MISCELLANEOUS RECOMMENDATIONS

Legislative Recommendation #53

Restructure the Earned Income Tax Credit (EITC) to Make It Simpler for Taxpayers and Reduce Improper Payments

PRESENT LAW

The Earned Income Tax Credit (EITC) is a refundable credit for low- and moderate-income working individuals and families. Eligibility for the EITC and the amount of EITC to which a taxpayer is entitled are based on a variety of factors including the taxpayer’s earned income, the number of qualifying children, and the taxpayer’s filing status.¹ The EITC follows a bell-shaped curve, adjusting the credit amount to income, family composition, and filing status. For tax year (TY) 2019, the bell curve plateaued at $6,557 for a family of one adult with three children earning no more than $19,050.²

An individual must meet three primary requirements to be a “qualifying child.” First, the individual must have a specific relationship to the taxpayer (son, daughter, adopted child, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or descendent of such a relative such as a grandchild, niece, or nephew). Second, the individual must share a residence with the taxpayer for more than half the year in the United States. Third, the individual must be under the age of 19 (or under age 24, if a full-time student) or be permanently and totally disabled.³ “Tie-breaker” rules prioritize who can claim a qualifying child.⁴

REASONS FOR CHANGE

Enacted in 1975, the EITC is the federal government’s largest benefits program for low-income workers.⁵ In 2017, taxpayers filed more than 26 million returns for EITC benefits totaling nearly $64.5 billion.⁶ While the EITC is widely considered to be an effective anti-poverty program, it suffers from several shortcomings. First, the eligibility requirements are complex. Some eligible taxpayers do not claim the EITC because they have difficulty figuring out how to do so, many taxpayers (and preparers) make inadvertent errors, and some taxpayers claim more EITC than they are entitled to receive. Second, the EITC was enacted at a time when two-parent families predominated. As alternative living arrangements have expanded, the credit eligibility rules in many cases no longer serve their intended purpose. Simplifying the eligibility requirements and modernizing the rules as they apply to non-traditional families could increase the participation rate among

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¹ IRC § 32.
³ The individual must also have a Social Security number that is valid for employment. IRC § 32(c)(3)(D) & (m).
⁴ If an individual may be claimed as a qualifying child by two or more taxpayers, the individual is treated as the qualifying child of the taxpayer who is (i) a parent or, (ii) if no parent claims the child, the taxpayer with the highest adjusted gross income for the taxable year. IRC §§ 152(c)(4)(A) & (C). If the parents claiming a qualifying child do not file a joint return, the child is treated as the qualifying child of (i) the parent with whom the child resided for the longest period of time during the taxable year, or (ii) if the child resided with both parents for the same amount of time during the taxable year, the parent with the higher adjusted gross income. IRC § 152(c)(4)(B).
⁶ Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2020-40-008, Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims (Feb. 26, 2020).
eligible taxpayers, allow guardians other than parents to receive benefits when they are principally caring for one or more children, and reduce “improper payments.”

RESTRUCTURE THE EITC AS TWO CREDITS: A WORKER CREDIT AND A CHILD BENEFIT

The National Taxpayer Advocate recommends restructuring the EITC into two credits: (i) a refundable worker credit based on each individual worker’s earned income, irrespective of the presence of a qualifying child, and (ii) a refundable child credit that would reflect the costs of caring for one or more children.

Worker Credit

Much like the current EITC, the worker credit would be structured to phase in as a percentage of earned income, reach a plateau, and then phase out. Unlike the current EITC, the credit would be uniform for each worker at a given income level and not vary depending on the number of children the worker has or, if the worker is married or filing separately, the couple’s combined income. This structure would target the credit to the lowest income taxpayers and help ensure that workers in low-wage jobs can meet their basic living expenses. To prevent wealthy taxpayers with relatively low levels of earned income from claiming the credit, the credit could phase out based on adjusted gross income (a broader measure of income that includes unearned income like capital gains, dividends, rents, and royalties) or the current EITC provision that denies the credit to taxpayers with excessive investment income could be retained. Since the IRS would have internal data to determine reported income, the credit should be easy to administer and improper payments could be nearly eliminated.

Child Credit

The child credit would be designed as a fixed amount per child, subject to an income phase-out, and would replace the portion of the existing EITC attributable to family size and the child tax credit. The current child tax credit (a smaller but similar benefit as the EITC) is a $2,000 credit that begins to phase out for joint filers with $400,000 of income and other filers with $200,000 of income. The Additional Child Tax Credit, which is the refundable portion of the Child Tax Credit, currently phases out as earned income increases, limiting the benefit to the lowest income taxpayers. Our proposed child credit would simplify

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7 An improper payment is defined as “any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements” and “any payment to an ineligible recipient.” Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e), 124 Stat. 2224 (2010), amending Improper Payments Information Act of 2002, Pub. L. No. 107–300, 116 Stat. 2350 (2002) (striking § 2(f) and adding § (f)(2)). For FY 2019, the IRS estimates that approximately 25 percent of the total EITC program payments were improper. TIGTA, Ref. No. 2020–40–025, Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments 2 (Apr. 30, 2020).
8 For examples regarding how to structure a per-worker credit, see Elaine Maag, Investing In Work by Reforming the Earned Income Tax Credit (2015).
9 Some experts caution that without a minimum wage, employers would reduce and capture the benefit of an increased EITC. See Austin Nichols & Jesse Rothstein, The Earned Income Tax Credit, in ECONOMICS OF MEANS-TESTED TRANSFER PROGRAMS IN THE UNITED STATES, vol. 1, at 137 (Robert A. Moffitt ed., 2016). Therefore, many proposals couple an increased childless EITC or worker credit with an increased minimum wage. See Isabel V. Sawhill & Quentin Karpilow, Raising the Minimum Wage and Redesigning the EITC, BROOKINGS INST. (Jan. 30, 2014), https://www.brookings.edu/research/raising-the-minimum-wage-and-redesigning-the-eitc.
10 IRC § 32(i).
11 IRC § 24(h)(3).
12 IRC § 24(d).
the contentious qualifying child provisions of the current code. Providing a phased-out child benefit would acknowledge that families need a threshold level of resources to support their children.

EXPAND THE CHILDLESS WORKER CREDIT AND MAKE IT AUTOMATIC FOR ELIGIBLE TAXPAYERS

Separate from the earned income credit for families with children, there is currently a slimmed down credit for childless workers. The maximum amount of this “childless worker” credit will be $538 in 2020. This is just eight percent of the $6,660 maximum credit for taxpayers claiming three children, which creates a troubling disparity. Additionally, more Millennials head a household in poverty than any other age group. And for calendar year 2019, the poverty rate is 8.9 percent for people aged 65 and older. Yet the childless worker portion of the EITC is limited to workers between the ages of 25 and 64. This age limitation harms significant segments of the population who could benefit from this income supplement because it does not reflect today's workforce.

When Congress initially implemented the EITC, one explanation for not making the EITC universally available to everyone was that students and retired individuals “often have low amounts of earned income because they work part-time or for short periods of time and may receive most of their support from family relatives or through social security or private pension plans.” However, only about 36 percent of Americans aged 25 years and older have a bachelor’s degree or higher, indicating it is a mistake to assume taxpayers under age 25 are primarily students. Furthermore, ignoring the needs of this population may go against the intent of the EITC since earnings can be tied to level of education (i.e., those with less education will, on average, earn less).

It is also no longer realistic to assume older taxpayers can safely rely on pensions and Social Security. One survey by the Board of Governors of the Federal Reserve System found that 25 percent of non-retired respondents had no retirement savings. Additionally, the number of taxpayers over 65 in the workforce is increasing. The labor force participation rate for workers aged 65 to 74 is projected to be approximately

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14 In TY 2020, the maximum credit for three or more children is $6,660. IRS, Earned Income Tax Credit Income Limits and Maximum Credit Amounts, https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-tax-credit-income-limits-and-maximum-credit-amounts (last visited Dec. 16, 2020).
17 IRC § 32(c)(1)(A)(i)(II).
20 While many factors can influence lifetime earnings, men with bachelor's degrees can expect to earn $655,000 more in median lifetime earnings than high school graduates and women with a bachelor's degrees can expect to earn $450,000 more in median lifetime earnings than high school graduates. Social Security Administration, Education and Lifetime Earnings (Nov. 2015), https://www.ssa.gov/policy/docs/research-summaries/education-earnings.html.
30 percent in 2026, compared to only approximately 18 percent in 1996. To ensure the EITC is getting to targeted taxpayers, the age of eligibility should be expanded to be more inclusive of today’s workforce.

Furthermore, taxpayers who are otherwise eligible could automatically requalify from year-to-year. Most EITC recipients have at least some Form W-2, Wage and Tax Statement, wage income, and errors associated with this type of income are relatively small in dollar terms. In TY 2018, about 16 percent of EITC recipients had both self-employment and W-2 income, while about 12 percent had only self-employment income. Moreover, as a result of changes made by the Protecting Americans from Tax Hikes (PATH) Act, the IRS has more accurate and timely data it can use to detect and prevent any overclaims of the worker credit based on W-2 income. The PATH Act requires employers to submit W-2s (and information returns for nonemployee compensation like Form 1099-NEC, Nonemployee Compensation) by January 31 and requires the IRS to hold refunds until February 15 if the taxpayer claims the EITC or the refundable portion of the child tax credit.

These legislative changes were made in part to prevent “refund fraud related to fabricated wages and withholdings.” Prior to the PATH Act, the IRS generally did not receive and match W-2s against tax returns until after refunds had been paid and the filing season had concluded. Now, the IRS receives the overwhelming majority of W-2s by early February and matches tax returns against the W-2s before paying refunds. As of February 10, 2020, the IRS had received about 236 million W-2s, which constituted about 90 percent of the number it had received during all of calendar year 2019. Assuming payouts of the worker credit are also held until February 15, this additional data would minimize improper payments of the credit associated with W-2 income, although improper payments associated with self-employment income would still exist.

MODERNIZE THE DEFINITION OF A QUALIFYING CHILD

The qualifying child rules of the current EITC structure often do not reflect the real-life living arrangements between children and adults. A 2016 study by the Tax Policy Center found that the number of households...

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22 U.S. Bureau of Labor Statistics, Labor Force Participation Rate for Workers Age 75 and Older Projected to Be Over 10 Percent by 2026, https://www.bls.gov/opub/ted/2019/labor-force-participation-rate-for-workers-age-75-and-older-projected-to-be-over-10-percent-by-2026.htm (May 29, 2019). For workers age 75 and older, the labor force participation rate has doubled since 1996. In 2026, the rate is projected to be nearly 11 percent, compared with nearly 5 percent in 1996. Id.


26 See Pub. L. No. 114-113, Division Q, Title II, § 201 (a) & (b), 129 Stat. 2242, 3076 (2015) (codified at IRC §§ 6071(c) and 6402 (m)).


28 IRS, IDT and IVO Modeling Analysis - MAIN Performance Report, slide 11 (Oct. 7, 2020). See IRC § 6402(m), which prevents the IRS from issuing certain refunds before Feb. 15 each year. The increase in timely received Form W-2 data, in conjunction with two other changes, likely resulted in more returns being released earlier in the process this year compared to last year. One change is the newly adopted systemic release feature that allows returns to be released back into normal processing systemically rather than waiting for an IRS employee to manually release the refund. The other is the availability of third-party documentation daily rather than weekly.
made up of “traditional families” (married parents with only biological children) has declined, while alternative family types, such as families led by single parents or cohabitating adults, have increased. Only 51.6 percent of children living in families with incomes at or below 200 percent of the Federal Poverty Level were in families headed by married couples. Low-income children were more likely to live with a single parent or in a multigenerational household, a cohabiting household, or a family with at least one non-biological child, as compared with higher income families. Since the EITC and other refundable credits are intended to support low-income working families, their eligibility rules should be revised to more accurately reflect the circumstances of their target population.

The Tax Court case of Cowan v. Commissioner illustrates how the current definition of a qualifying child does not match up with the taxpayers who truly care for children. In this case, Ms. Cowan was the legal guardian of a child, Marquis. Under state law, the guardianship automatically terminated when Marquis turned 18, which occurred in 2004. However, Ms. Cowan continued to provide Marquis with a home after he turned 18, and they continued to regard themselves as a family unit. Ms. Cowan never adopted Marquis and did not understand the legal significance of that status. Later, Marquis had a daughter, and they both lived with Ms. Cowan. In 2011, Ms. Cowan claimed Marquis’s daughter as her granddaughter for the EITC. The court disallowed the claim since she and Marquis are not legally related. However, Ms. Cowan and Marquis believed and acted as if they are family.

Instead of focusing on biological relationship, the definition of a qualifying child should consider which adult provides primary care for the child. This could include things such as who makes medical appointments for the child, who prepares meals for the child, and who is the contact for the child at school.

**RECOMMENDATIONS**

- Consolidate the numerous family status provisions into two: (i) a refundable EITC that would be awarded per individual worker and provide a work incentive and subsidy for low-income workers, and (ii) a refundable Child Credit that would reflect the cost of maintaining a household and raising a family.
- Expand the eligibility age for the modified refundable EITC to include workers 18 years of age and older with no age cap.
- Amend IRC § 152(c) to redefine and modernize the definition of a qualifying child to reflect the experiences of primary caregivers and their children. Things to consider would include which adult performs caregiving efforts and makes caregiving decisions.

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31 T.C. Memo. 2015-85.

32 For other illustrations of this problem, see National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress vol. 3, at 8 (Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government).

33 For more discussion on modernizing the definition of “qualifying child,” see National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress vol. 3, at 17-19 (Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government).
Legislative Recommendation #54

Provide Earned Income Tax Credit (EITC) Relief During National Disasters

PRESENT LAW

The Earned Income Tax Credit (EITC) is a refundable credit for low- and moderate-income working families. Eligibility for the EITC and the amount of EITC to which a taxpayer is entitled are based on a variety of factors, including the taxpayer’s earned income, the number of qualifying children, and the taxpayer’s filing status.¹ Taxpayers without children can qualify for the “childless EITC.” For tax year (TY) 2020, a single taxpayer with no children earning up to $15,820 and married taxpayers filing jointly with no children earning up to $21,710 could qualify for a maximum EITC benefit of $538, provided certain other requirements are met.² To claim the EITC, a taxpayer must file a tax return, even if the taxpayer otherwise does not have a filing obligation. Unemployment compensation (UC),³ while based on a taxpayer’s earned income, is not included in earned income and thus does not count in computing the amount of EITC benefits for which a taxpayer is eligible.⁴

The federal government can step in to assist state and local governments during times of emergency or major disaster.⁵ During previous disasters, Congress allowed eligible taxpayers to elect to use their prior year earned income to calculate the current year’s EITC.⁶ Most recently, Congress allowed this relief in 2020.⁷

REASONS FOR CHANGE

To calculate and substantiate the correct amount of EITC, a taxpayer needs to have records that show how much income he or she earned in that year. During times of declared disasters, taxpayers may struggle to piece together sufficient financial records to substantiate EITC claims. At the same time, they may be dealing with disaster-related financial turmoil and need the EITC quickly. Congress has allowed taxpayers to elect to use their prior year earned income to calculate the current year’s EITC in times of disaster. However, this relief is not permanent, so Congress must authorize it on a disaster-by-disaster basis.

The IRS could alleviate the wait for EITC benefits by allowing the childless portion to be issued to taxpayers automatically based on information a Legislative Recommendation in the IRS’s possession.⁸ This portion, a maximum of $538 in TY 2020, would assist in alleviating some financial stress during a disaster.

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¹ IRC § 32.
³ UC generally includes any amount received under an unemployment compensation law of the United States or a state. IRC § 85; Treas. Reg. § 1.85-1(b)(1).
⁴ IRC § 32(c)(2); Treas. Reg. § 1.32-2(c)(2).
⁸ See Restructure the Earned Income Tax Credit (EITC) to Make it Simpler for Taxpayers and Reduce Improper Payments, supra.
During major disasters like COVID-19 or hurricanes, many taxpayers experience a disruption in work, a furlough, or a job termination. If a taxpayer receives UC based on previous employment, the taxpayer cannot use his or her UC income to qualify for the EITC, likely compounding the income disruption. The apparent rationale for not counting UC is that the EITC historically provided a benefit only for individuals who work. But UC is paid exclusively to individuals who were working and were separated from their jobs due to no fault of their own. Moreover, UC benefits are limited in duration. Because UC is effectively a replacement for some of the wages the individual would have earned, treating UC as EITC-qualifying income would maintain the nexus between working and receiving EITC benefits if there are mass layoffs due to the effects of a natural or similar disaster beyond the worker’s control.

RECOMMENDATION

• Amend IRC § 32 to allow taxpayers to elect the use all of their prior year’s income to claim the EITC in the year of a disaster, to make childless EITC payments automatic during times of national disaster, and to allow taxpayers to include unemployment compensation as qualifying earned income in computing the EITC.

Legislative Recommendation #55

Exclude Taxpayers in Specific Circumstances From the Requirement to Provide a Social Security Number for Their Children to Claim the Child Tax Credit

PRESENT LAW

The Tax Cuts and Jobs Act (TCJA) amended IRC § 24 to require a taxpayer claiming the Child Tax Credit (CTC) to provide a Social Security number (SSN) valid for employment for a qualifying child.¹

IRC § 1402(g) exempts members of certain religious faiths from the requirement to pay self-employment tax if certain conditions are met. An individual may apply for an exemption from the self-employment tax requirements:

… if he is a member of a recognized religious sect or division thereof and is an adherent of established tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance of the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act).

To claim the exemption, the individual must apply on IRS Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits.²

REASONS FOR CHANGE

The requirement under IRC § 24 that a qualifying child claimed for the CTC have an SSN valid for employment was intended to prevent a taxpayer whose child is not a U.S. citizen or is not otherwise eligible for an SSN from receiving the CTC. However, the provision is having the unintended effect of disqualifying several taxpayer populations whose dependents do not have SSNs due to unique circumstances but who otherwise meet the requirements for the credit. These populations are being denied a valuable tax benefit that Congress did not intend to deny them. Affected taxpayers include:

• Taxpayers who do not apply for SSNs due to their deeply held religious beliefs, most notably the Amish;
• Taxpayers whose adopted children have not yet received SSNs; and
• Taxpayers unable to obtain an SSN for a qualifying child because the child was born and died in the same or consecutive tax years.

Prior to the TCJA amendment, IRC § 24 only required a taxpayer claiming a child as a qualifying child for the CTC to provide a taxpayer identification number (TIN) for the child. The IRS provided administrative relief to allow the credit to a taxpayer without a TIN for a qualifying child due to the taxpayer’s deeply held religious beliefs. Specifically, a taxpayer whose qualifying child did not have an SSN or other TIN due to the

¹ TCJA, Pub. L. No. 115-97, § 11022(a), 131 Stat. 2054, 2073-2074 (2017) (codified at IRC § 24(h)(7)).
² IRC § 1402(g).
taxpayer’s deeply held religious beliefs was allowed the credit if the taxpayer indicated on his tax return that he had an approved Form 4029 establishing he had met the requirements under IRC § 1402(g).

In certain circumstances, the IRS would request additional information from the taxpayer to prove the age, relationship, and residence of the child. Further, the language in the CTC prior to the TCJA permitted the IRS to allow the credit for taxpayers whose child only had an Adoption Taxpayer Identification Number (ATIN), which is a tax identification number issued for use while waiting to receive an SSN for the adopted child. Now, the IRS is no longer providing administrative relief to allow the CTC if the qualifying child lacks an SSN, unless the taxpayer’s child was born and died in the same or consecutive tax years.³

The National Taxpayer Advocate believes that the affected taxpayer populations are being treated unjustly because the TCJA language is broader than Congress intended and this drafting glitch should be fixed.

**RECOMMENDATION**

- Amend IRC § 24(h)(7) to allow a taxpayer to claim the CTC with respect to a qualifying child without an SSN if the taxpayer meets all other eligibility requirements for the credit, and if the taxpayer:
  - Is a member of a recognized religious group and meets the requirements under IRC § 1402(g);
  - Adopted a child (or has a child lawfully placed with the taxpayer for adoption) and provides an ATIN for the qualifying child; or
  - Had a child that was born and died in the same or consecutive tax years.

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Legislative Recommendation #56

Clarify Whether Dependents Are Required to Have Taxpayer Identification Numbers for Purposes of the Credit for Other Dependents

PRESENT LAW

The Tax Cuts and Jobs Act (TCJA) created a new tax credit, referred to as the credit for other dependents (ODC), by amending IRC § 24.1 IRC § 24 also provides for the child tax credit (CTC). Taxpayers whose dependents are not eligible to be claimed for the CTC (a credit of $2,000 per “qualifying child,” of which $1,400 is refundable) may be eligible to be claimed for the ODC (a nonrefundable credit of $500 per “dependent”).2

IRC § 24(e) provides that a “qualifying child” must have a Taxpayer Identification Number (TIN) for a taxpayer to claim a credit for the child under this section.3 IRC § 24(h)(7) further provides that the qualifying child’s TIN must be a Social Security number (SSN) valid for employment.4 Where the lack of the required SSN prevents a child from meeting the definition of a “qualifying child,” the child is treated as a dependent for the ODC.5

Under IRC § 24(h)(4), the ODC is available regarding a “dependent of the taxpayer (as defined in section 152).” There is no requirement in IRC § 152 that to be a “dependent,” an individual must have a TIN (either an SSN or an ITIN).6

REASONS FOR CHANGE

Despite the absence of a TIN requirement in the statute, the IRS has instructed taxpayers that to claim a dependent for the ODC, the dependent must have a TIN.7 The IRS has used its summary assessment

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2 IRC § 24(h)(4).
3 IRC § 24(h)(4).
4 Taxpayers are generally required to include their “identifying number,” which is generally a Social Security number for an individual, on the tax returns they file with the IRS. See IRC § 6109(a), (d). Individuals who are not eligible to be issued SSNs may be issued individual taxpayer identification numbers (ITINs) by the IRS. See Treas. Reg. § 301.6109-1(a)(1)(ii)(B) & (d)(3)(i).
5 IRC § 24(h)(7).
6 IRC § 24(h)(7).
7 The House version of the TCJA included a requirement that a dependent have a TIN for purposes of the ODC. This provision was dropped in the Senate version. See H.R. Conf. Rep. No. 115-466, 115th Cong., 1st Sess. at 225-227 (Dec. 15, 2017), https://www.congress.gov/115/crpt/hrpt466/CRPT-115hrpt466.pdf.

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authority to disallow the ODC claimed by nearly 113,000 taxpayers on their 2018 returns because their dependents did not have TINs.\(^8\)

In response to TAS’s inquiry, the IRS Office of Chief Counsel (OCC) explained its legal rationale as follows: “[I]n order to avoid treating dependents for whom a taxpayer may claim a credit under section 24(h)(4)(A) [i.e., the ODC] inconsistently, section 24(e)(1) [which imposes a TIN requirement for claiming a “qualifying child” for a credit under section 24] should be interpreted as applying to all dependents for whom a taxpayer claims a credit under section 24(h)(4)(A), not only a qualifying child described in section 24(h)(4)(C) [i.e., who is a “qualifying child” but lacks the SSN required by section 24(h)(7)].”\(^9\)

It is a basic canon of statutory construction that the plain language of a statute controls absent a clearly expressed legislative intent to the contrary.\(^10\) Here, there is no statutory requirement that a dependent have a TIN to be claimed for the ODC. The OCC simply invented that requirement, albeit it may further a reasonable policy goal. If taxpayers could claim ODC tax benefits without having to provide dependent TINs, the number of fraudulent ODC claims might increase.\(^11\)

Nevertheless, the TCJA legislative history suggests Congress considered a TIN requirement and did not adopt it. The House version of the TCJA included a requirement that a child have a TIN for purposes of the ODC but the subsequent Senate version of the TCJA did not, and the enacted bill followed the Senate approach. It is possible that a drafting error was made, but if so, Congress — not the IRS — should fix it.\(^12\)

To resolve the inconsistency between the absence of a TIN requirement in the ODC statute and the IRS’s decision to impose the requirement on its own, the National Taxpayer Advocate recommends that Congress clarify its intent.

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8 We presume that the IRS exercised its summary assessment authority in reliance on IRC § 6213(g)(2)(I), which includes in the definition of “mathematical or clerical error” “an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return.” As noted above, IRC § 24(e) imposes a TIN requirement for a “qualifying child” with respect to whom a taxpayer claims CTC. In any event, over 109,000 taxpayers were issued summary assessment notices, removing 112,714 dependents with respect to whom the ODC had been claimed because the dependents had invalid or missing TINs. IRS, Compliance Data Warehouse Individual Master File Individual Returns Transaction File (IRTF) Form 1040 and Entity tables, TY 2018, returns posted by cycle 202047. If $500 of ODC was claimed with respect to each dependent, then the total amount of disallowed ODC would be over $56 million (112,714 times $500).

9 Email communication from the office of Division Counsel/Associate Chief Counsel (National Taxpayer Advocate Program) to TAS Management & Program Analyst (Dec. 19, 2019) (on file with TAS). The email does not contain any references or citations to any legal authority for this position.

10 See, e.g., Consumer Product Safety Commission v. GTE Sylvania, Inc., 447 U.S. 102, 108 (1980) (“We begin with the familiar canon of statutory construction that the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.”); Connecticut Nat’l Bank v. Germain, 503 U.S. 245, 254 (1992) (“[W]hen the words of a statute are unambiguous, then, this first canon is also the last: ‘judicial inquiry is complete.’”).


12 A technical correction was proposed, but the correction was not enacted into law. See Joint Committee on Taxation, JCT-1-19, Technical Explanation of the House Ways and Means Committee Chairman’s Discussion Draft of the “Tax Technical and Clerical Corrections Act” 5 (Jan. 2, 2019), https://www.jct.gov/publications.html?func=startdown&id=5154. The fact that Congress sought to make this correction is further evidence that the law does not require dependents to have a TIN for purposes of the ODC.
RECOMMENDATIONS

• Clarify whether dependents whom a taxpayer claims the credit for other dependents under IRC § 24(h)(4) must have a taxpayer identification number.
• If dependents are required to have a taxpayer identification number for the credit for other dependents, clarify the type of taxpayer identification number required.
**Legislative Recommendation #57**

**Allow Members of Certain Religious Sects That Do Not Participate in Social Security and Medicare to Obtain Employment Tax Refunds**

**PRESENT LAW**

IRC § 3101 imposes a tax on wages paid to employees to fund old-age, survivors, and disability insurance (Social Security) and hospital insurance (Medicare) pursuant to the Federal Insurance Contributions Act (FICA).1 FICA tax is paid half by the employer and half by the employee.

IRC § 1401 imposes a comparable tax on self-employed individuals pursuant to the Self-Employment Contributions Act (SECA). SECA tax is paid by the self-employed individual.

Members of the Amish community sought exclusions from these taxes because the tenets of their religion prohibit them from accepting social insurance benefits. In response, Congress enacted IRC § 1402(g), which exempts self-employed individuals who are members of certain religious faiths from the requirement to pay SECA tax. An individual may apply for an exemption from SECA tax by filing IRS Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits,

… if he is a member of a recognized religious sect or division thereof and is an adherent of established tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance of the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act).

Congress subsequently enacted IRC § 3127 to exempt employers from paying their portion of FICA tax under IRC § 3111, provided that both the employer and the employee are members of a recognized religious sect, both the employer and the employee are adherents of established tenets or teachings of the sect, and both the employer and employee file and receive approval for exemption from their respective portions of FICA tax.2 The employer and employee each may receive approval by filing IRS Form 4029.3

IRC § 6413(b) requires the IRS to refund any overpayment of a taxpayer’s FICA tax.

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1 Under IRC § 3101, a tax of 6.2 percent is imposed on employee wages to fund old age, survivors and disability insurance, and an additional tax of 1.45 percent is imposed to fund hospital insurance. In certain circumstances, employee wages are subject to an additional 0.9 percent tax to further fund hospital insurance (Additional Medicare Tax). Employers are generally required to withhold FICA taxes from their employees’ wages under IRC § 3102(a).

2 IRC § 3127 establishes the requirements for employers and employees who are members and adherents of a recognized religious sect to be exempt from their respective FICA tax obligations as required under IRC §§ 3101 and 3111. If the employer is a partnership, all partners of that partnership must be members of and adhere to the tenets of a recognized religious sect. All partners of the partnership must apply and be approved individually for the exemption. Treas. Reg. § 31.3127-1(a).

3 For more information regarding the Form 4029 exemption application for members of recognized religious sects, see IRS Publication 517, Social Security and Other Information for Members of the Clergy and Religious Workers (Jan. 2020).
REASONS FOR CHANGE

The exemptions under IRC §§ 1402(g) and 3127 do not extend to members of recognized religious sects who work for employers that are not members of the same or any religious sect. Members of these sects pay for Social Security and Medicare benefits that their religious beliefs prohibit them from accepting. The National Taxpayer Advocate believes this result is inequitable. For example, the rationale for exempting self-employed Amish workers and Amish employees of Amish employers, as the law provides, applies equally to Amish employees who work for non-Amish employers.  

This inequity can be resolved by amending IRC § 6413 to allow employees who are members of a recognized religious group and work for an employer who is not a member of a recognized religious group to file a refund claim for their portion of remitted FICA tax. Amish leaders have expressed a preference for allowing Amish employees of non-Amish employers to recover the employee's portion of the FICA tax through a refund claim, rather than by exempting the employee from paying the FICA tax, to avoid imposing an additional recordkeeping burden on employers.

RECOMMENDATION

- Amend IRC § 6413 to allow employees who meet the definition of “a member of a recognized religious sect or division thereof” in IRC § 1402(g) to claim a credit or refund of the employee's portion of FICA taxes withheld from their wages.

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4 IRC § 1402(g). The discussion in this legislative recommendation applies to any member of a recognized religious sect or division thereof as described in IRC § 1402(g). Historically, the Amish and the Mennonites have been the religious groups that have utilized this provision.

5 Meeting between TAS and Amish leaders (Aug. 16, 2019). If this recommendation is enacted, an employer who is not a qualifying member of a recognized religious sect would remain liable for his or her portion of the FICA tax pursuant to IRC § 3111.

6 For legislative language generally consistent with this recommendation, see AMISH Act, H.R. 2714, 116th Cong. (2019).
Legislative Recommendation #58

Amend IRC § 36B(d)(2) to Prevent Individuals From Losing Some or All of Their Premium Tax Credits When Receiving Lump-Sum Social Security Benefits Attributable to a Prior Year

PRESENT LAW

IRC § 36B, enacted as part of the Patient Protection and Affordable Care Act, provides a tax credit to certain taxpayers to help them purchase health insurance through a Health Insurance Marketplace (i.e., the Exchange). This “premium tax credit” (PTC) is only available to taxpayers with household incomes between 100 percent and 400 percent of the Federal Poverty Level. It does not make any accommodation for taxpayers who receive a one-time lump-sum payment.

Eligible taxpayers can choose to receive advance payments of the PTC (referred to as APTC) in monthly amounts paid directly to the taxpayer’s insurance provider. The amount of APTC for which a taxpayer is eligible is based in part on the taxpayer’s anticipated household income for the year. The taxpayer must “reconcile” the APTC paid on his or her behalf with the amount of PTC for which the taxpayer is ultimately eligible on his or her tax return. If the APTC the taxpayer received exceeded the PTC that should have been allowed, the taxpayer generally will incur a tax liability. If a taxpayer’s household income, as defined by IRC § 36B(d)(2)(A), exceeds 400 percent of the Federal Poverty Level, the taxpayer must repay the full APTC.

Taxpayers applying for Social Security benefits may not receive a determination from the Social Security Administration (SSA) for one or more years. Consequently, the SSA may issue a substantial lump-sum award retroactive to the date the application was filed. A portion of these benefits may be taxable. To compute the taxable income portion of the lump-sum award (outside the context of the PTC), a taxpayer has the option of (i) calculating the taxable amount of the lump-sum payment using the general rules of IRC § 86, which base the taxability of Social Security payments on the taxpayer’s income for the year of receipt of the payment, or (ii) making an election under IRC § 86(e) to calculate the taxable portion of a lump-sum payment in a manner that allocates the payment over the period of years the payment covers.

However, IRC § 36B(d)(2)(B) does not allocate a multiyear lump-sum payment when computing modified adjusted gross income (MAGI) for PTC purposes. It requires the inclusion of the entirety of the multiyear

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1 Congress enacted the Patient Protection and Affordable Care Act (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010), to “improve access to and the delivery of health care services for all individuals, particularly low income, underserved, uninsured, minority, health disparity, and rural populations.” § 5001, 124 Stat. 588.
2 IRC § 36B(c)(1); Treas. Reg. 1.36B-2(b)(1). The Federal Poverty Level is defined by the Office of Management and Budget and is updated by the Secretary of Health and Human Services.
3 Household income is the sum of the taxpayer’s modified adjusted gross income (MAGI) plus the MAGI of family members: (i) for whom the taxpayer is allowed a deduction under IRC § 151 and (ii) who were required to file a federal income tax return under IRC § 1. IRC § 36B(d)(2).
4 IRC § 36B(f).
5 But cf., Treas. Reg. 1.36B-1(a)(3) (providing limitations on the repayment of APTC based on incomes below 400 percent of Federal Poverty Level).
retroactive award in the year of receipt, even if a portion of that award would be excludable from gross income under IRC § 86. This one-time lump sum augments the taxpayer’s income for that year only and may push MAGI over 400 percent of the Federal Poverty Level, regardless of whether any portion of the Social Security benefits relates to prior years or whether the benefits constitute taxable income in the year of receipt.

REASONS FOR CHANGE

A taxpayer cannot control the SSA’s application review process to plan for the month — or year — in which the SSA will issue the benefit award and potentially impact the APTC helping the taxpayer maintain health insurance. Consequently, the taxpayer’s income in the year of the award will be artificially inflated when compared to prior and subsequent years only because of the delay in the benefit award. For example, assume a low-income taxpayer without other income applied for Social Security benefits that would pay her $17,500 a year. If the SSA approved the application immediately, the taxpayer would receive annual benefits of $17,500 and could continue to qualify for the PTC in all years. However, if the SSA approved the application two years later, the taxpayer could receive a lump-sum payment of $52,500 in the third year ($17,500 benefits multiplied by two years of SSA evaluation plus $17,500 in the award year), rendering her ineligible for the PTC in that year and potentially requiring her to increase her tax liability by the amount of APTC already paid on her behalf in that year.

The PTC and APTC are benefits designed for low- and moderate-income individuals to assist with health insurance premium payments. The impact of receiving Social Security benefits in a lump-sum can be so harsh as to not only eliminate this assistance in a given year but also to create a substantial tax liability. Just as IRC § 86(e) gives taxpayers who receive lump-sum Social Security payments covering multiple years the option of computing their income for the year of the lump-sum payment by, in effect, treating the payment as having been received in the years to which the payment relates, the National Taxpayer Advocate recommends giving taxpayers a similar option to determine their MAGI for purposes of determining the amount of PTC for which they are eligible.

RECOMMENDATION

• Add a new subsection to IRC § 36B(d)(2) permitting taxpayers to include in MAGI only the taxable portion of a lump-sum Social Security payment calculated pursuant to IRC § 86(e) to determine the amount of PTC for which they are eligible.

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6 TAS Research estimates that more than 283,000 taxpayers were impacted by this lump-sum consequence in tax year 2018, which would have resulted in their disqualification for PTC. TAS Research further estimates that more than 53,000 of these taxpayers would have fallen below the poverty line but for their receipt of the lump-sum Social Security benefit. IRS, Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File.

7 This example is based on the 2020 Federal Poverty Level for a single-person household in the 48 contiguous states and Washington, D.C.

8 While this legislative recommendation focuses on the interaction between the PTC/APTC and Social Security benefits, we suggest considering the framework we present here for taxpayers who may experience the same financial impact when receiving other one-time lump-sum payments.
Legislative Recommendation #59

Amend IRC §§ 108(a) and 6050P to Provide That Gross Income Does Not Include, and the Department of Education Is Not Required to Report, Income From the Cancellation of Student Loans Under the Coronavirus Aid, Relief and Economic Security Act

PRESENT LAW

Creditors that forgive a debt of $600 or more generally are required to report the forgiveness to the IRS on Form 1099-C, Cancellation of Debt.1 Taxpayers generally must include the forgiven debt in income.2 IRC § 108 provides certain exceptions from this general rule. Additional exclusions appear in statutes outside of the IRC.3

Some of the longstanding exceptions, such as for bankruptcy or insolvency, apply to taxpayers in difficult economic conditions.4 Congress has enacted additional exceptions during difficult economic periods.5 Similarly, Congress enacted Section 1106(i) of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to exclude cancelled Paycheck Protection Program (PPP) loans from income.6 The IRS notified lenders they should not issue Forms 1099-C regarding forgiven PPP loans.7

Beyond cancellation of debt, Congress has allowed taxpayers to exclude from income other payments or benefits they receive during difficult times. For example, taxpayers were not required to include in income the Economic Stimulus Payments they received in 2008.8 The same is true of the Economic Impact Payments they received in 2020.9 Other payments taxpayers receive, such as “qualified disaster relief payments” and certain compensatory damages, are likewise not included in income.10

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1 IRC § 6050P(a); Treas. Reg. § 1.6050P-1(a).
2 IRC § 61(a)(11).
3 For example, where the Department of Education forgives student loans under the closed school discharge procedure, the forgiven debt is not included in income. See 20 U.S.C. § 1087(c)(4) (providing for loan discharge if the borrower, or the student on whose behalf a parent borrowed, could not complete the program of study at the school because the school closed while the student was enrolled or if the student withdrew from the school no more than 120 days before the school closed).
4 IRC § 108(a)(1)(A) & (B), both enacted in 1980, allow taxpayers whose debts are discharged in a Title 11 bankruptcy case, or who were insolvent when the debt was discharged, to exclude the forgiven debt from income. See Bankruptcy Tax Act of 1980, Pub. L. 96-589, § 2, 94 Stat. 3389 (1980). In administering the insolvency exception, the IRS has also considered the compliance burden on taxpayers and on the IRS. See Rev. Proc. 2020-11, 2020-6 I.R.B. 406 (Feb. 3, 2020) (providing relief to certain taxpayers whose student debt is forgiven).
6 See CARES Act, Pub. L. No. 116-136, § 1106(i), 134 Stat. 281, 301 (2020) (providing that “[f]or purposes of the Internal Revenue Code of 1986, any amount which (but for this subsection) would be includible in gross income of the eligible recipient by reason of forgiveness described in subsection (b) shall be excluded from gross income”).
10 IRC §§ 139(a), 104(a)(2).
Section 3508(c) of the CARES Act requires the Department of Education to cancel education loans of students who withdraw from an institution of higher education as a result of a qualifying emergency. The CARES Act does not contain any provision excluding these forgiven student loans from income.

**REASONS FOR CHANGE**

Allowing taxpayers whose student loans are forgiven under Section 3508 of the CARES Act to exclude the forgiven debt from income is consistent with Congress’s longstanding approach of providing tax relief to taxpayers who are experiencing financial difficulty. Such an exclusion would place taxpayers whose student loans are forgiven under Section 3508 of the CARES Act on the same footing as taxpayers whose loans are forgiven under Section 1106(i) of the Act.

**RECOMMENDATION**

- Amend IRC §§ 108 and 6050P to provide that gross income does not include, and the Department of Education is not required to report, income from forgiveness of student loans discharged under section 3508(c) of the CARES Act.

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Legislative Recommendation #60

Amend the Combat-Injured Veterans Tax Fairness Act of 2016 to Allow Veterans of the Coast Guard to Exclude Disability Severance Pay From Gross Income and File Claims for Credit or Refund for Taxes Withheld From Excluded Income

PRESENT LAW

IRC § 61(a)(1) provides that compensation for services is includable in gross income. Severance payments generally are treated as compensation and therefore subject to taxation.

IRC § 104(a)(4) provides an exclusion from gross income for payments received for personal injuries or sickness resulting from active service in the armed forces.

IRC § 104(b)(2) clarifies that the exclusion from gross income in IRC § 104(a)(4) applies to an amount received because of a combat-related injury or if an individual, upon application, could receive disability compensation from the Department of Veterans Affairs. IRC § 104(b)(3) defines “combat-related injury” as a personal injury or sickness that occurred “as a direct result of armed conflict, while engaged in extrahazardous service, or under conditions simulating war; or which is caused by an instrumentality of war.”

To obtain a credit or refund, a taxpayer must file a timely claim. IRC § 6511(a) provides that a taxpayer generally must file a claim for credit or refund within three years from the time the tax return was filed or two years from the time the tax was paid, whichever period expires later.

In 2016, Congress passed the Combat-Injured Veterans Tax Fairness Act (the “Act”).¹ In a findings section, the Act states: “Since 1991, the Secretary of Defense has improperly withheld taxes from severance pay for wounded veterans, thus denying them their due compensation and a significant benefit intended by Congress.” Recognizing that the period of limitation for filing a claim for credit or refund to recover overwithheld tax had long since expired for most tax years since 1991, the Act created an exception from the general period of limitation.

Specifically, the Act directed the Secretary of Defense (i) to identify disability severance pay (DSP) that was not considered gross income pursuant to IRC § 104(a)(4) and from which the Secretary improperly withheld tax and (ii) to send notices to all affected veterans notifying them of their eligibility to receive credits or refunds and providing instructions for filing amended tax returns. It further provided that veterans who received DSP from the Department of Defense may file timely claims for credit or refund within one year from the date of the notice sent by the Secretary of Defense or by the date the period of limitations described in IRC § 6511(a) expires, whichever is later.

IRC § 7701(a)(15) defines the terms “military or naval forces of the United States” and “Armed Forces of the United States” to include “all regular and reserve components of the uniformed services which are subject

to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force [as well as] the Coast Guard.”

**REASONS FOR CHANGE**

Notwithstanding that the IRC’s definition of “military or naval forces of the United States” includes the Coast Guard, the Act as drafted excludes veterans of the Coast Guard from its scope. Section 3(a) of the Act directed the Secretary of Defense to identify DSP paid after January 17, 1991, that should have been excluded from gross income, but the Coast Guard does not report to the Secretary of Defense. The Coast Guard reports to the Secretary of Homeland Security.

It seems likely that omitting the Coast Guard from the DSP tax relief provision resulted from a drafting error. Like members of the services within the Department of Defense, members of the Coast Guard often face perilous circumstances and potential injuries as they perform their mandated duties. For example, the Coast Guard maintains a “state of readiness to assist in the defense of the United States, including when functioning as a specialized service in the Navy pursuant to [14 USC] section 103.”

There is no reason Coast Guard veterans should not be provided the same additional time to file a claim for credit or refund as other veterans of the “military or naval forces of the United States.” While the number of veterans affected by this issue is relatively limited, the National Taxpayer Advocate believes fairness and parity in treatment among the armed forces of the United States require that this apparent drafting error be corrected.

**RECOMMENDATION**

- Amend Section 3(a) of the Combat-Injured Veterans Tax Fairness Act of 2016 to provide that the severance payments specified under Section 3(a) include those paid by the Secretary of Homeland Security (or predecessor) and to require the Secretary of Homeland Security to notify veterans of the Coast Guard about disability severance pay from which taxes were withheld.

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3 The Treasury Inspector General for Tax Administration (TIGTA) recently estimated that 1,116 Coast Guard veterans are affected. See TIGTA, Ref. No. 2020–40–029, Improvements Are Needed to Ensure That Members of the Military Receive Tax Benefits to Which They Are Entitled 13 (May 26, 2020).
Legislative Recommendation #61

Encourage and Authorize Independent Contractors and Service Recipients to Enter Into Voluntary Withholding Agreements

PRESENT LAW

IRC Chapter 24 (Collection of Income Tax at Source on Wages) provides for required withholding of taxes on wages paid to employees, certain gambling winnings, certain pensions and annuities, amounts subject to backup withholding, and certain other payments. In addition, IRC § 3402(p) provides for voluntary withholding at the option of the income recipient on certain payments such as Social Security benefits, unemployment benefits, and certain other benefits. IRC § 3402(p)(3) authorizes the Secretary to promulgate regulations to provide for withholding from any payment that does not constitute wages if the Secretary finds withholding would be appropriate and the payor and recipient of the payment agree to such withholding.

Although the Secretary may issue guidance by publication in the Internal Revenue Bulletin describing other payments for which withholding under a voluntary withholding agreement would be appropriate, the only such guidance issued to date is Notice 2013-77, dealing with dividends and other distributions by Alaska Native Corporations.

IRC § 6654(a) generally imposes a penalty for failure to pay sufficient estimated tax during the year, computed by applying (i) the underpayment rate established under IRC § 6621 (ii) to the underpayment (iii) for the period of the underpayment.

REASONS FOR CHANGE

Unlike employees, whose wage payments are subject to federal income tax withholding, independent contractors are generally responsible for paying their own income taxes. Independent contractors generally must make four estimated tax payments during the year. However, many contractors fail to make estimated tax payments for a variety of reasons and therefore face penalties under IRC § 6654. In addition, some do not save enough funds to pay their taxes at the end of the year. As a result, they face additional penalties and interest charges, and they may face IRS collection action, including liens and levies.

The absence of withholding on payments to independent contractors also has a negative impact on revenue collection. IRS National Research Program studies show that tax compliance is substantially lower among workers whose income taxes are not withheld.
This problem may be increasing as more workers are working in the so-called “gig economy.” To reduce the risk they will not save enough money to pay their taxes, some independent contractors would prefer that taxes be withheld throughout the year, as they are for employees. There is a legitimate debate about the circumstances under which withholding should be required. However, the National Taxpayer Advocate believes the law should not discourage workers and businesses from entering into voluntary withholding agreements when both parties wish to do so.

For many businesses, withholding on payments to independent contractors will not impose additional burden. In addition to paying independent contractors, most large companies have full-time employees, such as administrative staff, so they already have procedures in place to withhold. We understand businesses are reluctant to withhold due to concerns that the IRS may cite the existence of withholding agreements to challenge underlying worker classification arrangements. These concerns would be addressed if the IRS is restricted from citing the existence of a voluntary withholding agreement as a factor in worker classification disputes. Indeed, the IRS could, on a case-by-case basis, provide a safe-harbor worker classification in which it affirmatively agrees not to challenge the classification of workers who are party to such agreements, since these agreements will help ensure the IRS collects taxes.

**RECOMMENDATIONS**

- Amend IRC § 3402(p) to clarify that when voluntary withholding agreements are entered into by parties who do not treat themselves as engaged in an employer-employee relationship, the IRS may not consider the existence of such agreements as a factor when challenging worker classification arrangements.
- Direct the Secretary to evaluate the benefits of agreeing not to challenge worker classification arrangements when voluntary withholding agreements are in place.⁶

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⁶ For legislative language generally consistent with this recommendation, see Small Business Owners’ Tax Simplification Act, H.R. 3717, 115th Cong. § 9 (2017).
Legislative Recommendation #62

Require the IRS to Specify the Information Needed in Third-Party Contact Notices

PRESENT LAW

IRC § 7602(c)(1) generally requires the IRS to give taxpayers notice before contacting third parties (e.g., banks, employers, employees, vendors, customers, friends, and neighbors) to request information about them. The IRS may provide this third-party contact (TPC) notice only if it intends to make a TPC during the period specified in the notice, which may not exceed one year. Generally, the IRS must send the notice at least 45 days before making the TPC.

IRC § 7602(c)(3) waives the TPC notice requirement if (i) the taxpayer has authorized the contact; (ii) the IRS determines for good cause that notice would jeopardize the IRS’s tax collection efforts or may involve reprisal against any person; or (iii) the contact is made in connection with a criminal investigation. No law expressly requires the IRS to let the taxpayer know what specific information it needs (or needs to verify) before contacting third parties.

REASONS FOR CHANGE

The TPC notice requirement was enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98). The Senate report accompanying the bill explained that “taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties.” The House-Senate conference report accompanying RRA 98 stated that “in general” the TPC notice “will be provided as part of an existing IRS notice.” Based on the conference report, the IRS implemented the TPC notice requirement by including generic language in Publication 1, Your Rights as a Taxpayer, which the IRS sends to taxpayers in a variety of circumstances whether or not it plans to make a TPC.

When Congress enacted the Taxpayer First Act (TFA), it rejected the generic approach of including the TPC language in Publication 1. The TFA amended IRC § 7602(c) to require the IRS to send the TPC notice only when it intends to make a TPC and to send the TPC notice at least 45 days before making the contact. In explaining the change, the House report accompanying the TFA quoted testimony from a former IRS official who said the then-existing TPC notice requirement was “useless and does not effectively apprise taxpayers that such contact will be made, to whom it will be made, or that the taxpayer can request a third party contact report from the IRS.” The House report said TPCs “may have a chilling effect on the taxpayer’s business and could damage the taxpayer’s reputation in the community.” It also said the change would “provide taxpayers more of an opportunity to resolve issues and volunteer information before the IRS contacts third parties.”

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3 IRS Pub. 1, Your Rights as a Taxpayer (Sept. 2017). Under the heading “Potential Third Party Contacts,” Pub. 1 states, in part: “[W]e sometimes talk with other persons if we need information that you have been unable to provide or to verify information we have received.”
If the TPC notices were included “as part of an existing IRS notice” such as Form 4564, Information Document Request, which requests information from the taxpayer, then the new 45-day period would give the taxpayer a realistic opportunity to avoid a TPC that seeks new information by providing the information requested on the form. However, the IRS generally does not include a request for that information with the TPC notice.⁶

A tailored notice that identifies the specific information for which the IRS is about to contact third parties would be more effective in motivating taxpayers to provide the information than a generic notice. The IRS has previously tailored TPC notices in this way.⁷ Generating tailored notices would not unduly burden the IRS because most IRS third-party contacts occur in the collection context, where the IRS is seeking assets rather than information.⁸ In addition, in the subset of cases where the IRS is seeking specific information, identifying what information the IRS is seeking would empower the taxpayer to protect his or her reputation by providing the information so that the TPC is unnecessary. Thus, using tailored TPC notices is consistent with a taxpayer’s right to be informed and right to privacy, which includes the right to expect enforcement to be no more intrusive than necessary,⁹ and it might reduce the need for the IRS to spend resources needed to make the TPCs as well.

**RECOMMENDATION**

- Amend IRC § 7602(c) to clarify that in TPC notices the IRS must tell the taxpayer what information it needs and allow the taxpayer a reasonable opportunity to provide the information before contacting a third party, unless doing so would be pointless (e.g., because the taxpayer does not have the information the IRS needs) or an exception applies.

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⁶ See, e.g., IRS, New Third Party Contact Requirements, SBSE-05-0520-0639 (May 26, 2020); Letters 3164, Notification of Third Party Contact.

⁷ For further discussion, see National Taxpayer Advocate 2015 Annual Report to Congress 123, 127 (Most Serious Problem: Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers’ Businesses and Reputations); National Taxpayer Advocate 2018 Objectives Report to Congress 98-101 (Area of Focus: IRS Third Party Contact (TPC) Notices Should Be More Specific, Actionable, and Effective).

⁸ Third-party contacts often arise from IRS requests for payment from third parties, such as banks served with a levy for the taxpayer’s funds on deposit or in connection with the advertising or conduct of public auction sales of the taxpayer’s property. A prior TAS study found that the IRS made TPCs in 68.1 percent of its field collection cases and 8.5 percent of its field examination cases. National Taxpayer Advocate 2015 Annual Report to Congress 123 (Most Serious Problem: Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers’ Businesses and Reputations). This proposal generally does not cover collection contacts, because in those cases, the IRS is not asking a third party for information that the taxpayer could provide.

⁹ IRS, Pub. 1, Your Rights as a Taxpayer (Sept. 2017).
Legislative Recommendation #63

Authorize the Treasury Department to Issue Guidance Specific to IRC § 6713 Regarding the Disclosure or Use of Tax Return Information by Preparers

PRESENT LAW

IRC §§ 7216 and 6713 impose criminal and civil sanctions, respectively, on preparers who disclose or use tax return information for any purpose other than preparing or assisting in the preparation of a tax return, except as expressly permitted by statute or regulation. IRC § 7216 requires that a disclosure or use be knowing or reckless to constitute a criminal violation. IRC § 6713 does not require knowledge or recklessness for a civil violation.

Exceptions to the broad prohibition in IRC § 6713 are provided in IRC § 6713(c), which states that the rules of IRC § 7216(b) apply. IRC § 7216(b) authorizes the Secretary to create regulatory exceptions to the criminal penalty statute. Thus, the current statutory framework seemingly requires that exceptions be made either to both the criminal and civil statutes or to neither.

REASONS FOR CHANGE

IRC § 6713 has historically been identified as the civil counterpart to the criminal penalty imposed on tax return preparers under IRC § 7216. As one would expect, the criminal penalty under IRC § 7216 is substantially harsher than the civil penalty under IRC § 6713. For that reason, the Treasury Department is understandably reluctant to subject preparers to criminal sanctions except for egregious conduct, so it has used its regulatory authority to carve out broad exceptions from the general prohibition on the disclosure or use of tax return information set forth in IRC § 7216.

Because the exceptions under IRC § 7216 (criminal statute) are deemed to apply to IRC § 6713 (civil statute), there is no room for the Treasury Department and the IRS to designate the disclosure or use of tax return information due to negligence or for certain questionable business practices or the sale of certain products with high abuse potential as civil violations without also making them criminal violations. Therefore, if a prohibited disclosure or use is not egregious in nature (e.g., negligent noncompliance with form-and-content requirements for taxpayer consents), it is generally tolerated. The Treasury Department and the IRS will be more likely to strengthen taxpayer protections against the improper disclosure or use of taxpayer return information by return preparers if they are given the flexibility to promulgate separate regulations applicable to the civil penalty, without concern that the criminal penalty will also apply.

1 IRC § 6713 imposes a $250 penalty for each improper disclosure or use, with total penalties not to exceed $10,000 per calendar year. The penalty amount increases to $1,000 for each disclosure and use related to identity theft, with total penalties not to exceed $50,000 per calendar year. By contrast, IRC § 7216 makes the preparer guilty of a misdemeanor, and upon conviction, the preparer will be fined not more than $1,000 ($100,000 if the disclosure or use is related to identity theft) or imprisoned for not more than one year, or both, and liable for the costs of prosecution.


3 As a general matter, IRC § 7805(a) grants the Secretary the broad authority to promulgate regulations under the Internal Revenue Code. However, because IRC § 6713(c) provides that exceptions to IRC § 6713 are governed by the rules of IRC § 7216(b), it is not clear that the IRS may establish separate sets of exceptions for the two Code provisions.
RECOMMENDATION

• Amend IRC § 6713 to authorize the Secretary to prescribe regulations under IRC § 6713.
Legislative Recommendation #64

Increase the Individual Low Income Taxpayer Clinic Grant Cap and Index It for Inflation

PRESENT LAW

IRC § 7526 authorizes the Secretary, subject to the availability of appropriated funds, to make grants to provide matching funds for the development, expansion, or continuation of Low Income Taxpayer Clinics (LITCs). The LITC program was authorized as part of the IRS Restructuring and Reform Act of 1998 (RRA 98) to represent low-income taxpayers involved in controversies with the IRS, including audits, appeals, collection matters, and tax litigation, and to provide education about taxpayer rights and responsibilities in multiple languages for taxpayers who speak English as a second language.\(^1\) If a clinic charges a fee, it must not charge more than a nominal amount for services.

IRC § 7526(c)(1) imposes an annual aggregate limitation of $6 million for LITC grants “[u]nless otherwise provided by specific appropriation.”

IRC § 7526(c)(2) imposes an annual limitation on grants to a single clinic of $100,000.

IRC § 1(f) prescribes rules for the annual indexing of tax brackets based on the Consumer Price Index for all-urban consumers (CPI) and the Chained Consumer Price Index for All Urban Consumers (C-CPI-U).

REASONS FOR CHANGE

The LITC program is an effective and low-cost means to assist low-income taxpayers. During grant year 2019, the LITC Program Office awarded grants to 131 organizations in 46 states and the District of Columbia.\(^2\) Many clinics recruit attorneys and certified public accountants to accept cases on a \textit{pro bono} basis. By using grants to coordinate and leverage the volunteer contributions of tax professionals in this way, clinics often provide services worth far more than the dollar value of the grants they receive. In 2019, volunteers provided over 56,000 hours of service to LITCs.\(^3\)

The LITC program has attracted broad bipartisan support since its inception, and Congress has increased the annual funding level by specific appropriation since 1998. For fiscal year 2021, the funding level was set at $13 million — more than double the amount specified in IRC § 7526(c)(1).\(^4\)

However, the annual limitation of $100,000 on grants to individual clinics has never been increased. Since RRA 98 was enacted in July 1998, inflation has increased by about 60 percent.\(^5\) Therefore, despite the increase in aggregate program funding, clinics are effectively operating with substantially less grant money.


\(^{3}\) Id.


today than in 1998. Some clinics, such as clinics responsible for large geographic areas or sizeable taxpayer populations, could productively use additional funds.

In relative terms, doubling of aggregate program funding without any increase in the amounts that may be provided to individual clinics is undermining Congress’s original intent of increasing access to justice and preventing the efficient allocation of grant dollars. To ensure congressional intent is met now and in the future, the National Taxpayer Advocate recommends Congress increase the per-clinic annual cap from $100,000 to $150,000 and index it for inflation in future years.

RECOMMENDATION

• Amend IRC § 7526(c)(2) to increase the annual clinic funding limitation to $150,000 and index the limitation to rise with inflation in future years pursuant to the rules prescribed in IRC § 1(f).
Legislative Recommendation #65

Compensate Taxpayers for “No Change” National Research Program Audits

PRESENT LAW

There is no provision under present law that authorizes compensation of taxpayers who are audited under the IRS’s National Research Program (NRP) or provides relief from the assessment of tax, interest, and penalties that may result from an NRP audit.

REASONS FOR CHANGE

Through the NRP, the IRS conducts audits of randomly selected taxpayers. The NRP benefits tax administration by gathering strategic information about taxpayer compliance behavior as well as information about the causes of reporting errors. This information helps the IRS update its workload selection formulas and thereby enables it to focus its audits on returns with relatively high likelihoods of error. It also helps the IRS to estimate the “tax gap.” In addition, NRP studies benefit Congress by providing taxpayer compliance information that is useful in formulating tax policies.

For the tens of thousands of individual taxpayers (or businesses) that are subject to NRP audits, however, they impose significant burden. In essence, these taxpayers, even if fully compliant, serve as “guinea pigs” to help the IRS improve the way it does its job. They must contend with random and intensive audits that consume their time, drain resources (including representation fees), and may impose an emotional and reputational toll.

In 1995, the House Ways and Means Subcommittee on Oversight held a hearing on the NRP’s predecessor, the Taxpayer Compliance Measurement Program (TCMP). Testimony provided during the hearing, and subsequent witness responses to questions-for-the-record, indicated that TCMP audits imposed a heavy burden on taxpayers and reflected a strong view that audited taxpayers were bearing the brunt of a research project intended to benefit the tax system as a whole. Proposals raised at the hearing included compensating taxpayers selected for TCMP audits as well as possibly waiving tax, interest, and penalties assessed during the audits.

Following the hearing, the House Budget Committee included a proposal in its 1995 budget reconciliation bill to compensate individual taxpayers by providing a tax credit of up to $3,000 for TCMP-related expenses. Ultimately, this proposal was not adopted. Instead, the IRS was pressured to stop conducting TCMP audits. The inability to perform regular TCMP audits, however, undermined effective tax administration because it prevented the IRS from updating its audit formulas. Using older formulas likely meant that more compliant taxpayers faced (unproductive) audits and that audit revenue declined.

About a decade later, the IRS reinstated the TCMP under the new NRP name. Some procedures were changed, but the random selection of taxpayers and the burden on many of these taxpayers remained substantially unchanged. For the same reasons identified during the 1995 House hearing, the National

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Taxpayer Advocate believes it is appropriate to recognize that taxpayers audited under the NRP are bearing a heavy burden to help the IRS improve the effectiveness of its compliance activities. A tax credit or authorized payment would alleviate the monetary component of the burden. Further relief could be provided by waiving any assessment of tax, interest, and penalties resulting from an NRP audit. Such a waiver might also improve the accuracy of the NRP audits, as taxpayers might be more likely to be forthcoming with an auditor if they were assured they would not face additional assessments. However, this waiver should not apply where tax fraud or an intent to evade tax is uncovered in an NRP audit.

RECOMMENDATIONS

• Amend the IRC to compensate taxpayers for no change NRP audits through a tax credit or other means.
• Consider waiving the assessment of tax, interest, and penalties resulting from an NRP audit, absent fraud or an intent to evade federal taxes.
Legislative Recommendation #66

Establish the Position of IRS Historian Within the Internal Revenue Service to Record and Publish Its History

PRESENT LAW

The IRS, as a federal agency, is required to properly maintain and manage its records under the Federal Records Act\(^1\) and to provide access to these records to the public under the Freedom of Information Act.\(^2\) However, the IRS is not required to publish a historical analysis of its tax administration programs and policies.

REASONS FOR CHANGE

A documented history of the IRS’s programs and policies would assist Congress, the agency itself, and the public. It would assist Congress by helping Members and staff gain a fuller understanding of the IRS’s successes and failures, so future legislation can be developed in a manner that plays to the agency’s strengths and helps to address the agency’s weaknesses. It would help the IRS assess its programs, reduce redundant efforts, and share knowledge within the agency. In addition, an IRS historian could assist the public by promoting a more accountable and transparent IRS.\(^3\)

During the early 1990s, the IRS decided to hire an IRS historian. However, the relationship was tense, and the individual who held the position told Congress that the IRS undermined her work and fought transparency, concluding that “the IRS shreds its paper trail, which means there is no history, no evidence, and ultimately no accountability.”\(^4\) The IRS eliminated the position and never hired a historian again.

Numerous offices of history operate in the executive, judicial, and legislative branches.\(^5\) Government historians serve various roles, such as researching and writing for publication and internal use, editing historical documents, preserving historical sites and artifacts, and providing historical information to the public through websites and other media.\(^6\) Historians should be objective and accurate, particularly when preparing histories that can be controversial.\(^7\) For example, the Historian of the Department of State is required to publish a documentary history of the foreign policy decisions and actions of the United States, including facts providing support for, and alternative views to, policy positions ultimately adopted, without omitting or concealing defects in policy.\(^8\) Historians in federal agencies serve an important role, and because

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1 44 U.S.C. §§ 3101-3107.
3 See, e.g., 22 U.S.C. § 4351(a), which states in pertinent part: “Volumes of this publication [Foreign Relations of the United States historical series] shall include all records needed to provide a comprehensive documentation of the major foreign policy decisions and actions of the United States Government, including the facts which contributed to the formulation of policies and records providing supporting and alternative views to the policy position ultimately adopted.” (Emphasis added).
7 Id.
more U.S. citizens interact with the IRS than any other federal agency, the public interest and potential benefit in learning from the agency’s successes and failures are high.

RECOMMENDATION

- Add a new subsection to IRC § 7803 to establish the position of IRS historian within the IRS. The IRS historian should have expertise in federal taxation and archival methods, be appointed by the Secretary of the Treasury in consultation with the Archivist of the United States, and report to the Commissioner of Internal Revenue. The duties of the IRS historian require access to IRS records, including tax returns and return information (subject to the confidentiality and disclosure provisions of IRC § 6103). The IRS historian should be required to report IRS history objectively and accurately, without omitting or concealing defects in policy.\(^9\)

\(^9\) For additional background, see National Taxpayer Advocate 2011 Annual Report to Congress 582-586 (Legislative Recommendation: Appoint an IRS Historian).