

# NATIONAL TAXPAYER ADVOCATE 2022 PURPLE BOOK: COMPILATION OF LEGISLATIVE RECOMMENDATIONS TO STRENGTHEN TAXPAYER RIGHTS AND IMPROVE TAX ADMINISTRATION

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## INTRODUCTION

Section 7803(c)(2)(B)(ii)(IX) of the IRC requires the National Taxpayer Advocate, as part of the annual report to Congress, to propose legislative recommendations to resolve problems encountered by taxpayers. This year, we present 68 legislative recommendations.

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

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

By our count, Congress has enacted approximately 50 legislative recommendations that the National Taxpayer Advocate has proposed. See Appendix 2 for a complete listing. That total includes approximately 23 provisions that were included as part of the Taxpayer First Act.<sup>1</sup>

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

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

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<sup>1</sup> Taxpayer First Act, Pub. L. No. 116-25, 133 Stat. 981 (2019). We say Congress enacted "approximately" a certain number of National Taxpayer Advocate recommendations because in some cases, enacted provisions are substantially similar to what we recommended but are not identical. The statement that Congress enacted a National Taxpayer Advocate recommendation is not intended to imply that Congress acted solely because of the recommendation. Congress, of course, receives suggestions from a wide variety of stakeholders on an ongoing basis.

We highlight these ten legislative recommendations for particular attention, in no particular order:

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

Because of the pandemic, the IRS postponed the tax return filing deadline to July 17 in 2020 and to May 17 in 2021. These postponements of the filing deadline limit the amounts that taxpayers can recover in a way that was not intended and that will cause some taxpayers to lose the ability to recover overpayments. For example, a taxpayer who filed her 2019 return by the postponed filing deadline of July 15, 2020, might reasonably believe she would be eligible for a refund if she files a claim before July 15, 2023. However, if her taxes (withholding payments) are deemed paid on April 15, 2020, any claim for credit or refund filed after April 15, 2023, would be disallowed by the IRS. This is a trap for the unwary. We recommend Congress extend the lookback period when the filing deadline is postponed by the IRS due to a disaster declaration to three years *plus the period of the postponement*.

- **Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers.** The IRS receives over 160 million individual income tax returns each year, and paid tax return preparers prepare the majority of these returns. Both taxpayers and the tax system depend heavily on the ability of preparers to prepare accurate tax returns. Yet numerous studies have found that non-credentialed tax return preparers routinely prepare inaccurate returns, which harms taxpayers and tax administration. To protect the public, federal and state laws generally require lawyers, doctors, securities dealers, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications and, in most cases, to pass competency tests. Taxpayers and the tax system would benefit from requiring tax return preparers to pass minimum competency tests.

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

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

within 60 days means they may have unknowingly conceded the adjustment and forfeited their right to challenge the IRS's position in the Tax Court. Amending IRC § 6213(b) to require that the IRS specifically describe the error giving rise to the adjustment and inform taxpayers that they have 60 days to request that the summary assessment be abated would help ensure taxpayers understand the adjustment and their rights. Additionally, requiring the IRS to send the notice either by certified or registered mail would underscore the significance of the notice and provide an additional safeguard to ensure that taxpayers are receiving this critical information.

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

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

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