In addition, a taxpayer who could not afford to pay tax in 2012 might have earned additional income or acquired additional assets and be able to make payments currently.

> *Example*: A taxpayer last filed a tax return in 2012 when he earned $60,000. In 2013, he retired due to age or disability. He did not pay his tax liability and still has a balance due. Since 2012, his income has consisted solely of Social Security benefits, and he has not had a filing obligation. Under the IRS's approach, it will look at his 2012 tax return, determine his income is above 200 percent of the Federal Poverty Level, and assign his case to a PCA. Yet this is a case the TFA sought to exclude from assignment to a PCA.
>
> By contrast, if the same taxpayer earned only $30,000 in 2012, and third-party information reports show he earned $100,000 in 2019, the case might not be assigned to a PCA under the IRS's approach, even though the taxpayer can make payments currently.

To ensure that collectibility determinations are made based on current data, TAS has recommended that the IRS utilize information on a tax return if one has been filed in the last two years and, if not, that the IRS compute AGI from the information reporting documents the IRS receives. No method will be perfect. If the IRS uses third-party information reporting documents to make collectibility determinations, income not reported on those documents, such as self-employment income, will not be taken into account. But that is likely to be true even when the IRS relies on filed tax returns, as tax gap studies show most income not reported to the IRS on third-party documents is not reported on tax returns, either.[4]

In addition, the IRS will have to use gross income rather than AGI when relying on information reporting documents because it will not know for which adjustments a taxpayer qualifies. That may have the effect of overestimating a taxpayer's AGI and therefore assigning some cases to PCAs that should have been excluded. Even so, we believe basing collectibility determinations on recent information will be far more accurate than reaching back for information up to ten years old.[5] In a recent audit report, TIGTA reached a similar conclusion and similarly recommended that the IRS consider using "both last return filed information and third-party income information in its methodology to exclude low-income taxpayers from PCA inventory."[6]

RECOMMENDATION

- Amend IRC § 6306(d)(3)(F) to direct the IRS to determine an individual's adjusted gross income "for the most recent taxable year for which such information is available" by reference to the individual's most recently filed tax return if one has been filed in the preceding two years or, if not, by reference to information reporting documents described in part III of subchapter A of chapter 61 of the Internal Revenue Code.

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4 IRS Pub. 1415, Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013, at 14 (rev. Sept. 2019), https://www.irs.gov/pub/irs-pdf/p1415.pdf. The study estimated the net misreporting percentage (NMP) of income subject to little or no information reporting is 55 percent. The NMP is roughly equivalent to the percentage of income that goes unreported. Prior tax gap studies have shown, as one would expect, that the nonreporting percentage is higher for income subject to no information reporting than income subject to little information reporting.

5 A data run the IRS performed to compare the method the IRS is using with the method TAS has proposed found it would exclude roughly the same number of taxpayers. Cases assigned to PCAs as of September 12, 2019, were matched to the Individual Returns Transaction File to determine the last individual income tax return filed and to the Information Returns Master File to determine current income reported by third-party payors. For the reasons described above, we believe the TAS approach would do a better job of identifying the taxpayers whom Congress intended to exclude.

6 Treasury Inspector General for Tax Administration, Ref. No. 2021-30-010, *Fiscal Year 2021 Biannual Independent Assessment of Private Collection Agency Performance* 20 (Dec. 2020).