Preface: Introductory Remarks by the National Taxpayer Advocate

HONORABLE MEMBERS OF CONGRESS:

Each year, the National Taxpayer Advocate has the privilege of submitting her Annual Report to Congress. I respectfully submit this year's report for your consideration and welcome the opportunity to discuss it in more detail. Section 7803(c)(2)(B)(ii) of the IRC requires the National Taxpayer Advocate to submit an annual report to the House Committee on Ways and Means and the Senate Committee on Finance that, among other things, includes a summary of the ten most serious problems encountered by taxpayers and makes administrative and legislative recommendations to mitigate those problems. In each of the ten Most Serious Problem discussions, we are including an IRS narrative response. By doing so, we intend to help readers see both TAS's perspective and the IRS's perspective on the source and nature of key challenges and potential solutions. Although the annual report focuses on the ten Most Serious Problems, I view my role as requiring continual efforts to improve taxpayer service and tax administration by working collaboratively with the IRS throughout the year on both newly identified problems and longstanding challenges.[1]

The statute also requires the report to identify the ten federal tax issues most frequently litigated in court. This year, we took a hybrid approach to that discussion, reviewing decided cases and for the first time, analyzing issues raised in filed petitions with the U.S. Tax Court. This analysis provides a broader perspective on taxpayer problems that are not initially solved at the administrative level.

The year 2021 provided no shortage of taxpayer problems. As I stated in my Fiscal Year 2022 Objectives Report, this past year and the 2021 filing season conjure up every possible cliché for taxpayers, tax professionals, the IRS, and its employees – it was a perfect storm; it was the best of times and the worst of times; patience is a virtue; with experience comes wisdom and with wisdom comes experience; out of the ashes we rise; and we experienced historical highs and lows. Calendar year 2021 was surely the most challenging year taxpayers and tax professionals have ever experienced – long processing and refund delays, difficulty reaching the IRS by phone, correspondence that went unprocessed for many months, collection notices issued while taxpayer correspondence was awaiting processing, limited or no information on the Where's My Refund? tool for delayed returns, and – for full disclosure – difficulty obtaining timely assistance from TAS.

The IRS Deserves Credit for Playing the Hand It Was Dealt

One irony of the past year is that, despite its challenges, the IRS performed well under the circumstances. The imbalance between the IRS's workload and its resources has never been greater. On the workload side, the number of individual taxpayers the IRS serves has increased by about 19 percent since 2010, as the number of Form 1040 series returns rose from about 142 million in that year to about 169 million in 2021.[2] While there is no perfect measure of the IRS's workload, return filings are a good approximation because most IRS work – including fraud screening, telephone calls, audits, collection actions, TAS cases, Appeals cases, Tax Court cases, and other downstream consequences – keys off the number of taxpayers filing returns. During the last 18 months, Congress charged the IRS with administering several COVID-19 pandemic financial relief programs, including three rounds of stimulus payments (also known as Economic Impact Payments), monthly payments of the Advance Child Tax Credit (AdvCTC), reduction of the taxability of unemployment compensation in the middle of the 2021 filing season, and other provisions directly impacting tax administration. Each financial relief program consumed considerable IRS resources to administer, including overall planning, information technology (IT) programming, implementation, public communications, and responding to taxpayers' questions and account issues. To address these needs, the IRS had to reallocate resources from its core tax administration responsibilities.

Over the last decade, examination coverage has decreased, enforcement efforts have been negatively impacted, and the Level of Service has continued to drop as the IRS's workforce and budget have declined. On the resources side, the IRS's baseline budget has been reduced by about 20 percent on an inflation-adjusted basis since fiscal year (FY) 2010, and its workforce has shrunk by about 17 percent.[3] Although Congress provided supplemental funding to help the IRS implement pandemic-relief programs, it is not feasible for an agency the size of the IRS to staff up and train new employees quickly. The IRS also is limited in its ability to hire new employees when funding is provided on a one-time basis because there is no assurance it will have sufficient funding in future years to retain those employees. In addition, the social distancing required during the pandemic forced the agency to close or limit staffing in processing centers where employees work in close quarters, further restricting its production capacity.

Despite its limitations, the IRS processed most e-filed tax returns timely, it issued 130 million refunds totaling $365 billion,[4] it issued 478 million stimulus payments totaling $812 billion,[5] and it sent AdvCTC payments to over 36 million families that totaled over $93 billion.[6] The IRS's leadership and workforce deserve considerable credit for their accomplishments.

Yet 2021 Was the Most Challenging Year Ever for Taxpayers

There is no way to sugarcoat the year 2021 in tax administration: From the perspective of tens of millions of taxpayers, it was horrendous. Among the lowlights:

- **Processing Backlogs Led to Long Refund Delays.** The IRS was behind before the 2021 filing season had even started because it carried over approximately 11.7 million returns from 2020. It took until June 2021 before the IRS had processed virtually all 2019 returns. Then, in 2021, the IRS received approximately 17 million original Form 1040 series returns on paper.[7] Paper returns have been taking up to at least eight months to process.[8] In addition, the IRS closed the filing season with 9.8 million individual returns in its Error Resolution System (ERS) that required manual processing for each return. Millions of additional returns were worked in ERS at other points during the year. The IRS also issued over 11 million math error notices relating to Recovery Rebate Credit (RRC) claims, and in many cases, refunds were not released until taxpayers responded in writing, potentially delaying refunds by many months.

  Overall, 77 percent of individual taxpayers received refunds in 2021,[9] so processing delays translated directly into refund delays. Refund delays have a disproportionate impact on low-income taxpayers. (Earned Income Tax Credit (EITC) benefits are worth up to $6,660, Child Tax Credit benefits are worth up to $2,000 per qualifying child under tax year 2020 rules, and RRCs are potentially worth several thousand dollars for families who did not receive advance payments.) Millions of taxpayers rely on the benefits from these programs to pay their basic living expenses, and when refunds are substantially delayed, the financial impact can range from mild inconvenience to severe financial hardship.

  For taxpayers who filed an amended return, the processing (and refund) delays have been even longer than the delays for original paper returns. As of December 18, 2021, the IRS reported it had a backlog of 2.3 million unprocessed Forms 1040-X, Amended U.S. Individual Income Tax Return, and that processing times "can be more than 20 weeks instead of up to 16."[10] We have seen cases where processing has taken considerably longer than 20 weeks, including more than a year. The manual reviews will take substantial time, preventing the IRS from digging out of that hole in the foreseeable future.

  Business returns have also been subject to processing delays. At the close of the filing season, the IRS reported more than seven million business returns that required manual processing. Delays in processing Forms 941, Employer's Quarterly Federal Tax Return, and Forms 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, have been significant. As of December 15, the IRS reported it had 2.8 million unprocessed Forms 941 and about 427,000 Forms 941-X that cannot be processed until the related Forms 941 are processed.[11]

For individuals, estates, or trusts that file Form 1045, Application for a Tentative Refund, or corporations that file Form 1139, Corporation Application for a Tentative Refund, relating to the carryback of net operating losses, the IRS is not even providing information on refund wait times. As of December 21, the most recent update on IRS.gov had been posted on September 14 and states: "We continue to experience inventory backlogs longer than the normal 90-day statutory period. … Currently, we cannot provide a timeframe."

- **Telephone Service Was the Worst It Has Ever Been.** During the COVID-19 pandemic, call volume skyrocketed, reaching a historic level of calls, which has made it even harder for taxpayers to receive assistance. In FY 2021, the IRS received about 282 million telephone calls. Customer service representatives (CSRs) only answered about 32 million, or 11 percent, of those calls. That meant most callers could not obtain answers to their tax law questions, get help with account problems, or speak with a CSR to respond to a compliance notice. Among the lucky one in nine callers who was able to reach a CSR, the IRS reported that hold times averaged 23 minutes. Practitioners and taxpayers have reported that hold times were often much longer, and frustration and dissatisfaction was high throughout the year with the low level of phone service.

- **The IRS Took Months to Process Taxpayer Responses to Its Notices, Further Delaying Refunds and in Some Cases Leading to Premature Collection Notices.** The IRS sent tens of millions of notices to taxpayers during 2021. These included nearly 14 million math error notices, Automated Underreporter notices (where an amount reported on a tax return did not match the corresponding amount reported to the IRS on a Form 1099 or other information reporting document), notices requesting a taxpayer authenticate his or her identity where IRS filters flagged a return as potentially fraudulent, correspondence examination notices, and collection notices. In many cases, taxpayer responses were required, and if the IRS did not process a response, it could take adverse action or not release the refund claimed on the tax return.

  For many IRS programs, the "normal" processing time for taxpayer correspondence is 45 days. Based on our casework and practitioner feedback, processing time for some categories of correspondence has been running six months or longer. At this writing, the IRS last updated its website with information on the status of processing taxpayer responses to notices or letters on January 13, 2021 – almost a year ago. It states: "We're getting mail, but it's taking us longer to process it."[12] Like return processing delays, correspondence processing delays can harm taxpayers. In cases where the IRS is holding a refund until it receives a taxpayer response, correspondence processing delays mean refund delays.

  Where the IRS issued compliance notices, the IRS's automated systems ordinarily move cases to the next step in the compliance process if a taxpayer's response is not recorded within a specified number of days. For example, failure to respond to a math error notice within 60 days means the tax is assessed and the taxpayer loses the right to contest it in the U.S. Tax Court. Failure to pay an assessed liability means the case is moved to the collection function. To prevent enforcement actions from taking place before the IRS processed taxpayer responses, the IRS generally reprogrammed its systems to allow additional time. But there were gaps. For example, we are aware of cases where taxpayers received notices of intent to levy while their responses requesting abatement of a math error assessment or disputing a proposed examination adjustment were still awaiting processing, or their amended returns had not been processed. The lack of proactive disclosure of key information or clear guidance created needless confusion and additional work for taxpayers and the IRS.

- **The IRS's Where's My Refund? Tool Often Could Not Answer That Question.** The IRS heavily promotes Where's My Refund? and taxpayers rely on it to determine when they can expect to receive their refunds. However, the program suffers from significant limitations that rendered it non-functional for tens of millions of taxpayers experiencing delays. The tool does not explain any status delays, the reason for the delay, where the return is in the process, or what needs to be done. It just reflects that the return has been received, that the refund was approved, or that the refund was sent. For millions of taxpayers, that meant many months without any status updates, and some are still waiting for their refunds.

When taxpayers can't get information regarding when they will receive their refunds, they call the IRS. Unfortunately, CSRs rarely have more information than taxpayers can see on Where's My Refund? Particularly for taxpayers who need their refunds to pay for current living expenses, the absence of information can cause deep concern and sometimes panic, leading to more telephone calls that are just as unproductive.

TAS Faced Challenges Providing Timely Assistance to Taxpayers

Congress created TAS to serve as a "safety net" for taxpayers, but over the past few years, the combination of more cases, fewer experienced Case Advocates, and an inability to close cases due to limited IRS resources has caused the TAS safety net to fray. That has increased case cycle times, made it harder for taxpayers to reach TAS, and reduced service levels for taxpayers and congressional offices that refer cases to us. From FY 2017 to FY 2021, TAS's case receipts rose from 167,000 to 264,000 – a 58 percent increase – while our appropriated funding on an inflation-adjusted basis declined by about six percent. When taxpayers cannot get their problems resolved directly with the IRS, they often contact their congressional offices for assistance. The number of cases TAS received from congressional offices demonstrates the magnitude of the challenges taxpayers experienced in 2021. In the three years preceding the pandemic, TAS received between 10,000 and 11,000 congressional referrals annually. Last year, we received more than 66,000 congressional referrals – more than *six times* as many cases as in pre-pandemic years.

Although our employees are resilient and want to help every taxpayer needing assistance, we had to make some difficult decisions during the past year to address our workload challenges. One was to reinstate our prior policy against accepting cases where the sole issue was a delay in the processing of an original or amended tax return so we could focus more of our limited resources on cases where our Case Advocates can have a direct and meaningful impact on the outcome. We are continually reassessing how we can apply our limited resources to provide maximum benefit for the greatest number of taxpayers.

The time our Case Advocates spend on each case has risen because of the pandemic and the difficulty moving cases through the system. TAS employees advocate for the taxpayer but rarely have the delegated authority to implement the relief the taxpayer is seeking. That is for good reason. TAS was not created to serve as a second IRS; rather, it was designed to help taxpayers by advocating and working with the IRS to resolve problems. When the IRS gets behind in responding to TAS case referrals, however, cases back up. Taxpayers must wait longer to receive relief, and our Case Advocates must spend additional time following up with the IRS and updating the taxpayer until the case is ultimately resolved, causing frustration for both taxpayers and TAS employees.

The Most Serious Problems Encountered by Taxpayers in 2021 Were Exacerbated by the COVID-19 Pandemic, But They Resulted From Longstanding Underfunding of the IRS

The Most Serious Problems I identify in this report deal primarily with taxpayer service and IT challenges, including processing and refund delays, inadequate taxpayer service, limited functionality of online taxpayer accounts, and the IRS's inability to date to develop effective procedures to communicate with taxpayers and tax professionals by email. Over the past year, there has been a tendency to focus on the unique challenges posed by the pandemic and to attribute IRS service and technology shortcomings to these circumstances. There is no doubt the pandemic has had a big impact, but taxpayer services and technology at the IRS were inadequate long before the pandemic. In our 2019 report, we wrote:

> The President's Management Agenda emphasizes the importance of high-quality customer service and cites the American Customer Satisfaction Index (ACSI) and the Forrester U.S.

> Federal CX Index™ as key benchmarks. Those indices find the IRS is among the lowest performing federal agencies when it comes to the customer experience. The ACSI report for 2018 ranks the Treasury Department tied for 10th out of 12 Federal Departments and says that "most [IRS] programs score … well below both the economy-wide national ACSI average and the federal government average." The 2019 Forrester report ranked the IRS as 13th out of 15 federal agencies and characterized the IRS's score as "very poor."[13]

In 2019, Congress passed the Taxpayer First Act (TFA) due to its concerns about the IRS's performance. The title of the act was intended to send a clear message: The IRS should reassess its business practices to prioritize taxpayer needs. The TFA directed the IRS to develop comprehensive multiyear plans to improve taxpayer services and modernize its IT systems, which the IRS has developed. These plans are thoughtful and ambitious, and if implemented, they have the potential to dramatically transform the IRS's operations. But aspects of the plan require considerable funding to implement. With limited funding, limited resources, and the impact of the COVID-19 pandemic, the IRS is struggling to timely meet its core mission of delivering a successful filing season.

As I mentioned earlier, the number of individual income tax returns the IRS receives – a reasonable approximation of its workload – has increased by 19 percent since FY 2010, while its baseline appropriation on an inflation-adjusted basis has decreased by nearly 20 percent. This imbalance has left the IRS without enough resources to meet taxpayer needs, let alone to invest in additional personnel and technology. Telephone service is one example. In FY 2019, the most recent pre-pandemic year, the IRS received almost 100 million telephone calls, and CSRs answered just 29 million. That is simply a resource issue. Additional technology resources and more employees are required if the IRS is going to answer more telephone calls.

More funding is also required for the IRS to improve its technology systems. The two IRS systems containing the official records of individual and business taxpayer accounts are the oldest major technology systems in the federal government. The IRS also has about 60 case management systems that generally are not interconnected; each function's employees must transcribe or import information from other electronic systems and mail or fax it to other functions. Obsolete IT systems limit the functionality of online taxpayer accounts, prevent taxpayers from obtaining full details about the status of their cases, and prevent the IRS from selecting the best cases for compliance actions. Although the IRS is making strides with its case management system, it still has a long way to go.

The FY 2022 Financial Services and General Government appropriations bills working their way through Congress would increase IRS funding by about 14 percent, and the version of the Build Back Better Act passed by the House would provide additional funding of nearly $80 billion over ten years. As this report is going to press, it is not clear what funding changes will be enacted into law. What is clear is that to meet taxpayer needs, the IRS requires substantial additional funding to timely process returns, timely address taxpayer correspondence, answer taxpayer telephone calls, and develop robust online taxpayer accounts to provide quality taxpayer service and improve tax enforcement and tax administration. I encourage Congress to consider these needs carefully as it makes its final spending decisions.

Legislative Recommendations

The National Taxpayer Advocate 2022 Purple Book makes 68 recommendations to strengthen taxpayer rights and improve tax administration. Most of the recommendations 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 these ten legislative recommendations for particular attention, in no particular order:

- **Revamp the IRS Budget Structure and Provide Sufficient Funding to Improve the Taxpayer Experience and Modernize the IRS's Information Technology Systems.** Since FY 2010, the IRS budget has been reduced by nearly 20 percent after adjusting for inflation. Largely as a result of these budget reductions, the IRS cannot provide top quality service or enforce the law with fairness to all. For example, the IRS finished the 2021 filing season with a backlog of 35.3 million returns that required manual processing. When taxpayers called the IRS for assistance, only about 11 percent reached a CSR, with hold times for taxpayers who got through averaging about 23 minutes. In addition, the IRS's IT systems desperately need upgrades. In FY 2021, the IRS collected about $4.1 trillion on a budget of about $11.9 billion, producing a remarkable average return on investment of about 345:1. Additional funding for the IRS would not only improve taxpayer service but would almost surely increase revenue collection.
- **Amend the Lookback Period for Allowing Tax Credits or Refunds Under IRC § 6511(b)(2)(A) to Include the Period of Any Postponement of Time for Filing a Return Under IRC § 7508A.** Taxes withheld from wages and estimated tax payments are generally deemed paid on the tax return filing deadline of April 15. To be timely, a taxpayer's claim for credit or refund generally must be filed within three years from the date the return was filed or two years from the date the tax was paid, whichever period is longer. If the taxpayer files a refund claim within three years from the date the return was filed, the taxpayer can only get a credit or refund of excess amounts paid within the preceding three years, plus six months (*i.e.*, the lookback period) if the taxpayer obtained a six-month extension for filing the original return. However, a taxpayer who filed pursuant to a "postponement" granted by the IRS because of a federally declared disaster will not recover excess amounts paid within the period of postponement.

  Because of the pandemic, the IRS postponed the tax return filing deadline to July 15 in 2020 and to May 17 in 2021.[14] These postponements of the filing deadline limit the amounts that taxpayers can recover in a way that was not intended and that will cause some taxpayers to lose the ability to recover overpayments. For example, a taxpayer who filed her 2019 return by the postponed filing deadline of July 15, 2020, might reasonably believe she would be eligible for a refund if she files a claim before July 15, 2023. However, if her taxes (withholding payments) are deemed paid on April 15, 2020, any claim for credit or refund filed after April 15, 2023, would be disallowed by the IRS. This is a trap for the unwary. We recommend Congress extend the lookback period when the filing deadline is postponed by the IRS due to a disaster declaration to three years *plus the period of the postponement*.
- **Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers.** The IRS receives over 160 million individual income tax returns each year, and paid tax return preparers prepare the majority of these returns. Both taxpayers and the tax system depend heavily on the ability of preparers to prepare accurate tax returns. Yet numerous studies have found that non-credentialed tax return preparers routinely prepare inaccurate returns, which harms taxpayers and tax administration. To protect the public, federal and state laws generally require lawyers, doctors, securities dealers, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications and, in most cases, to pass competency tests. Taxpayers and the tax system would benefit from requiring tax return preparers to pass minimum competency tests.

  The IRS sought to implement minimum standards beginning in 2011, including passing a basic competency test, but a U.S. Court of Appeals affirmed a U.S. district court opinion that held the IRS lacked the authority to impose preparer standards without statutory authorization. The plan the IRS rolled out in 2011 was developed after extensive consultation with stakeholders and was supported by almost all such stakeholders. We recommend Congress authorize the IRS to reinstitute minimum competency standards.

- **Expand the Tax Court's Jurisdiction to Hear Refund Cases and Assessable Penalties.** 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. Although this dichotomy between deficiency cases and refund cases has existed for decades, we recommend Congress give all taxpayers the option to litigate their tax disputes in the U.S. Tax Court. Due to the tax expertise of its judges, the Tax Court is often better equipped to consider tax controversies than other courts. It is also more accessible to less knowledgeable and unrepresented taxpayers than other courts because it uses informal procedures, particularly in certain disputes that do not exceed $50,000 for one tax year or period.
- **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 credits: (i) a refundable worker credit based on each individual worker's earned income, despite the presence of a qualifying child, and (ii) a refundable child credit. For wage earners, claims for the worker credit could be verified with nearly 100 percent accuracy by matching claims on tax returns against Forms W-2, 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 a child credit into a larger family credit. The National Taxpayer Advocate published a report making this recommendation in 2019, and we continue to advocate for it.
- **Expand the Protection of Taxpayer Rights by Strengthening the Low Income Taxpayer Clinic (LITC) Program.** The LITC program effectively assists low-income taxpayers and taxpayers who speak English as a second language. When the LITC grant program was established as part of the IRS Restructuring and Reform Act of 1998, IRC § 7526 limited annual grants to no more than $100,000 per clinic. The law also imposed a 100 percent matching requirement. A clinic cannot receive more in LITC grant funds than it is able to match. The nature and scope of the LITC program has evolved considerably since 1998, and those requirements are preventing the program from providing high quality assistance to the largest possible universe of eligible taxpayers. We recommend that Congress remove the per-clinic cap and allow the IRS to reduce the match requirement to 50 percent if doing so would provide coverage for additional taxpayers.
- **Clarify That Supervisory Approval Is Required Under IRC § 6751(b) Before Proposing 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. …" At first, it seems a requirement that an "initial determination" be approved by a supervisor would mean the approval must occur before the penalty is proposed. However, the timing of this requirement has been the subject of considerable litigation, with some courts holding that the supervisor's approval might be timely even if provided after a case has gone through the IRS Independent Office of Appeals and is in litigation. Very few taxpayers choose to litigate their tax disputes. Therefore, to effectuate Congress's intent that the IRS not penalize taxpayers in certain circumstances without supervisory approval, the approval must 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 the taxpayer proposing a penalty.
- **Require That Math Error Notices Describe the Reason(s) for the Adjustment With Specificity, Inform Taxpayers They May Request Abatement Within 60 Days, and Be Mailed by Certified or Registered Mail.** Under IRC § 6213(b), the IRS may make a summary assessment of tax arising from a mathematical or clerical error, as defined in IRC § 6213(g). When the IRS does so, IRC § 6213(b)(1) requires that it send the taxpayer a notice describing "the error alleged and an explanation thereof." By law, the taxpayer has 60 days from the date of the notice to request that the summary assessment be abated. Many taxpayers do not understand that failing to respond to an IRS math error notice within 60 days means they may have unknowingly conceded the adjustment and forfeited their right to challenge the IRS's position in the Tax Court. Amending IRC § 6213(b) to require that the IRS

specifically describe the error giving rise to the adjustment and inform taxpayers that they have 60 days to request that the summary assessment be abated would help ensure taxpayers understand the adjustment and their rights. Additionally, requiring the IRS to send the notice either by certified or registered mail would underscore the significance of the notice and provide an additional safeguard to ensure that taxpayers are receiving this critical information.

- **Amend IRC § 6330 to Provide That "an Opportunity to Dispute" an Underlying Liability Means an Opportunity to Dispute Such Liability in a Prepayment Judicial Forum.** IRC §§ 6320(b) and 6330(b) provide taxpayers with the right to request an independent review of a Notice of Federal Tax Lien (NFTL) filed by the IRS or a proposed levy action. The purpose of these collection due process (CDP) rights is to give taxpayers adequate notice of IRS collection activity and provide a meaningful hearing to determine whether the IRS properly filed an NFTL or proposed a levy. The IRS and the courts interpret the current law to mean that an opportunity to dispute the underlying liability includes a prior opportunity for a conference with the IRS Independent Office of Appeals offered either before or after assessment of the liability, even where there is no opportunity for judicial review of the Appeals conference.

  The value of CDP proceedings is undermined when taxpayers who have never had an opportunity to dispute the underlying liability in a prepayment judicial forum are precluded from doing so during their CDP hearing. These taxpayers have no alternative but to pay the tax and then seek a refund by filing a suit in a U.S. district court or the U.S. Court of Federal Claims – an option that not all taxpayers can afford. In our view, the circumstances in which taxpayers may challenge the IRS's liability determination in a CDP hearing should be expanded to include taxpayers who did not receive a notice of deficiency or the opportunity to dispute the underlying liability in a prepayment judicial forum.

- **Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures.** IRC § 6212 requires the IRS to issue a "notice of deficiency" before assessing certain liabilities. IRC § 6671(a) authorizes the IRS to assess some penalties without first issuing a notice of deficiency. These penalties are generally subject to judicial oversight only if taxpayers first pay the penalty and then sue for a refund. The IRS takes the position that various international information reporting penalties are also immediately assessable without issuing a notice of deficiency, including the penalty under IRC § 6038 for failure to file Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations. Taxpayers who are savvy enough to request an abatement based on reasonable cause or to request a conference with the IRS Independent Office of Appeals frequently obtain relief from assessable penalties. Specifying that deficiency procedures apply would prevent the systemic assessments the IRS so often abates. The proposed legislative change would require the IRS to issue a notice of deficiency before assessing penalties under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D, thus allowing taxpayers to seek prepayment judicial review in the U.S. Tax Court and enhancing the taxpayers' *right to a fair and just tax system*.

TAS Accomplishments During 2021

Despite extraordinary challenges, TAS employees accomplished a lot for taxpayers during 2021. The significant majority of TAS's budget and employees are devoted to casework – assisting taxpayers with account-specific problems. In FY 2021, our case advocacy employees closed nearly 252,000 cases – 23 percent more than the nearly 205,000 cases we closed in FY 2020. We also assisted over 30,000 taxpayers whose circumstances did not require us to open a case.

The other main TAS function, systemic advocacy, aims to identify problems affecting groups of taxpayers and devise solutions. Initially, we work with the IRS to solve problems internally. If we are unsuccessful, we raise our concerns in our reports to Congress. The year 2021 provided no shortage of systemic taxpayer problems, and later in this Prologue, we include a list of "TAS Successes" highlighting just some of our successes.

The following examples illustrate the nature of our systemic work:

- The IRS issued over 11 million math error notices relating to the RRC. However, about 6.5 million math error notices issued last spring assessing additional tax failed to contain critical taxpayer rights information. Under math error procedures, the IRS may assess tax in specified circumstances without going through normal deficiency procedures, but it must abate the assessment if the taxpayer disagrees and makes an abatement request within 60 days. Math error notices generally explain this, but this pool of RRC notices did not. When TAS learned of the omission, we urged the IRS to send a second round of corrected notices that provided the taxpayers with an explanation and a new 60-day period to request abatement. The IRS agreed and sent supplemental letters that provided an apology, explained the rules, and gave taxpayers an additional 60 days to respond, protecting their *rights to be informed* and *to pay no more than the correct amount of tax*.
- When Congress authorized COVID-19 pandemic-related stimulus payments in 2020, the law characterized the amounts as credits against tax (RRCs), but it also directed the IRS to make advance payments of the credit amounts to the extent possible. It provided that the advance payments should not be offset to satisfy prior-year tax liabilities and non-tax debts (except past-due child support for the first round of advance payments). In December 2020, a change in the law provided that the credits were subject to regular offset rules. This change created an inconsistency in treatment between taxpayers who received advance payments, which were generally not subject to offset, and taxpayers to whom the IRS was not able to make advance payments, who stood to lose some or all of their credit claims to offsets when they claimed the RRC on their 2020 returns. TAS raised the issue of inconsistent treatment, and the IRS ultimately agreed to use its discretionary authority under IRC § 6402(a) to not offset RRCs for outstanding federal tax liabilities. The IRS will be applying the same methodology for the third round of stimulus payments, so taxpayers claiming the RRCs on their 2021 tax returns will be treated consistently with taxpayers who received their stimulus payments as advance payments in 2021.

We are highlighting these examples because they are indicative of the systemic advocacy activities we undertake to protect taxpayer rights and reduce taxpayer burden.

At a Glance

New this year to the report is the "At a Glance" section. For each of the ten Most Serious Problems we identify in this report, At a Glance summarizes what taxpayers want from the IRS, explains why the problem is serious, and provides some key statistics. The section "what taxpayers want from the IRS" comes directly from an IRS survey about taxpayer attitudes and preferences. The goal is to give the reader the ability to quickly glance over the material and grasp some of the impediments that must be overcome to improve service to taxpayers. For those used to long government reports, we hope this three-page format interests you. The more rigorous analysis is included in each Most Serious Problem. Essentially, the At a Glance is a front door of sorts – inviting and welcoming a discussion on why these challenges must be overcome to ensure taxpayers timely receive their refunds, credits, payments, and other services that support their families, communities, and our nation's way of life. I hope this intrigues you, and if so, please join the discussion on how the IRS can better serve taxpayers.

Conclusion

During the last two years, we have lived through a period of "all COVID-19, all the time" in tax administration, just as we have in our personal lives, communities, and jobs. Many challenges created by the pandemic are highlighted in this report.

But it is important to recognize that, for the most part, the pandemic did not create new challenges for the IRS as much as it highlighted longstanding challenges and areas that require attention. My main recommendation to Congress is to provide the IRS with additional funding to enable it to meet taxpayer needs and to conduct sufficient oversight to ensure the additional funding is well spent. Here are some of my key recommendations that additional funding could support:

- To address the unacceptable processing backlogs and refund delays associated with paper tax returns: (1) reduce barriers to e-filing so all taxpayers who prepare their returns using software can submit them electronically and (2) implement scanning technology so the IRS can machine read paper returns, eliminating the need for manual transcription of all return entries.
- To improve levels of service and reduce frustration for taxpayers and tax professionals trying to reach the IRS by phone: increase CSR staffing and implement "customer callback" technology on all telephone lines so taxpayers and tax professionals don't have to wait on hold and can receive a return call when the next CSR is available.
- To enable taxpayers to transact business more easily with the IRS: (1) expand the functionality of online taxpayer accounts so individual and business taxpayers can see all relevant information and use the accounts to communicate with the IRS and (2) prioritize development of a system that will allow taxpayers and tax professionals to communicate with IRS personnel by secure email.
- To keep taxpayers informed and set expectations at appropriate levels: be proactively transparent and communicate challenges, as well as successes, to the public. Like many organizations, the IRS tends to accentuate good news and downplay problems. When problems arise that affect taxpayers, however, taxpayers have a right to full and accurate information. We recommend, for example, that the IRS post a filing season dashboard, updated at least weekly, that lists each category of work and the length of time it is taking to complete it (*e.g.,* number of weeks to process paper tax returns, number of weeks to process math error and other taxpayer correspondence by category, percentage of taxpayers who called the IRS the previous week and reached an employee).

I look forward to working with Congress and the IRS, and together with my TAS team, we stand ready to help improve taxpayer service and tax administration to benefit all taxpayers.

Respectfully submitted,

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National Taxpayer Advocate
December 31, 2021

Endnotes

1 IRC § 7803(c)(2)(A).
2 *See* IRS 2010 Filing Season Statistics (week ending Dec. 31, 2010), https://www.irs.gov/newsroom/2010-filing-season-statistics (showing 142 million returns processed); IRS Filing Season Statistics (week ending Dec. 3, 2021) https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-3-2021 (showing 169 million returns received).
3 IRS response to TAS information request (Dec. 17, 2021).
4 *See* IRS 2010 Filing Season Statistics (week ending Dec. 31, 2010), https://www.irs.gov/newsroom/2010-filing-season-statistics.
5 The IRS reports it issued 160 million payments worth $270 billion under the Coronavirus Aid, Relief, and Economic Security (CARES) Act; 147 million payments worth $142 billion under the COVID-related Tax Relief Act of 2020; and 171 million payments worth $400 billion under the American Rescue Plan Act of 2021. *See* IRS News Release, IR-2021-38, As required by law, all first and second Economic Impact Payments issued; eligible people can claim Recovery Rebate Credit (Feb. 16, 2021), https://www.irs.gov/newsroom/as-required-by-law-all-first-and-second-economic-impact-payments-issued-eligible-people-can-claim-recovery-rebate-credit; IRS News Release, IR-2021-157, More than 2.2 million additional Economic Impact Payments disbursed under the American Rescue Plan (July 21, 2021), https://www.irs.gov/newsroom/more-than-2-point-2-million-additional-economic-impact-payments-disbursed-under-the-american-rescue-plan.
6 IRS News Release, IR-2021-249, Families will soon receive their December advance Child Tax Credit payment; those not receiving payments may claim any missed payments on the upcoming 2021 tax return (Dec. 15, 2021), https://www.irs.gov/newsroom/families-will-soon-receive-their-december-advance-child-tax-credit-payment-those-not-receiving-payments-may-claim-any-missed-payments-on-the-upcoming-2021-tax-return.
7 *See* IRS Filing Season Statistics (week ending Dec. 3, 2021) https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-3-2021 (showing 169 million returns received overall and 152 million returns received through e-file). Because the IRS logged some returns in 2021 that were received in 2020 and has not yet logged all returns received in 2021, the number is approximate.
8 IRS Operations During COVID-19: Mission-Critical Functions Continue https://www.irs.gov/newsroom/irs-operations-during-covid-19-mission-critical-functions-continue (last visited Dec. 22, 2021) ("[A]ll paper and electronic individual refund returns received prior to April 2021 have been processed if the return had no errors or did not require further review. As of December 10, 2021, we had 6.2 million unprocessed individual returns.").
9 *See* IRS Filing Season Statistics (week ending Dec. 3, 2021) https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-3-2021 (showing the IRS has issued 129.8 million refunds out of 168.5 million returns processed).
10 IRS Operations During COVID-19: Mission-Critical Functions Continue ("Filed a Tax Return" section updated Dec. 20, 2021), https://www.irs.gov/newsroom/irs-operations-during-covid-19-mission-critical-functions-continue (last visited Dec. 22, 2021).
11 *Id.*
12 *Id.*
13 National Taxpayer Advocate 2019 Annual Report to Congress iv (footnotes omitted).
14 The IRS postponed the filing season due date to June 15, 2021, for taxpayers in certain states (Louisiana, Oklahoma, and Texas) that have been impacted by severe winter storms, following recent disaster declarations issued by the Federal Emergency Management Agency. *See* IRS, LA-2021-02, IRS Announces Tax Relief for Louisiana Severe Winter Storm Victims (Mar. 10, 2021), https://www.irs.gov/newsroom/irs-announces-tax-relief-for-louisiana-severe-winter-storm-victims; IRS, OK-2021-01, IRS Announces Tax Relief for Oklahoma Severe Winter Storm Victims (Feb. 25, 2021), https://www.irs.gov/newsroom/irs-announces-tax-relief-for-oklahoma-severe-winter-storm-victims; IRS, TX-2021-02, IRS Announces Tax Relief for Texas Severe Winter Storm Victims (Feb. 22, 2021), https://www.irs.gov/newsroom/irs-announces-tax-relief-for-texas-severe-winter-storm-victims.