

#### 4. IMPLEMENT SYSTEMIC FIRST TIME ABATEMENT BUT ALLOW SUBSTITUTION OF REASONABLE CAUSE

The IRS generally offers taxpayers who are subject to failure-to-file, failure-to-pay, or failure-to-deposit penalties an administrative first time abatement (FTA) of those penalties, provided that taxpayers are in compliance and have not utilized FTA within the last three years.<sup>14</sup> This administrative waiver is applied after a manual review generally triggered by a request from the taxpayer for either reasonable cause relief or FTA.<sup>15</sup> The IRS is considering, and TAS supports, systemically applying the FTA as a means of promoting fairness and reducing burdens for both taxpayers and the IRS.

TAS recommends that the IRS apply FTA automatically when it evaluates a given taxpayer for the three covered penalties. The IRS would program its system so that when taxpayers filed their returns, the system would determine eligible taxpayers and grant FTA without the need for taxpayers to request relief. Ineligible taxpayers would receive a penalty and an opportunity to request relief based upon reasonable cause. As things stand now, FTA is generally only granted where taxpayers affirmatively request penalty relief or where the IRS has some other reason to review for FTA eligibility.<sup>16</sup> One of the equitable benefits of a systemic FTA, by contrast, is that it is accessible to everybody, regardless of their level of sophistication. This will result in an equitable application of the administrative waiver. Additionally, because the IRS's computer system would automatically apply the systemic FTA, the IRS can impact the broadest possible range of eligible taxpayers while decreasing personnel costs associated with the program.

The increased reach of systemic FTA is well illustrated by looking to data from tax year 2021. In that year, the IRS granted the FTA to approximately 200,000 taxpayers with respect to the failure-to-file, failure-to-pay, and failure-to-deposit penalties.<sup>17</sup> In comparison, TAS analysis shows that a systemic FTA would have waived penalties for approximately 4.5 million taxpayers.<sup>18</sup> Another way of looking at the data is to consider the number of FTA waivers as a percentage of the total taxpayers assessed failure-to-file, failure-to-pay, and failure-to-deposit penalties. Under the current policy, the IRS abated approximately two percent of these penalties due to FTA, while under a systemic process, TAS estimates that the IRS would abate 50 percent.<sup>19</sup> All of the additional taxpayers who would benefit from systemic FTA are already eligible for FTA; they are simply missing out on relief because they do not know to ask for it. In the upcoming year, TAS will continue to encourage IRS decision-makers to make the policy changes and resource allocations the program needs to move forward.

The IRS applies FTA, when available, prior to considering reasonable cause relief.<sup>20</sup> This ordering rule, which is a matter of IRS policy, is applied despite the circumstance that reasonable cause is established by statute and is intended for situations where the taxpayer exercised ordinary business care and prudence.<sup>21</sup> Even where a taxpayer has reasonable cause, FTA supersedes that relief, thereby eliminating access to FTA for the next

14 Internal Revenue Manual (IRM) 20.1.1.3.3.2.1, First Time Abate (FTA) (Mar. 29, 2023) (providing an administrative waiver from failure-to-file penalties under IRC §§ 6651(a)(1), 6698(a)(1), or 6699(a)(1), failure-to-pay penalties under IRC § 6651(a)(2) and IRC 6651(a)(3), and failure-to-deposit penalty under IRC § 6656). See also IRS, Penalty Relief Due to First Time Abate or Other Administrative Waiver, <https://www.irs.gov/payments/penalty-relief-due-to-first-time-abate-or-other-administrative-waiver#eligible> (last visited May 22, 2023).

15 IRM 20.1.1.3.3.2.1(3), First Time Abate (FTA) (Mar. 29, 2023). IRS personnel can apply FTA unilaterally if they identify taxpayer eligibility on their own initiative.

16 Taxpayers who have requested relief for other reasons may also receive FTA, and if a taxpayer is eligible for FTA relief after all other account discrepancies have been corrected, then the IRS will apply FTA to the remaining penalty. IRM 20.1.1.3.3.2.1(16), First Time Abate (FTA) (Mar. 29, 2023).

17 IRS, CDW, Individual Master File for Tax Year 2021 Returns (Mar. 2023).

18 *Id.*

19 *Id.* The actual number of taxpayers eligible for FTA will vary depending on whether the taxpayer is in payment compliance at the time of the request. Additionally, not all FTA eligibility requirements could be tested.

20 IRM 20.1.1.3.3.2.1(12), First Time Abate (FTA) (Mar. 29, 2023).

21 IRC §§ 6651(a), 6656(a), 6698(a), 6699(a); Treas. Reg. § 301.6651-1(c)(1).

three years.<sup>22</sup> To address this situation, TAS has proposed allowing taxpayers who receive FTA and who also have a good case for reasonable cause relief to apply for reasonable cause in lieu of the FTA, thus preserving FTA eligibility for future years. TAS refers to this mechanism as “reasonable cause substitution.” The IRS is philosophically resistant to such a policy change and has also indicated that it might not be a feasible option due to programming limitations. TAS will continue to pursue communication with the IRS in this area and explore ways of moving forward.

#### **Objective 4 for FY 2024 – TAS will collaborate with IRS stakeholders to implement systemic FTA in conjunction with recharacterized reasonable cause relief.**

- Activity 1: Provide IRS decision-makers with support via a white paper and follow-up conversations for allocating the requisite information technology funding and moving forward with systemic FTA.
- Activity 2: Conduct a meeting with the IRS Office of Servicewide Penalties aimed at reaching agreement regarding the desirability and feasibility of allowing substituted reasonable cause relief.

### **5. REDUCE BURDEN ON TAXPAYERS APPLYING FOR AN INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER**

The IRS continues to rely on a paper-based system for processing applications for Individual Taxpayer Identification Number (ITIN) applications.<sup>23</sup> Like other paper processing systems at the IRS, processing of paper ITIN applications is subject to backlogs.<sup>24</sup> Backlogs harm taxpayers in a variety of ways, including delayed refunds and disallowance of claimed tax benefits.<sup>25</sup> When the IRS experiences backlogs processing ITIN applications and paper returns, it can delay taxpayer refunds for months. Taxpayers with expired ITINs can experience further delays in processing their tax returns.<sup>26</sup> Because some state agencies calculate benefits based on family size, as reported on a tax return, ITIN delays may impact benefits. If a taxpayer has an eligible dependent but is unable to obtain an ITIN for the dependent, it may result in a reduction of state benefits, increasing taxpayer burden.

In its SOP, the IRS expressed intentions to modernize the ITIN process and expand services for ITIN holders and international taxpayers but did not provide any details.<sup>27</sup> To prevent unnecessary delays, encourage voluntary compliance, and reward these individuals for doing the right thing by filing U.S. tax returns, the National Taxpayer Advocate recommended the IRS develop and implement a procedure that allows applicants

22 IRM 20.1.1.3.6.1, RCA and First Time Abate (FTA) Consideration (Mar. 29, 2023).

23 An ITIN is a unique tax processing number the IRS issues to individuals who need to file a return or have a federal tax reporting obligation but who do not have and are not eligible for a Social Security number from the Social Security Administration. See IRC § 6109; Treas. Reg. § 301.6109-1. All ITIN applications, including renewals, must include a U.S. federal tax return unless the taxpayer meets an exception to the filing requirement. New applicants must apply with a paper tax return if they do not meet one of the narrow exceptions.

24 See, e.g., National Taxpayer Advocate Fiscal Year 2023 Objectives Report to Congress 23-24 (Systemic Advocacy Objective: *Restore Tax Benefits That Were Disallowed Due to Individual Taxpayer Identification Number Renewal Processing Delays*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/06/JRC23\\_SAO\\_SystAdvObjs.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/06/JRC23_SAO_SystAdvObjs.pdf); National Taxpayer Advocate 2022 Annual Report to Congress 34-44 (Most Serious Problem: *Processing Delays: Paper Backlogs Caused Refund Delays for Millions of Taxpayers*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2023/01/ARC22\\_MSP\\_01\\_Processing-Delays.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2023/01/ARC22_MSP_01_Processing-Delays.pdf).

25 See National Taxpayer Advocate Fiscal Year 2023 Objectives Report to Congress 23-24 (Systemic Advocacy Objective: *Restore Tax Benefits That Were Disallowed Due to Individual Taxpayer Identification Number Renewal Processing Delays*), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/06/JRC23\\_SAO\\_SystAdvObjs.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/06/JRC23_SAO_SystAdvObjs.pdf). When non-citizens seek U.S. citizenship, immigration authorities view compliance with U.S. tax laws favorably. See, e.g., 8 U.S.C. § 1427(a); 8 C.F.R. § 316.10; *Abuhekal v. U.S. Citizenship & Immigr. Servs.*, 2011 WL 2600709, at \*5 (D. Minn. June 30, 2011) (“Timely payment of taxes supports a finding of good moral character.... Conversely, failure to file or make timely payment of taxes may support a finding of a lack of good moral character”) (internal citations omitted).

26 See Instructions for Form W-7, Application for IRS Individual Taxpayer Identification Number (Nov. 2021).

27 IRS, Pub. 3744, IRS Inflation Reduction Act Strategic Operating Plan (Apr. 2023).