

National Taxpayer Advocate 2021 Purple Book

Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration

INTRODUCTION

Section 7803(c)(2)(B)(ii)(IX) of the IRC requires the National Taxpayer Advocate, as part of the annual report to Congress, to propose legislative recommendations to resolve problems encountered by taxpayers. This year, we present 66 legislative recommendations.

We have taken the following steps to make these recommendations as accessible and user-friendly as possible for Members of Congress and their staffs:

- We have consolidated our recommendations from various sections of this year's report, prior reports, and other sources into this single volume.
- We have grouped our recommendations into categories that generally reflect the various stages in the tax administration process so that, for example, return filing issues are presented separately from audit and collection issues.
- We have presented each legislative recommendation in a format like the one used for congressional committee reports, with "Present Law," "Reasons for Change," and "Recommendation(s)" sections.
- Where bills have been introduced in the past that are generally consistent with a recommendation, we have included a footnote at the end of the recommendation that identifies those bills. (Because of the large number of bills introduced in each Congress, we almost surely have overlooked some. We apologize for any bills we have inadvertently omitted.)
- We have compiled a table, which appears at the end of this volume as Appendix 1, that identifies additional materials relating to our recommendations, where such materials exist. In addition to identifying a larger number of prior bills than we cite in our footnotes, the table provides references to more detailed issue discussions that have been included in prior National Taxpayer Advocate reports.

By our count, Congress has enacted approximately 46 legislative recommendations that the National Taxpayer Advocate has proposed. See Appendix 2 for a complete listing. That total includes approximately 23 provisions that were included as part of the Taxpayer First Act.¹

The Office of the Taxpayer Advocate is a non-partisan, independent organization within the IRS that advocates for the interests of taxpayers. We have dubbed this the "Purple Book" because the color purple, as a mix of red and blue, has come to symbolize bipartisanship. Historically, tax administration legislation has attracted bipartisan support. Most recently, the Taxpayer First Act was approved by both the House and the Senate on voice votes with no recorded opposition.

We believe most of the recommendations presented in this volume are non-controversial, common sense reforms that will strengthen taxpayer rights and improve tax administration. We hope the tax-writing committees and other Members of Congress find it useful.

We highlight the following ten legislative recommendations for particular attention:

- **Provide the IRS with sufficient funding to meet taxpayer needs and improve tax compliance.**
Since fiscal year (FY) 2010, the IRS's budget has been reduced by about 20 percent after adjusting for

inflation. As a result, the IRS has been unable to meet taxpayer needs (*e.g.*, the IRS received over 100 million telephone calls in FY 2020, yet employees were only able to answer about 24 percent). The IRS also has been unable to modernize its information technology (IT) systems. Antiquated IT, in turn, limits the ability of customer service representatives to effectively assist taxpayers and prevents the IRS from offering fully functional online taxpayer accounts. In FY 2020, the IRS collected about \$3.5 trillion on a budget of about \$11.51 billion, producing a remarkable return on investment of more than 300:1. Thus, additional funding for the IRS would not only improve taxpayer service but would almost surely increase revenue collection as well.

- **Authorize the IRS to establish minimum competency standards for federal tax return preparers.** Most taxpayers rely on paid preparers to prepare their returns, yet the Government Accountability Office, the Treasury Inspector General for Tax Administration, and other entities have found that preparers make significant errors that can harm both taxpayers and the public fisc. The IRS sought to implement minimum standards for tax return preparers beginning in 2011, including requiring non-credentialed preparers to pass a basic competency test. However, a federal court held the IRS could not implement key components of its plan without statutory authorization. The IRS’s plan was well-thought-out, having been developed after extensive consultation with stakeholders. Minimum preparer standards are still needed to protect taxpayers and improve tax compliance. Statutory authorization would allow the IRS to implement them.
- **Expand the U.S. Tax Court’s jurisdiction to hear refund cases.** Under current law, taxpayers who owe tax and wish to litigate a dispute with the IRS must go to the U.S. Tax Court, while taxpayers who have paid their tax and are seeking a refund must file suit in a U.S. district court or the U.S. Court of Federal Claims. All taxpayers should have the option to litigate their tax disputes in the U.S. Tax Court. Tax Court judges are specialists, so they understand the nuances of complex tax issues more clearly, and they are well-accustomed to working with unrepresented taxpayers.
- **Restructure the Earned Income Tax Credit (EITC) to make it simpler for taxpayers and reduce improper payments.** TAS has long advocated for dividing the EITC into two separate 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. For wage earners, claims for the worker credit could be verified with nearly 100 percent accuracy by matching income information on tax returns against Forms W-2, thereby reducing the improper payments rate on those claims to nearly zero. The portion of the EITC that varies based on family size would be combined with the child tax credit into a single family credit.
- **Increase the annual award cap for Low Income Taxpayer Clinics (LITCs).** When the LITC matching grant program was established as part of the IRS Restructuring and Reform Act of 1998 (RRA 98), IRC § 7526 limited annual grants to no more than \$100,000 per clinic. The cap was not indexed for inflation, and as a result, the per-clinic grant maximum is now much lower in real-dollar terms. In light of the significant value LITCs provide, we are recommending that Congress increase the per-clinic cap to at least \$150,000 and then index it to rise with inflation.
- **Clarify that supervisory approval is required before the IRS imposes certain penalties.** IRC § 6751(b)(1) states: “No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination....” While it may appear requiring that an “initial determination” be approved by a supervisor would mean the approval must occur before the penalty is proposed, the timing of this requirement has been the subject of considerable litigation. Therefore, to effectuate Congress’s intent that the IRS not penalize taxpayers in certain circumstances without supervisory approval, the approval should be required earlier in the process. We recommend that Congress amend

IRC § 6751(b)(1) to require that written supervisory approval be provided *before* the IRS sends a written communication to a taxpayer proposing a penalty.

- **Require taxpayer consent before allowing IRS Counsel or Compliance personnel to participate in an Independent Office of Appeals conference.** Historically, the IRS’s Counsel and Compliance functions provided input into Appeals conferences via the taxpayer case file and, if the case was particularly large or complex, at a pre-conference. However, Counsel and Compliance generally did not attend Appeals conferences with taxpayers, leaving taxpayers and Appeals Officers free to develop rapport, seek common ground, and pursue case resolution. In October 2016, Appeals revised provisions of the Internal Revenue Manual to allow Appeals Officers to include personnel from Counsel and Compliance in taxpayer conferences as a matter of routine. In our view, this has compromised the value of the Independent Office of Appeals and is inconsistent with Congress’s intent to “reassure taxpayers of the independence” of Appeals. We recommend that Congress require explicit taxpayer consent regarding the inclusion of Counsel or Compliance personnel in advance of any conference between Appeals and a taxpayer.
- **Clarify that taxpayers may raise innocent spouse relief as a defense in collection proceedings and bankruptcy cases.** Congress has enacted rules to relieve “innocent spouses” from joint and several liability in certain circumstances. If the IRS denies a taxpayer’s request for innocent spouse relief, the taxpayer generally may seek review of the adverse determination in the Tax Court. However, the Tax Court does not have jurisdiction over collection suits arising under IRC §§ 7402 or 7403, or over bankruptcy proceedings arising under Title 11 of the U.S. Code. Courts have reached inconsistent decisions about whether taxpayers may raise innocent spouse relief as a defense in those categories of cases, undermining the innocent spouse protections and potentially resulting in differing treatment of similarly situated taxpayers. We recommend Congress clarify that taxpayers may raise innocent spouse claims in all such proceedings.
- **Amend the Combat-Injured Veterans Tax Fairness Act of 2016 to allow veterans of the Coast Guard to file claims for credit or refund of taxes improperly withheld from disability severance pay (DSP).** The 2016 Act created an exception from the statute of limitations to allow otherwise time-barred refunds in cases where the Secretary of Defense wrongfully withheld tax from severance payments to wounded veterans. Although the tax code’s definition of “military or naval forces of the United States” includes the Coast Guard, the Act as drafted excluded veterans of the Coast Guard from its scope. It appears that omitting the Coast Guard from the DSP tax relief provision may have 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. While the number of veterans affected by this issue is relatively small, fairness and parity in treatment among the armed forces of the United States require that this apparent drafting error be corrected, and that a claims period be opened for this group of taxpayers.
- **Clarify that the National Taxpayer Advocate may hire independent legal counsel.** IRC § 7803(c) requires the National Taxpayer Advocate to operate independently of the IRS in key respects. To help ensure this independence, the conference committee report accompanying RRA 98 stated: “The conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate.” This is similar to the authority Congress has granted inspectors general to ensure their independence. Until 2015, the National Taxpayer Advocate was able to hire attorneys to advise her, advocate for taxpayers, and write key sections of her two statutorily-mandated reports to Congress. But the Treasury Department at that time began to enforce a Departmentwide policy that requires all attorney-advisors in the Department to report to the General Counsel absent a statutory exception. To continue to

advocate for taxpayers effectively and independently, the National Taxpayer Advocate requires statutory authorization to hire attorney-advisors who do not report to other agency officials.