

6. FORMALIZE 45-DAY RESPONSE TIME FROM ALL IRS FUNCTIONS TO RECOMMENDATIONS MADE BY THE TAXPAYER ADVOCACY PANEL

The Taxpayer Advocacy Panel (TAP), an independent Federal Advisory Committee to the IRS, was established in 2002. TAP helps identify tax issues of importance to taxpayers and provides a taxpayer perspective to the IRS on key programs, products, and services. It also serves as a focus group that makes recommendations to the IRS and the National Taxpayer Advocate. Since its inception, TAP has worked with over 700 civilian volunteers who agree to dedicate 200-300 hours a year for three-year terms. The panel's mission is to listen to taxpayers, identify taxpayer issues, and make suggestions to improve IRS services. It operates under the authority of the Federal Advisory Committee Act and is guided by TAS, which provides staff to assist TAP and facilitate consideration of its recommendations. During the first 20 years of TAP's existence, it made more than 2,200 recommendations to improve the IRS's taxpayer service, products, and procedures.³⁷ Some examples include implementation of customer callback technology on IRS phone lines, creation of the taxpayer online portal, and various improvements to the Volunteer Income Tax Assistance program.

TAP submitted 201 recommendations to the IRS in 2022. Of those submitted, 133 (66 percent) were still awaiting IRS response at the end of the year.³⁸ Unlike other TAS functions, TAP does not have an established process with the IRS Business Operating Divisions (BODs) for working the recommendations it submits. TAP currently works primarily with W&I; however, as the panel continues to evolve and broaden its work to additional IRS functions, a negotiated Service Level Agreement (SLA) or standard operating procedure for working TAP recommendations is necessary to ensure TAP receives timely and complete IRS responses.

Objective 6 for FY 2024 – TAS will work with the IRS BODs to develop procedures for the IRS in reviewing and responding to TAP recommendations, and if necessary, establish steps to reach an SLA or mutually agreed upon standard operating procedure for considering TAP recommendations.

- Activity 1: Review and analyze the current SLAs between TAS and BODs for working Case Advocacy Operations Assistance Requests to identify best practices transferable to the recommendation process.
- Activity 2: Review and analyze the processes used by other administrative bodies that work with the IRS, such as the Internal Revenue Service Advisory Council and the Electronic Tax Administration Advisory Committee, to identify best practices.
- Activity 3: Conduct an analysis of the current workflow processes and evaluate their effectiveness and timeliness for functional replies. TAP will look into developing a more effective post-recommendation dialogue process that considers the age, priority status, and number of times a recommendation is transferred between functions.

7. ELIMINATE SYSTEMIC ASSESSMENTS AND OFFER A FIRST TIME ABATEMENT WAIVER FOR INTERNATIONAL INFORMATION RETURN PENALTIES

Taxpayers who have certain foreign financial interests and cross-border business activities are subject to a range of U.S. reporting requirements. Many of these requirements come with significant penalty potential when a filing is late, incomplete, or inaccurate, even if the information report itself does not relate to any income. In particular, TAS is concerned about the international information return (IIR) penalty regime contained within Title 26, Subtitle F, Chapter 61, Subchapter A, Part III.³⁹ The IRS's position regarding these penalties is that

³⁷ IRS, Pub. 4444, Taxpayer Advocacy Panel 2022 Annual Report 1 (Mar. 2023).

³⁸ *Id.* at 8.

³⁹ See, e.g., National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_MSP_08_International.pdf.

they are not subject to deficiency procedures and are immediately assessable, which means that taxpayers do not have access to prepayment judicial review in the U.S. Tax Court. The National Taxpayer Advocate's position, recently corroborated by the U.S. Tax Court in *Farhy v. Commissioner*,⁴⁰ is that these penalties neither contain nor cross-reference any language authorizing the IRS to treat them as assessable.⁴¹ Instead, under *Farhy*, collection of these penalties would fall to the U.S. Department of Justice.⁴²

Most of these penalties are assessed systemically, at the time the IRS receives a late information return, which causes substantial inequities and inefficiencies in tax administration. As an example, between processing years (PYs) 2014 and 2022, there were an average of 9,800 IRC § 6038 penalties systemically assessed per year.⁴³ Of those penalties, the mean abatement rate was 69 percent per year, with a minimum rate of 48 percent (as of March 2023) and a maximum rate of 88 percent.⁴⁴ These systemic assessments totaled an average of \$354 million per year, of which \$281 million was abated on average – an abatement rate of 80 percent per year by dollars.⁴⁵ By contrast, the number of manual assessments averaged only 685 per year from PYs 2014 to 2022, with an average abatement rate of 23 percent per year.⁴⁶ In terms of dollars, the average aggregate manual penalty assessment per year was \$36 million, of which 19 percent was abated.⁴⁷

These high abatement rates demonstrate that the systemic regime burdens taxpayers with the need to provide documentation to fight unjustified penalties approximately half the time. However, a more taxpayer-favorable approach is possible. If the IRS stopped systemically assessing these penalties and Congress made them subject to deficiency procedures, taxpayers would have access to full prepayment administrative and judicial review prior to the assessment of the penalties. IIR penalties are abated for a variety of reasons, including that the underlying income tax return received the FTA waiver.⁴⁸ Nevertheless, these penalties should be directly eligible for FTA, ideally the systemic FTA, for which the National Taxpayer Advocate has broadly advocated.⁴⁹ Offering an IIR-specific FTA waiver would help extend equitable treatment to taxpayers and bring administrative efficiency in this area to the IRS. For example, it would ensure that taxpayers with new IIR reporting obligations do not slip through the cracks simply because their underlying returns were on time and are therefore not eligible for FTA.

40 *Farhy v. Comm'r*, 160 T.C. 6 (2023).

41 The National Taxpayer Advocate and a number of commentators have long held this position. See, e.g., Erin Collins & Garrett Hahn, *Foreign Information Reporting Penalties: Assessable or Not?*, TAX NOTES, July 9, 2018, at 211; Robert S. Horwitz, *Can the IRS Assess or Collect Foreign Information Reporting Penalties?*, TAX NOTES, Jan. 21, 2019, at 301; Frank Agostino & Phillip J. Colasanto, *The IRS's Illegal Assessment of International Penalties*, TAX NOTES, Apr. 8, 2019, at 261; National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_MSP_08_International.pdf.

42 *Farhy v. Comm'r*, 160 T.C. 6 (2023).

43 IRS, CDW, Individual Master File, PY 2014-2022, (Mar. 2023); IRS, CDW, Business Master File, PY 2014-2022, (Mar. 2023).

44 *Id.*

45 *Id.* We note that because of broad penalty relief provided by the IRS with respect to certain late filing penalties for 2019 and 2020 returns in Notice 2022-36, 2022-36 I.R.B. 188, we cannot differentiate which abatements were due to the broad penalty relief for those tax years, but we believe that the initiative contributed to a higher abatement rate for those years and consequently a higher average abatement rate for the period of 2014-2022.

46 IRS, CDW, Individual and Business Master File (Mar. 2023).

47 *Id.*

48 See, e.g., National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_MSP_08_International.pdf.

49 For a more detailed discussion on this topic, see Systemic Advocacy Objective: *Implement Systemic First Time Abate But Allow Substitution of Reasonable Cause*, *supra*.

Objective 7 for FY 2024 – TAS will advocate to end systemic assessment of international information return penalties and to develop an FTA waiver specific to these penalties.

- Activity 1: TAS subject matter experts will meet with the IRS to discuss the possibility of ending the systemic assessment regime for Chapter 61 IIR penalties.
- Activity 2: TAS subject matter experts will meet with the IRS Office of Servicewide Penalties to discuss the possibility of developing an FTA waiver for Chapter 61 IIR penalties.

8. MODERNIZE IRS PAPER PROCESSING PROCEDURES

Since the 2020 filing season, millions of taxpayers have experienced significant delays waiting for the IRS to process paper-filed tax returns and taxpayer correspondence.⁵⁰ The unprecedented paper processing and refund issuance delays caused taxpayers to experience financial hardship and confusion regarding the status of their cases and filings. During the final months of 2022, the IRS made substantial strides in reducing the backlog of paper-filed tax returns. Despite this progress, the IRS still started Filing Season 2023 with significant paper inventories, including an inventory of about 4.9 million pieces of taxpayer correspondence and about 1.5 million amended returns.⁵¹ The IRS ended Filing Season 2023 with a similar inventory of paper taxpayer correspondence (about five million) and about 3.4 million amended returns (an increase of nearly 127 percent).⁵²

The IRS relies on outdated manual practices to process paper-filed tax returns, amended returns, and paper correspondence. In its IRA SOP, the IRS indicated plans to “scan and digitalize all incoming paper forms, returns, and communications.”⁵³ Implementation of scanning technology and digitalization will modernize paper processing procedures and reduce taxpayer burden by decreasing processing times and refund turnaround times. As part of the IRS’s Digital Intake scanning initiative, the IRS began scanning some forms, including Forms 940, 941, and 1040.⁵⁴

Objective 8 for FY 2024 – TAS will work with the IRS as it implements plans to modernize paper processing procedures to streamline the processing of paper-filed returns and correspondence.

- Activity 1: Monitor the IRS implementation of scanning technology and digitalization to process paper-filed IRS forms and correspondence and make administrative recommendations, as needed, to minimize taxpayer burden.

50 National Taxpayer Advocate 2022 Annual Report to Congress 34-48 (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.

51 IRS, W&I, Status of Unopened Mail and Backlog Inventory (Dec. 30, 2022) (showing data as of Dec. 23, 2022); Email from W&I (Jan. 3, 2023) (on file with TAS).

52 IRS, W&I, Wage and Investment Inventory Report (Apr. 29, 2023) (as of Apr. 22, 2023).

53 IRS, Pub. 3744, IRS Inflation Reduction Act Strategic Operating Plan 22 (Apr. 2023).

54 The IRS also has two scanning initiatives underway: Digital Intake with Lockbox and Digital Intake with Industry Partners. IRS News Release IR 2023-41, IRS Begins New Digital Initiative; Form 940 Scanning Process Off to Strong Start; Other Forms to Start Soon (Mar. 8, 2023).