

IMPROVE ASSESSMENT AND COLLECTION PROCEDURES

Legislative Recommendation #11

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

PRESENT LAW

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 it does so, IRC § 6213(b)(1) requires that the IRS 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.¹ If the taxpayer does not make an abatement request within 60 days, the assessment is final, and the taxpayer has lost his or her right to challenge the IRS’s position in the Tax Court. If the taxpayer requests an abatement, the IRS must abate the summary assessment. If the IRS continues to believe the taxpayer owes the tax, it may audit the taxpayer and propose an adjustment by issuing a notice of deficiency; if it does so, the taxpayer will have the right to challenge the IRS’s position in the Tax Court.

REASONS FOR CHANGE

Many taxpayers do not understand the significance of “deficiency procedures” and do not understand that the failure to respond to an IRS math error notice within 60 days means they have conceded the adjustment and forfeited their right to challenge the IRS’s position in the Tax Court. Notably, the law does not specify how the IRS must describe the math error or require the IRS to inform taxpayers they have 60 days to request the math error assessment be reversed. Further, unlike a notice of deficiency, which carries consequences similar to that of a math error notice (*i.e.*, assessment of tax that may result in future collection actions), IRC § 6213 does not require a math error notice be sent to a taxpayer by certified or registered mail.²

Although the statute requires the IRS to describe “the error alleged and an explanation thereof” in a notice, the descriptions are often very general. Some notices provide taxpayers with a list of possible errors – leaving them uncertain which error, if any, was committed. Other notices may indicate that a taxpayer understated his or her adjusted gross income but not specify which item of gross income was understated. Further, during calendar year (CY) 2021, the IRS neglected to include language informing taxpayers they have 60 days to request an abatement in about 6.5 million math error notices.³ Although the IRS later corrected this omission by sending taxpayers letters explaining the 60-day period, many taxpayers were left confused about what they needed to do, if anything.

¹ IRC § 6213(b)(2)(A).

² IRC § 6212(a). “If the Secretary determines that there is a deficiency in respect of any tax imposed ... he is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail.”

³ Erin M. Collins, Math Error, Part II: Math Error Notices Aren’t Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information/>.

It is unclear whether the IRS's explanation of alleged errors satisfies the statutory requirement when it makes a general statement or states that the error is due to one of multiple possible causes, since the statute does not describe the degree of specificity required. However, it is clear that the omission of the 60-day language from math error notices does not invalidate the notices, because IRC § 6213(b) does not require the IRS to tell taxpayers they have 60 days to request an abatement. While the IRS generally does so, the practice should not be discretionary. Amending IRC § 6213(b) to require that the IRS specifically describe the error giving rise to the adjustment and inform taxpayers 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 notice be sent either by certified or registered mail would underscore the significance of the notice and be yet another safeguard to ensure that taxpayers are receiving this critical information.

RECOMMENDATION

- Amend IRC § 6213(b)(1) to require that:
 - All math error notices provide a detailed explanation of the specific error, including the line number on the return or the line number on the schedule (whichever is more specific) on which the alleged error was made.
 - All math error notices include a statement that the taxpayer has 60 days from the date of the notice to request that the summary assessment be abated, and prominently display at the top of the notice the date on which the 60-day period expires.
 - All such notices will be sent either by certified or registered mail.

Legislative Recommendation #12**Continue to Limit the IRS's Use of "Math Error Authority" to Clear-Cut Categories Specified by Statute****PRESENT LAW**

Before the IRS may assess a deficiency, IRC § 6213(a) ordinarily requires that it send the taxpayer a "notice of deficiency" that gives the taxpayer 90 days (150 days if addressed to a taxpayer outside the United States) to contest it by filing a petition with the U.S. Tax Court (known as "deficiency procedures"). The taxpayer's ability to appeal a deficiency determination to the Tax Court before paying the tax is central to the taxpayer's *right to appeal an IRS decision in an independent forum*.¹

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

REASONS FOR CHANGE

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

Because math error procedures are cheaper and simpler for the IRS than deficiency procedures, the Department of the Treasury in the past has requested that Congress grant it the authority to add new categories of "correctable errors" by regulation.²

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

1 See IRC § 7803(a)(3)(E) (identifying the "right to appeal a decision of the Internal Revenue Service in an independent forum" as a taxpayer right).

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

circumstances in which the IRS has used math error authority to address discrepancies that have undermined taxpayer rights.³

If the IRS uses math error authority to address more complex issues that require additional fact finding, its assessments are more likely to be wrong, and the IRS's computer-generated notices, which confuse many taxpayers in the simplest of circumstances, are likely to become even more difficult to understand.⁴ A recent example illustrates a significant omission on math error notices, where taxpayers' Recovery Rebate Credits were adjusted. In 2021 the IRS issued about 6.5 million math error notices that omitted the 60-day time period language for requesting an abatement of the tax.⁵ The IRS later reissued letters to these taxpayers informing them of their right to request an abatement, and restarted the 60-day time period from the date of these new letters. Confusing notices such as these may prevent some taxpayers from responding timely. As a result, these taxpayers will lose their right to challenge the adjustments in court before paying, undermining the taxpayers' *right to appeal an IRS decision in an independent forum*.

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

RECOMMENDATIONS

- Do not give the IRS authority to add new categories of "correctable errors" by regulation. Because the deficiency procedures created by Congress provide important taxpayer protections, Congress should retain the sole authority to determine whether and when to create new exceptions to deficiency procedures by adding categories of mathematical or clerical errors.
- Amend IRC § 6213(g) to authorize the IRS to exercise its existing (and any new) authority to summarize assess a deficiency due to "clerical errors" only where: (i) there is a discrepancy between a return entry

3 See, e.g., National Taxpayer Advocate 2018 Annual Report to Congress 164 (Most Serious Problem: *Post-Processing Math Error Authority: The IRS Has Failed to Exercise Self-Restraint in Its Use of Math Error Authority, Thereby Harming Taxpayers*); National Taxpayer Advocate 2018 Annual Report to Congress 174 (*Math Error Notices: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden*); National Taxpayer Advocate 2015 Annual Report to Congress 329-339 (Legislative Recommendation: *Math Error Authority: Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*); National Taxpayer Advocate 2014 Annual Report to Congress 163-171 (Most Serious Problem: *Math Error Notices: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 5 (*Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, at 92-93 (*Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); National Taxpayer Advocate 2011 Annual Report to Congress 74-92 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*); National Taxpayer Advocate 2006 Annual Report to Congress 311 (Most Serious Problem: *IRS Implementation of Math Error Authority Impairs Taxpayer Rights*); National Taxpayer Advocate 2003 Annual Report to Congress 113 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 25 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 186 (Legislative Recommendation: *Math Error Authority*); National Taxpayer Advocate 2001 Annual Report to Congress 33 (Most Serious Problem: *Explanations on Math Error Authority*).

4 Erin M. Collins, Math Error, Part I, NATIONAL TAXPAYER ADVOCATE BLOG (July 28, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-i/>; Erin M. Collins, Math Error, Part II: Math Error Notices Aren't Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information/>.

5 Erin M. Collins, Math Error, Part II: Math Error Notices Aren't Just Confusing; Millions of Notices Adjusting the Recovery Rebate Credit Also Omitted Critical Information, NATIONAL TAXPAYER ADVOCATE BLOG (Aug. 3, 2021), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-math-error-part-ii-math-error-notices-arent-just-confusing-millions-of-notices-adjusting-the-recovery-rebate-credit-also-omitted-critical-information/>.

and reliable government data; (ii) the IRS's notice clearly describes the discrepancy and how to contest it; (iii) the IRS has researched all information in its possession that could help reconcile the discrepancy; (iv) the IRS does not have to evaluate documentation to make a determination; and (v) there is a low abatement rate for taxpayers who respond.

- Amend IRC § 6213(g) to provide that the IRS is not authorized to use any new criteria or data to make summary assessments unless the Department of the Treasury, in conjunction with the National Taxpayer Advocate, has evaluated and publicly reported on the reliability of the criteria or data for that intended use.⁶

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

Legislative Recommendation #13**Require Independent Managerial Review and Written Approval Before the IRS May Assert Multiyear Bans Barring Taxpayers From Receiving Certain Tax Credits and Clarify That the Tax Court Has Jurisdiction to Review the Assertion of Multiyear Bans****PRESENT LAW**

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

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

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

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

REASONS FOR CHANGE

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

These refundable credits can be a lifeline to low-income taxpayers. A 2019 TAS study found that on average, EITC accounted for more than 20 percent of taxpayers' adjusted gross incomes. Given the potentially devastating financial impact of multiyear bans, adequate safeguards are critical to ensure both that the IRS imposes a ban only when a taxpayer acts with the requisite state of mind and that a taxpayer has access to meaningful review of an IRS final determination to assert the ban.

Presently, the IRS may disallow an examined year's credit and assert a multiyear ban against claiming the credit in future years when it issues a notice of deficiency at the conclusion of an audit. A taxpayer may contest a notice of deficiency in the Tax Court, but it is uncertain whether the court has jurisdiction to review the IRS's assertion of a ban applicable to future tax years that has no impact on the taxpayer's liability for the tax year before the court.¹ Once a ban on claiming a credit in future years takes effect, the IRS will disallow the credit if the taxpayer claims it, and it may do so using its summary assessment procedures. The IRS would issue a notice of deficiency in that instance only if the taxpayer disputes the summary assessment.

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

Written Managerial Approval

The IRS's internal rules allow it to impose two-year bans automatically in some EITC cases.² The IRS is expanding the practice of automatically imposing bans to include the refundable portion of the CTC (referred to as the additional child tax credit, or ACTC).³ In all other ban cases, IRS procedures require a manager to review the case independently and approve the assertion of a ban in writing.⁴ IRC § 6751(b), which generally requires managerial approval before the IRS imposes penalties, does not apply to multiyear bans. Significantly, two TAS research studies of two-year ban cases found that this required managerial approval is usually lacking.⁵

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

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

Tax Court Jurisdiction

IRC § 6214 restricts the Tax Court to determining the amount of tax owed in the tax year(s) before the court. Thus, the court may determine whether the taxpayer properly claimed credits for the year that is the subject of a notice of deficiency. By contrast, the court may not have jurisdiction to determine whether the IRS's asserted ban should apply to the future years that are not before it, even if the ban is proposed in the notice of deficiency, because a ban has no effect on a taxpayer's liability in the tax year in which it is imposed (it affects only the following two or ten years).⁶ If the Tax Court does not consider whether a ban was properly imposed and the ban is left intact, and the taxpayer claims the banned credit on a subsequent return, the IRS will disallow the claim and may do so pursuant to its summary assessment procedures. The taxpayer would then be required to dispute the summary assessment and, once the IRS issues a notice of deficiency for the subsequent year, seek Tax Court review to determine whether the taxpayer properly claimed the credits. However, it is not clear whether the Tax Court has jurisdiction to determine whether the IRS properly imposed the ban in an earlier year that is not before the court (and if it lacks that jurisdiction, it may conclude that because the ban is intact, the court does not have the authority to allow the credit in the ban years).

Transparency is a critical element of taxpayer rights and fairness, and taxpayers should understand clearly when they may seek Tax Court review of an adverse IRS determination. In most cases, the law is clear. Here,

2 Internal Revenue Manual (IRM) 4.19.14.7.1.5, Project Codes 0027 and 0028 – EITC Recertification with a Proposed 2 Year EITC Ban (Dec. 16, 2020).

3 The American Rescue Plan Act, Pub. L. No. 117-2, § 9611, 135 Stat. 4, 359-376 (2021), makes the CTC fully refundable for tax year 2021. See Treasury Inspector General for Tax Administration, Ref. No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* 8 (May 10, 2021) (reporting that "IRS management stated that, starting in Processing Year 2021, systemic processes will assess the two-year ban for the ACTC.").

4 IRM 4.19.14.7.1(3), 2/10 Year Ban – Correspondence Guidelines for Exam Technicians (CET) (Dec. 11, 2019).

5 See National Taxpayer Advocate 2019 Annual Report to Congress vol. 2, at 239-256 (Research Study: *Study of Two-Year Bans on the Earned Income Tax Credit, Child Tax Credit, and American Opportunity Tax Credit*); National Taxpayer Advocate 2013 Annual Report to Congress 103-115 (Most Serious Problem: Earned Income Tax Credit: *The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*).

6 See note 1, *supra*.

the law is not clear, and there appear to be four possible outcomes: (i) the Tax Court may have jurisdiction to review a ban both for the year in which it is imposed and for the year in which it is effective; (ii) the Tax Court may have jurisdiction to review a ban for the year in which it is imposed but not for the year in which it is effective; (iii) the Tax Court may not have jurisdiction to review a ban for the year in which it is imposed but may have jurisdiction to review it for the year in which it is effective; or (iv) the Tax Court may not have jurisdiction to review a ban at any time. These procedural uncertainties undermine the taxpayer's *rights to appeal an IRS decision in an independent forum and to a fair and just tax system* and require clarification.

RECOMMENDATIONS

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

Legislative Recommendation #14**Allow Additional Time for Taxpayers to Request Abatement of a Math Error Assessment Equal to the Additional Time Allowed to Respond to a Notice of Deficiency When the Math Error Notice Is Addressed to a Person Outside the United States****PRESENT LAW**

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

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

REASONS FOR CHANGE

An estimated nine million U.S. citizens live abroad, as well as about 228,000 U.S. military service personnel.² In addition, more than 340,000 U.S. students study overseas.³ Taxpayers living abroad (temporarily or permanently) often require more time to respond to IRS notices than taxpayers living in the United States. Mail delivery takes longer in both directions – in some cases, depending on where the taxpayer is located, substantially longer. In addition, persons temporarily abroad often do not have access to their tax or financial records, making it difficult for them to respond immediately.

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- 1 See, e.g., *Levy v. Comm’r*, 76 T.C. 228 (1981) (holding that the 150-day rule is applicable to a U.S. resident who is temporarily outside the country when the notice is mailed and delivered); *Looper v. Comm’r*, 73 T.C. 690 (1980) (holding that the 150-day rule is applicable where a notice is mailed to an address outside the United States); *Lewy v. Comm’r*, 68 T.C. 779 (1977) (holding that the 150-day rule is applicable to a foreign resident who is in the United States when the notice is mailed but is outside the United States when the notice is delivered); *Hamilton v. Comm’r*, 13 T.C. 747 (1949) (holding that the 150-day rule is applicable to a foreign resident who is outside the United States when the notice is mailed and delivered).
 - 2 For Fiscal Year (FY) 2019, the Department of State estimates that about nine million U.S. citizens lived abroad. U.S. Department of State, Bureau of Consular Affairs, *Consular Affairs by the Numbers*, FY 2019 data (Jan. 2020), <https://travel.state.gov/content/dam/travel/CA-By-the-Number-2020.pdf>. As of June 30, 2021, about 228,000 U.S. military service personnel were stationed abroad, including military reserve personnel and Department of Defense civilian employees. U.S. Department of Defense, Defense Manpower Data Center (DMDC), *Military and Civilian Personnel by Service/Agency by State/Country*, <https://dwp.dmdc.osd.mil/dwp/app/dod-data-reports/workforce-reports>.
 - 3 Open Doors, U.S. Study Abroad: All Destinations, <https://opendoorsdata.org/data/us-study-abroad/all-destinations> (last visited Sept. 2, 2020) (showing 341,751 U.S. students studied abroad during the 2017-2018 academic year).

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

RECOMMENDATION

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

Legislative Recommendation #15**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****PRESENT LAW**

IRC § 6212 requires the IRS to issue a “notice of deficiency” before assessing certain liabilities. When the IRS issues a notice of deficiency, IRC § 6213 authorizes the taxpayer to petition the U.S. Tax Court within 90 days (or 150 days for notices addressed to a person outside the U.S.) to review the IRS determination.

IRC § 6671(a) authorizes the IRS to assess some penalties without first issuing a notice of deficiency.¹ These penalties are generally subject to judicial oversight only if taxpayers first pay the penalty and then incur the cost of taking the case to a U.S. district court or the U.S. Court of Federal Claims.² Although IRC § 6671(a) specifically references only the “penalties and liabilities provided by this subchapter” (*i.e.*, Chapter 68, Subchapter B of the IRC), the IRS takes the position that various international information reporting penalties in Chapter 61 are also immediately assessable without the issuance of 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.³

REASONS FOR CHANGE

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, particularly where the IRS systemically imposes a penalty (rather than imposing it manually during an audit).⁴ TAS has previously reported that the IRS abated between 71 percent and 88 percent of dollars systemically assessed under IRC §§ 6038 and 6038A. Specifying that deficiency procedures apply would prevent the systemic assessments the IRS so often abates, a process that unnecessarily consumes resources for the IRS and imposes undue burdens on taxpayers. Moreover, allowing taxpayers to seek judicial review without the necessity of prepayment would remove a restriction that Congress did not impose and that disproportionately affects taxpayers with limited resources.

The National Taxpayer Advocate does not agree with the IRS’s legal position that foreign information reporting penalties in Chapter 61 may be assessed without the issuance of a notice of deficiency under current

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- 1 These “assessable” penalties are generally those that are due and payable upon notice and demand. Unlike penalties subject to deficiency procedures, assessable penalties carry no rights to a 30-day letter, agreement form, or notice requirements prior to assessment. Internal Revenue Manual (IRM) 20.1.9.1.5, Common Terms and Acronyms (Jan. 29, 2021).
 - 2 See IRC § 7422 for requirements relating to refund suits. For legislative recommendations to address the issue of “pay to play” judicial review, see Legislative Recommendation: *Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*, and Legislative Recommendation: *Expand the Tax Court’s Jurisdiction to Hear Refund Cases and Assessable Penalties*, *infra*. See also National Taxpayer Advocate 2021 Purple Book, Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 94-97 (*Repeal Flora and Expand the Tax Court’s Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).
 - 3 The IRS also treats the penalties imposed under IRC §§ 6038A, 6038B, 6038C, and 6038D for failing to file various international information returns as assessable penalties. IRM 20.1.9.2 (Jan. 29, 2021); IRM 20.1.9.7.3 (Jan. 29, 2021).
 - 4 See National Taxpayer Advocate 2020 Annual Report to Congress 119, 124-125 (Most Serious Problem: *International: The IRS’s Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*) (reporting that when penalties under IRC §§ 6038 and 6038A are applied systemically, the abatement percentage, measured by number of penalties, ranges from 55 to 72 percent, and by dollar value of penalties ranges from 71 to 88 percent). The IRS abates manual assessments at rates ranging from 17 percent to about 39 percent by number, and from eight percent to about 66 percent by dollar.

law. In light of its position, however, the proposed legislative change would eliminate future litigation and enhance the taxpayers' *right to a fair and just tax system*.⁵

RECOMMENDATION

- Amend IRC § 6212 to require the IRS to issue a notice of deficiency before assessing penalties under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D.

5 See National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*).

Legislative Recommendation #16**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****PRESENT LAW**

IRC §§ 6320(b) and 6330(b) provide taxpayers with the right to request an independent review of a Notice of Federal Tax Lien filed by the IRS or of 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 a notice of federal tax lien or whether it may proceed to deprive the taxpayer of property through a levy. In a CDP hearing, conducted by a settlement officer with the IRS Independent Office of Appeals (Appeals), a taxpayer may raise a variety of issues, including collection alternatives and spousal defenses. Under IRC § 6330(c)(2)(B), however, a taxpayer may only dispute the existence or amount of the underlying tax liability if the taxpayer “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.”¹

The IRS and the courts interpret IRC § 6330(c)(2)(B) and Treasury regulations under IRC §§ 6320 and 6330 to mean that an opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals, even where the taxpayer had no prior opportunity for prepayment judicial review of the liability and no subsequent prepayment judicial review of the Appeals determination is available.² Additionally, at least one Court of Appeals has held that IRC § 6330(c)(4)(A) is an independent basis for denying a merits hearing in the CDP process if a prior merits hearing occurred.³

In a recent deficiency case applying these rules, *Lander v. Commissioner*,⁴ the Tax Court held the taxpayer was not permitted to dispute the underlying liability in a CDP hearing where the taxpayer did not receive the notice of deficiency sent by the IRS but obtained an Appeals hearing as a part of the audit reconsideration process.⁵ Because the underlying liability was not at issue in the CDP hearing, the taxpayer was precluded from disputing the underlying liability in the Tax Court proceeding.⁶ Thus, by seeking to resolve his tax liability through audit reconsideration, the taxpayer forfeited his right to seek judicial review of the liability in a prepayment forum.

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- 1 IRC §§ 6320(c), 6330(c)(2)(B). The phrase “underlying tax liability” includes the tax deficiency, any penalties and additions to tax, and statutory interest. *Katz v. Comm’r*, 115 T.C. 329, 339 (2000).
 - 2 Treas. Reg. §§ 301.6320-1(e)(3), Q&A (E)(2), 301.6330-1(e)(3), Q&A (E)(2), provides that “an opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability. An opportunity for a conference with Appeals prior to the assessment of a tax subject to deficiency procedures is not a prior opportunity for this purpose.” The Tax Court and at least three Courts of Appeal have upheld the validity of these regulations. *Lewis v. Comm’r*, 128 T.C. 48, 61 (2007); *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017); *Keller Tank Services II, Inc. v. Comm’r*, 854 F.3d 1178 (10th Cir. 2017); *Our Country Home Enterprises, Inc. v. Comm’r*, 855 F.3d 773 (7th Cir. 2017).
 - 3 *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017). IRC § 6330(c)(4)(A) provides that an issue may not be raised at a CDP hearing “(i) if the issue was raised and considered at a previous hearing under section 6320 or in any other previous administrative or judicial proceeding; and (ii) the person seeking to raise the issue participated meaningfully in such hearing or proceeding.”
 - 4 *Lander v. Comm’r*, 154 T.C. 104 (2020), holding that the conference with Appeals as part of the audit reconsideration process constituted “an opportunity to dispute the tax liability” under IRC § 6330(c)(2)(B).
 - 5 A notice of deficiency allows taxpayers to petition the Tax Court for *de novo* review of the IRS’s determination under IRC § 6213(a), but audit reconsiderations are not subject to Tax Court review.
 - 6 At the conclusion of a CDP hearing, the taxpayer, within 30 days of the Appeals settlement officer’s determination, may petition the Tax Court for review of the determination. IRC §§ 6230(c), 6330(d). If the taxpayer’s underlying liability was not at issue in the CDP hearing, the taxpayer will be precluded from disputing the underlying liability in the Tax Court proceedings. Treas. Reg. § 301.6330-1(f)(2), Q&A (F)(3).

In some non-deficiency cases, mere notification of the right to request an Appeals conference is treated as a “prior opportunity” to dispute the liability. For example, the IRS assesses certain penalties without issuing a notice of deficiency.⁷ Some “summary” penalty assessments are made systemically (*i.e.*, they are automatically imposed by a computer rather than manually imposed during an audit).⁸ When the IRS makes these summary assessments, it notifies the taxpayer of the proposed penalty by sending a letter or notice that makes mention of the taxpayer’s right to seek a conference with Appeals.⁹ For purposes of the Trust Fund Recovery Penalty, for example, this correspondence constitutes “an opportunity to dispute such liability,” even when the taxpayer does not request a conference in response to the letter and no conference takes place.¹⁰ Whether or not the taxpayer requests or receives a conference with Appeals in response to the letter, the taxpayer will not be permitted to dispute the merits of the liability at a CDP hearing or in Tax Court, even if the liability resulted from an automated system rather than any human intervention. To obtain judicial review of the underlying liability, the taxpayer must pay the tax – generally the full amount due – and seek a refund.¹¹

One exception to the full payment rule applies to “divisible” taxes. When an assessment may be divisible into a tax on each transaction or event, the taxpayer need only pay enough to cover a single transaction or event before filing suit.¹²

Additional provisions in IRC § 6330 preserve the integrity of CDP hearings. Appeals Officers may disregard requests for CDP hearings that are made to delay collection.¹³ Among the matters that cannot be raised at a CDP hearing are “specified frivolous submissions” as defined in IRC § 6702(b)(2)(A).¹⁴

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- 7 Assessable penalties are primarily found in IRC §§ 6671 through 6720C. The IRS also treats the penalties found in IRC §§ 6038 and 6038A as assessable penalties, a practice the National Taxpayer Advocate believes is not supported by statute. See National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS’s Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*). See also Legislative Recommendation: 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, *supra*.
- 8 IRM 21.8.2.20.2(1), Form 5471 Penalties Systemically Assessed From Late-Filed Form 1120 Series or Form 1065 (Mar. 26, 2018); IRM 21.8.2.21, Form 5472 - Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Oct. 1, 2016); IRM 21.8.2.21.2(1), Form 5472 Penalties Systemically Assessed From Late-Filed Form 1120 Series (Mar. 18, 2020).
- 9 In some notices, a description of the right to seek a conference with Appeals is brief and does not appear until the end of the notice. For example, the IRS issues Notice CP 15, Notice of Penalty Charge, to advise taxpayers of a proposed assessable penalty under IRC § 6038. On the second page of the notice, near the end, the notice advises: “If you wish to appeal this penalty, send the IRS at the address shown on page 1 of this notice a written request to appeal within 30 days from the date of this notice. Your request should include any explanation and documents that will support your position. Your explanation should reflect all facts that you contend are reasonable cause for not asserting this penalty.”
- 10 Treas. Reg. §§ 301.6320-1(e)(4), Example 3, 301.6330-1(e)(4), Example 3, relating to the trust fund recovery penalty (TFRP) under IRC § 6672. The IRS sends Letter 1153, Proposed Trust Fund Recovery Penalty Notification, to inform taxpayers it is asserting the TFRP and courts have held Letter 1153 is an “opportunity to dispute such liability.” *Bletsas v. Comm’r*, T.C. Memo. 2018-128, *aff’d* 784 F. App’x 835 (2d Cir. 2019); *Smith v. Comm’r*, T.C. Memo. 2015-60; *Thompson v. Comm’r*, T.C. Memo. 2012-87.
- 11 See 28 U.S.C. § 1346(a)(1) (providing that once a taxpayer pays the tax, the taxpayer may file suit in a U.S. district court or the U.S. Court of Federal Claims to recover any tax the taxpayer believes has been erroneously assessed or collected). In *Flora v. United States*, 362 U.S. 145 (1960), the U.S. Supreme Court held that, with limited exceptions, a taxpayer must have “fully paid” the assessment (called the “full payment rule”) before filing suit in these courts.
- 12 The TFRP, for example, is a divisible tax. After the IRS assesses the penalty, the responsible person need only pay the amount due with respect to a single employee for a single quarter before filing suit. Other exceptions to the full payment rule include IRC § 6694(c) (applicable to those who have paid 15 percent of certain assessable preparer penalties) and IRC § 6703(c) (applicable to those who have paid 15 percent of the assessable penalties under IRC §§ 6700 and 6701 relating to promoting abusive tax shelters and aiding and abetting understatements).
- 13 IRC § 6330(g) provides: “Notwithstanding any other provision of this section, if the Secretary determines that any portion of a request for a hearing under this section or section 6320 meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A), then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.”
- 14 IRC § 6330(c)(4)(B). IRC § 6702 allows for the imposition of a penalty of up to \$5,000 where a request for a CDP hearing is “either based on a position the IRS has identified as frivolous or reflects a desire to delay or impede the administration of federal tax laws.” IRC § 6702(b)(2)(A)(i) & (ii), (B)(i), (c).

REASONS FOR CHANGE

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. Taxpayers who wish to dispute their underlying liability in a judicial forum but cannot raise the issue in a CDP hearing due to the application of IRC § 6330(c)(2)(B) have no alternative but to pay the tax and then seek a refund, an option that not all taxpayers can afford, particularly when the liability consists of high-dollar assessable, non-divisible penalties.¹⁵ In addition, in deficiency cases where the taxpayer did not receive a notice of deficiency, the decision whether to request a conference with Appeals has ramifications that most taxpayers will not anticipate and that reward taxpayers who have skilled representation. Specifically, savvy taxpayers may refrain from seeking to resolve their liabilities through, for example, the audit reconsideration process in order to preserve their ability to adjudicate their underlying liabilities in a later CDP hearing, while taxpayers without sophisticated knowledge of these rules may request audit reconsideration without recognizing that doing so will cause them to lose their ability to later adjudicate their underlying liabilities in a CDP hearing.

The National Taxpayer Advocate believes that judicial and administrative interpretations limiting a taxpayer's ability to challenge the IRS's liability determination in a CDP hearing are inconsistent with Congress's intent when it enacted CDP procedures. Compared to the burden the current rules place on taxpayers, and in view of the statutory safeguards already in place to prevent frivolous or meritless CDP proceedings, allowing more taxpayers to dispute their tax liabilities in CDP hearings will better protect taxpayer rights without imposing an undue administrative burden on the IRS or the Tax Court.

RECOMMENDATIONS

- Amend IRC § 6330(c)(2)(B) to allow taxpayers to raise challenges to the existence or amount of the underlying tax liability at a CDP hearing for any tax period if the taxpayer did not receive a valid notice of deficiency for such liability or, in non-deficiency cases, the taxpayer did not have an opportunity to dispute the liability in a prepayment judicial forum.
- Clarify that IRC § 6330(c)(4)(A) applies only to collection issues and not to liability issues, which are addressed exclusively in IRC § 6330(c)(2)(B).

¹⁵ For legislative recommendations to address the issue of "pay to play" judicial review, see Legislative Recommendation: *Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*, and Legislative Recommendation: *Expand the Tax Court's Jurisdiction to Hear Refund Cases and Assessable Penalties*, *infra*. See also National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 94-97 (Repeal Flora and Expand the Tax Court's Jurisdiction, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can)*.

Legislative Recommendation #17**Amend IRC § 6402(a) to Prohibit Offset of the Earned Income Tax Credit Portion of a Tax Refund****PRESENT LAW**

IRC § 6343(a)(1)(D) requires the Secretary to release a levy if she determines the levy “is creating an economic hardship due to the financial condition of the taxpayer.”

IRC § 7122 authorizes the IRS to accept offers in compromise and requires the Secretary to publish guidelines for evaluating offers to ensure “that taxpayers entering into a compromise have an adequate means to provide for basic living expenses.”

IRC § 6402(a) generally authorizes the IRS to offset a taxpayer’s refund and apply it to satisfy a prior-year federal tax liability, but it does not require the IRS to do so. For taxpayers who are experiencing an economic hardship, the IRS may “bypass” the offset and issue the refund to the taxpayer.¹ This is referred to as an “offset bypass refund” (OBR).² The timeframe for requesting an OBR is narrow. The IRS must approve an OBR between the date the return is filed and the date the IRS assesses the tax shown on the return. This period is approximately ten to 20 days when a return is filed electronically.³ Once an offset has taken place, the IRS does not have the legal authority to pay the refund even if a taxpayer can demonstrate economic hardship.

The Earned Income Tax Credit (EITC) is a refundable credit for low-income working individuals and families.⁴ For tax year 2020, the maximum amount of the credit was \$6,660 for a family consisting of one adult with three children and earning between \$14,800 and \$19,349.⁵ The EITC is claimed on a tax return and is included in the computations that determine whether a taxpayer is entitled to receive a refund and, if so, the amount of the refund. Therefore, when a refund is offset to satisfy a prior-year federal tax liability, the taxpayer will not receive some or all of the EITC for which he or she is otherwise eligible.

REASONS FOR CHANGE

Congress created the EITC to provide financial support for low-income individuals and families, enhance workforce participation, and reduce poverty. It enacted such statutes as IRC §§ 6343(a)(1)(D) and 7122, to protect taxpayers from IRS collection actions where these actions would leave a taxpayer unable to pay his or her basic living expenses. To determine whether a collection action would leave a taxpayer in that position, the IRS publishes schedules of national and local allowances annually known as “Allowable Living Expenses” (ALEs). The IRS generally will refrain from taking collection actions if it determines that a taxpayer’s ALEs are less than the taxpayer’s income. However, the IRS may continue to offset refunds the taxpayer claims on a return, unless the taxpayer knows to request an OBR.

The OBR process is obscure and difficult to navigate. OBRs may only be approved during the short timeframe between the date a tax return is filed and the date the tax is assessed – typically, ten to 20 days.

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- 1 Treas. Reg. § 301.6343-1(b)(4)(i) provides that an economic hardship exists when an IRS action would cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses.
 - 2 However, if the taxpayer has non-tax federal debts, past due child support, or state income tax or unemployment compensation debts, the IRS must make an offset with respect to those liabilities. See IRC § 6402(c) & (d).
 - 3 With the IRS transitioning to CADE 2, this period will become shorter. Internal Revenue Manual 21.2.1.4, Customer Account Data Engine 2 (CADE 2) (Jan. 4, 2012), explains in paragraph (2) that some of the benefits of CADE 2 are daily transaction posting and quicker refunds.
 - 4 IRC § 32.
 - 5 IRS, Pub. 596, Earned Income Credit (EIC) 34 (Jan. 26, 2021).

In fiscal year 2021, only 511 taxpayers received OBRs.⁶ Particularly during the last two years when many Americans have been struggling financially due to the COVID-19 pandemic, significantly more taxpayers could have benefited from an OBR but did not know to request one.

Consistent with congressional intent that the IRS refrain from taking collection actions that will impose economic hardships on taxpayers, the National Taxpayer Advocate recommends that Congress prohibit the IRS from offsetting the portion of a taxpayer's refund attributable to the EITC. While EITC eligibility is not the sole indicator of economic hardship, it provides a good approximation because the credit is only available to taxpayers whose incomes are below a specified threshold. The credit in tax year 2020 plateaued at \$538 for a single taxpayer with no qualifying children who earned between \$7,000 and \$8,749. The same credit plateau applied to married taxpayers filing jointly with no qualifying children who earned between \$7,000 and \$9,200. For a single taxpayer with three qualifying children earning between \$14,800 and \$19,349, the credit plateaued at \$6,660.⁷

Using the EITC as a proxy for economic hardship for purposes of OBR eligibility will also eliminate the administrative burden the current process imposes on both taxpayers, who have to produce substantiation of hardship, and the IRS, which must review each request on a case-by-case basis. To be clear, we are not recommending that the full refund be released – just the amount attributable to the EITC. Programming would be straightforward, rendering it easily administrable.⁸

RECOMMENDATION

- Amend IRC § 6402(a) to prohibit offset of the EITC portion of a taxpayer's refund to satisfy prior-year tax liabilities.

6 IRS, Compliance Data Warehouse, Individual Master File Transaction History table (data as of Oct. 28, 2021).

7 IRS, Pub. 596, Earned Income Credit (EIC) 32-34 (Jan. 26, 2021).

8 The Section of Taxation of the American Bar Association (ABA) has also advocated for a prohibition against offsetting the refunds of EITC recipients. It recently wrote: "OBRs are narrow in the relief they provide, typically only resulting in a payment of the amount of the specifically demonstrated past due bill or other emergency. This might provide only temporary relief when the taxpayer's hardship is a recurring expense, or when the hardship is one that is not easily quantified (for example, food insecurity)." ABA, Comments Regarding Review of Regulatory and Other Relief to Support Taxpayers During COVID-19 Pandemic (Jan. 15, 2021), <http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2021/011521comments.pdf> (footnote omitted).

Legislative Recommendation #18**Require the IRS to Waive User Fees for Taxpayers Who Enter Into Low-Cost Installment Agreements or Who Have an Adjusted Gross Income Equal to or Less Than 250 Percent of the Federal Poverty Level****PRESENT LAW**

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

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

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

REASONS FOR CHANGE

Even the reduced IA user fee for low-income taxpayers may deter these taxpayers from applying for IAs and paying their taxes voluntarily. Taxpayers ineligible for the reduced fee may also be experiencing some level of financial hardship, as evidenced by their inability to pay their balance at once. The cost to the IRS of OPAs and DDIAs is so low that requiring a user fee may cost the government more in lost tax revenue and increased enforcement costs than the user fee generates.

The IRS is required to identify low-income individuals who request an installment agreement, and it does so systemically by placing an indicator on a taxpayer’s account based on the taxpayer’s last filed return. Taxpayers whose accounts are marked with a low-income indicator do not pay the \$43 fee when they request an IA. Low-income taxpayers without the indicator on their accounts may complete and submit Form 13844, Application for Reduced User Fee for Installment Agreement, for fee waiver approval. Removing the requirement to pay for an IA could encourage more low-income taxpayers to become compliant with their tax obligations. Taxpayers whose incomes exceed the 250 percent threshold and who enter into DDIAs should also be relieved of paying an IA user fee. This would incentivize more taxpayers to shift to an online resolution and acknowledge that this virtual transaction involves minimal employee cost for the IRS.

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

RECOMMENDATION

- Amend IRC § 6159 to require the IRS to waive the user fee for all direct-debit IAs and for IAs with taxpayers whose adjusted gross income is equal to or less than 250 percent of the Federal Poverty Level.²

² For legislative language generally consistent with this recommendation, see Taxpayer Bill of Rights Enhancement Act of 2017, S. 1793, 115th Cong. § 301 (2017); Taxpayer Protection and Assistance Act, S. 1321, 109th Cong. § 301 (2006).

Legislative Recommendation #19**Improve Offer in Compromise Program Accessibility by Repealing the Partial Payment Requirement and Restructuring the User Fee****PRESENT LAW**

IRC § 7122(a) authorizes the IRS to settle a tax debt by accepting an offer in compromise (OIC). According to Policy Statement 5-100, the IRS will “accept an offer in compromise when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential.” Taxpayers whose offers are accepted must file and pay their taxes for the next five years, as stated on IRS Form 656, Offer in Compromise (2021) (Section 7, items l and m). If they fail to remain in compliance for the five-year period, the IRS may seek to collect the amounts it compromised.

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

REASONS FOR CHANGE

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

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

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

RECOMMENDATION

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

² For legislative language generally consistent with this recommendation, see John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 206 (2021); Taxpayer Protection Act, H.R. 2171, 115th Cong. § 206 (2017); Taxpayer Protection Act, H.R. 4912, 114th Cong. § 206 (2015); Taxpayer Assistance Act, H.R. 4994, 111th Cong. § 202 (2010). For additional background, see, e.g., National Taxpayer Advocate 2006 Annual Report to Congress 507-519 (Legislative Recommendation: *Improve Offer in Compromise Program Accessibility*).

Legislative Recommendation #20**Modify the Requirement That the Office of Chief Counsel Review Certain Offers in Compromise****PRESENT LAW**

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

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

REASONS FOR CHANGE

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

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

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

RECOMMENDATION

- Amend IRC § 7122(b) to repeal the requirement that Counsel review all OICs in civil cases where the unpaid amount of tax assessed (including any interest, additional amount, addition to tax, or assessable penalty) is \$50,000 or more and replace it with language authorizing the Secretary to require Counsel review of OICs in cases that she determines present significant legal issues.³

1 See Internal Revenue Manual 8.23.4.3.2, Counsel Review of Acceptance Recommendations (Apr. 24, 2020).

2 Emails from IRS Office of Chief Counsel (Nov. 29, 2021, Sept. 1, 2020, and Aug. 9, 2019).

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

Legislative Recommendation #21**Amend IRC § 7122 to Require the IRS to Refund Any Payment Collected Pursuant to a Federal Tax Lien That Exceeds the Amount of an Accepted Offer in Compromise****PRESENT LAW**

IRC § 7122 authorizes the Secretary to sign an agreement (an “offer in compromise” or OIC) with a taxpayer to settle the taxpayer’s tax liabilities for less than the amount owed. OICs take one of two forms: (i) the taxpayer may pay the agreed amount in a single lump-sum¹ or (ii) the taxpayer may pay the agreed amount through periodic payments,² generally monthly. Treas. Reg. § 301.7122-1(b) provides that the IRS may compromise liabilities to the extent there is doubt as to liability or doubt as to collectibility, or to promote effective tax administration. With respect to offers based on doubt as to collectibility, the IRS has a legal basis to compromise when the taxpayer’s equity in assets and future income potential are less than the taxpayer’s liabilities. The IRS follows guidelines set forth in Internal Revenue Manual (IRM) 5.8.5 to evaluate a taxpayer’s equity in assets and future income potential. According to IRS Policy Statement 5-100, an OIC is considered a “legitimate alternative to declaring a case as currently not collectible or to a protracted installment agreement” and the goal is to “achieve the collection of what is potentially collectible at the earliest possible time and at the least cost to the government.”

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

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

IRC § 6331(a) authorizes the IRS to “levy upon all property and rights to property,” but the IRS generally cannot enforce a levy while an offer is pending, for 30 days following the rejection of an offer, or during any period when an appeal is being considered.³ The IRS may maintain a lien on any property owned by the taxpayer until all payments are made.⁴

REASONS FOR CHANGE

When the IRS accepts an OIC, the IRS contracts to settle a tax liability for less than the full amount of the liability. Prior to accepting an OIC, the IRS carefully reviews and verifies the taxpayer’s financial condition.⁵

1 See IRC § 7122(c)(1)(A).

2 See IRC § 7122(c)(1)(B).

3 See IRC § 6331(k).

4 IRS Form 656-B, Offer in Compromise (Apr. 2020).

5 IRM 5.8.5, Financial Analysis (Mar. 23, 2018).

It calculates a taxpayer's "reasonable collection potential" (RCP), accounting for assets, future income, other lienholders, and allowable living expenses.⁶ Generally, an OIC is not accepted unless the offer proposed by the taxpayer is equal to or greater than the RCP, as calculated by the IRS.

In certain situations where the IRS has filed a lien on taxpayer property, the IRS may end up collecting more than the amount originally calculated as the taxpayer's reasonable collection potential. IRC § 6325 and IRS internal guidance call for a lien on property to remain in place until the taxpayer has made all payments.⁷ If a taxpayer sells property subject to lien prior to completing payment on the OIC, liens superior to the federal tax lien must be satisfied and the costs of sale must be paid. Thereafter, the IRS may take the remaining sale proceeds up to the full amount of its original lien, as provided by IRC § 6321 and stated in Section 7, Paragraph (q), of Form 656. As a result, the IRS may collect more than the taxpayer's RCP that it had computed when it accepted the OIC.⁸

RECOMMENDATION

- Amend IRC § 7122 to require the IRS to return to the taxpayer any amount collected pursuant to a federal tax lien in excess of the payment amount of an accepted OIC, unless otherwise agreed upon, provided the taxpayer disclosed all material income and assets⁹ to the IRS on his or her application and made all payments in accordance with the terms of the agreement.

6 IRM 5.8.4.3.1, Components of Collectibility (Apr. 30, 2015).

7 IRM 5.8.10.6, Discharge and Subordination Requests (July 20, 2020).

8 In some cases, the IRS enters into collateral agreements in which the IRS and the taxpayer agree that if real property is sold, the IRS will automatically receive a certain percentage of the sale price, even if the OIC offer amount is paid in full.

9 IRS Form 656-B, Offer in Compromise (Apr. 2020).

Legislative Recommendation #22**Require the IRS to Mail Notices at Least Quarterly to Taxpayers With Delinquent Tax Liabilities****PRESENT LAW**

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

REASONS FOR CHANGE

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

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

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

RECOMMENDATION

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

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

Legislative Recommendation #23**Clarify When the Two-Year Period for Requesting Return of Levy Proceeds Begins****PRESENT LAW**

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

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

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

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

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

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

REASONS FOR CHANGE

The IRS may issue levies to attach a taxpayer's assets, such as wages, pension benefits, annuities, or Social Security benefits, that result in multiple payments over many years. The IRS has the authority to return levy proceeds to a third party or the taxpayer if the person requests the proceeds within two years of the date of levy. The IRS generally interprets the "date of levy" to mean the date the IRS delivers by mail or by hand a notice of levy to the person in possession of the property levied. In the case of a continuous levy under IRC § 6331(e), the date of levy is the date the notice of levy is first served by hand or by mail on the person in

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

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

3 The Treasury regulations under IRC § 6331 do not define the term "date of levy" when the levy occurs through electronic means as used in the FPLP. The IRS's policy is set forth in the Internal Revenue Manual (IRM). See IRM 5.11.7.2.7, Returning FPLP Levy Proceeds (Sept. 23, 2016); IRM 5.19.9.3.8, Return of FPLP Levy Proceeds (Oct. 20, 2016).

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

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

RECOMMENDATION

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

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

Legislative Recommendation #24**Protect Retirement Funds From IRS Levies, Including So-Called “Voluntary” Levies, in the Absence of “Flagrant Conduct” by a Taxpayer****PRESENT LAW**

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

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

REASONS FOR CHANGE

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

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

As a result, taxpayers who have not engaged in “flagrant conduct” in their tax matters and who therefore would have been shielded from levies on their retirement accounts in the past may agree to “voluntary” levies out of fear or anxiety, and thus may find themselves in economic hardship during retirement.

Under IRC § 6334, the IRS is prohibited from levying on certain sources of payment, such as unemployment and child support. These exceptions reflect policy determinations. For example, Congress has determined that the IRS should not levy on child support payments because doing so would likely harm the children who rely on those benefits for support. To better protect retirement savings, the National Taxpayer Advocate believes that retirement savings should be added to the list of exempt property, absent “flagrant conduct,” and that the term “flagrant conduct” should be defined in the statute.

1 Internal Revenue Manual (IRM) 5.11.6.3(5), Funds in Pension or Retirement Plans (May 26, 2021).

2 The IRM provides examples of flagrant conduct. See IRM 5.11.6.3(6), Funds in Pension or Retirement Plans (May 26, 2021). However, the IRM does not provide a definition of the term and it can be changed at any time.

3 IRM 5.11.6.3(3), Funds in Pension or Retirement Plans (May 26, 2021).

4 The IRS will still verify that the taxpayer has received collection due process rights, consider collection alternatives, and analyze whether the taxpayer relies on funds in the retirement account (or will in the near future) for necessary living expenses. IRM 5.11.6.3(3), (4), and (7), Funds in Pension or Retirement Plans (May 26, 2021).

RECOMMENDATIONS

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

5 For legislative language generally consistent with this recommendation, see John Lewis Taxpayer Protection Act, H.R. 3738, 117th Cong. § 203 (2021); Taxpayer Protection Act, H.R. 4912, 114th Cong. § 203 (2016); and Taxpayer Rights Act, S. 2333 and H.R. 4128, 114th Cong. §§ 306 & 307 (2015).

Legislative Recommendation #25

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

PRESENT LAW

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

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

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

REASONS FOR CHANGE

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

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

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

At the recommendation of the Office of the Taxpayer Advocate, the IRS has written procedures into its Internal Revenue Manual (IRM) that provide additional taxpayer protections before a case may be referred to the DOJ for the filing of a lien foreclosure suit.⁴ The IRM prescribes certain initial steps IRS employees must take, such as attempting to identify the occupants of a residence and advising the taxpayer about Taxpayer Advocate Service assistance options. It also sets forth an internal approval process prior to referring a lien enforcement case to the DOJ. However, the IRM is simply a set of instructions to IRS staff. Taxpayers

¹ *United States v. Rodgers*, 461 U.S. 677, 709 (1983).

² *Id.* at 680, 709-710.

³ S. REP. NO. 105-174, at 86-87 (1998).

⁴ See, e.g., IRM 5.17.4.8.2.5, Lien Foreclosure on a Principal Residence (May 23, 2019); IRM 5.17.12.20.2.2.4, Additional Items for Lien Foreclosure of Taxpayer’s Principal Residence (May 24, 2019); IRM 25.3.2.4.5.2(3), Actions Involving the Principal Residence of the Taxpayer (Nov. 24, 2021).

generally may not rely on IRM violations as a basis for challenging IRS actions in court, and the IRS may modify or rescind IRM provisions at any time.

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

RECOMMENDATIONS

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

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

Legislative Recommendation #26**Provide Collection Due Process Rights to Third Parties Holding Legal Title to Property Subject to IRS Collection Actions****PRESENT LAW**

Current law authorizes the IRS to file Notices of Federal Tax Lien (NFTLs) and levy upon (seize) all property or rights to property of “any person liable to pay any tax” who neglects or refuses to do so, including property owned by certain third parties (individuals or entities). These third parties include nominees, alter egos and persons to whom lien-encumbered property is transferred (collectively, “affected third parties”).¹ In connection with taking these collection actions, the Secretary must provide collection due process (CDP) rights to “the person described in section 6321” (in the case of liens) and to “any person with respect to any unpaid tax” before levying against property (in the case of levies).²

REASONS FOR CHANGE

Congress created the CDP notice and hearing procedures to give taxpayers the right to a meaningful hearing before the IRS levies their property or immediately after the IRS files an NFTL against their property. During a CDP hearing with the IRS Independent Office of Appeals (Appeals), a taxpayer has the right to raise defenses, challenge the appropriateness of collection actions, and propose collection alternatives. If the parties cannot otherwise resolve the issue, Appeals may issue an adverse Notice of Determination that is subject to review in the U.S. Tax Court and that may thereafter be appealed to the U.S. Courts of Appeals.

For purposes of CDP eligibility, the Treasury regulations interpret the statutory term “person” as including only the taxpayer (*i.e.*, the person upon whom the tax was imposed and who refused or neglected to pay following notice and demand). Thus, affected third parties are not afforded CDP rights.³ This interpretation is inconsistent in some respects with the stated congressional intent, and the Treasury Department could have interpreted the statute otherwise. The CDP regime was enacted by the IRS Restructuring and Reform Act of 1998, and in explaining CDP rights, the accompanying conference report referred to “[t]he taxpayer (or affected third party).”⁴ In addition, CDP levy rights are statutorily afforded to “persons,” and are neither limited to taxpayers nor to persons who originally neglected or refused to pay the tax. The term “taxpayer” is defined in IRC § 7701(a)(14) as “any person subject to any internal revenue tax,” which in this context arguably may include affected third parties, given that the IRS is seeking to collect from them.

In some affected third-party circumstances, the IRS seeks to collect from specific property (*e.g.*, encumbered property that has been transferred to a third party, whether or not as a nominee). In other cases, the IRS seeks to collect from all property of the affected third party (*e.g.*, an alter ego).⁵ In both situations, the IRS may file NFTLs that identify the affected third party and levy upon property that, under state law, belongs to the affected third party.

1 See IRC §§ 6323(f) and 6331(a).

2 IRC §§ 6320(a)(1) and 6331(d)(1). See also IRC §§ 6321, 6322, 6323(a), 6323(f), 6323(h)(6), and 6331(a). Section 6321 also refers to “any person liable to pay any tax.” A CDP lien notice will only be given to the person described in IRC § 6321 who is named on the NFTL. Treas. Reg. § 301.6320-1(a)(2) Question and Answer (Q&A)-A1. A CDP levy notice will only be given to the person described in IRC § 6331(a). Treas. Reg. § 301.6330-1(a)(3) Q&A-A1.

3 See Treas. Reg. §§ 301.6320-1(a)(2) Q&A-A7, 301.6330-1(a)(3) Q&A-A2, 301.6320-1(b)(2) Q&A-B5, and 301.6330-1(b)(2) Q&A-B5.

4 H.R. REP. NO. 105-599, at 264 (1998) (Conf. Rep.).

5 See *Oxford Capital Corp. v. U.S.*, 211 F.3d 280, 284 (5th Cir. 2000); Internal Revenue Manual 5.17.2.5.7(2), Property Held by Third Parties (Jan. 8, 2016).

Importantly, the current collection regime, including the available remedies for alleged nominees, alter egos, and persons to whom encumbered property is transferred is costly, unduly burdensome, and inefficient, and it lacks adequate procedural safeguards. First, there is no opportunity for administrative review of the IRS's underlying, and sometimes opaque, determination that a person is a nominee or alter ego of a taxpayer. Second, without CDP rights affected third parties may seek administrative relief, where available, only after the respective collection action has occurred – meaning only after the harm, which may be irreparable, has occurred.⁶ Third, the available judicial remedies are not likely to provide expeditious relief from the effect of the third-party NFTL or levy and are costly for the third parties and the government.⁷ Some third parties who cannot afford the significant expense and burden of litigation may never be able to challenge an inappropriate or unlawful collection action.

In pre-pandemic years, the IRS generally issued over 1.5 million CDP notices to taxpayers, tens of thousands of taxpayers requested CDP hearings, and over a thousand taxpayers filed CDP petitions in the U.S. Tax Court.⁸ By comparison, the IRS filed only about 1,500 nominee and 500 alter ego NFTLs annually when we last obtained data.⁹ Thus, expressly providing CDP rights to affected third parties would not impose an undue administrative burden on the IRS. Rather, it would save resources for both the government and the affected third parties by reducing litigation costs.

For these reasons, the National Taxpayer Advocate believes it is inequitable for taxpayers responsible for tax debts to receive the full protection of IRC §§ 6320 and 6330, while innocent third parties holding legal title to property subject to IRS collection actions do not receive these due process protections.

RECOMMENDATION

- Amend IRC §§ 6320 and 6330 to extend CDP rights to affected third parties who hold legal title to property subject to IRS collection actions.¹⁰

6 The third party may seek reconsideration by the IRS office collecting the tax, by requesting a Collection Appeals Program (CAP) hearing before Appeals, or by requesting assistance from the National Taxpayer Advocate. Because a CAP hearing is not a CDP hearing under IRC § 6330, any determination made as part of the CAP hearing is not subject to judicial review by the U.S. Tax Court under IRC § 6330(d)(1).

7 For example, if the IRS has filed an NFTL, the third party who holds the title is left with the option to bring an action to quiet title under 28 U.S.C. § 2410 in district court. To contest a nominee, alter ego, or transferee levy, the affected third party has to file a wrongful levy action under IRC § 7426 in district court.

8 In addition, we identified 107,359 business taxpayers that requested CDP hearings in FY 2021. IRS Compliance Data Warehouse (CDW), Business Master File Transaction History table (FY 2021); IRS CDW, Individual Master File Transaction History table (FY 2021). The total number of CDP petitions filed in the Tax Court was compiled by the IRS Office of Chief Counsel (Nov. 18, 2021). IRS, Counsel Automated Tracking System, Subtype DU. Inventory pending as of September 30, 2021. This data does not include cases on appeal. The IRS has taken fewer collection actions since the start of the COVID-19 pandemic, and CDP requests have therefore been lower over the last two years.

9 See National Taxpayer Advocate 2012 Annual Report to Congress 545, 550 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).

10 For more detail, see National Taxpayer Advocate 2012 Annual Report to Congress 544 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions*).

Legislative Recommendation #27**Extend the Time Limit for Taxpayers to Sue for Damages for Improper Collection Actions****PRESENT LAW**

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

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

REASONS FOR CHANGE

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

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

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

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

RECOMMENDATION

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

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

Legislative Recommendation #28**Direct the IRS to Implement an Automated Formula to Identify Taxpayers at Risk of Economic Hardship****PRESENT LAW**

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

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

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

REASONS FOR CHANGE

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

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

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

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

To address this problem, the TAS Research function has developed an automated algorithm that we believe can, with a high degree of accuracy, identify taxpayers whose incomes are below their ALEs. If the IRS

1 In FY 2018, TAS estimated that 39 percent of ACS taxpayers who entered into streamlined IAs had incomes at or below their ALEs. This estimate allowed two-vehicle ownership expenses for married taxpayers filing joint returns. TAS published a study on the feasibility of using an algorithm to identify taxpayers at risk of economic hardship in the National Taxpayer Advocate 2020 Annual Report to Congress. This study used a more conservative estimate of ALEs, allowing only one vehicle-ownership expense. See National Taxpayer Advocate 2020 Annual Report to Congress 249-267 (TAS Research Study: *The IRS Can Systemically Identify Taxpayers at Risk of Economic Hardship and Screen Them Before They Enter Into Installment Agreements They Cannot Afford*).

validates this formula or develops an alternative formula that is reasonably accurate, it could place a “low-income” indicator on the accounts of all taxpayers whom the formula identifies as having incomes below their ALEs.²

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

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

RECOMMENDATION

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

2 In 2018, in response to legislation that directed the IRS to waive or reimburse IA user fees for taxpayers with adjusted gross incomes at or below 250 percent of the Federal Poverty Level, the IRS developed a “Low Income Indicator” (LII). To date, however, the IRS uses the LII solely to determine user fees – not to determine a taxpayer’s eligibility for collection alternatives. In addition, although the legislation directed the IRS to determine adjusted gross income for “the most recent year for which such information is available,” the IRS is making the determination solely on the basis of the taxpayer’s most recent filed return, even if the taxpayer has not filed a return, or even had a filing requirement, in recent years. Where no return has been filed within the past two years, we recommend the IRS utilize information reporting data (e.g., Forms W-2 and 1099) to make the determination.

Legislative Recommendation #29**Revise the Private Debt Collection Rules to Eliminate the Taxpayers Intended to Be Excluded by the Taxpayer First Act****PRESENT LAW**

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

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

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

REASONS FOR CHANGE

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

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

The TFA underscored this point by directing the IRS to determine an individual’s AGI “for the most recent taxable year for which such information is available.” Using tax returns going back ten years to make current collection decisions stands the logic of collectibility determinations on its head. A taxpayer who could afford to pay tax in 2012 may not be able to do so today – and these are the cases Congress intended to exclude from assignment to PCAs. Conversely, a taxpayer who could not afford to pay tax in 2012 might have earned additional income or acquired additional assets and be able to make payments currently.

Example: A taxpayer last filed a tax return in 2012 when he earned \$60,000. In 2013, he retired due to age or disability. He did not pay his tax liability and still has a balance due. Since 2012,

1 IRC § 6306(a) & (c).

2 TFA, Pub. L. No. 116-25, § 1205, 133 Stat. 981, 989 (2019) (adding IRC § 6306(d)(3)(F)).

3 See, *e.g.*, IRC § 7122(d) (directing the Secretary, for purposes of evaluating offer-in-compromise submissions, to “develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses”).

his income has consisted solely of Social Security benefits, and he has not had a filing obligation. Under the IRS's approach, it will look at his 2012 tax return, determine his income is above 200 percent of the Federal Poverty Level, and assign his case to a PCA. Yet this is a case the TFA sought to exclude from assignment to a PCA.

By contrast, if the same taxpayer earned only \$30,000 in 2012, and third-party information reports show he earned \$100,000 in 2019, the case might not be assigned to a PCA under the IRS's approach, even though the taxpayer can make payments currently.

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

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

RECOMMENDATION

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

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

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

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