MISCELLANEOUS RECOMMENDATIONS

Legislative Recommendation #56

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

PRESENT LAW

The Earned Income Tax Credit (EITC) is a refundable credit for low- and moderate-income working individuals and families. Eligibility for the EITC and the amount of EITC a taxpayer may claim are based on a variety of factors, including the taxpayer's earned income, the number of qualifying children, and the taxpayer's filing status.[1] For tax year (TY) 2020, the EITC plateaued at $6,660 for a family of one adult with three children earning between $14,800 and $19,349.[2]

An individual must meet three primary requirements to be a taxpayer's "qualifying child" for the EITC.[3] First, the individual must have a specific blood or legal relationship to the taxpayer.[4] Second, the individual must share a residence in the United States with the taxpayer for more than half the year.[5] Third, the individual must be under the age of 19 (or under age 24 if a full-time student) or be permanently and totally disabled.[6]

Taxpayers without children may also claim the EITC.[7] Prior to 2021, the "childless" EITC was limited to taxpayers aged 25 to 64. In TY 2020, the credit plateaued at $538 for married taxpayers with no qualifying children filing jointly earning between $7,000 and $9,199, and at the same $538 amount for single taxpayers without qualifying children earning between $7,000 and $8,749. The American Rescue Plan Act of 2021 (ARPA) raised the maximum EITC from $538 to $1,502 and raised the income eligibility cap to $27,379 for married taxpayers filing jointly and to $21,429 for single taxpayers.[8] ARPA temporarily expanded the age range of childless workers eligible for the EITC to include younger adults aged 19 to 24 (excluding students under 24 attending school at least part time) and temporarily removed the upper age limit (previously age 64) for TY 2021.[9] Qualified former foster youth and qualified homeless youth also temporarily became eligible to claim the EITC at age 18.[10]

Unemployment compensation (UC),[11] while based on a taxpayer's earned income and included in adjusted gross income (AGI), is not generally included in earned income and thus does not count in computing the amount of EITC for which a taxpayer is eligible.[12]

1 IRC § 32.
2 IRS, Pub. 596, Earned Income Credit (EIC) 33-34 (Jan. 26, 2021).
3 Where there are competing claims for the same child, "tie breaker" rules prioritize the claims. IRC § 152(c)(4)(B).
4 IRC §§ 32(c)(3)(a) & 152(c)(2).
5 IRC § 32(c)(3)(c).
6 IRC §§ 32(c)(3)(A) & 152(c)(3). The individual must also have a Social Security number that is valid for employment. IRC § 32(c)(3)(D) & (m).
7 IRC § 32(c)(1)(A)(ii).
8 ARPA, Pub. L. No. 117-2, § 9621, 135 Stat. 4, 152-153 (2021) (codified in IRC § 32(n)).
9 IRC § 32(n).
10 IRC § 32(n)(1)(B)(iii).
11 IRC § 85; Treas. Reg. § 1.85-1(b)(1). Unemployment compensation generally includes any amount received under an unemployment compensation law of the United States or a state.
12 IRC § 32(c)(2); Treas. Reg. § 1.32-2(c)(2).

REASONS FOR CHANGE

Enacted in 1975, the EITC is one of the federal government's largest anti-poverty programs for low-income workers.[13] For TY 2020, taxpayers filed about 25 million returns claiming EITC benefits worth about $62 billion.[14] The EITC is considered to be an effective anti-poverty program. However, the eligibility requirements are complex, and as a result, the program suffers from a relatively high rate of improper payments that could be reduced if the eligibility requirements were simplified.[15] In addition, the EITC was enacted at a time when families with biological or legal relationships with the claimed children predominated. Modernizing the eligibility requirements to recognize non-traditional families could increase the participation rate among eligible taxpayers, allow guardians other than parents to receive benefits when they are the principal caretakers, and reduce improper payments. Finally, the credit should be made available to taxpayers who enter the workforce at age 19 and taxpayers who remain in the workforce after age 65.

Restructure the EITC as Two Credits: A Worker Credit and a Child Credit

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

Worker Credit

Much like the current EITC, the credit would phase in as a percentage of earned income, reach a plateau, and then phase out.[16] Unlike the current EITC, the credit amount would depend solely on income and would not vary based on whether the taxpayer is claiming one or more qualifying children. Increasing the worker component of the EITC would provide a greater incentive to work, which is a main objective of the credit. This structure also would target the credit to the lowest-earning taxpayers, based on AGI (a broader measure of income that includes unearned income like capital gains, dividends, rents, and royalties).[17] This would be similar to the current EITC provision that denies the credit to taxpayers with excessive investment income.[18]

This change could also substantially reduce improper payments. The IRS receives Forms W-2 and other information reporting documents directly from employers and other payors of income. For that reason, it can accurately verify income amounts for EITC recipients who are employees, by far the largest group of EITC claimants.[19]

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13 IRS, About EITC, https://www.eitc.irs.gov/eitc-central/about-eitc/about-eitc (last visited Nov. 2, 2021).

14 IRS, Statistics for Tax Returns With the Earned Income Tax Credit (EITC), https://www.eitc.irs.gov/eitc-central/statistics-for-tax-returns-with-eitc/statistics-for-tax-returns-with-the-earned-income (updated Dec. 6, 2021) (showing data as of December 2020).

15 An improper payment is defined as "any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements" and "any payment to an ineligible recipient." Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e), 124 Stat. 2224 (2010), amending Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002) (striking § 2(f) and adding § (f)(2)). For fiscal year 2019, the IRS estimates that approximately 25 percent of the total EITC program payments were improper. Treasury Inspector General for Tax Administration, Ref. No. 2020-40-025, *Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments* 2 (Apr. 30, 2020).

16 For examples regarding how to structure a per-worker credit, see Elaine Maag, *Investing in Work by Reforming the Earned Income Tax Credit* (2015).

17 Some experts caution that without a minimum wage, employers would reduce and capture the benefit of an increased EITC. *See* Austin Nichols & Jesse Rothstein, *The Earned Income Tax Credit*, Economics of Means-Tested Transfer Programs in the United States, vol. 1, at 137 (Robert A. Moffitt ed., 2016). Therefore, many proposals couple an increased childless EITC or worker credit with an increased minimum wage. *See* Isabel V. Sawhill & Quentin Karpilow, *Raising the Minimum Wage and Redesigning the EITC*, Brookings Inst. (Jan. 30, 2014), https://www.brookings.edu/research/raising-the-minimum-wage-and-redesigning-the-eitc.

18 IRC § 32(i).

19 A relatively small percentage of EITC claimants are self-employed individuals. The IRS receives somewhat less information from third-party payors with respect to self-employed individuals.

Unemployment Compensation

Taxpayers who receive UC based on their employment earnings cannot use their UC income to qualify for the EITC. The apparent rationale for not counting UC is that the EITC was designed largely to provide a work incentive. However, UC is paid exclusively to individuals who were working and became separated from their jobs due to no fault of their own. Most recently, millions of individuals who had been employed lost their jobs during the COVID-19 pandemic when certain segments of the economy, such as restaurants, hotels, and airlines, substantially reduced their workforces. In other instances, local disasters such as hurricanes adversely affect segments of the economy and lead to mass layoffs. Because UC is effectively a replacement for a portion of the wages working individuals would have earned if they had not been separated from their jobs and because UC benefits are only paid for a limited number of months, treating UC as EITC-qualifying income would maintain the nexus between working and receiving EITC.[20]

Child Credit

The child credit would be designed as a fixed amount per qualifying child, subject to an AGI phase-out, and would replace the portion of the existing EITC that is based on the number of qualifying children the taxpayer claims. This could be accomplished by retaining ARPA's changes to the Child Tax Credit (CTC) and by modernizing the definition of qualifying child. Some of ARPA's CTC changes include increasing the maximum credit amount from $2,000 to $3,000 ($3,600 for children under six), making the credit fully refundable for certain taxpayers, increasing a qualifying child's age from 17 to 18, and changing the income phase-outs.

Modernize the Definition of a Qualifying Child

The qualifying child rules of the current EITC structure may not reflect real-life living arrangements. A 2016 study by the Tax Policy Center found that the number of households made up of "traditional families" (married parents with only biological children) has declined, while alternative family types, such as families led by single parents or cohabitating adults, have increased.[21] Only 51.6 percent of children living in families with incomes at or below 200 percent of the Federal Poverty Level were in families headed by married couples. Low-income children were more likely to live with a single parent or in a multigenerational household, a cohabiting household, or a family with at least one non-biological child, as compared with higher income families.[22] Since the EITC is a credit for lower income families, its eligibility should more accurately reflect its target population.[23]

RECOMMENDATIONS

- Separate the refundable EITC into two components: a worker credit and a child credit.
- Permanently expand the expiring age eligibility for the EITC to individuals who have attained age 19 (age 18 in the case of qualified former foster youth or qualified homeless youth and age 24 for specified students), with no upper age limit.

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20 Note: we recognize an unintended consequence of UC being included in AGI is that it may diminish a taxpayer's EITC claim, and in some instances, may make taxpayers ineligible to claim the EITC.

21 Elaine Maag, H. Elizabeth Peters & Sarah Edelstein, *Increasing Family Complexity and Volatility*: *The Difficulty in Determining Child Tax Benefits* 10 (2016). *See also* National Taxpayer Advocate 2016 Annual Report to Congress 334 (Legislative Recommendation: *Tax Reform*: *Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*).

22 Elaine Maag, H. Elizabeth Peters & Sarah Edelstein, *Increasing Family Complexity and Volatility*: *The Difficulty in Determining Child Tax Benefits* 10 (2016).

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

- Amend IRC § 32(c)(2)(A)(i) to include unemployment compensation as EITC-qualifying earned income.
- Amend IRC §§ 32(c) and 24(c) to modernize the definition of a qualifying child in IRC § 152(c), to reflect evolving family units.[24]

24 Relevant considerations should include which adult performs caregiving and makes caregiving decisions for the child, including factors like who prepares meals, who transports the child to school, and who makes medical appointments for the child. For a more detailed discussion on modernizing the definition of a "qualifying child," see National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress vol. 3, at 17-19 (*Earned Income Tax Credit*: *Making the EITC Work for Taxpayers and the Government*).

Legislative Recommendation #57

Allow Taxpayers the Option of Using Prior Year Income to Claim the Earned Income Tax Credit (EITC) During Federally Declared Disasters

PRESENT LAW

The Earned Income Tax Credit (EITC) is a refundable credit for low- and moderate-income working families. Eligibility for the EITC and the amount of EITC to which a taxpayer is entitled are based on several factors, including the taxpayer's earned income, the number of qualifying children, and the taxpayer's filing status.[1] Taxpayers without qualifying children may be eligible for the "childless EITC."[2]

IRC § 165(i)(5) defines a "Federally declared disaster" as any disaster determined by the President to warrant federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, and a "disaster area" as any area so determined to warrant federal assistance.

On numerous occasions when the President has declared a disaster, Congress has passed legislation to give taxpayers who earn less income in the disaster year than the prior year the option of using their prior-year income to calculate their EITC benefits.[3] This provision is referred to as the "EITC lookback rule." Most recently, Congress authorized the EITC lookback rule for tax years 2020 and 2021 to provide relief from the COVID-19 pandemic.[4]

REASONS FOR CHANGE

In general, the EITC is designed to incentivize work, and its benefits are only available to individuals who have earned income. During major disasters like the COVID-19 pandemic or hurricanes, many employed individuals experience a disruption in work, a furlough, or a job termination. If these taxpayers have income levels that qualified them for EITC benefits, they may suffer a double financial hit. They not only lose the income from their jobs, but because they are no longer earning income, they also may lose their EITC benefits.

The EITC lookback rule is designed to provide relief to taxpayers in this circumstance. To illustrate, assume an individual who was consistently employed for several years was laid off when the COVID-19 pandemic struck in early 2020. As a result, she did not have sufficient 2020 earned income to qualify for significant EITC benefits. The EITC lookback rule provided relief by allowing her to qualify for EITC benefits on the basis of her income in 2019.

To date, Congress has authorized use of the EITC lookback rule on a disaster-by-disaster basis. This one-off approach leaves taxpayers (and the IRS) with uncertainty and means that relief is only provided in circumstances where Congress takes an affirmative act. To ensure that all individuals affected by a federally declared disaster receive relief, the National Taxpayer Advocate recommends that Congress revise IRC § 32 to

1 IRC § 32.

2 *Id.*

3 *See, e.g.*, American Rescue Plan Act, Pub. L. No. 117-2, § 9626, 135 Stat. 4, 157 (2021); Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, § 211, Div. EE, Title II (2020); Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63, § 504, 131 Stat. 1168, 1183 (2017); Heartland Disaster Tax Relief of 2008, Pub. L. No. 110-343, Div. C, Title VII, Subtitle A, § 701, 122 Stat. 3765, 3912 (2008); Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, Title IV, § 406, 119 Stat. 2016, 2028 (2005).

4 *Id.*

permanently provide this election to all taxpayers who are affected by a federally declared disaster as defined by IRC § 165(i)(5).

RECOMMENDATION

- Amend IRC § 32 to allow taxpayers who are affected by a federally declared disaster as defined by IRC § 165(i)(5) to elect the use of their prior year's earned income to calculate and claim the EITC.[5]

5 For legislative language generally consistent with this recommendation, see COVID-19 Earned Income Act, S. 3542 & H.R. 6762, 116th Cong. (2020), except that our recommendation is to make relief permanent rather than specific to a single tax year.

Legislative Recommendation #58

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

PRESENT LAW

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

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

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

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

REASONS FOR CHANGE

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

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

Prior to the TCJA amendment, IRC § 24 only required a taxpayer claiming a child as a qualifying child for the CTC to provide a taxpayer identification number (TIN) for the child. The IRS provided administrative relief to allow the credit to a taxpayer without a TIN for a qualifying child due to the taxpayer's deeply held religious beliefs. Specifically, taxpayers whose qualifying children did not have an SSN or other TIN due to the taxpayers' deeply held religious beliefs were allowed the credit if the taxpayers indicated on their tax returns that they have an approved Form 4029 establishing that they had met the requirements under IRC § 1402(g).

In certain circumstances, the IRS would request additional information from the taxpayer to prove the age, relationship, and residence of the child. Further, the language in the CTC prior to the TCJA permitted the

1 TCJA, Pub. L. No. 115-97, § 11022(a), 131 Stat. 2054, 2073-2074 (2017) (codified at IRC § 24(h)(7)).
2 IRC § 1402(g).

IRS to allow the credit for taxpayers whose children only had Adoption Taxpayer Identification Numbers (ATINs), which are tax identification numbers issued for use while waiting to receive SSNs for the adopted children. Now, the IRS is no longer providing administrative relief to allow the CTC if a qualifying child lacks an SSN, unless the taxpayer's child was born and died in the same or consecutive tax years.[3]

The National Taxpayer Advocate believes that the affected taxpayer populations are being treated unjustly because the TCJA language did not provide an exception to the SSN requirement for qualifying children for these specific groups, thereby denying them the CTC to which they are otherwise entitled.

RECOMMENDATION

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

3 The IRS Office of Chief Counsel has opined that the IRS is legally prohibited from allowing the CTC with respect to a child who lacks an SSN because of religious or conscience-based objections. *See* Program Manager Technical Advice (PMTA), Administration of the Child Tax Credit for Objectors to Social Security Numbers, POSTS-117474-18, PMTA 2019-2 (Mar. 29, 2019). For an in-depth discussion regarding TAS's disagreement with this advice, see *The Tax Filing Season*: *Hearing Before the H. Subcomm. on Government Oversight of the H. Comm. on Ways and Means*, 116th Cong. 22-27 (2019) (testimony of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress 48 (Area of Focus: *TAS Will Urge the IRS to Reconsider Its Position on the Application of the Religious Freedom Restoration Act to the Social Security Requirement Under IRC § 24(h)(7), Which Has the Effect of Denying Child Tax Credit Benefits to the Amish and Certain Other Religious Groups*); Nina E. Olson, *The IRS's Position on the Application of the Religious Freedom Restoration Act to the Social Security Requirement Under Internal Revenue Code § 24(h)(7) Has the Effect of Denying Child Tax Credit Benefits to the Amish and Certain Other Religious Groups*, National Taxpayer Advocate Blog (June 26, 2019), https://www.taxpayeradvocate.irs.gov/news/ntablog-the-second-circuit-in-borenstein-helped-to-close-the-gap-in-the-tax-courts-refund-jurisdiction-but-only-for-taxpayers-in-that-circuit/. *See also* Internal Revenue Manual 3.12.3.26.17.6, TIN Requirements (EC 287) (Apr. 15, 2020).

Legislative Recommendation #59

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

PRESENT LAW

IRC § 24 authorizes a Child Tax Credit (CTC) of up to $2,000 per "qualifying child," of which up to $1,400 is refundable.[1] The Tax Cuts and Jobs Act (TCJA) added a new provision to IRC § 24 that allows a nonrefundable credit of $500 for each "dependent" who is not a "qualifying child."[2] This nonrefundable credit is referred to as the credit for other dependents (ODC).[3]

IRC § 24(e) provides that a "qualifying child" must have a Taxpayer Identification Number (TIN) to be claimed under this section. IRC § 24(h)(7) further provides that the qualifying child's TIN must be a Social Security number (SSN) valid for employment in the United States.

Under IRC § 24(h)(4), the ODC is available for a "dependent of the taxpayer (as defined in section 152)." There is no requirement in IRC § 152 that to be a "dependent," an individual must have a TIN (either an SSN or an Individual Taxpayer Identification Number (ITIN)). IRC § 24 specifically provides that where a qualifying child's lack of an SSN prevents a taxpayer from claiming the CTC for that child, the taxpayer may receive the ODC for that child.[4]

REASONS FOR CHANGE

Despite the absence of a TIN requirement in the statute, the IRS has instructed taxpayers that to claim a dependent for the ODC, the dependent must have a TIN.[5] The IRS has used its summary assessment authority to disallow the ODC claimed by over 118,000 taxpayers on their 2019 returns because their dependents did not have TINs.[6]

In response to TAS's inquiry, the IRS Office of Chief Counsel explained its legal rationale as follows: "[I]n order to avoid treating dependents for whom a taxpayer may claim a credit under section 24(h)(4)(A) [*i.e.*, the ODC] inconsistently, section 24(e)(1) [which imposes a TIN requirement for claiming a "qualifying child" for a credit under section 24] should be interpreted as applying to all dependents for whom a taxpayer claims

1 The American Rescue Plan Act, Pub. L. No. 117-2, § 9611, 135 Stat. 4, 359-376 (2021) makes this credit fully refundable and, for tax year 2021, increases it to $3,000 for children under 18 and to $3,600 for children under six.

2 Tax Cuts and Jobs Act (TCJA), Pub. L. 115-97, § 11022, 131 Stat. 2054, 2073 (2017), adding IRC § 24(h)(4), applicable to taxable years beginning after Dec. 31, 2017, and before Jan. 1, 2026.

3 IRC § 24(h)(4).

4 IRC § 24(h)(4)(C).

5 *See, e.g.*, IRS Pub. 972, Child Tax Credit and Credit for Other Dependents 2 (Jan. 11, 2021). *See also* IRS Form 1040 and 1040-SR Instructions 20 (Apr. 13, 2021).

6 We presume that the IRS exercised its summary assessment authority in reliance on IRC § 6213(g)(2)(I), which includes in the definition of "mathematical or clerical error" "an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return." Over 118,000 taxpayers were issued summary assessment notices, removing 102,146 dependents with respect to whom the ODC had been claimed because the dependents had invalid or missing TINs. (The 118,000 taxpayers include both primary and secondary taxpayers on married filing joint returns, and correspond to 70,248 tax returns.) IRS, Compliance Data Warehouse, Individual Master File Individual Returns Transaction File (IRTF) Form 1040 and Entity tables, TY 2019, returns posted by cycle 202134. If $500 of ODC was claimed with respect to each dependent, then the total amount of disallowed ODC would be over $51 million (*i.e.*, 102,146 times $500).

a credit under section 24(h)(4)(A), not only a qualifying child described in section 24(h)(4)(C) [*i.e.*, who is a "qualifying child" but lacks the SSN required by section 24(h)(7)]."[7]

It is a basic canon of statutory construction that the plain language of a statute controls absent a clearly expressed legislative intent to the contrary.[8] Here, there is no statutory requirement that a dependent have a TIN to be claimed for the ODC. The IRS Office of Chief Counsel (OCC) appears to have imposed the requirement on its own, likely to deter fraudulent claims. The TCJA legislative history suggests Congress considered a TIN requirement and did not adopt it. The House version of the TCJA included a requirement that a dependent have a TIN for purposes of the ODC but the subsequent Senate version of the TCJA did not, and the enacted bill followed the Senate approach.[9] It is possible that a drafting error was made, but if so, Congress – not the IRS – should fix it.[10]

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

RECOMMENDATIONS

- Clarify whether a dependent with respect to whom a taxpayer claims the ODC under IRC § 24(h)(4) is required to have a taxpayer identification number.
- If a dependent with respect to whom a taxpayer claims the ODC is required to have a taxpayer identification number, clarify the type of taxpayer identification number required.

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

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

9 *See* H.R. Conf. Rep. No. 115-466, at 225-227 (Dec. 15, 2017), https://www.congress.gov/115/crpt/hrpt466/CRPT-115hrpt466.pdf.

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

Legislative Recommendation #60

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

PRESENT LAW

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

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

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

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

Congress subsequently enacted IRC § 3127 to exempt employers from paying their portion of FICA tax under IRC § 3111, provided that both the employer and the employee are members of a recognized religious sect, both the employer and the employee are adherents of established tenets or teachings of the sect, and both the employer and employee file and receive approval for exemption from their respective portions of FICA tax.[2] The employer and employee each may receive approval by filing IRS Form 4029.[3]

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

REASONS FOR CHANGE

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

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

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

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

Amish workers and Amish employees of Amish employers, as the law provides, applies equally to Amish employees who work for non-Amish employers.[4]

This inequity can be resolved by amending IRC § 6413 to allow employees who are members of a recognized religious group and work for an employer who is *not* a member of a recognized religious group to file a refund claim for their portion of remitted FICA tax. Amish leaders have expressed a preference for allowing Amish employees of non-Amish employers to recover the employee's portion of the FICA tax through a refund claim, rather than by exempting the employee from paying the FICA tax, to avoid imposing an additional recordkeeping burden on employers.[5]

RECOMMENDATION

- Amend IRC § 6413 to allow employees who meet the definition of "a member of a recognized religious sect or division thereof" in IRC § 1402(g) to claim a credit or refund of the employee's portion of FICA taxes withheld from their wages.[6]

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

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

6 For legislative language generally consistent with this recommendation, see Religious Exemptions for Social Security and Healthcare Taxes Act, H.R. 6183, 117th Cong. (2021).

Legislative Recommendation #61

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

PRESENT LAW

IRC § 36B, enacted as part of the Patient Protection and Affordable Care Act, provides a tax credit to certain taxpayers to help them purchase health insurance through a Health Insurance Marketplace (*i.e.*, the Exchange).[1] For years other than 2021 and 2022,[2] this credit, known as the "premium tax credit" (PTC), is only available to taxpayers with household incomes between 100 percent and 400 percent of the Federal Poverty Level.[3] It does not make any accommodation for taxpayers who receive a one-time lump-sum payment of Social Security benefits.

Eligible taxpayers can choose to have advance payments of the PTC (referred to as APTC) in monthly amounts paid directly to the taxpayer's insurance provider. The amount of APTC for which a taxpayer is eligible is based in part on the taxpayer's anticipated household income for the year.[4] The taxpayer must "reconcile" on his or her tax return the amount of APTC paid on his or her behalf with the amount of PTC that the taxpayer is allowed for the year of coverage.[5] If the APTC paid exceeds the PTC allowed, the taxpayer will incur a tax liability equal to the excess APTC amount, subject to a limitation for taxpayers with household incomes under 400 percent of the Federal Poverty Level.[6] If a taxpayer's household income exceeds 400 percent of the Federal Poverty Level, the taxpayer generally must increase his or her tax liability by the full APTC amount paid on the taxpayer's behalf.

When individuals apply for Social Security disability benefits, they may not receive a determination from the Social Security Administration (SSA) for one or more years. Consequently, the SSA may issue a substantial lump-sum award retroactive to the date the application was filed. A portion of these benefits may be taxable. To compute the taxable portion of the lump-sum award in the year the SSA makes the payment, the taxpayer has the option of (i) calculating the taxable amount of the lump-sum payment using the general rules of IRC § 86, which base the taxability of Social Security payments on the taxpayer's income for the year of receipt of the payment or (ii) making an election under IRC § 86(e) to allocate the lump-sum payment over the period of years the payment covers and calculating the taxable portion of the payment based on the taxpayer's income for those years.

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

1 Congress enacted the Patient Protection and Affordable Care Act (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010), to "improve access to and the delivery of health care services for all individuals, particularly low income, underserved, uninsured, minority, health disparity, and rural populations." § 5001, 124 Stat. 588.

2 Section 9661 of the American Rescue Plan Act of 2021 (ARPA), Pub. L. No. 117-2, 135 Stat. 4, 182-83 (2021), allows taxpayers with household incomes over 400 percent of the Federal Poverty Level to be eligible for a PTC, but only for tax years beginning in 2021 and 2022.

3 IRC § 36B(c)(1); Treas. Reg. § 1.36B-2(b)(1). The Federal Poverty Level is defined by the Office of Management and Budget and is updated annually by the Secretary of Health and Human Services. *See*, *e.g.*, 86 Fed. Reg. 7732 (Feb. 1, 2021).

4 Household income is the sum of the taxpayer's modified adjusted gross income (MAGI), the MAGI of the taxpayer's spouse if a joint return is filed, and the MAGI of the taxpayer's dependents required to file a federal income tax return under IRC § 1. *See* IRC § 36B(d)(2).

5 IRC § 36B(f).

6 *But cf.*, section 9662 of the ARPA, which suspends the requirement to increase tax liability for excess APTC for tax years beginning in 2020. Pub. L. No. 117-2, 135 Stat. 4, 183 (2021).

award in the year of receipt,[7] even if a portion of that award would be excludable from gross income under IRC § 86. This one-time lump-sum payment increases the taxpayer's MAGI for that year only and may push household income over 400 percent of the Federal Poverty Level, regardless of whether any portion of the Social Security benefits relates to prior years or whether the benefits are includible in income in the year of receipt.

REASONS FOR CHANGE

A taxpayer cannot control the SSA's application review process to plan for the month – or year – in which the SSA will issue the benefit award and potentially impact the APTC helping the taxpayer maintain health insurance. Consequently, the taxpayer's household income in the year of the award will be artificially inflated when compared to prior and subsequent years due to the delay in the benefit award. For example, assume a low-income taxpayer without other income applied for Social Security benefits that would pay her $17,500 a year. If the SSA approved the application immediately, the taxpayer would receive annual benefits of $17,500 and could continue to qualify for the PTC in all years. However, if the SSA approved the application two years later, the taxpayer could receive a lump-sum payment of $52,500 in the third year ($17,500 benefits multiplied by two years of SSA evaluation plus $17,500 in the award year), which would result in household income over 400 percent of the Federal Poverty Level, thus rendering her ineligible for the PTC in that year and potentially requiring her to increase her tax liability by the amount of APTC already paid on her behalf in that year.[8]

The PTC and APTC are benefits designed for low- and moderate-income individuals to assist with health insurance premium payments. The impact of receiving Social Security benefits in a lump sum can be so harsh as to not only eliminate the value of this assistance in a given year but also to create a substantial tax liability.[9] Just as IRC § 86(e) gives taxpayers who receive lump-sum Social Security payments covering multiple years the option of computing their income for the year of the lump-sum payment by, in effect, treating the payment as having been received in the years to which the payment relates, the National Taxpayer Advocate recommends adjusting the calculation of MAGI to exclude any portion of a lump-sum Social Security benefits payment attributable to a prior year for purposes of determining the amount of PTC for which they are eligible.

RECOMMENDATION

- Amend IRC § 36B(d)(2) to exclude from MAGI any portion of a lump-sum Social Security benefits payment attributable to a prior year pursuant to IRC § 86 for purposes of determining whether a taxpayer is eligible for a PTC and, if eligible, the amount of PTC allowed.[10]

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7 TAS Research estimates that nearly 288,000 taxpayers were impacted by this lump-sum consequence in tax year 2019, which would have resulted in their disqualification for PTC. IRS, Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File.

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

9 While this legislative recommendation focuses on the interaction between the PTC/APTC and Social Security benefits, we suggest considering the framework we present here for taxpayers who may experience the same financial impact when receiving other one-time lump-sum payments, such as Railroad Retirement Board (RRB) benefits.

10 For legislative language generally consistent with this recommendation, see Build Back Better Act, H.R. 5376, 117th Cong. § 137303 (as passed by the U.S. House of Representatives, Nov. 19, 2021).

Legislative Recommendation #62

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

PRESENT LAW

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

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

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

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

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

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

IRC § 7701(a)(15) defines the terms "military or naval forces of the United States" and "Armed Forces of the United States" to include "all regular and reserve components of the uniformed services which are subject to the jurisdiction of the Secretary of Defense, the Secretary of the Army, the Secretary of the Navy, or the Secretary of the Air Force [as well as] the Coast Guard."

1 Pub. L. No. 114-292, 130 Stat. 1500 (2016).

REASONS FOR CHANGE

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

It seems likely that omitting the Coast Guard from the DSP tax relief provision resulted from a drafting error. Like members of the services within the Department of Defense, members of the Coast Guard often face perilous circumstances and potential injuries as they perform their mandated duties. For example, the Coast Guard maintains a "state of readiness to assist in the defense of the United States, including when functioning as a specialized service in the Navy pursuant to [14 USC] section 103."[2] There is no reason Coast Guard veterans should not be provided the same additional time to file a claim for credit or refund as other veterans of the "military or naval forces of the United States." While the number of veterans affected by this issue is relatively limited,[3] the National Taxpayer Advocate believes fairness and parity in treatment among the armed forces of the United States require that this apparent drafting error be corrected.

RECOMMENDATION

- Amend Section 3(a) of the Combat-Injured Veterans Tax Fairness Act of 2016 to provide that the severance payments specified under Section 3(a) include those paid by the Secretary of Homeland Security (or predecessor) and to require the Secretary of Homeland Security to notify veterans of the Coast Guard about disability severance pay from which taxes were withheld.[4]

2 14 U.S.C. § 102.

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

4 For legislative language generally consistent with this recommendation, see Coast Guard Combat-Injured Tax Fairness Act, H.R. 3739, 117th Cong. § 2 (2021).

Legislative Recommendation #63

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

PRESENT LAW

IRC Chapter 24, Collection of Income Tax at Source on Wages, provides for required withholding of taxes on wages paid to employees, certain gambling winnings, certain pensions and annuities, amounts subject to backup withholding, and certain other payments. In addition, IRC § 3402(p) provides for voluntary withholding at the option of the income recipient on certain payments such as Social Security benefits, unemployment benefits, and certain other benefits.[1] IRC § 3402(p)(3) authorizes the Secretary to promulgate regulations to provide for withholding from any payment that does not constitute wages if the Secretary finds withholding would be appropriate and the payor and recipient of the payment agree to such withholding.[2]

Although the Secretary may issue guidance by publication in the Internal Revenue Bulletin describing payments for which withholding under a voluntary withholding agreement would be appropriate,[3] the only such guidance issued to date is Notice 2013-77, dealing with dividends and other distributions by Alaska Native Corporations.[4]

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

REASONS FOR CHANGE

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

The absence of withholding on payments to independent contractors also has a negative impact on revenue collection. IRS National Research Program studies show that tax compliance is substantially lower among workers whose income taxes are not withheld.[5]

This problem may be increasing as more workers are working in the so-called "gig economy." In fact, as of 2021 there were about 50 million U.S. workers participating in the gig economy.[6] To reduce the risk they will not save enough money to pay their taxes, some independent contractors would prefer that taxes be withheld throughout the year, as they are for employees. There is a legitimate debate about the circumstances under

1 IRC § 3402(p)(1)(C) & (p)(2).

2 IRC § 3402(p)(3) authorizes the promulgation of regulations for withholding from (i) an employee's remuneration for services that do not constitute wages and (ii) any other agreed-upon source that the Secretary finds appropriate. The Secretary must find the withholding would be appropriate "under the provisions of [IRC chapter 24, Collection of Income Tax at Source on Wages]." Payments made when a voluntary withholding agreement is in effect are treated as if they are wages paid by an employer to an employee for purposes of the income tax withholding provisions and related procedural provisions of subtitle F of the IRC.

3 *See* Treas. Reg. § 31.3402(p)-1(c).

4 Notice 2013-77, 2013-50 I.R.B. 632.

5 Government Accountability Office, GAO-17-371, *Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates* (Apr. 18, 2017), https://www.gao.gov/products/GAO-17-371.

6 Statista, *Gig Economy in the U.S. – Statistics & Facts* (Jan. 21, 2021), https://www.statista.com/topics/4891/gig-economy-in-the-us/.

which withholding should be required. However, the National Taxpayer Advocate believes the law should not discourage workers and businesses from entering into voluntary withholding agreements when both parties wish to do so.

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

RECOMMENDATIONS

- Amend IRC § 3402(p) to clarify that when voluntary withholding agreements are entered into by parties who do not treat themselves as engaged in an employer-employee relationship, the IRS may not consider the existence of such agreements as a factor when challenging worker classification arrangements.
- Direct the Secretary to evaluate the benefits of agreeing not to challenge worker classification arrangements when voluntary withholding agreements are in place.[7]

7 For legislative language generally consistent with this recommendation, see Small Business Owners' Tax Simplification Act, H.R. 3717, 115th Cong. § 9 (2017).

Legislative Recommendation #64

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

PRESENT LAW

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

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

REASONS FOR CHANGE

The TPC notice requirement was enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98). The Senate report accompanying the bill explained that "taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties."[1] The House-Senate conference report accompanying RRA 98 stated that "in general" the TPC notice "will be provided as part of an existing IRS notice."[2] Based on the conference report, the IRS implemented the TPC notice requirement by including generic language in Publication 1, Your Rights as a Taxpayer, which the IRS sends to taxpayers in a variety of circumstances whether or not it plans to make a TPC.[3]

When Congress enacted the Taxpayer First Act (TFA), it rejected the generic approach of including the TPC language in Publication 1. The TFA amended IRC § 7602(c) to require the IRS to send the TPC notice only when it intends to make a TPC and to send the TPC notice at least 45 days before making the contact.[4] In explaining the change, the House report accompanying the TFA quoted testimony from a former IRS official who said the then-existing TPC notice requirement was "useless and does not effectively apprise taxpayers that such contact will be made, to whom it will be made, or that the taxpayer can request a third party contact report from the IRS."[5] The House report said TPCs "may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community." It also said the change would "provide taxpayers more of an opportunity to resolve issues and volunteer information before the IRS contacts third parties."

If the TPC notices were included "as part of an existing IRS notice" such as Form 4564, Information Document Request, which requests information from the taxpayer, then the new 45-day period would give the taxpayer a realistic opportunity to avoid a TPC that seeks new information by providing the information

1 S. Rep. No. 105-174, at 77 (1998).
2 H.R. Rep. No. 105-599, at 277 (1998) (Conf. Rep.).
3 IRS Pub. 1, Your Rights as a Taxpayer (Sept. 2017). Under the heading "Potential Third Party Contacts," Pub. 1 states, in part: "[W]e sometimes talk with other persons if we need information that you have been unable to provide or to verify information we have received."
4 Pub. L. No. 116-25, § 1206, 133 Stat. 981, 990 (2019).
5 H.R. Rep. No. 116-39, pt. 1, at 44-45 (2019). This report accompanied H.R. 1957, 116th Cong. (2019). Congress ultimately made one change to H.R. 1957 unrelated to the TPC provision and enacted the TFA as H.R. 3151, 116th Cong. (2019). However, H.R. Rep. No. 116-39 remains the sole committee report explaining the TFA.

requested on the form. However, the IRS generally does not include a request for that information with the TPC notice.[6]

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

RECOMMENDATION

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

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

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

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

9 IRS, Pub. 1, Your Rights as a Taxpayer (Sept. 2017).

Legislative Recommendation #65

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

PRESENT LAW

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

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

REASONS FOR CHANGE

IRC § 6713 has historically been identified as the civil counterpart to the criminal penalty imposed on tax return preparers under IRC § 7216. As one would expect, the criminal penalty under IRC § 7216 is substantially harsher than the civil penalty under IRC § 6713.[1] For that reason, the Treasury Department is understandably reluctant to subject preparers to criminal sanctions except for egregious conduct, so it has used its regulatory authority to carve out broad exceptions from the general prohibition on the disclosure or use of tax return information set forth in IRC § 7216.[2]

Because the exceptions under IRC § 7216 (criminal statute) are deemed to apply to IRC § 6713 (civil statute), there is no room for the Treasury Department and the IRS to designate the disclosure or use of tax return information due to negligence or for certain questionable business practices or the sale of certain products with high abuse potential as civil violations without also making them criminal violations. Therefore, if a prohibited disclosure or use is not egregious in nature (*e.g.*, negligent noncompliance with form-and-content requirements for taxpayer consents), it is generally tolerated. The Treasury Department and the IRS will be more likely to strengthen taxpayer protections against the improper disclosure or use of taxpayer return information by return preparers if they are given the flexibility to promulgate separate regulations applicable to the civil penalty, without concern that the criminal penalty will also apply.[3]

RECOMMENDATION

- Amend IRC § 6713 to authorize the Secretary to prescribe regulations under IRC § 6713.

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

2 *See* Treas. Reg. § 301.7216-2.

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

Legislative Recommendation #66

Expand the Protection of Taxpayer Rights by Strengthening the Low Income Taxpayer Clinic Program

PRESENT LAW

IRC § 7526 authorizes the Secretary, subject to the availability of appropriated funds, to provide grants as matching funds for the development, expansion, or continuation of Low Income Taxpayer Clinics (LITCs). The LITC program was authorized as part of the IRS Restructuring and Reform Act of 1998 to provide free or nominal-cost representation of low-income taxpayers who are involved in controversies with the IRS and to provide education about taxpayer rights and responsibilities in multiple languages for taxpayers who speak English as a second language (ESL taxpayers).

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

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

IRC § 7526(c)(5) limits the amount of federal LITC funding a clinic may receive to the amount it raises from other sources (*i.e.*, a 100 percent matching funds requirement). The match may be in cash or third party in-kind contributions (*e.g.*, volunteer time, donated supplies).

REASONS FOR CHANGE

The LITC program is an effective and low-cost means to assist low-income and ESL taxpayers. In 2021, the LITC Program Office awarded grants to 130 organizations in 47 states and the District of Columbia.[1] In 2020, the most recent year for which complete data is available, clinics receiving grant funds represented nearly 20,000 taxpayers dealing with an IRS tax controversy, including in cases before the U.S. Tax Court. They provided consultations or advice to an additional 18,000 taxpayers. The clinics work closely with the Tax Court and the IRS Office of Chief Counsel to resolve docketed cases on a pre-trial basis where possible. They helped taxpayers secure more than $5.8 million in tax refunds and reduced or corrected taxpayers' liabilities by more than $116 million. They also brought thousands of taxpayers back into filing and payment compliance, and helped ensure that individuals understood their rights and responsibilities as U.S. taxpayers by conducting more than 1,000 educational activities that were attended by nearly 134,000 individuals.[2]

The success of the LITC program is tied largely to the extensive use of volunteers. Some 1,500 volunteers contributed to the success of LITCs by volunteering over 42,000 hours of their time. More than 65 percent of the volunteers were attorneys, certified public accountants, or enrolled agents.[3]

There are many underserved low-income taxpayers across the nation that could benefit from LITC assistance, but IRC § 7526 contains restrictions that limit expansion of the LITC program to assist additional taxpayers. First, the annual limitation on grants to a single clinic of $100,000, which has remained unchanged since 1998, prevents the LITC Program Office from awarding additional funds to qualified clinics that have demonstrated excellence in assisting low-income and ESL taxpayers and the ability to efficiently handle more cases. Even if the restriction were to be retained, the $100,000 cap enacted in 1998 would have to be

1 *See* IRS Pub. 4134, Low Income Taxpayer Clinic List (July 2021).
2 *See* IRS Pub. 5066, Low Income Taxpayer Clinics 2021 Program Report 4 (revised Nov. 2021), https://www.irs.gov/pub/irs-pdf/p5066.pdf.
3 *Id*. at 14.

raised to about $170,000 simply to reflect the effects of inflation.[4] However, the LITC Program Office could ensure more taxpayers receive LITC services if it is given discretion to provide larger grants to clinics that demonstrate they can use funds productively, consistent with the objective of providing maximum geographic coverage to taxpayers across the United States. In 2019, Congress authorized an analogous program, the Volunteer Income Tax Assistance (VITA) matching grant program, which provides free tax return preparation for individuals with low to moderate incomes (*i.e.*, below the maximum EITC threshold), individuals with disabilities, and individuals with limited English proficiency.[5] In doing so, it did not impose a per-program grant limitation. We recommend that the per-clinic limitation in the LITC statute be similarly removed.

Second, the 100 percent matching funds requirement may serve as a barrier to coverage. The purpose of the match requirement is to ensure that each clinic's management has a broad commitment to serving taxpayers and solicits resources to further that objective. In general, strong clinics do not have difficulty meeting the requirement, and we believe the match requirement generally should be retained. In limited circumstances, however, resources to meet the match requirement may be limited, and taxpayers would be better served if the LITC Program Office is given the discretion to reduce it (but not below 50 percent). The LITC Program Office has encountered difficulty identifying and funding clinics in certain geographic areas, and a lower match requirement may make it economically feasible for other potential clinics to operate. If our recommendation to eliminate the $100,000 per-clinic funding cap is adopted, clinics that can meet the 100 percent matching funds requirement when receiving grants of $100,000 may have difficulty raising funds in excess of $100,000 on a 1:1 basis. Thus, clinics awarded grants in excess of $100,000 should not be held to the same 100 percent matching funds requirement, and the LITC Program Office should be authorized to exercise limited discretion in setting an appropriate matching rate.

Third, the LITC statute, written in 1998, authorizes the program at a funding level of up to $6 million "[u]nless otherwise provided by specific appropriation." In practice, the $6 million authorization has not had an impact because the program is routinely funded by specific appropriation. The current appropriation is for $13 million.[6] However, raising the authorized appropriation level would make a statement of congressional support regarding the success of the program and the importance of providing representation for low-income taxpayers and education and outreach for ESL taxpayers.

RECOMMENDATIONS

- Eliminate the $100,000 per-clinic funding cap imposed under current law by removing subsection (2) from IRC § 7526(c) and renumbering subsequent subsections accordingly.
- Amend IRC § 7526(c)(5) to provide that the 100 percent "matching funds" requirement is the general rule but that the Secretary has the discretion to set a lesser matching rate (but not below 50 percent) where doing so would expand coverage to additional taxpayers.
- Raise the overall authorized LITC program funding limitation from $6 million to $25 million in IRC § 7526(c)(1) and provide that the amount is to be increased annually by the percentage increase during the preceding calendar year in the Chained Consumer Price Index for All Urban Consumers (as published by the Bureau of Labor Statistics of the Department of Labor).

4 *See* Bureau of Labor Statistics, CPI Inflation Calculator, https://www.bls.gov/data/inflation_calculator.htm (last visited Nov. 24, 2021).
5 *See* IRC § 7526A (generally modeled after the IRC § 7526 LITC statute).
6 Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, 134 Stat. 1182, 1385 (2020).

Legislative Recommendation #67

Compensate Taxpayers for "No Change" National Research Program Audits

PRESENT LAW

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

REASONS FOR CHANGE

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

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

In 1995, the House Ways and Means Subcommittee on Oversight held a hearing on the NRP's predecessor, the Taxpayer Compliance Measurement Program (TCMP).[1] Testimony provided during the hearing, and subsequent witness responses to questions-for-the-record, indicated that TCMP audits imposed a heavy burden on taxpayers and reflected a strong view that audited taxpayers were bearing the brunt of a research project intended to benefit the tax system as a whole. Proposals raised at the hearing included compensating taxpayers selected for TCMP audits as well as possibly waiving tax, interest, and penalties assessed during the audits.

Following the hearing, the House Budget Committee included a proposal in its 1995 budget reconciliation bill to compensate individual taxpayers by providing a tax credit of up to $3,000 for TCMP-related expenses.[2] Ultimately, this proposal was not adopted. Instead, the IRS was pressured to stop conducting TCMP audits. The inability to perform regular TCMP audits, however, undermined effective tax administration because it prevented the IRS from updating its audit formulas. Using older formulas likely meant that more compliant taxpayers faced (unproductive) audits and that audit revenue declined.

About a decade later, the IRS reinstated the TCMP under the new NRP name. Some procedures were changed, but the random selection of taxpayers and the burden on many of these taxpayers remained substantially unchanged. For the same reasons identified during the 1995 House hearing, the National Taxpayer Advocate believes it is appropriate to recognize that taxpayers audited under the NRP are bearing a heavy burden to help the IRS improve the effectiveness of its compliance activities. A tax credit or authorized payment would alleviate the monetary component of the burden. Further relief could be provided by waiving any assessment of tax, interest, and penalties resulting from an NRP audit. Such a waiver might also improve

1 *Taxpayer Compliance Measurement Program, Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 104th Cong. (1995).

2 *See* H.R. Rep. No. 104-280, vol. 2, at 28 (1995).

the accuracy of the NRP audits, as taxpayers might be more likely to be forthcoming with an auditor if they were assured they would not face additional assessments. However, this waiver should not apply where tax fraud or an intent to evade tax is uncovered in an NRP audit.

RECOMMENDATIONS

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

Legislative Recommendation #68

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

PRESENT LAW

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

REASONS FOR CHANGE

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

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

Numerous offices of history operate in the executive, judicial, and legislative branches.[5] Government historians serve various roles, such as researching and writing for publication and internal use, editing historical documents, preserving historical sites and artifacts, and providing historical information to the public through websites and other media.[6] Historians should be objective and accurate.[7] For example, the Historian of the Department of State is required to publish a documentary history of the foreign policy decisions and actions of the United States, including facts providing support for, and alternative views to, policy positions ultimately adopted, without omitting or concealing defects in policy.[8] Historians in federal agencies serve an important role, and because more U.S. citizens interact with the IRS than any other federal agency, the public interest and potential benefit in learning from the agency's successes and failures are high.

RECOMMENDATION

- Add a new subsection to IRC § 7803 to establish the position of IRS historian within the IRS. The IRS historian should have expertise in federal taxation and archival methods, be appointed by the Secretary

1 44 U.S.C. §§ 3101-3107.

2 5 U.S.C. § 552.

3 See, *e.g.*, 22 U.S.C. § 4351(a), which states in pertinent part: "Volumes of this publication [Foreign Relations of the United States historical series] shall include *all records* needed to provide a comprehensive documentation of the major foreign policy decisions and actions of the United States Government, including the facts which contributed to the formulation of policies and records providing supporting and alternative views to the policy position ultimately adopted" (emphasis added).

4 *See Practices & Procedures of the Internal Revenue Service*: *Hearings Before the S. Comm. on Finance*, 105th Cong. 35 (Sept. 23-25, 1997) (statement of Shelley Davis, former IRS Historian).

5 Society for History in the Federal Government, *History at the Federal Government*, http://www.shfg.org/history-at-fedgov (last visited Sept. 28, 2021).

6 Society for History in the Federal Government, *Historical Programs in the Federal Government*: *A Guide* (1992), http://www.shfg.org/resources/Documents/Historical%20Programs.pdf.

7 *Id*.

8 22 U.S.C. § 4351(a).

of the Treasury in consultation with the Archivist of the United States, and report to the Commissioner of Internal Revenue. The duties of the IRS historian require access to IRS records, including tax returns and return information (subject to the confidentiality and disclosure provisions of IRC § 6103). The IRS historian should be required to report IRS history objectively and accurately, without omitting or concealing defects in policy.[9]

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