

The IRS Has Been Slow to Address the Adverse Impact of its Lien Filing Policies on Taxpayers and Future Tax Compliance

Status Update: The IRS Has Been Slow to Address the Adverse Impact of its Lien Filing Policies on Taxpayers and Future Tax Compliance

RESPONSIBLE OFFICIALS

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DEFINITION OF PROBLEM

The filing of a notice of federal tax lien (NFTL) can be a useful tool in a comprehensive and balanced strategy to increase tax compliance. However, as stated in the 2009 Annual Report to Congress, when used improperly, an NFTL can severely damage the financial welfare of the affected taxpayer, and reduce federal revenue and tax compliance for years to come.¹ Despite the National Taxpayer Advocate's specific concerns and actionable recommendations, the IRS has not altered its lien filing policies. It continues to disregard the potential adverse impact of an NFTL on a taxpayer's financial condition and files many liens automatically, without substantive human review or the exercise of discretion or judgment applied to the taxpayer's facts and circumstances. These policies continue to harm an increasing number of taxpayers. Among our findings:

- The IRS increased lien filings by approximately 14 percent over the prior year and about 550 percent from fiscal year (FY) 1999 despite scant evidence that liens generate commensurate tax revenue;²
- The IRS is now filing liens against nearly 1.1 million taxpayers a year, damaging their credit record in the midst of the worst economy in several generations, especially harming low income and minority taxpayers;³
- The total number of taxpayers harmed by IRS lien filing policies is much greater than 1.1 million because over five million liens filed in recent years continue to negatively affect taxpayers' credit for at least seven years from the date they pay off their debts;⁴ and

¹ National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*). See also National Taxpayer Advocate 2009 Annual Report to Congress 357-364 (Legislative Recommendation: *Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens*).

² IRS, *Fiscal Year 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. During FY 1999-2009, when adjusted for inflation, the total dollars IRS collected actually declined by about seven percent from \$29.4 billion to \$27.2 billion (in terms of real dollars valued as of 2009). IRS, *Statistics of Income (SOI) Data Books, Table 16, Delinquent Collection Activities, 1999-2009*. See also Bureau of Labor Statistics, Dept. of Labor, *Consumer Price Index - All Urban Consumers (CPI-U)*, available at <http://www.bls.gov/CPI/>.

³ IRS, *Fiscal Year 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. See also Fortune, *The IRS's Problem with Minorities* (Dec. 2, 2010) (citing study entitled *IRS Enforcement's Impact on Minority Communities*, exclusively conducted for Fortune by Thomas M. Evans, CEO of TaxLifeboat, a firm that advises taxpayers on resolving their problems with the IRS); and New York Times, *E.E.O.C. Sues Kaplan Over Hiring* (Dec. 21, 2010) (reporting that the Equal Employment Opportunity Commission sued Kaplan Higher Education Corporation alleging discrimination against black job applicants through the way it uses credit histories in its hiring processes).

⁴ The IRS filed 5,200,913 NFTLs during the past seven years. IRS, *Fiscal Year 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf. A damaging notation remains on the taxpayer's consumer credit report for at least seven years from the date of lien release. The Fair Credit Reporting Act, § 605(a)(3), 15 U.S.C. § 1681c(a)(3).

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- The IRS still has not undertaken studies to evaluate the effectiveness of its lien filing policies in terms of collected revenue and effect on future tax compliance.

In January 2010, the National Taxpayer Advocate issued two Taxpayer Advocate Directives (TADs) directing the IRS to implement specific improvements to its lien filing policies and procedures, and to grant relief to taxpayers harmed by automatic filing.⁵ The IRS has not adequately addressed these concerns. As a result, NFTL filing practices continue harming millions of taxpayers, risk undermining future tax compliance, and cause millions of taxpayer dollars to be spent on potentially unnecessary lien filing fees.⁶

ANALYSIS OF PROBLEM

Background

The National Taxpayer Advocate thoroughly examined IRS lien filing policies in the 2009 Annual Report to Congress. She proposed several administrative and legislative steps to improve these policies and procedures, and to grant relief to taxpayers harmed by automatic filings.⁷ Notwithstanding this compelling analysis, the IRS increased its lien filings by approximately 14 percent, from about 966,000 in FY 2009 to about 1.1 million in FY 2010.⁸ Moreover, the IRS continues to file NFTLs early in collection cases, even though it cannot track the source of payments on past due accounts to measure the effectiveness of its collection actions.⁹ The IRS has declined to change its automatic lien filing practices, which contradict its own longstanding policy.¹⁰

⁵ Taxpayer Advocate Directives (TADs) 2010-1 and 2010-2 (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>.

⁶ The IRS estimates that a lien filing costs between \$25 and \$100, plus labor costs. IRS, *Collection Process Study* (CPS) 122 (Sept. 30, 2010). The IRS may spend up to \$109 million in lien filing costs annually, not including labor costs, based on 1,096,376 NFTLs filed in FY 2010. IRS, *Fiscal Year 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

⁷ National Taxpayer Advocate 2009 Annual Report to Congress 17-40; National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18. See also National Taxpayer Advocate 2009 Annual Report to Congress 357-364.

⁸ In FY 2010, the IRS filed 1,096,376 NFTLs. IRS, *FY 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

⁹ See Most Serious Problem: *The IRS Should Accurately Track Sources of Balance Due Payments to Determine the Revenue Effectiveness of Its Enforcement Activities and Service Initiatives*, *supra*. NFTL filings have increased by over 550 percent in the past 11 years, from about 168,000 in FY 1999 to nearly 1.1 million in FY 2010. While FY 2010 SOI data are unavailable, TAS estimates that the inflation-adjusted collection revenue (in 2010 dollars) has essentially remained flat (it has increased by just four percent based on an alternative measure that the IRS has recently published), which is likely attributable to the IRS's efforts with curbing offshore tax evasion. IRS, *FY 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf; Bureau of Labor Statistics, Dept. of Labor, Consumer Price Index - All Urban Consumers (CPI-U), available at <http://www.bls.gov/CPI/> (last visited Oct. 10, 2009). See, e.g., IRS, IRS Commissioner Doug Shulman's Statement on UBS/Voluntary Disclosure Program (Nov. 16, 2010) (estimating revenue effect of the program at about \$3.6 billion dollars), available at <http://www.irs.gov/newsroom/article/0,,id=231520,00.html>; Reuters, *Deutsche Bank U.S. Tax Fraud Deal Opens Floodgates* (Dec. 22, 2010) (reporting Deutsche Bank's \$553.6 million and UBS's \$780 million settlement with the IRS).

¹⁰ IRS Policy Statement 5-47 states: "...All pertinent facts must be carefully considered as the filing of the notice of lien may adversely affect the taxpayer's ability to pay and thereby hamper or retard the collection process." Internal Revenue Manual (IRM) 1.2.14.1.13 (Oct. 9, 1996). In the context of Collection Due Process hearings, Congress made clear that the IRS shall consider whether any proposed collection action "balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection be no more intrusive than necessary." IRC § 6330(c)(3)(C) (cross referenced by IRC §. 6320(c)). At present, IRS lien filing procedures do not do much balancing. They focus almost exclusively on tax collection without regard for the legitimate concern of affected persons that collection actions be no more intrusive than necessary.

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On January 20, 2010, the National Taxpayer Advocate issued two TADs, directing the Commissioner, Wage and Investment (W&I) Division, and Commissioner, Small Business/Self-Employed (SB/SE) Division,¹¹ to:

- Immediately discontinue the automatic filing of NFTLs on Currently Not Collectible (CNC) hardship accounts with an unpaid balance of \$5,000 or more, require employees to make NFTL filing determinations based on a meaningful review of the facts of each taxpayer's case, and require managerial approval for the filing of an NFTL in all cases where the taxpayer has no assets;¹²
- Allow, upon the request of a taxpayer, the withdrawal of an NFTL in situations where one of the statutory withdrawal criteria is satisfied, even if the underlying lien has been released;
- Include the complete TAS training video, *Taxpayer Rights: Collection Case Studies*, in the mandatory annual continuing professional education training about exercising judgment and discretion before and after NFTL filing for collection employees and managers in the Collection Field function (Cff); and
- In consultation with TAS, develop separate training on this topic for employees and managers in the Automated Collection System (ACS).¹³

The IRS responded by establishing a task force to undertake a comprehensive review of IRS collection practices, as well as to conduct a joint study with TAS Research of the utility of filing an NFTL on accounts deemed CNC. The National Taxpayer Advocate applauds the IRS's task force undertaking, in which TAS actively participated.¹⁴ However, the IRS to date has not changed its current NFTL guidance.¹⁵ On March 24, 2010, the Commissioners of SB/SE and W&I appealed TADs 2010-1 and 2010-2 to the Deputy Commissioner

¹¹ See TAD 2010-1, *Immediately discontinue automatic lien filing on Currently Not Collectible (CNC) hardship accounts with an unpaid balance of \$5,000 or more, require employees to make meaningful notice of federal tax lien (NFTL) filing determinations, and require managerial approval for filings of an NFTL in all cases where the taxpayer has no assets* (Jan. 20, 2010); TAD 2010-2, *Withdrawal of a notice of federal tax lien (NFTL) where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released* (Jan. 20, 2010). For copies of the TADs see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>.

¹² See TAD 2010-1 (Jan. 20, 2010).

¹³ See TAD 2010-2 (Jan. 20, 2010).

¹⁴ TAS actively participated in the IRS CPS, an extensive overview of IRS collection processes, and the CPS Tools Assessment Team, which conducted a policy review and in-depth analysis of the various tools used by Collection, including determining the efficiency and appropriateness of liens for different categories of taxpayers. The Executive Director, Systemic Advocacy represents the National Taxpayer Advocate on the Collection Governance Council, and is a member of the CPS Advisory Board, which is overseeing the study and reviews its findings and recommendations.

¹⁵ The IRS Office of Chief Counsel has advised the IRS that its IRM is in compliance with the IRS Restructuring and Reform Act of 1998 (RRA 98). Memorandum dated Feb. 12, 2010, from Gary D. Gray, Deputy Associate Chief Counsel (Procedure and Administration) to Frederick W. Schindler, Director, Collection Policy (SB/SE). The memorandum characterizes the impact of a lien-filing on a taxpayer's financial viability as a "second-order hardship" and states rather clinically: "As an involuntary creditor not involved in the extension of credit, the Service is not in a position to evaluate these potential hardships and lacks the resources to effectively account for them in the large number of CNC hardship cases." The National Taxpayer Advocate fundamentally disagrees with the memorandum's conclusion that existing IRS procedures adhere to the policy underlying RRA 98. As described in the 2009 Annual Report, the intent of Congress in requiring managerial approval of lien filings for the first time was to provide additional taxpayer protections. Since RRA 98, the IRS has moved in the opposite direction. It has changed its policy in a wide swath of cases to require that liens be imposed unless an employee obtains managerial approval to refrain from making the filing. In our view, such a policy is clearly at odds with the intent of RRA 98.

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for Services and Enforcement.¹⁶ On March 31, 2010, the National Taxpayer Advocate supplemented and reissued TAD 2010-1 to the Deputy Commissioner for Services and Enforcement.¹⁷ The National Taxpayer Advocate simultaneously issued an interim guidance memorandum to TAS employees, clarifying how they can best advocate for taxpayers affected by IRS automatic lien filing policies.¹⁸ The memo advises employees to use sound judgment in evaluating relevant facts and circumstances with respect to the filing of an NFTL in cases involving installment agreements (IAs), offers in compromise (OICs), or CNC determinations.

Following subsequent meetings with the National Taxpayer Advocate, the Deputy Commissioner for Services and Enforcement issued a response to the TADs on June 10, 2010, which noted that:

[t]he IRS fully appreciates the views and concerns expressed by the Office of the National Taxpayer Advocate. However, making significant fundamental changes to lien policies and procedures such as those directed in TAD 2010-1 have the potential to materially affect the revenue collected for the United States. Thus, any potential changes should be carefully considered and supported by clear and consistent data as to the effect of the changes including the rights and obligations of taxpayers, effective and efficient resource allocation and revenue collected or foregone. In order to consider the specific directives of TAD 2010-1, additional study is necessary.¹⁹

On September 30, 2010, the IRS completed the CPS study and issued recommendations to the Deputy Commissioner for Services and Enforcement.²⁰

The IRS response to the National Taxpayer Advocate's concerns is inadequate and fails to address the potential harm its lien policies create for taxpayers and tax administration alike.

The CPS study recommended establishing nationwide pilots in ACS campuses and in the CFF to apply new lien filing criteria for taxpayers meeting revised income and other

¹⁶ Appeal of TAD 2010-1 (Mar. 24, 2010). The chief(s) of IRS function(s) subject to a TAD may appeal the proposed action within ten calendar days from the date on the TAD. See IRM 13.2.1.6.2, *TAD Appeal Process* (July 19, 2009). The National Taxpayer Advocate met with IRS executives on a number of occasions after the issuance of TADs and briefed them about her concerns and the results of the lien filing study published in Volume 2 of the National Taxpayer Advocate 2009 Annual Report to Congress.

¹⁷ In subsequent discussions, the SB/SE Commissioner and the National Taxpayer Advocate agreed to continue working on several of the concerns identified in TAD 2010-2, including an agreement to issue IRS guidance about NFTL withdrawal after lien release, the roll-out of the TAS training video on taxpayer rights to CFF employees, and the creation of a TAS-SB/SE-W&I team to develop similar training for ACS employees.

¹⁸ National Taxpayer Advocate, *Interim Guidance Memorandum*, Control No. TAS-13.1-0310-003 (Mar. 31, 2010). For a copy of this memorandum, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix IX, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>.

¹⁹ Memorandum for Nina E. Olson, National Taxpayer Advocate, from Steven T. Miller, on Taxpayer Advocate Directives 2010-1, 2010-2, and 2010-3 (June 10, 2010).

²⁰ IRS, *Collection Process Study (CPS)* (Sept. 30, 2010).

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criteria.²¹ Except for this change, the recommendations anticipate the IRS would retain current guidance about lien filings.

The National Taxpayer Advocate is very concerned that, according to the IRS's own estimates, these suggested policy changes will reduce the IRS's 1.1 million annual lien filings by only 40,000 to 41,000, or about .3 percent.²² At the same time, the IRS has increased lien filings by 130,758 NFTLs in FY 2010 compared to FY 2009.²³

The IRS justifies its current and proposed policies based on the following arguments: 1) need to protect the government's interest; 2) need to establish priority in bankruptcy; and 3) need to establish priority in assets since the value fluctuates dependent on economic conditions.²⁴

First, the IRS does not define these government interests, which may include not only the interest in the current debt, but also the interest in the financial viability of the taxpayer. A financially viable taxpayer with improved earning potential may generate an increased amount of tax revenue in the future and be able to pay the existing tax debt. The government also has a vested interest in cultivating a voluntarily compliant taxpayer who can pay future taxes.

Second, while it is true that the determination of secured status for an allowed claim of the government under Bankruptcy Code § 506(a) is dependent upon the filing of a tax lien, it does not mean that automatic filing of NFTLs on CNC (hardship) accounts with any unpaid balance threshold will necessarily protect the government's interest in the taxpayer's assets in bankruptcy. Under § 506(a) of the Bankruptcy Code, the claim of a creditor that is secured by the debtor's property is divided into secured and unsecured portions if the collateral is worth less than the face amount of the claim.²⁵ Thus, there are a secured claim equal to the value of the collateral and an unsecured claim equal to the deficiency.

When the IRS has filed an NFTL, all property of the debtor in which the estate has an interest subject to the lien must be valued in order to ascertain the lien's value. Internal Revenue Manual (IRM) 5.16.1.2.9(1) states that "generally, these [CNC hardship] cases involve no income or assets, no equity in assets or insufficient income to make any payment without causing hardship."²⁶ Hence, the IRS itself acknowledges that in CNC cases the

²¹ CPS at 121. The pilots are generally recommended for a three-month period. However, the CPS team also suggested that the new criteria remain in place after the initial three-month period ends rather than revert to the current criteria because "repeated changes to criteria would prove confusing for employees and minimize the impact of eventual implementation." *Id.*

²² CPS at 122.

²³ IRS, *FY 2010 Enforcement Results*, available at http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf.

²⁴ Appeal of TAD 2010-1, Memorandum for Nina E. Olson, National Taxpayer Advocate, from Christopher Wagner, Commissioner, SB/SE Division, and Richard Byrd, Commissioner, W&I Division (Mar. 24, 2010). See also Memorandum for Nina E. Olson, National Taxpayer Advocate, from Steven T. Miller, on Taxpayer Advocate Directives 2010-1, 2010-2, and 2010-3 (June 10, 2010); CPS at 121.

²⁵ 11 U.S.C. § 506(a).

²⁶ IRM 5.16.1.2.9(1), *Hardship* (May 5, 2009).

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amount of the secured claim in bankruptcy would be at or close to zero. Fiscal year 2010 data clearly support this premise: the IRS collected more in bankruptcy proceedings on unsecured priority claims than on secured claims.²⁷ Moreover, the statutory lien survives the bankruptcy for property excluded from the bankruptcy estate whether or not an NFTL has been filed.²⁸ Therefore, the IRS can sometimes collect discharged taxes after the bankruptcy even when an NFTL was not filed, if the statutory lien attaches to property excluded from the bankruptcy estate, such as a pension.²⁹

Finally, the National Taxpayer Advocate is concerned that the IRS is substituting another automatic filing threshold for the exercise of discretion or judgment applied to the taxpayer's facts and circumstances, especially when it bases a lien filing determination on the *existence* of real property, not the *equity* in assets. During the current economic downturn, many taxpayers find the fair market value of their real estate is substantially less than they owe on their mortgages. In such situations, a lien filing based on the mere *existence* of real property will undoubtedly harm both the taxpayers and the government because the NFTL will not attach to any tangible interest in the property and will instead decrease the taxpayers' ability to obtain credit to repay tax debts. It is true that the general economic environment or individual financial circumstances of taxpayers suffering an economic hardship today or repaying liabilities pursuant to an IA may improve in the future, resulting in equity in assets. At that time, the government might reap some benefit from filing the NFTL. By analyzing internal sources, such as its own Information Returns Program (IRP) data (which provide verifiable third party documentation),³⁰ as well as Accurint to confirm real estate, business property, and motor vehicle records, the IRS can determine the existence of equity in assets to which a lien could attach.³¹ The IRS can and should review the taxpayer's financial information on a regular basis, and make timely NFTL filing determinations, when economic conditions improve or the taxpayer acquires equity in assets. The IRS possesses or has access to a wealth of financial data pertaining to taxpayers. The IRS should utilize this data prudently to develop a balanced lien filing strategy.

While additional studies on the effectiveness and impact of lien filing policies may be helpful, the National Taxpayer Advocate respectfully disagrees with the IRS's position that

²⁷ IRS, Collection Activity Report NO-5000-31, *IMF Report of Bankruptcies* (Oct. 5, 2010), Total - All Chapters, line 2.1. In FY 2008, the total collection for all chapters showed \$201,096,960 collected from unsecured priority claims and \$47,374,751 collected from secured claims. The IRS also collected \$31,752,097 from general unsecured claims. For definitions, see 11 U.S.C. §§ 506(secured claim); 507(a)(8) (priority claim).

²⁸ SB/SE, *Interim Guidance for Insolvency Monitoring of Lien Releases*, Control No. SB/SE-05-1209-071 (Dec. 16, 2009).

²⁹ IRC § 6321; 11 U.S.C. §§ 541(a) and (c)(2). See also *U.S. v. Rogers*, 558 F. Supp. 2d 774 (N.D. Ohio 2008) (holding statutory lien attached *in rem* to the retirement interest excluded from the bankruptcy estate).

³⁰ IRM 2.3.35.1 (Aug. 1, 2003). The IRP allows IRS employees to request either online or hardcopy Information Returns Processing (IRP) transcripts from the Information Returns Master File (IRMF), e.g., Form 1098, *Mortgage Interest Statement* (demonstrating home ownership) or Form 1099-INT, *Interest Statement* (demonstrating asset ownership).

³¹ Accurint is a service provided by Lexis-Nexis, with which the IRS has an unlimited annually renewable contract. See Accurint, <http://www.accurint.com> (last visited Sept. 25, 2010).

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it cannot consider recommended actions until it completes the study and pilots.³² TAS research studies have sufficiently demonstrated that current lien filing policies and practices actively and unnecessarily harm taxpayers. Particularly in the area of CNC taxpayer accounts, there is no sound policy or revenue basis for *automatically* filing liens based on an unpaid balance of assessment threshold.

TAS is actively advocating for taxpayers that experience harm from current NFTL filing policies and has issued Taxpayer Assistance Orders (TAOs) in some cases.³³ TAS is also conducting its own study of the impact of NFTL filings on future tax compliance.³⁴ The objectives of this study are: 1) to determine whether any amounts of payments are likely attributable to the NFTL; 2) to determine the effect of the NFTL on future payment compliance; 3) to determine the effect of the NFTL on future filing compliance; and 4) to determine whether the NFTL is associated with a decline in future income.³⁵ Upon issuance of this report, the National Taxpayer Advocate will elevate the TADs to the Commissioner of Internal Revenue for his review and action.

The IRS's delay in issuing guidance about NFTL withdrawals following lien releases unnecessarily harms taxpayers and may undermine future tax compliance.

The IRS Office of Chief Counsel issued an opinion on October 8, 2009, concluding “that as a legal matter, the IRS may file a certificate of withdrawal after a lien release.”³⁶ However, the IRS has failed to change its procedures to conform to the opinion. In response to the TAD, the IRS committed to draft guidance to change its policy and implement the opinion by mid-July 2010.³⁷ The recently released Collection Process Study also recommended approving NFTL withdrawal requests after a lien is released, but limited such withdrawals to few specific situations.³⁸ The scope of the proposed guidance did not fully address the

³² For a detailed discussion of IRS's inability to accurately measure the effectiveness of any of its collection actions because it cannot accurately track the sources of balance due payments, see Most Serious Problem: *The IRS Should Accurately Track Sources of Balance Due Payments to Determine the Revenue Effectiveness of Its Enforcement Activities and Service Initiatives*, *supra*.

³³ See IRC § 7811(a). In FY 2010, the National Taxpayer Advocate, TAS Area Directors, and Local Taxpayer Advocates issued 26 Taxpayer Assistance Orders (TAOs) which involved lien issues. From October 1, 2010, to December 20, 2010, TAS issued additional six TAOs.

³⁴ TAS Research will analyze a cohort of delinquent individual tax return filers (IMF) taxpayers, who had new unpaid tax liabilities in tax year (TY) 2002, to determine what impact exists from the imposition of NFTLs. TAS Research will study the payment activities and subsequent compliance behavior of these taxpayers. Particularly, this analysis will compare payment activity and compliance behavior for taxpayers with and without a NFTL. TAS Research will examine payment compliance and the overall compliance behavior on these taxpayers' TY 2002 to TY 2009 tax modules.

³⁵ For a more detailed discussion of the design of this study, see *Estimating the Impact of Liens on Taxpayer Compliance Behavior: An Ongoing Research Initiative*, vol. 2, *infra*.

³⁶ Memorandum from Branch 3 (Procedure and Administration) to Special Counsel (National Taxpayer Advocate), Ref. No. POSTN-133674-09 (Oct. 8, 2009). A lien that is “released” is reflected on the taxpayer's credit record for seven years from the date of the release. However, an NFTL that is “withdrawn” is treated as if it had not been filed and is removed from the record.

³⁷ Memorandum for Nina E. Olson, National Taxpayer Advocate, from Steven T. Miller, Deputy Commissioner for Services and Enforcement, on TADs 2010-1, 2010-2, and 2010-3 (June 10, 2010); Appeal of TAD 2010-2 (Mar. 24, 2010). In addition, the CPS acknowledged that “[a]pproving lien withdrawal applications after lien releases could enhance taxpayers' financial viability and increase future tax revenue.” CPS at 125.

³⁸ CPS at 125-126. The CPS recommended that the IRS generally approve NFTL withdrawal requests for taxpayers who full pay and for liens resulting from substitute for return (SFR) assessments where subsequently filed returns resulted in the taxpayers owing no tax. It did not recommend approval of NFTL withdrawal requests when the lien is released due to expiration of the statute. In our view, these recommendations do not follow the criteria established by the statute for NFTL withdrawals. See IRC § 6323(j)(1).

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National Taxpayer Advocate's concerns, nor did it provide appropriate relief in accordance with the statute. TAS substantially redrafted the guidance in consultation with the Special Counsel to the National Taxpayer Advocate. To date, the IRS has not provided the National Taxpayer Advocate with an updated draft of this guidance.

More than a year has passed since the Office of Chief Counsel issued its opinion regarding NFTL withdrawals after lien releases. The IRS has still not acted on this opinion. Because the IRS failed to issue appropriate NFTL withdrawal guidance, the current policy of disallowing NFTL withdrawals after a tax lien release continues to harm taxpayers.

The IRS should improve communications and processes associated with rectifying erroneous lien filings.

In May 2010, TAS opened an Immediate Intervention project concerning the release of federal tax liens when the filing of the NFTL was erroneous.³⁹ Under IRC § 6326(b) and the related regulations, if the IRS erroneously files an NFTL, the certificate of release must include a statement that such filing was erroneous.⁴⁰ In a number of TAS cases, the computer-generated Form 668(Z), *Certificate of Release of Federal Tax Lien*, did not contain this statutorily required language.⁴¹ Thus, the consumer credit bureaus considered the releases to have been issued because the tax liability was satisfied or unenforceable under IRC § 6325(a) (rather than a release under IRC § 6326(b)). When this occurs, a damaging notation remains on the taxpayer's consumer credit report for at least seven years from the date of release.⁴² Consequently, victims of erroneous NFTL filings incur the additional burden of proving to credit reporting bureaus that the filings were incorrect.

Even when the IRS provides the Letter of Apology (Letter 544) in these cases, it uses a fillable PDF form that prints out with gaps and extra spaces. According to an official with a major credit reporting agency, the credit bureau may reject the letter as suspicious when a taxpayer submits it to substantiate an erroneous NFTL filing.⁴³ The IRS has agreed to clarify and supplement IRM guidance regarding certificates of release for erroneously filed liens, and to fix the spacing in Letter 544.

CONCLUSION

The National Taxpayer Advocate will zealously advocate for the IRS to change its lien filing policies and practices until the IRS addresses her concerns and resolves the underlying

³⁹ IRC § 6326(b); Treas. Reg. § 301.6326-1. An immediate intervention is an operational issue, identified internally or externally, which causes immediate, significant harm to multiple taxpayers and demands an urgent response. IRM 13.2.1.4.2.1 (July 16, 2009). The TAS analyst assigned to an immediate intervention must develop an action plan for resolution within five calendar days of assignment. IRM 13.2.2.4.1 (July 16, 2009).

⁴⁰ IRC § 6326(b); Treas. Reg. § 301.6326-1.

⁴¹ IRC § 6326(b) and regulations require the IRS to expeditiously (and, to the extent practicable, within 14 days after such determination) issue a certificate of release of an erroneous lien which "shall include in such certificate a statement that such filing was erroneous." IRC § 6326(b); Treas. Reg. § 301.6326-1.

⁴² The Fair Credit Reporting Act, § 605(a)(3), 15 U.S.C. § 1681c(a)(3).

⁴³ TAS teleconference with Experian Senior Vice President (Apr. 30, 2010).

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issues. The National Taxpayer Advocate will keep working to improve IRS lien filing policies and processes in a manner that would benefit both taxpayers and the United States. Moreover, TAS employees will advocate on behalf of taxpayers in lien cases and issue TAOs where appropriate. The National Taxpayer Advocate expects the IRS will collaborate with TAS on these issues, and she will regularly report to Congress on the progress of this effort.

In conclusion, the National Taxpayer Advocate reiterates her recommendations that the IRS:

1. Immediately rescind its policy of automatically filing liens against accounts designated as “currently not collectible” due to economic hardship based on an unpaid balance threshold.
2. Require managerial approval for NFTL filings in all cases where the taxpayer has no significant equity in assets.
3. Revise the Internal Revenue Manual to base lien filing determinations on a thorough review of information including the taxpayer’s assets, the taxpayer’s income, and the value of the taxpayer’s equity in the assets; and determine after weighing all the facts and circumstances whether (i) the lien will attach to property, (ii) the benefit to the government from the NFTL filing outweighs the harm to the taxpayer, and (iii) the filing will jeopardize the taxpayer’s ability to comply with the tax laws in the future.
4. To reverse the damage to a taxpayer’s credit rating, the IRS also should develop and issue guidance allowing, upon the request of the taxpayer, the withdrawal of an NFTL where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released.

Status Update: The IRS Offer in Compromise Program Continues to be Underutilized

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RESPONSIBLE OFFICIAL

Chris Wagner, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

For the past nine years, the National Taxpayer Advocate has identified the IRS offer in compromise (OIC) program as one of the most serious problems facing taxpayers.¹ The current economic climate has led to a nine percent increase in offer receipts.² However, the IRS accepts roughly one offer for every 290 taxpayers with a delinquent account.³ Meanwhile, the IRS places over a million taxpayers' accounts into currently not collectible (CNC) status each year, which undermines revenue collection goals.⁴ Moreover, the IRS generally files notices of federal tax lien (NFTLs) against taxpayers for balances exceeding \$5,000 after offer acceptance, return, or rejection, which hampers taxpayers who are actively trying to pay their tax debts.⁵

To its credit, over the last year the IRS has conducted several significant studies of the OIC program, and revised procedures for processing some of the offers worked in the Centralized Offer in Compromise units (COIC).⁶ If the IRS adopts and implements certain recommendations from these studies (discussed below), the IRS finally will have accepted and implemented its Policy Statement 5-100 and the IRS Restructuring and Reform Act of 1998's OIC directives, and made the offer program an integral part of its collection strategy. The IRS now has a roadmap to reinvigorate the OIC program—it just needs to do it.⁷

¹ National Taxpayer Advocate 2009 Annual Report to Congress 196-216; National Taxpayer Advocate 2008 Annual Report to Congress 26-28; National Taxpayer Advocate 2007 Annual Report to Congress 374-387; National Taxpayer Advocate 2006 Annual Report to Congress 83-109, 507-519; National Taxpayer Advocate 2005 Annual Report to Congress 270-291; National Taxpayer Advocate 2004 Annual Report to Congress 226-245, 311-341, 433-50; National Taxpayer Advocate 2003 Annual Report to Congress 99-112; National Taxpayer Advocate 2002 Annual Report to Congress 15-24; National Taxpayer Advocate 2001 Annual Report to Congress 202-215.

² IRS Small Business/Self-Employed Division (SB/SE), *OIC Executive Summary Report* (Sept. 2010). The current economic climate is evidenced by an unemployment rate of nearly ten percent, and one out of every 389 homes in foreclosure. Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey*, available at http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers&series_id=LNS14000000 (last visited Dec. 6, 2010); RealtyTrac, National Real Estate Trends, <http://www.realtytrac.com/TrendCenter/Default.aspx?address=&T=> (last visited Dec. 6, 2010).

³ At the beginning of Fiscal Year (FY) 2010, there were 4,031,093 taxpayers with delinquent accounts. During FY 2010, the IRS accepted only 13,886 offers. SB/SE, Collection Activity Report NO-5000-2.

⁴ SB/SE, Collection Activity Report NO-5000-149, *Recap of Currently Not Collectable Report* (Oct. 1, 2010) (1,302,856 taxpayers were placed in currently not collectible (CNC) status from October 1, 2009, to September 30, 2010). The IRS will suspend collection activity by placing an account into CNC status when it has limited resources to collect the delinquent taxes, it is unable to locate the taxpayer, or the taxpayer is unable to pay.

⁵ Internal Revenue Manual (IRM) 5.8.4.13(5) (June 1, 2010). See also National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

⁶ See The MITRE Corporation, *Offer in Compromise Study* (Jan. 20, 2010); Siegel + Gale, *Offer in Compromise, Strategic Recommendations* (July 31, 2009); IRS, *Collection Process Study*, Final Report (Sept. 30, 2010); IRS, *COIC Streamline Processing Test Executive Briefing* (May 27, 2010).

⁷ IRM 1.2.14.1.18, *Policy Statement 5-100* (Jan. 30, 1992); IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206 (1998); H.R. Conf. Rep. 599, 105th Cong., 2d Sess., 289 (1998).

Status Update: The IRS Offer in Compromise Program Continues to be Underutilized

ANALYSIS OF PROBLEM

Background

An OIC is an agreement in which the government accepts less than the full amount owed in exchange for the taxpayer's promise to comply with tax laws for at least five years.⁸ The IRS's offer program allows for the compromise of tax liabilities based upon doubt as to liability (DATL), doubt as to collectability (DATC), and effective tax administration (ETA).⁹

Most OIC applications fall into the DATC category.¹⁰ IRS procedures allow for the acceptance of a DATC offer when the amount reflects reasonable collection potential (RCP), unless special circumstances exist.¹¹ The IRS calculates RCP as an amount equal to the value of all of the taxpayer's equity in assets, plus four, five, or more years' worth of future income (net of reasonable living expenses).¹²

IRS Policy Statement 5-100 provides that the success of the offer program will depend on taxpayers making offers consistent with their ability to pay. The policy further requires that offers will be accepted in the best interests of the government and the taxpayer to provide a fresh start towards compliance, in lieu of a protracted installment agreement (IA) or placing an account into CNC status.¹³ Yet the IRS reported almost \$29 billion as CNC in FY 2010, and maintains a CNC inventory of over \$66 billion (representing almost 3.1 million taxpayers), and a large inventory of "inactive" cases in its queue.¹⁴

⁸ Internal Revenue Code (IRC) § 7122.

⁹ IRC § 7122; Treas. Reg. § 301.7122-1, *et seq.*; Form 656, *Offer in Compromise* (Mar. 2009); Form 656-B, *Offer in Compromise Booklet* (Mar. 2009). The IRS accepts doubt as to liability (DATL) offers when the IRS has a legitimate doubt the taxpayer owes part or all of the tax liability; and doubt as to collectability (DATC) offers when the IRS doubts the taxpayer could fully pay the tax liability within the statutory period for collection. The IRS accepts effective tax administration (ETA) offers when the taxpayer has no doubt the tax is correct and the IRS may collect the full amount, but "economic hardship" or "equity and/or public policy" conditions are present. IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206 (1998); H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess., 289 (1998); Treas. Reg. § 301.7122-1(b)(3). "Economic hardship" occurs when an individual is unable to pay reasonable basic living expenses. See Treas. Reg. § 301.6343-1.

¹⁰ In FY 2009, IRS Collection received 52,102 offers, of which two percent, or 1,041, were submitted as ETA offers, and the remaining 98 percent were submitted as DATC offers. The IRS also received 1,347 DATL offers in FY 2009, of which none were accepted. SB/SE, *OIC Executive Summary Report* (Sept. 2009). SB/SE response to TAS research request (July 15, 2010). SB/SE response to second TAS research request (Sept. 29, 2010).

¹¹ IRM 5.8.1.1.3(3) (Mar. 16, 2010); IRM 5.8.4.3 (June 1, 2010). The IRS can accept a DATC offer if special circumstances exist that create an economic hardship and prevent a taxpayer from being able to pay the RCP.

¹² IRM 5.8.1.1.3(1) (Mar. 16, 2010).

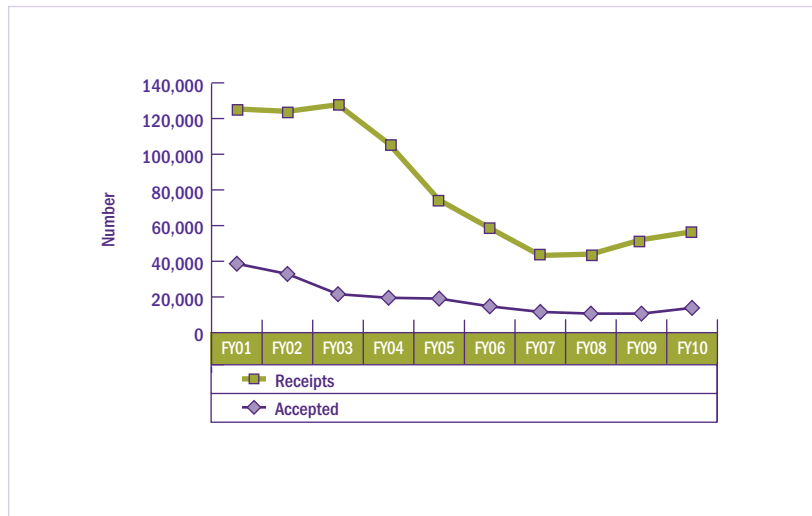
¹³ IRM 1.2.14.1.18 (Jan. 30, 1992).

¹⁴ IRM 5.16.1.1 (June 29, 2010). IRS Policy Statement P-5-71 provides the IRS authority to report an account as CNC for a variety of reasons (e.g., unable to pay, unable to contact or locate, and death). This generally suspends collection actions but the liability is still due and owing; thus, penalties and interest continue to accrue until the statutory period of collection expires. IRS, Collection Activity Report NO-5000-149, *Recap of Accounts Currently Not Collectible Reports* (Oct. 1, 2010). The IRS Collection queue is an inventory of cases awaiting assignment to the Collection Field function. While these cases are considered to be "open" collection accounts, they remain inactive until assigned to a revenue officer. At the conclusion of FY 2010, the IRS reported 3,328,895 Taxpayer Delinquent Accounts (*i.e.*, balance due assessments) as residing in the Collection queue. IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 1, 2010).

The Current State of the OIC Program

As illustrated by Figure 1.23.1 below, the program has experienced a steady decline in offers received and accepted since FY 2001 with a slight improvement in FY 2010.¹⁵

FIGURE 1.23.1, FY 2001 - FY 2010 OIC Receipts and Acceptances



Offer receipts have increased by nine percent and acceptances have risen by 30 percent, yet the IRS accepted less than 14,000 offers while its collection inventory grew to almost 4.3 million taxpayers in FY 2010.¹⁶

IRS Consultants Confirm Deep-Rooted Problems in the Offer Program.

The MITRE Corporation's study of the offer program revealed continuing problems, centered on a lack of leadership and clear policy guidance to employees.¹⁷ Further, MITRE found that offer examiners lack a consistent approach to identifying special circumstances.¹⁸ Another firm, Siegel and Gale, observed that the "eight-step" process described in the OIC forms is misleading and unduly burdensome (and actually involves more than 100 steps) to taxpayers; the instructions are lengthy and detached from the forms; and debt information in the collection information statement, which is the centerpiece of the process, is overlooked by the IRS.¹⁹

¹⁵ IRS, Collection Activity Report NO-5000-108, *Monthly Report of Offer in Compromise Activity (FY 2001-FY 2010)*.

¹⁶ The IRS received 56,539 offers in FY 2010; 4,437 more than in FY 2009. The IRS accepted 13,886 offers in FY 2010; 3,221 more than in FY 2009. SB/SE, *OIC Executive Summary Report* (Sept. 2010); IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Oct. 1, 2010).

¹⁷ See The MITRE Corporation, *OIC Study, Executive Advisory Board Briefing* (Mar. 4, 2010). MITRE noted that under current IRS procedures, taxpayers whose offers are accepted are usually wage earners, are most often represented by a power of attorney (POA), are more likely to have older tax liabilities, own a home with negative equity, and have experienced a life-changing event. The MITRE Corporation, *Offer in Compromise Study* 33 (Jan. 20, 2010).

¹⁸ The MITRE Corporation, *Offer in Compromise Study* 31-32, 34 (Jan. 20, 2010).

¹⁹ Siegel + Gale, *Offer in Compromise, Strategic Recommendations* 10-13 (July 31, 2009).

Status Update: The IRS Offer in Compromise Program Continues to be Underutilized

The National Taxpayer Advocate believes the IRS is taking a positive step by obtaining advice from MITRE and Siegel and Gale, but she does not agree with all of the consultants' recommendations. For example, MITRE recommended simplifying the application form due to concerns that the request for creditor information was confusing taxpayers because it was not used to calculate the offer.²⁰ We believe the IRS should be using this information to evaluate expenses and allowable living expenses (ALEs) to accept more offers (*i.e.*, it should allow payments on unsecured debt when calculating RCP).²¹ Siegel and Gale believed there was too much emphasis on DATL and ETA offers and wanted to change the names of the offer forms.²² However, because the title of the form and these types of offers are dictated by statute and regulations, the IRS should continue to provide these options to taxpayers.

The National Taxpayer Advocate believes the IRS should eliminate the lengthy forms and requirements for substantial amounts of information early in the process. The IRS has access to a significant amount of financial information about the taxpayer, beyond tax information, which it can use to construct an initial financial picture of the taxpayer.²³ The offer process should begin with the submission of a simple application and minimal attached documentation. The examiner would schedule an initial call with the taxpayer to discuss the process and the information needed to continue, which the IRS would document in a letter to the taxpayer. Once the IRS received the information, it would examine and decide whether to accept the offer.

In Improving the Offer Program, the IRS Must Not Lose Touch with Its Customers.

During a focus group conducted at the IRS Nationwide Tax Forums in 2009, one practitioner shared this opinion about the experience dealing with the IRS:

The biggest thing that I see wrong is that the IRS employees have a chip on their shoulders and see the practitioners as the enemy and will not work with them to get the offer accepted. . . . When you get correspondence back regarding an offer and you call them back, no one knows who they are and you can't get a hold of them . . .²⁴

This practitioner's opinion mirrors the results of the most recent customer satisfaction surveys about the offer process.

²⁰ The MITRE Corporation, *Offer in Compromise Study* 19, 23-24 (Jan. 20, 2010).

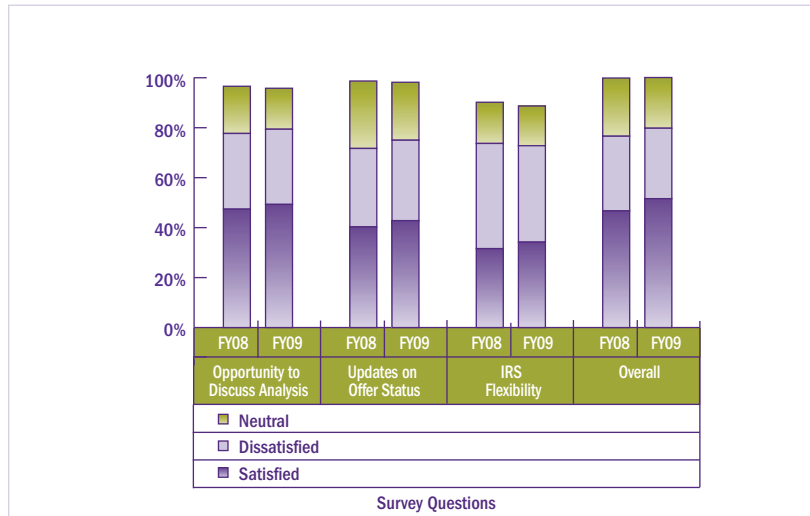
²¹ See Most Serious Problem: *The IRS Does Not Know the Impact of Ignoring Non-IRS Debt When Analyzing a Taxpayer's Ability to Pay an IRS Debt*, *supra*.

²² Siegel + Gale, *Offer in Compromise, Strategic Recommendations* 36 (July 31, 2009); Siegel + Gale, Form 656, *Offer in Compromise* (July 2009).

²³ The COIC gathers Accurant (asset locator tool), DMV records, and internal sources to verify the fair market value of assets to build cases for offer consideration. IRM 5.8.3.4.2 (Mar. 26, 2010). The IRS also has various Internet resources, such as Smart.Alx (for credit bureau research) and LexisNexis (for legal research), and intranet resources. IRM 5.1.18.3 (Sept. 17, 2010).

²⁴ IRS, 2009 Nationwide Tax Forums, OIC focus group conducted by TAS – San Diego (July 14, 2009).

FIGURE 1.23.2, FY 2008 and FY 2009 Combined OIC Field and COIC Customer Satisfaction Survey Results²⁵



In 2009, taxpayers responding to the survey were satisfied with the opportunity to discuss analysis, updates on offer status, and IRS flexibility 49, 42, and 34 percent of the time, respectively. Many respondents felt the first consideration for the IRS is how to reject an offer.²⁶ One reason for the high levels of customer dissatisfaction may be how the IRS defines offer program “success.” COIC quality measures include customer accuracy, professionalism, timeliness, and disposition time, but not whether offer examiners consider special circumstances or educate taxpayers about the offer process.²⁷

The Results of the IRS Collection Process Study and Recent Changes to COIC Procedures May Begin the Revival of the Offer Program.

In May 2010, SB/SE briefed IRS executives on its plan to test new procedures to increase efficiencies and improve the quality of OIC case decisions. The procedures are designed to “streamline” the COIC process by eliminating non-value added actions, and reduce taxpayer burden by reducing documentation requirements and placing renewed emphasis on telephone contacts in lieu of standard written communication. The procedures also introduce more flexibility for case decisions made by COIC offer examiners by adjusting requirements for evaluating the equity in assets, and the value of payments the IRS may

²⁵ SB/SE, *Offer in Compromise Customer Satisfaction Survey Results for FY09* 9 (June 30, 2010), SB/SE, *Offer in Compromise Customer Satisfaction Survey Results for FY08* 9 (June 30, 2009). The sum of the percents for some response choices does not equal 100 percent because “not applicable” responses are not shown.

²⁶ SB/SE, *Offer in Compromise Customer Satisfaction Survey Results for FY09*, Brookhaven 51-15 (“rejection or returning of offers without the opportunity to provide additional information makes it seem like the agent is just trying to get rid of the offers”); Brookhaven 51-21 (“too many offer examiners are under pressure to “close” offers by rejection outright”); Memphis 52-3 (“it seems that a rejection is the first concern, rather than making the offer acceptable to both parties...”); Memphis 52-20 (“no flexibility on part of IRS . . . rejection letter - then case closed”); South Atlantic 53-2 (“due to lack of response or inability to negotiate a positive outcome (for both IRS and the taxpayer), the IRS seems to be unable or unwilling to find an agreeable result and would instead prefer rejection or return of the offer . . .”); Gulf States 54-18 19 (“the process . . . is geared towards rejection of offers”) (June 30, 2010).

²⁷ The MITRE Corporation, *Offer in Compromise Study* 36, 43-45 (Jan. 20, 2010); IRM 5.13.4 (Aug. 28, 2009).

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receive from the taxpayer's future income.²⁸ These procedures are in place for cases involving wage earners, unemployed individuals, and self-employed taxpayers who fit certain criteria.²⁹ SB/SE intends to evaluate the results of this new approach at the end of the calendar year.

While it may be too soon to draw firm conclusions, it appears that early results of the modified COIC procedures are very encouraging. IRS data reflect significant increases in the number of offers accepted by COIC (*e.g.*, during the fourth quarter of FY 2010, COIC accepted 87 percent more offers than in the same period of FY 2009, and the dollars accepted in these offers increased by 64 percent).³⁰ During the same period, program performance in the OIC Field operation did not reflect corresponding improvements, and dollars accepted in compromise by the OIC Field groups (excluding Appeals) decreased by 42 percent during FY 2010.³¹ While the COIC improvements may not be entirely attributable to the new process, it certainly appears that this initiative has installed a new perspective in the manner in which OICs are being worked in these units. The National Taxpayer Advocate is encouraged by these indicators and looks forward to reviewing the ongoing results of the new "streamlined" processing and SB/SE's analysis of this effort, including plans to expand the application of these procedures to the general OIC program.

There is further evidence of potential improvements to the OIC program. In response to the National Taxpayer Advocate's concerns about IRS collection practices, the IRS Deputy Commissioner for Services and Enforcement chartered the Collection Process Study (CPS) to review collection practices, identify potential improvements, and recommend enhancements.³² Concerning the offer program, the CPS recommends the IRS develop and implement more realistic expense standards, redefine RCP, and implement an OIC outreach campaign for low income taxpayers in CNC status.³³

Specifically, the CPS proposes to make the ALE standards more flexible by allowing taxpayers' actual expenses less than 110 percent of the established national standards, developing separate expense standards for taxpayers who rent or own their homes, and permitting **minimum** payments on certain debts junior to the federal tax lien (*e.g.*, state tax debts, credit cards, and student loans).³⁴ Further, the CPS recommends that the IRS:

²⁸ IRS, *COIC Streamline Processing Test Executive Briefing 6* (May 27, 2010). The RCP typically includes the value of all of the taxpayer's assets plus future income (net of reasonable living expenses) for 48, 60, or the number of months remaining in the statutory period for collection depending on the payment terms of the offer. IRM 5.8.5.6(1) (Sept. 30, 2008).

²⁹ IRS, *COIC Streamline Processing Test Executive Briefing 5* (May 27, 2010).

³⁰ IRS, Collection Activity Report NO-5000-108, *Monthly Report of Offer in Compromise Activity* (Oct. 4, 2010 and Oct. 6, 2009). These data reflect only COIC activity, and do not include offers accepted by Appeals.

³¹ *Id.*

³² IRS, *Collection Process Study, Final Report 1* (Sept. 30, 2010).

³³ *Id.* at 8-10.

³⁴ *Id.* at 89.

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- Revise Policy Statement 5-100 to state that the RCP should reflect the “amount of delinquent taxes that the IRS actually expects to collect from the taxpayer if the OIC is rejected;”
- Adopt procedures to eliminate the inclusion of dissipated assets, exclude up to \$2,500 equity in vehicles, use forced sale value (75 percent of value) instead of quick sale value (80 percent) for personal residences, exclude up to \$400 in retired debt attributed to a vehicle loan, waive or eliminate the 20 percent down payment requirement; and
- Define “protracted installment agreement” as an IA that lasts five years or the remaining statutory period for collection, whichever is shorter.³⁵

The National Taxpayer Advocate applauds the CPS for recommending steps that support her proposals in current and past annual reports, and looks forward to seeing these recommendations implemented.³⁶

CONCLUSION

The offer program provides an excellent opportunity to give taxpayers a fresh start while enhancing the government’s goal of bringing taxpayers into compliance. The IRS’s attempts to enhance this program will fall short unless it looks at taxpayers’ complete financial situations, uses the appropriate measures, gathers comments from customers, and clearly communicates goals for OIC acceptance and future compliance to its employees.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS take the following specific actions to improve the OIC program:

1. Adopt the Collection Process Study recommendations concerning allowable living expenses, reasonable collection potential, and OIC outreach for low income taxpayers in currently not collectible status.
2. Expand the scope and incorporate the positive elements of the Centralized Offer in Compromise unit’s new streamlined processing procedures into routine IRM direction covering all OICs, including those worked in the OIC Field operation.
3. Revamp OIC quality reviews to evaluate whether offer examiners consider special circumstances and educate taxpayers about the offer process.

³⁵ IRS, *Collection Process Study, Final Report* 91-92 (Sept. 30, 2010).

³⁶ See Most Serious Problem: *The IRS Does Not Know the Impact of Ignoring Non-IRS Debt When Analyzing a Taxpayer’s Ability to Pay an IRS Debt*, *supra*; National Taxpayer Advocate 2009 Annual Report to Congress 216. The recommendations to the IRS included, among other things, reinstating its 1992 procedures to more closely follow Policy Statement 5-100, recommending OICs consistent with the collectibility curve to taxpayers whose tax liabilities have aged more than three years, requiring offer processors to build an offer file with information the IRS already has, and offer examiners or offer specialists exploring potential offers with taxpayers by telephone.

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4. Conduct periodic studies to review taxpayer compliance one to ten years after offer acceptance and rejection (*i.e.*, did the IRS collect what was offered, did the taxpayer stay compliant, and for how long).

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

RESPONSIBLE OFFICIAL

Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

Any individual who has a tax return filing obligation but is not eligible to obtain a Social Security number (SSN) must apply to the IRS for an Individual Taxpayer Identification Number (ITIN).¹ Yet the IRS processes most ITIN applications only when they are attached to paper returns, which creates a recurring bottleneck of ITIN applications and tax returns during peak tax season, totaling 1.6 million applications and more than 960,000 returns in 2010 alone.² This policy precludes first-time ITIN applicants from filing electronic returns, and causes backlogs of hundreds of thousands of unworked and suspended applications.³ Taxpayers whose applications are suspended may also have their refunds delayed for as long as eight months.⁴ Of the 117,000 suspended applications as of April 10, 2010, 115,000 (98 percent) had associated and still unprocessed paper tax returns.⁵ A prior year analysis of ITIN returns showed that 83 percent of the taxpayers were due refunds totaling more than \$500 million.⁶

For several years, the National Taxpayer Advocate has expressed serious concerns about IRS processing of ITIN applications and associated tax returns.⁷ This status update on the ITIN program will discuss recent improvements to IRS processes and procedures and address the following concerns:

- Inefficient ITIN processing, resulting in recurring seasonal bottlenecks of ITIN applications; and
- Extended delays in processing hundreds of thousands of tax returns and refunds annually when the associated ITIN applications are suspended.

¹ Internal Revenue Code (IRC) § 6109; Treas. Reg. § 301.6109-1(d)(3).

² IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*.

³ On April 11, 2009, the ITIN Program Office had 360,000 unworked applications in inventory, of which 347,000 (97 percent) included unprocessed paper tax returns. On March 20, 2010, the IRS had another peak of unworked applications totaling 195,000, of which 192,000 (99 percent) had unprocessed paper returns. IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. All percentages hereinafter are computed from the unrounded numbers.

⁴ Internal Revenue Manual (IRM) 3.21.263.7.3 (Jan. 1, 2010); IRM 21.4.1.3 (May 10, 2010). See also IRS, *ITIN Production Report, Yearly Comparative Data* (2008, 2009, and 2010).

⁵ IRS, *ITIN Production Report, Yearly Comparative Data* (Apr. 10, 2010).

⁶ IRS, *Individual Taxpayer Identification (ITIN) Usage Analysis for 2004 (Follow-on) Project # 4-06-25-2-051N* (March 2007).

⁷ See National Taxpayer Advocate 2009 Annual Report to Congress 520-522; National Taxpayer Advocate 2008 Annual Report to Congress 126-140; National Taxpayer Advocate 2004 Annual Report to Congress 143-162; National Taxpayer Advocate 2003 Annual Report to Congress 60-86. In 2003, 2004, and 2008, the National Taxpayer Advocate identified the IRS's failure to timely process ITIN applications as a Most Serious Problem.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

ANALYSIS OF PROBLEM

Background

The National Taxpayer Advocate addressed problems with the processing of ITIN applications or associated tax returns in the 2003, 2004, 2008, and 2009 Annual Reports to Congress. In February 2009, the National Taxpayer Advocate issued a Taxpayer Advocate Directive⁸ directing the IRS to develop a process that allows taxpayers to obtain ITINs during the year without an associated return, upon proof of employment and withholding (or self-employment).⁹ The National Taxpayer Advocate has briefed the Commissioner regarding the changes to the ITIN process mandated in the directive, and continues to advocate on this matter at the highest levels of IRS leadership. However, the IRS has not adequately addressed these concerns or acted to acknowledge, and more importantly alleviate, the undue hardship placed on these taxpayers.

Recent Improvements to ITIN Processes and Procedures

The National Taxpayer Advocate applauds the IRS's recent steps to assist decedent and minor ITIN applicants, and commends the IRS for beginning to measure unworked ITIN inventory. Acting on the National Taxpayer Advocate's recommendations from the 2008 Annual Report to Congress and Taxpayer Advocate Directive 2009-1,¹⁰ the IRS made significant progress in improving ITIN processes and procedures. This includes the following:

- The IRS began measuring the backlog of unworked ITIN inventory in 2008;¹¹
- As the result of an agreement with TAS, effective April 1, 2009, the IRS reversed its prior policy and began routinely assigning ITINs to qualified decedents so long as a death certificate was submitted for the applicant.¹² The Wage and Investment (W&I) Division promptly issued guidance to IRS employees, changed the Internal Revenue Manual (IRM), and electronically notified all ITIN acceptance agents;¹³
- In 2010, the IRS revised instructions for Form W-7, *Application for Individual Taxpayer Identification Number (ITIN)*, and Publication 1915, *Understanding Your IRS Individual Taxpayer Identification Number*, regarding the issuance of ITINs to decedents;¹⁴ and
- The IRS acted promptly on the National Taxpayer Advocate's concern about the then-new requirement for all minor applicants to submit birth certificates. The requirement

⁸ See Taxpayer Advocate Directive (TAD) 2009-1 (Processing of Forms W-7/Filing of ITIN Applications and Associated Tax Returns) (Feb. 25, 2009), *infra*.

⁹ *E.g.*, three consecutive pay stubs or other payment documentation, employment or independent contractor commitment letters or contracts, Forms 1099-MISC, *Miscellaneous Income*, etc.

¹⁰ See National Taxpayer Advocate 2008 Annual Report to Congress 140; TAD 2009-1 (Feb. 25, 2010).

¹¹ See IRS, *ITIN Production Report, Yearly Comparative Data* (Sept. 27, 2008).

¹² On May 5, 2009, the National Taxpayer Advocate signed a formal memorandum of understanding with the Director of W&I Submission Processing on ITIN application procedures for deceased applicants.

¹³ Servicewide Electronic Research Program (SERP) Alert 090413, *Change in ITIN Decedent Policy* (Apr. 10, 2010); IRM 3.21.263.6.1.36 (Apr. 10, 2009); IRM 3.21.263.7.8 (Apr. 10, 2009).

¹⁴ Instructions for Form W-7 (Jan. 2010); IRS Publication 1915, *Understanding Your IRS Individual Taxpayer Identification Number* (2010).

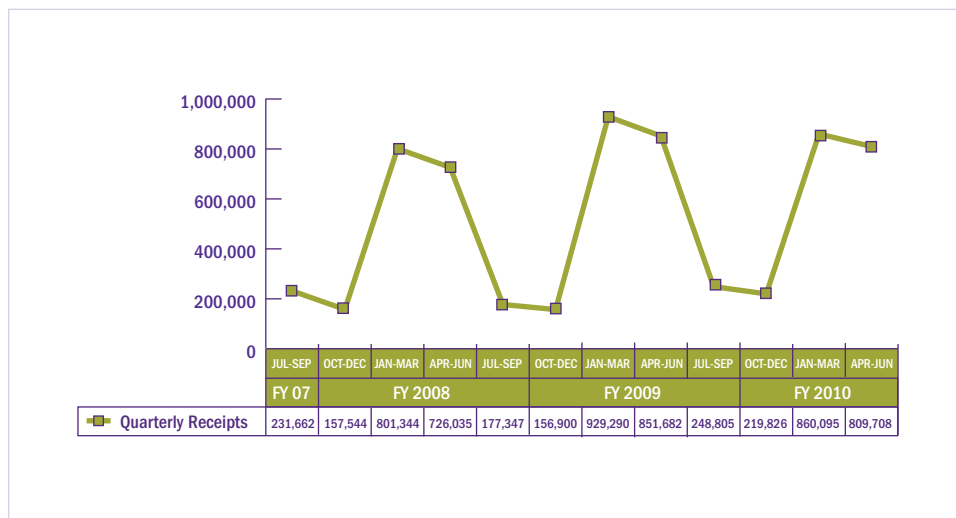
Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

was not properly communicated and was burdensome and unnecessary for applicants who submitted passports.¹⁵ The IRS updated the form instructions and agreed to process ITIN applications of dependents, including deceased minors, without birth certificates if a passport or at least two acceptable identification documents are enclosed.¹⁶

ITIN Processing Remains Inefficient and Causes Recurring Seasonal Bottlenecks of ITIN Applications During Peak Tax Season.

The IRS processes most ITIN applications only when they are associated with attached paper returns. As shown in Figure 1.24.1 below, this policy results in a recurring bottleneck of about 900,000 ITIN applications during peak tax return filing season.¹⁷

FIGURE 1.24.1, ITIN Receipts by Quarter, FY 2007 – FY 2010¹⁸



¹⁵ Prior to January 2, 2009, the IRS accepted medical and school records or a national identity card for minors. IRM 3.21.263.4.7 (Oct. 14, 2008). For purposes of an ITIN application, a minor is anyone under 14 years of age (under 18 if a student). IRM 3.21.263.4.7 (Mar. 31, 2009).

¹⁶ IRM 21.3.4.20.11 (July 24, 2009) and IRM 3.21.263.6.1.36 (Jan. 1, 2010). See also IRM 3.21.263.4.7 (Jan. 15, 2010). Systemic Advocacy Management System (SAMS) Project 15154 successfully negotiated the update to IRM 3.21.263.5.3.4 (July 24, 2009).

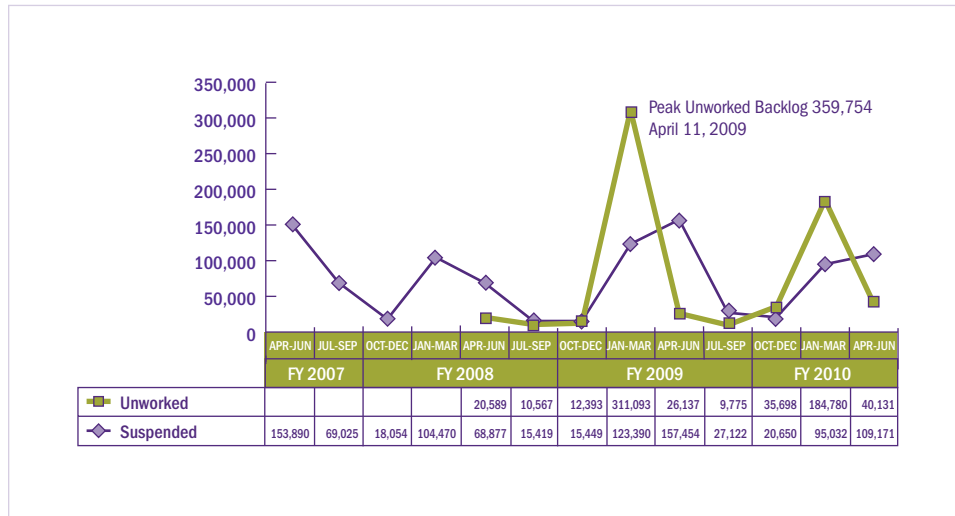
¹⁷ IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*.

¹⁸ IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. In FY 2010, April-June figures are from the period ending June 12, 2010.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

These seasonal bottlenecks strain IRS resources and create repeated backlogs of unworked and suspended ITIN applications, as illustrated by Figure 1.24.2 below.¹⁹

FIGURE 1.24.2, Unworked and Suspended ITIN Application Backlogs by Quarter, FY 2007 – FY 2010²⁰



On April 11, 2009, the ITIN Program Office had 360,000 *unworked* applications in inventory, of which 347,000 (97 percent) included unprocessed paper tax returns as shown on Figure 1.24.2.²¹ On March 20, 2010, the IRS had another peak of unworked applications totaling 195,000, of which 192,000 (99 percent) had unprocessed paper returns.²²

Although the peak unworked inventory declined significantly from FY 2009 to FY 2010, the year-end inventory for calendar year 2009 rose by about 29 percent from 27,000 on December 31, 2008, to 34,000 on December 31, 2009.²³ The ITIN Program Office explained the growth by citing a 27 percent increase in scheduled receipts and a planned management action to carry over sufficient inventory for training purposes.²⁴ The National Taxpayer Advocate is concerned that the IRS intentionally delayed the processing of ITIN

¹⁹ The IRS began measuring unworked inventory in June 2008 in response to a recommendation from the National Taxpayer Advocate’s 2008 Annual Report to Congress. See IRS, *ITIN Production Reports, Yearly Comparative Data* (June 28, 2008), measure titled *Applications Awaiting Input*. See also National Taxpayer Advocate 2008 Annual Report to Congress 140.

²⁰ IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. Unless otherwise noted, all figures reflect inventory levels at the end of the quarter and do not necessarily show peak inventory. For example, the peak of 359,754 unworked ITIN applications for FY 2009 occurred in the week ending April 11, 2009 (the ending unworked ITIN inventory for the preceding quarter was 311,093 on March 28, 2009). In FY 2010, April-June figures are from the period ending June 12, 2010.

²¹ *Id.* All percentages hereinafter are computed from the unrounded numbers.

²² *Id.* See particularly *ITIN Production Report, Yearly Comparative Data* (Mar. 20, 2010).

²³ The IRS had 47,017 unworked ITIN applications on December 31, 2009, of which 12,700 were fraudulent cases placed in the system temporarily to allow the IRS to revoke the ITINs. E-mail from Program Manager, ITIN Policy Section (Feb. 2, 2010).

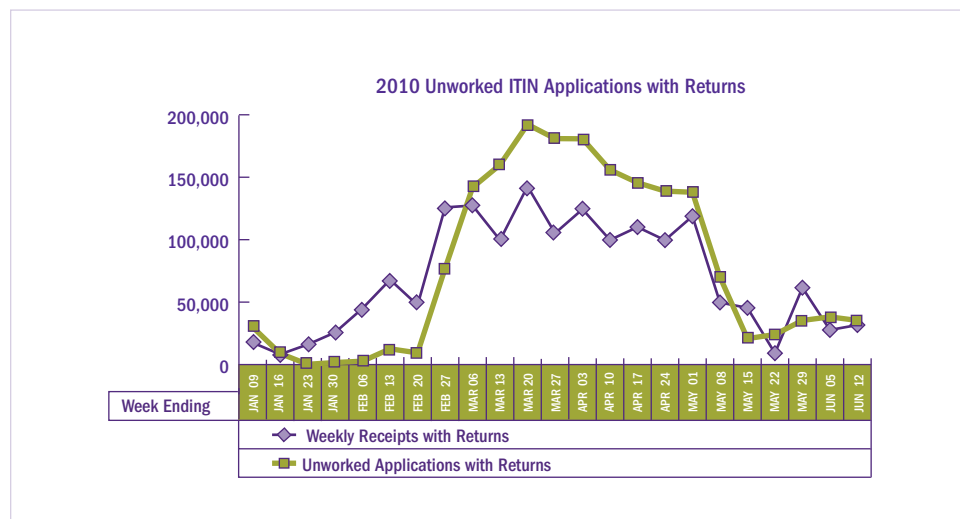
²⁴ E-Mail from Program Manager, ITIN Policy Section (Feb. 2, 2010).

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applications for training purposes. Such action unnecessarily harms affected taxpayers and is unacceptable from both tax administration and taxpayer service perspectives.

A similar comparison of unworked applications to weekly receipts from January to June 2010 (see Figure 1.24.3) shows the current policy creates a cycle in which, despite employees' best efforts, the IRS cannot keep up with ITIN applications and tax returns.

FIGURE 1.24.3, Unworked ITIN Applications with Returns, January to June 2010²⁵



Current IRS Policy Delays the Processing of Hundreds of Thousands of Returns Annually When the Associated ITIN Applications are Suspended.

The seasonal strain on IRS resources also delays the processing of tax returns filed with suspended applications.²⁶ As Figure 1.24.2 shows, the IRS has high volumes of suspended applications during the second and third quarters of each fiscal year, corresponding to its peak return processing periods. By June 27, 2009, the IRS had 157,000 suspended applications in inventory compared to 69,000 on June 28, 2008, an increase of 129 percent.²⁷ Thus, a relatively small increase of roughly 128,000 applications (16 percent) in the first three months of the 2009 filing season over the previous year caused a substantial increase of about 89,000 (or 129 percent) in the suspense inventory.²⁸

²⁵ IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*. In FY 2010, April-June figures are from the period ending June 12, 2010.

²⁶ The IRS suspends an ITIN application if documentation necessary for its processing is missing. The associated tax return with a suspended application is also suspended and will not be processed until the suspense period has elapsed. See IRM 3.21.263.5.2.8(2) (Jan. 1, 2010); IRM 3.21.263.5.2.11(2) (Oct. 14, 2008).

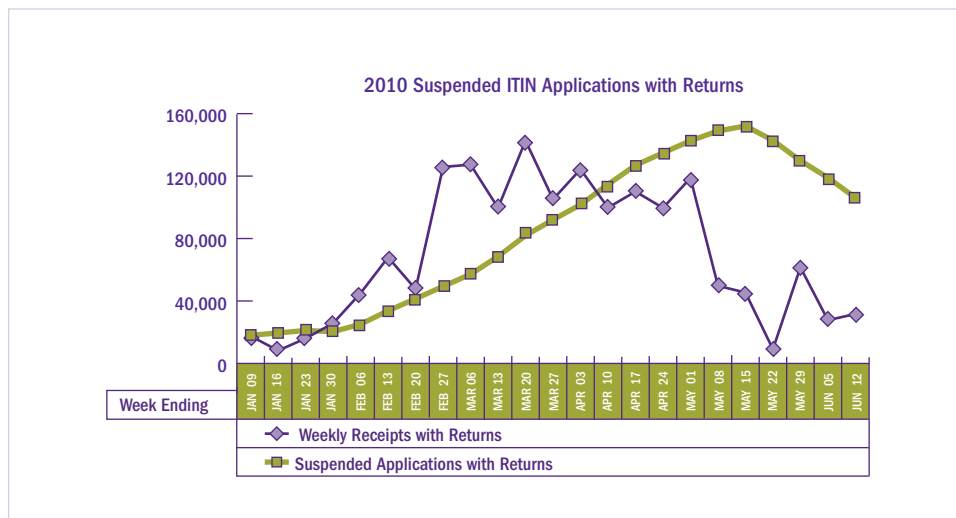
²⁷ IRS, *ITIN Production Report, Yearly Comparative Data* (June 28, 2008, and June 27, 2009).

²⁸ IRS, *ITIN Production Report, Yearly Comparative Data* (Mar. 29, 2008, and Mar. 28, 2009). The IRS received 801,344 applications in 2008 compared to 929,290 in 2009.

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The policy of requiring most ITIN applicants to file tax returns with their applications also requires the IRS to postpone processing those returns until it assigns or denies the ITIN. Taxpayers whose ITIN applications are suspended may experience a delay of as long as eight months in receiving refunds.²⁹ For example, of the 117,000 suspended applications as of April 10, 2010, 115,000 (98 percent) had associated and still unprocessed paper tax returns.³⁰ However, the IRS does not measure the total numbers of unworked and suspended applications and the average days for resolution on the ITIN Real Time System, its inventory management system.³¹ Figure 1.24.4 below compares suspended ITIN applications filed with returns to weekly ITIN receipts, showing that the IRS’s approach to ITIN processing consistently creates a large backlog of unprocessed returns. These delays impose a significant burden on taxpayers.³²

FIGURE 1.24.4, Suspended ITIN Applications with Returns from January to June 2010³³



²⁹ IRM 3.21.263.7.3 (Jan. 1, 2010) and IRM 21.4.1.3 (May 10, 2010) provide standard timeframes for ITIN refund processing: a total of 16-18 weeks for issuing a refund if the ITIN application is filed during peak filing season (January 15 through April 30), and an additional 12-14 weeks from the time of mailing of any requested supporting documentation if an ITIN application was suspended.

³⁰ IRS, *ITIN Production Report, Yearly Comparative Data* (Apr. 10, 2010).

³¹ IRM 3.21.263.5.11 (Oct. 14, 2008) lists the management reports currently available from the ITIN Real Time System, the database used for processing ITIN applications.

³² Foreign persons selling U.S. real property interests make up another class of taxpayers who are unduly burdened by the requirement to file a return before obtaining an ITIN. For example, escrow agents must often withhold taxes and file withholding tax returns, but without a pre-assigned TIN, problems occur when the taxpayer attempts to claim withholding on a tax return. For a description of the convoluted process of processing ITINs for Foreign Investment in Real Property Tax Act of 1980 withholding, see IRM 3.21.263.5.9.1(3) (Oct. 14, 2008). See also SAMS Project 16762.

³³ IRS, *ITIN Production Reports, Yearly Comparative Data* (Jan. 9 through June 12, 2010).

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CONCLUSION

Because most ITIN applications are attached to tax returns, the IRS must process a 12-month ITIN workload in the four-month filing season. Regular, non-seasonal processing of ITIN applications would be less burdensome to taxpayers and more efficient for the IRS. Thus, the National Taxpayer Advocate offers these preliminary recommendations:

1. Assign ITINs throughout the year upon proof of employment or self-employment; and
2. Measure the timeliness of ITIN processing on the Real Time System, including the total numbers of unworked and suspended applications and the average days for resolution.

IRS COMMENTS

ITIN Accomplishments

The IRS received over two million applications and issued over 1.8 million ITINs during 2009. Through mid-September 2010, the IRS received over 1.9 million applications and assigned over 1.6 million ITINs. These figures represent a significant increase from 1.5 million applications and less than one million ITINs assigned in 2004 and reflect the IRS's commitment to meeting the needs of non-resident and resident alien taxpayers in meeting their U.S. tax return filing and payment requirements.

We appreciate the National Taxpayer Advocate's acknowledgement of the improvements made in the ITIN program. The IRS continually strives to provide the best possible service without unduly burdening the taxpayer while preserving the integrity of the tax system. In addition to the improvements noted by the National Taxpayer Advocate, we are very pleased to report that there have been numerous additional enhancements.

The IRS implemented new mandatory training for all Acceptance Agents (AA). AAs are individuals or entities, such as colleges, financial institutions, accounting firms, etc., that have entered into formal agreements with the IRS that enable them to assist alien applicants in obtaining ITINs. Certifying Acceptance Agents (CAA) are AAs that are also authorized to verify an applicant's identity and foreign status on behalf of the IRS, thus further facilitating and streamlining the ITIN application process for these taxpayers. This training ensures all AAs and CAAs have the basic knowledge to assist resident and non-resident aliens in obtaining ITINs for federal tax administration purposes. During 2010, the IRS also implemented its first ITIN Filing Season Readiness Webinar specifically designed to provide the latest ITIN-related information and address questions or issues raised by AAs in anticipation of the coming filing season.

The IRS established quality standards and implemented a quality review program to measure the accuracy of AA submissions and delivered new reporting capabilities for use in monitoring AA activities. If an AA's quality is below established standards, the IRS now has a three-step monitoring program to improve quality that includes a warning, probation,

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

and termination process. IRS also developed an ITIN AA Compliance Review Program that is conducted by IRS Revenue Agents on-site to evaluate the quality of AAs' adherence to program requirements. These reviews validate the accuracy of W-7 applications and ensure compliance with document retention standards and office security requirements as required in Revenue Procedure 2006-10. The thoroughness of these reviews is reflected in the fact that 237 such visits during 2010 resulted in issuance of 138 warning letters, 27 probation letters, and 50 recommendations for removal from the program.

The IRS established a standard open season from May through August for accepting AA applications. This ensures fair and equitable treatment of all applicants, gives practitioners sufficient time to apply without adversely impacting the filing season, establishes parity among practitioners, and improves the use of IRS resources. The IRS also implemented a 100 percent FBI background check for all AA applicants.

The IRS is improving the customer experience in applying for an ITIN by increasing the number of CAAs available at IRS-sponsored Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites. These sites provide free tax return preparation assistance and taxpayer education for low income and elderly taxpayers. IRS is also improving its guidance and procedures for assisting taxpayers requesting ITIN assistance at our nationwide Taxpayer Assistance Centers.

The IRS is improving its employees' experience by completely revising IRM 3.21.236 to update and clarify procedures related to the ITIN Real Time System (RTS) used by IRS employees to process ITIN applications. IRM 3.21.264 was also updated to include clear and effective procedures for accurately processing Form 13551, *Application to Participate in the ITIN Acceptance Agent Program*.

The IRS increased its efforts to reduce tax fraud by working closely with the IRS Criminal Investigation Division to identify schemes that rely on the use of ITINs to claim fraudulent refunds. Finally, the *ITIN Production Report* reflects that cycle times for W-7 applications significantly improved in 2010.

TABLE 1.24.5, Form W-7 Cycle Times

	April 11, 2009	April 10, 2010
With Return		
To Input	18 days	11 days
To Final Disposition	26 days	18 days
Without Return		
To Input	28 days	11 days
To Final Disposition	36 days	29 days

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

IRS Policy of Requiring ITIN Applications to Include Tax Returns

With respect to the issues raised in the report, the IRS disagrees with the report's definition and analysis of the problem, as well as the conclusions and preliminary recommendations. As noted below, we believe this analysis is flawed and that the conclusions are based on erroneous characterizations of IRS performance.

The National Taxpayer Advocate recommends the IRS allow taxpayers to obtain ITINs throughout the year without an associated return, upon proof of employment and withholding (or self-employment). The report contends the current requirement to attach a tax return to the Form W-7, *ITIN Application*, is the cause of recurring seasonal bottlenecks in processing ITIN applications. This recommendation ignores the valid tax administration purpose for the requirement to attach a return to Form W-7.

In 1996, the U.S. Department of the Treasury issued regulations that introduced the ITIN and required foreign persons to use an ITIN as their unique identification number on federal tax returns (see T.D. 8671, 1996-1 C.B. 314). These regulations were intended to address the concern by the IRS and Treasury Department that without a unique number, taxpayers could not effectively be identified and their tax returns could not be efficiently processed. As a result, ITINs are issued by the IRS to non-resident and resident alien individuals that do not have, and do not qualify for, a Social Security number (SSN). ITINs enable these individuals to comply with U.S. tax laws and provide the IRS a means to effectively process and account for their returns and payments. An ITIN does not authorize work in the U.S., establish immigration status, or provide a valid form of identification outside of the federal tax system. For this reason, the IRS does not apply the same strict standards as agencies that provide genuine identity certification, such as a requirement to apply in person or third-party verification of identity documentation.

Because most ITIN applications are received from resident aliens, in December 2003, the IRS adopted a requirement for most ITIN applicants to attach a valid tax return to their Form W-7 application. Resident aliens include non-citizens that do not have, and do not qualify to obtain, an SSN. As a result, the preponderance of ITIN applications from resident aliens employed in the U.S. represent applications from foreign nationals working in the U.S. illegally. This fact has been noted by the Government Accountability Office and the Treasury Inspector General for Tax Administration (see GAO-04-529T and TIGTA Audit # 200230050). As a result, this procedure was designed to ensure that the ITIN assigned to such alien individuals is used for its proper tax administration purpose. Associating the issuance of the ITIN with the filing of a tax return is the only reliable method for IRS to verify the number is being requested and used for tax administration purposes. As a result, ITINs are no longer issued solely based upon a statement that an applicant requires an ITIN in order to file a return without proof that the individual actually needs the number to do so.

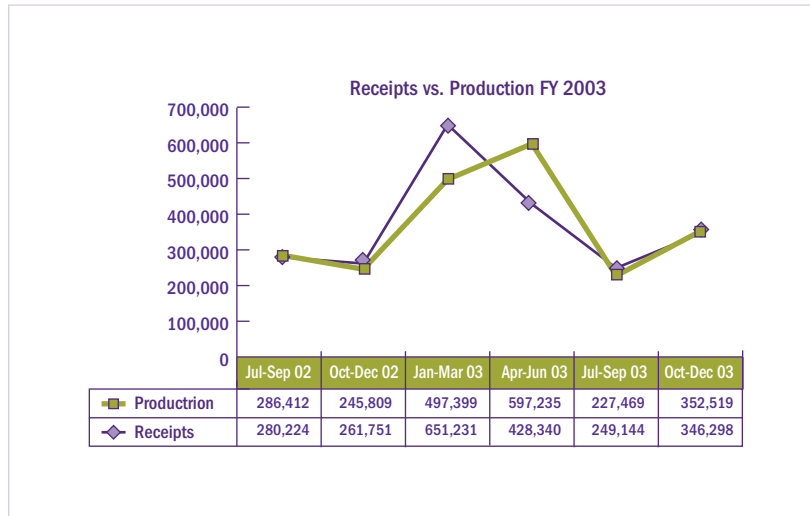
Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

The IRS had, and continues to have, significant and valid concerns that ITINs were being requested for non-tax purposes, such as for obtaining a driver's license. Because a growing number of states were beginning to accept ITINs for driver's license purposes, in August 2003, the IRS took the unprecedented step of sending letters to the department of motor vehicles in each state to alert them to the risks of accepting ITINs as a form of non-tax identification. In March 2004, this and related concerns about potential misuse of ITINs were also the subject of a joint hearing before the House Ways and Means Subcommittees on Oversight and Social Security. During this hearing, the General Accounting Office, now the Government Accountability Office, testified that it was able to obtain a bogus ITIN and use it for a variety of non-tax purposes that could allow someone to blend into society under a false identity. In light of these concerns, the IRS believes the requirement to attach a return to the Form W-7 ITIN application strikes a reasonable balance between the competing objectives of facilitating aliens' compliance with U.S. tax laws and ensuring, to the extent possible, that ITINs are not issued for purposes other than federal tax administration. The National Taxpayer Advocate's recommendation to assign ITINs upon proof of employment or self-employment in lieu of the requirement to file a tax return with the ITIN application will not achieve the same degree of assurance. Submission of a pay stub by a resident alien that may reflect use of a stolen or false SSN for employment (or similar claim of self-employment) does not establish or equate to the intent to file a U.S. tax return.

In support of the recommendation, the National Taxpayer Advocate maintains that the requirement to file a return with the ITIN application is inefficient and causes recurring seasonal bottlenecks of ITIN application during peak tax season. The receipt pattern shown in the report properly depicts the increase in applications immediately before and after the due date for individual tax returns. However, as reflected in the chart below, an analysis of ITIN applications received in 2003 (the year prior to the requirement to attach a tax return to the ITIN application) shows the very same increase in volume at the same time of year. As a result, the seasonal increase in applications identified by the National Taxpayer Advocate cannot be directly associated with the mandate requiring a tax return with an ITIN application. The 2003 ITIN application receipt pattern also parallels the receipt patterns for income tax returns. As a result, it is just as logical to surmise that the ITIN application receipt patterns the National Taxpayer Advocate is concerned about would continue even without the requirement to attach a return as resident-alien taxpayers focus on their return filing requirements during the filing season similar to U.S. citizens.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

FIGURE 1.24.6, ITIN Applications and Production, FY 2003



The report also raises concerns that the IRS intentionally delays the processing of ITIN applications for training purposes, thus further contributing to peak season inventories. The IRS does not routinely hold ITIN applications for training purposes. All classroom training utilizes manually prepared work examples (dummy applications). Once the classroom training is complete and employees report to their new jobs, generally in January/February, on-the-job (OJT) training continues as the employees work live cases. As the National Taxpayer Advocate’s report reflects, there are recurring seasonal peaks of ITIN applications beginning in January at about the same time new employees are reporting to their jobs. Consequently, there is no need for the IRS to carry over live work for OJT purposes. This assertion by the National Taxpayer Advocate is based on an e-mail exchange that occurred unrelated to development of the National Taxpayer Advocate’s 2010 Annual Report to Congress and that does not reflect the practice of the IRS. The IRS disagrees with the assertion in the report.

With regard to the National Taxpayer Advocate’s additional concern that taxpayers who are filing an ITIN application with a tax form are not able to file electronically and may not receive their refunds as quickly as other taxpayers, it is important to note that a taxpayer must apply for and obtain an ITIN only with their initial tax return. This is necessary to ensure an ITIN is used for its intended purpose. As a result, the taxpayer is unable to file electronically for the first year only. Any subsequent years are not affected. We believe the requirement to attach a return to the ITIN application and the one-time need for an alien taxpayer to file a paper tax return is reasonable and prudent in light of the concerns outlined above.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

Timeliness of ITIN Processing

The seasonal inventory figures cited in the report are largely irrelevant to the discussion of the issue. Multiple IRS programs have inventories that fluctuate. Seasonal inventories are successfully managed by the IRS's ability to plan for and work these inventories. In the ITIN program, our 2010 goal for input of applications submitted with tax returns is 11 business days, seven days less than 2009. Despite the inventories cited in the report, the *ITIN Production Report* reflects that ITIN applications with returns were input in 18 days as of mid-April 2009 and 11 days as of mid-April 2010.

The IRS also disagrees with the generalization that taxpayers whose applications are suspended may also have their refunds delayed for as long as eight months. While theoretically possible, this is not the norm and is based on the National Taxpayer Advocate's interpretation of cited IRM provisions that instruct IRS Accounts Management employees how to respond to refund inquiries. In fact, IRM 3.21.263.7.3, cited in the report, contains no tax return processing timeframes for ITIN returns at all; rather it cautions employees to refer to the guidelines for refund return processing timeframes that apply to all tax returns. IRM 21.4.1.3, also cited in the report as a basis for this statement, is the procedures used by Accounts Management employees in responding to any refund inquiries. It is important to understand that ITIN applications are only suspended because they are incomplete and IRS needs additional information from the applicants before it can properly process their applications. The maximum time allowed for any suspended application is 65 days (IRM 3.21.263.5.10.5.1), after which the IRS will reject the application and process the attached return without assigning an ITIN. However, the *ITIN Yearly Comparative Report* for the week ending April 10, 2010 (a peak period) reflects the average final disposition for ITIN applications with returns was 18 days, down from 26 days in the prior year. Final disposition is the time in days to process all ITIN applications that were complete, *and includes cases in suspense with return*. Once cases in suspense are perfected or the taxpayer fails to respond, the attached paper tax return is processed in the same manner – and with the same speed – as any other paper tax return.

Further, timeliness is measured for all categories in the ITIN program, including W-7 applications that are considered perfected, suspended, or rejected. The IRS measures cycle time from the date a W-7 application is received until its final disposition, which is the date the application is closed. The *ITIN Comparative Report* produced every week with data from the RTS system used to process ITIN applications includes the number of days for input and final disposition for every W-7 application. These measures are defined as:

- **Input:** the average number of days measured from the IRS received date to the date the application is entered on RTS.
- **Final Disposition:** the average number of days measured from the IRS received date to the date the application is either assigned an ITIN or rejected on the system. The “final disposition” includes all the time that any application is suspended prior to assignment or rejection.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

RTS is a robust system. A key feature of RTS is the ability to systematically process W-7's in real-time. The system assigns the Document Locator Number (DLN) used to track all applications and either assigns a unique ITIN for the taxpayer or creates reject or suspense correspondence per automated business rules. For complete applications, RTS automatically issues an ITIN Assignment Notice by mail. The system also tracks all suspended applications and generates a rejection notice (final disposition) when the suspense period expires.

The IRS agrees that management information specific to suspended ITIN applications on RTS is limited. As the National Taxpayer Advocate is aware, the IRS has plans, contingent on funding availability, to expand and improve the management reports available through RTS to specifically monitor the status of suspended ITIN applications. Nevertheless, current timeliness measures ensure that applications submitted with tax returns are processed and refunds are issued timely.

For the reasons discussed above and as discussed in prior reports discussing this same recommendation, the IRS does not agree with the preliminary recommendations and does not plan to change its policy on this issue.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

Taxpayer Advocate Service Comments

The National Taxpayer Advocate commends the IRS for recent improvements to the ITIN Acceptance Agent Program. However, she is very disappointed with the IRS maintaining its policy of requiring ITIN applications to be filed only with paper tax returns.³⁴ This policy burdens applicants and artificially delays processing of over one million tax returns and associated refunds annually. The IRS maintains that receiving a return with the application is “the *only* reliable method for IRS to verify the number is being requested and used for tax administration purposes” (emphasis added). However, the IRS has offered no rationale for this statement. *Despite concerns about ITIN misuse, the IRS does not address how its refusal to issue an ITIN upon early proof of earned income may instead perpetuate the misuse or fabrication of SSNs or fake ITINs for employment purposes.*

The IRS permits an exception for ITIN assignment for a taxpayer who owns “an asset that generates income subject to IRS information reporting and/or tax withholding requirements.”³⁵ *This inconsistent treatment of unearned and earned income for assigning ITINs essentially ignores the legal requirement to provide the taxpayer identification number regardless of the type of income at issue.*³⁶ Yet the IRS does not permit assignment of an ITIN based on a comparable showing of earned income from U.S. sources, such as pay stubs and affidavits, until the applicant actually files a tax return. In contrast, an employer can obtain a TIN by filing an online Employer Identification Number (EIN) application and have the EIN assigned instantly online without any proof of identity or any tax administration purpose.³⁷ The willingness of the IRS to issue ITINs for interest bearing accounts, and with no evidence of intent to file a tax return, deflates the IRS’s argument for delaying the issuance of ITINs to applicants with earned income.

The applicable Treasury Regulation requires the individual to make an ITIN application “far enough in advance of the first required use of the IRS individual taxpayer identification number to permit issuance of the number in time for compliance with such requirement.”³⁸ The National Taxpayer Advocate suggests that the taxpayer provides a strong evidence of the intent to file a tax return well in advance of the filing season by submitting multiple pay stubs, affidavits signed under penalty of perjury, independent contractor agreements and paychecks, etc.

The IRS also states the filing of applications under the pre-2004 regime parallels the current filing pattern, and suggests that the change in the policy advocated by the National

³⁴ While the IRS denies electronic filing to one million ITIN returns annually, it touts that electronic filing is now preferred by 70 percent of individual filers. See IRS, *Nearly 70 Percent of Taxpayers Used IRS e-file in 2010*, IR-2010-112 (Nov. 10, 2010), at <http://www.irs.gov/newsroom/article/0,,id=231381,00.html>.

³⁵ IRS Pub. 1915, *Understanding Your IRS Individual Taxpayer Identification Number 12* (Apr. 2010).

³⁶ IRC § 6109; Treas. Reg. § 301.6109-1(d)(3).

³⁷ See EIN Online Application, at <http://www.irs.gov/businesses/small/article/0,,id=102767,00.html> (last visited Nov. 23, 2010).

³⁸ Treas. Reg. § 301.6109-1(d)(3)(ii).

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

Taxpayer Advocate may not affect taxpayer filing behavior. The IRS's analysis does not consider that prior to 2004, applicants might have anticipated the need for the ITIN and requested the number at the beginning of the year when the income was earned, *e.g.*, up to one year before the tax return would become due. The post-2003 policy change resulted in a dramatic increase in both percentage and number of ITIN applications in the first two quarters of the year. While IRS receipts for June through December totaled 35.5 percent of all calendar year 2003 receipts, the receipts for the same period of CY 2009 totaled only 20.8 percent.³⁹ The policy change caused a statistically significant change in taxpayer behavior, leaving hundreds of thousands of taxpayers to wait until peak filing season to request an ITIN.⁴⁰

Despite the IRS's contentions about protecting national security and deterring fraud, the IRS does not have a process for or a method of revoking dormant ITINs. The fact that the IRS does not revoke dormant ITINs undermines the IRS's claim that it cannot issue ITINs during the year due to national security concerns, despite the proof of tax-generating activity. Instead of arbitrarily and unreasonably refusing to consider the well-balanced approach to ITIN assignment proposed by the National Taxpayer Advocate,⁴¹ the IRS should find a way to verify that previously issued ITINs have been used for tax administration purposes and systematically revoke dormant numbers after notifying the ITIN holders. This approach would help the IRS ensure that the ITINs are used for tax administration purposes, without imposing significant and unnecessary burden on this taxpayer population.

Finally, the IRS's comments do not address the National Taxpayer Advocate's concern that the IRS does not properly measure the overall ITIN process, from the receipt of an application to the acceptance of the return and release of the refund. The IRS tracks a mere average timeframe for processing all applications. It does not separately measure its two distinct work processes: one for applications that are complete and ready, and another for those that are incomplete, require follow-up contact with taxpayers, and are suspended for weeks or months. In addition, the IRS's measures of both of these processing streams do not include the ultimate processing of the suspended paper returns and associated refunds. In other words, the IRS does not measure this process from the perspective of the taxpayer's experience, which would create a sense of urgency. The IRS should measure the overall ITIN process from the time it receives the application to the time it accepts the tax return and issues the refund.

³⁹ See chart *Receipts vs. Production FY 2003*, *supra*; IRS, *ITIN Production Reports* (Mar. 28, June 27, Sept. 26, and Dec. 31, 2009).

⁴⁰ IRS, *ITIN Production Reports, Yearly Comparative Data, FYs 2007-2010*.

⁴¹ The National Taxpayer Advocate recommends assignment of ITINs during the year, prior to filing season, upon proof of employment and withholding (or self-employment), *e.g.*, three consecutive pay stubs or other payment documentation, employment or independent contractor commitment letters or contracts, Forms 1099-MISC, *Miscellaneous Income*, etc.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Assign ITINs throughout the year upon proof of employment or self-employment;
2. Develop a process to verify that previously issued ITINs have been used for tax administration purposes and revoke unused ITINs on a regular basis after notifying ITIN holders; and
3. Measure the overall ITIN process on the Real Time System, from the receipt of an ITIN application to the acceptance of the tax return, including the total numbers of unworked and suspended applications and the average days for resolution.

Status Update: Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers

February 25, 2009

MEMORANDUM FOR RICHARD E. BYRD, JR.
COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Nina E. Olson
National Taxpayer Advocate

SUBJECT: Taxpayer Advocate Directive 2009-1 (Processing of Forms
W-7/Filing of ITIN Applications and Associated Tax Returns)

TAXPAYER ADVOCATE DIRECTIVE

I am issuing this Taxpayer Advocate Directive (TAD) to direct the Commissioner, Wage and Investment Division:

- 1) to develop a process that allows individual taxpayers to obtain Individual Taxpayer Identification Numbers (ITINs) without an associated tax return upon proof of employment and withholding (or self-employment);¹ and
- 2) to develop a process for routine assignment of ITINs to deceased applicants who are otherwise entitled to a taxpayer identification number and upon proof of a legitimate tax need.

I direct that such processes be developed by and implemented prior to the 2010 filing season.

I. Authority

This TAD is being issued pursuant to Delegation Order No. 13-3, which grants the National Taxpayer Advocate the authority to issue a TAD to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.² I have raised concerns, in writing (via three Annual Reports to Congress³), regarding the IRS policy of allowing taxpayers to submit ITIN applications only when associated with a tax return. In addition, I have raised concerns, in writing (via the 2008 Annual Report to Congress), regarding the IRS's refusal to issue ITINs for deceased individuals. Attached is

¹ To address the IRS's concern that persons may seek an ITIN for a non-tax purpose, the IRS should require documentation of employment and withholding (or self-employment), e.g., pay stubs, Forms 1099-MISC, *Miscellaneous Income*, etc. as proof that they will need to file a form with the IRS that requires a TIN.

² Internal Revenue Manual (IRM) 1.2.50, *Delegation of Authorities for Taxpayer Advocate Service Activities* (Aug. 1, 2008); Delegation Order 13-3 (formerly DO-250, Rev. 1) (Jan. 17, 2001). See also IRM 13.2.1.5, *Taxpayer Advocate Directives* (Aug. 21, 2000).

³ National Taxpayer Advocate 2003 Annual Report to Congress 60-86; National Taxpayer Advocate 2004 Annual Report to Congress 143-62; National Taxpayer Advocate 2008 Annual Report to Congress 126-40.

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the Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*, from the National Taxpayer Advocate's 2008 Annual Report to Congress, which serves as a formal memorandum issued to the responsible operating area within the meaning of IRM 13.2.1.5.1.3 (Oct. 1, 2001), and which includes the IRS formal written response, declining to make those changes. In addition, since 2002, TAS has raised these concerns in IRS-TAS taskforces and working groups. Therefore, all procedural requirements for issuing this TAD have been satisfied.⁴

II. Background

Federal law requires individuals with U.S. income, regardless of immigration status, to pay U.S. taxes. Section 6109 of the Internal Revenue Code provides that if a person is required to file a return, statement, or other document with the IRS, the person must include an identifying number. In general, an individual required to furnish a taxpayer identifying number must use a social security number.⁵ Taxpayers who are not eligible for a Social Security number must obtain an ITIN before they can file a U.S. tax return.⁶ The requirement to provide a taxpayer identifying number does not end upon death; deceased individuals are also required by law to furnish a taxpayer identification number when filing returns or other documents with the IRS.

Because of concerns about the use of ITINs for nontax purposes, the IRS requires taxpayers to document their identity and tax administration need for the number before it will issue an ITIN.⁷ With limited exceptions, the IRS also requires all ITIN applicants to demonstrate the need for a number by submitting the application along with a tax return filed on paper (*i.e.*, the return cannot be submitted electronically).⁸ In addition, the IRS generally refuses to issue ITINs for deceased individuals as a matter of policy.

III. Reasons for Issuing This TAD

Because a taxpayer generally cannot obtain an ITIN before filing a return, the IRS receives most ITIN applications during the tax return filing season. Thus, the IRS's restriction creates a bottleneck of ITIN applications at that time.⁹ This bottleneck also delays tax return

⁴ In advance of issuing a TAD, the National Taxpayer Advocate is required to work with and communicate with the owners of the process in order to correct the problem. IRM 13.2.1.5.1 (Aug. 21, 2000). The requirement to issue a proposed TAD was satisfied when the Most Serious Problem was submitted to the IRS for comment. Thus, the procedural requirements set forth in IRM 13.2.1.5.1.4 have been satisfied.

⁵ Treas. Reg. § 301.6109-1(a)(1)(ii)(A).

⁶ Treas. Reg. § 301.6109-1(a)(1)(ii)(B).

⁷ In contrast, it is much easier for an employer to obtain a TIN by filing an online Employer Identification Number (EIN) application, with the EIN assigned instantly online without any proof of identity or tax administration purpose. See EIN Online Application, at <http://www.irs.gov/businesses/small/article/0,,id=102767,00.html> (last visited Jan. 5, 2009).

⁸ For example, applicants who have income from property or an income-generating asset (e.g., a savings account) may still apply for an ITIN at any time throughout the tax year, substantiating their need for an ITIN by simply attaching a letter from a third party, such as a bank or financial institution. IRS Pub. 1915, *Understanding Your IRS Individual Taxpayer Identification Number* 11 (Jan. 2009).

⁹ Of the 1,409,903 ITIN applications with tax returns received by September 30, 2008, at the AUSPC, 1,201,109 (or 85 percent) had been received by May 19, 2008. IRS, *ITIN SP001 Reports* (May 19, and Sept. 30, 2008).

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processing and associated refunds, causing significant taxpayer burden.¹⁰ For example, in 2005 alone, the inability to receive an ITIN before preparing and filing a paper tax return caused processing delays that affected 280,000 refunds totaling over \$500 million.¹¹

Due to the taxpayer burden created by these delays, in my 2003, 2004, and 2008 Annual Reports to Congress, I identified the IRS's failure to timely process ITIN applications as a Most Serious Problem.¹² In the IRS's formal response to the 2008 Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*, it stated:

[T]he IRS had, and continues to have, significant and valid concerns that ITINs were being requested for non-tax purposes, such as for obtaining a driver's license.... In light of these concerns, the IRS believes the requirement to attach a return to the Form W-7 ITIN application strikes a reasonable balance between the competing objectives of facilitating compliance with U.S. tax laws and ensuring, to the extent possible, that ITINs are not issued for purposes other than federal tax administration. The National Taxpayer Advocate's suggested acceptance of a pay stub in lieu of the requirement to file a tax return with the ITIN application will not achieve the same degree of assurance.¹³

I believe that a taxpayer can document the need for an ITIN without providing a return. Indeed, the IRS will issue an ITIN before receiving a return if the taxpayer owns "an asset that generates income subject to IRS information reporting and/or tax withholding requirements."¹⁴ This inconsistent treatment of unearned and earned income for assigning ITINs ignores the legal requirement for the taxpayer to furnish a taxpayer identification number when filing returns or other documents with the IRS, regardless of the type of income at issue.¹⁵ I have proposed a well-balanced approach to developing a process for taxpayers to obtain ITINs at any time during the year, rather than just during filing season, upon proof of employment and withholding (or self-employment), *e.g.*, pay stubs, Forms 1099-MISC, *Miscellaneous Income*, etc. Such an approach would help the IRS smooth out its workload during the year especially the logjam created when ITIN applications are received during the filing season, while allowing the taxpayers to e-file and receive their refunds expeditiously.

In my 2008 Annual Report to Congress, I expressed a concern about the IRS's policy to deny ITIN applications to deceased individuals, which causes unwarranted negative tax

¹⁰ In addition, the IRS requirement for ITIN applicants to file paper returns is inconsistent with the congressional mandate for the IRS to achieve an 80 percent e-file rate. See Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998).

¹¹ ITIN processing delays also result in other burdens as described in my 2008 Annual Report to Congress (Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*), which is attached.

¹² National Taxpayer Advocate 2003 Annual Report to Congress 60-86; National Taxpayer Advocate 2004 Annual Report to Congress 143-62; National Taxpayer Advocate 2008 Annual Report to Congress 126-40.

¹³ National Taxpayer Advocate 2008 Annual Report to Congress 137.

¹⁴ IRS Pub. 1915, *Understanding Your IRS Individual Taxpayer Identification Number* 11 (Jan 2009).

¹⁵ IRC § 6109; Treas. Reg. § 301.6109-1(d)(3).

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consequences to their estates or, in the case of a deceased dependent, to the primary taxpayer.¹⁶ In the IRS's formal response to the 2008 Most Serious Problem, *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*, the IRS concluded:

[I]t was not prudent to allow ITINs for decedent applicants due to increased vulnerability of fraud, the limited tax purpose (one time use), and the IRS's limited ability to monitor and subsequently revoke the number to eliminate future use.... As a result, effective for the 2009 filing season we will make every effort to accommodate decedent ITIN applications on a case-by-case basis after a review of the particular circumstances involved in each such application.¹⁷

The IRS does not explain how an ITIN assigned to a decedent is any more susceptible to fraud or misuse than one assigned to a yet living applicant. As a result of the business decision to consider ITIN applications for deceased individuals only on a case-by-case basis, such deceased individuals, their estates, spouses, or dependents may be unable to secure a taxpayer identifying number and claim certain tax benefits such as personal exemption, dependency exemption, child tax credit, or a particular filing status.

I believe the IRS ITIN Policy should uniformly apply to all ITIN applicants living or deceased, upon satisfaction of documentary evidence requirements and proof of a legitimate tax need.

If you have any questions, please contact Rosty Shiller on my staff at (202) 622-4248.

Attachment (3)

cc: Linda Stiff, Deputy Commissioner, Services and Enforcement

¹⁶ National Taxpayer Advocate 2008 Annual Report to Congress 126-40.

¹⁷ National Taxpayer Advocate 2008 Annual Report to Congress 137.

Status Update: The IRS's Handling of Collection Statute Expiration Dates Continues to Adversely Affect Taxpayers

RESPONSIBLE OFFICIALS

Chris Wagner, Commissioner, Small Business/Self-Employed Division
Richard E. Byrd Jr., Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

By statute, the IRS generally has ten years from the assessment of a tax to collect the amount due.¹ The collection statute expiration date (CSED) is sometimes difficult to track because the collection period may be extended by taxpayer agreement or suspended by certain provisions of the tax code.² The IRS continues to miscalculate CSEDs in some instances, subjecting taxpayers to unlawful collection. According to a TAS analysis of IRS data, over 4,600 taxpayers have accounts with CSED extensions or waivers that would violate IRS policy if entered into today.³

ANALYSIS OF PROBLEM

IRS Responds to Excessive CSED Waiver Extensions

On January 20, 2010, the National Taxpayer Advocate issued a Taxpayer Advocate Directive (TAD) to the Commissioner of the IRS Small Business/Self-Employed Division (SB/SE) directing resolution, adjustment, or correction of all accounts with CSEDs extended beyond 15 years after assessment (plus any statutory suspensions).⁴ In connection with this directive, SB/SE requested an opinion from the IRS Office of Chief Counsel on whether the IRS could terminate or modify CSED waivers on accounts exceeding current policy limits, and whether the IRS could write off or abate taxes on these accounts as “excessive in amount” under IRC § 6404(a)(1).⁵

The Office of Chief Counsel opined that the IRS cannot modify or rescind waivers extending the collection statute, eliminating an opportunity for the IRS to cancel and thereby

¹ Internal Revenue Code (IRC) § 6502(a)(1).

² The IRS and the taxpayer may extend the statutory period for collection by agreement in connection with an installment agreement or before releasing a levy after the ten-year period. IRC § 6502(a)(2). A number of IRC sections provide the period may also be suspended by operation of law. See, e.g., IRC § 6015(e)(2); IRC § 6330(e); IRC § 6331(i) & (k); IRC § 6503.

³ TAS Research data from IRS Compliance Data Warehouse (CDW) extract (Sept. 24, 2009).

⁴ National Taxpayer Advocate, TAD 2010-3 (Jan. 20, 2010). National Taxpayer Advocate Report to Congress FY 2011 Objectives App. VIII, 14-20 (June 30, 2010).

⁵ The IRS Office of Chief Counsel is legal counsel to the IRS. IRC § 7803(b)(2).

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resolve waivers that violate current policy.⁶ Further, Counsel concluded the IRS can only abate assessments “excessive in amount” under IRC § 6404(a)(1) if the assessments are incorrect, thereby limiting IRS authority to write off accounts with CSED extensions that violate current IRS policy to cases where administration and collection costs would not warrant collection under IRC § 6404(c).⁷

On June 10, 2010, the IRS Deputy Commissioner for Services and Enforcement responded to the TAD by agreeing that the IRS would participate in a TAS-SB/SE workgroup to review, correct, and resolve accounts with excessively long CSED extensions. The IRS stated that it will follow Counsel's guidance and abate taxes subject to these lengthy extensions only when the collection and administration costs associated with a particular account would not warrant collection.⁸ Further, the IRS may employ administrative remedies, such as permanently suspending collection (including offsets) or accepting offers in compromise (OICs), to resolve these accounts.⁹ In December 2010, SB/SE notified TAS that it had validated and accepted the list prepared by TAS in 2009 of over 4,600 taxpayer accounts with excessively long CSED extensions. SB/SE and TAS will now develop a data collection instrument and review the particular circumstances of the accounts. The National Taxpayer Advocate commends the IRS for being responsive to her concerns and urges the IRS to apply all due haste in resolving this problem.

The IRS Uses a Makeshift Process to Resolve CSED Errors.

Notwithstanding the progress made on excessive CSED extensions, the IRS has not attempted to centralize the operations that correct taxpayers' miscalculated CSEDs. In response to the concerns described in the National Taxpayer Advocate's 2009 Annual Report to Congress, the IRS agreed to review its training program on CSEDs to address any gaps, to monitor the accuracy of CSED computations, and change its programs as needed.¹⁰ The National Taxpayer Advocate recognizes the IRS computes many CSEDs accurately.

⁶ National Office Program Manager Technical Advice, PMTA-2010-10 (Feb. 12, 2010). Counsel relied on *Simmons v. Westover*, 76 F. Supp. 442, 450-452 (S.D. Cal. 1948), as support for the proposition that unilateral waivers of the collection statute may not be modified or rescinded. In *Simmons*, the court explained the IRS may have accepted a limited waiver with a fixed expiration to prevent the taxpayer from giving notice to unilaterally revoke an unlimited waiver, but concluded that the subsequent limited waiver was insufficient. The court suggests a taxpayer could unilaterally revoke an unlimited waiver if it lasted for an unreasonable period and was “clearly inoperative.” The court also concluded it did not need to decide if unlimited waivers automatically expire because the 12-year period (including seven years of inactivity by the IRS) in *Simmons* was not an unreasonable time because the taxpayer had received the benefit he had sought – avoiding enforced collection during the period. As a result, the court's analysis might be read to suggest that under certain circumstances (not present in *Simmons*) unlimited or lengthy waivers may expire when unreasonable. Because there is no clear precedent and the statutory scheme has changed since *Simmons* was decided, the National Taxpayer Advocate will request that Counsel revisit the issue of whether a CSED waiver can be modified or rescinded.

⁷ *Burns v. United States*, 974 F.2d 1064 (9th Cir. 1992) (interpreting “excessive in amount” under IRC § 6404(a)(1)). *But see H & H Trim & Upholstery Co. v. Commissioner*, T.C. Memo. 2003-9 (interpreting “excessive in amount” under IRC § 6404(a)(1) as applying to abatements where it would be unfair or unjust to enforce the tax assessment).

⁸ IRS, Memorandum from Deputy Commissioner for Services and Enforcement re: Taxpayer Advocate Directives 2010-1, 2010-2 and 2010-3 (June 10, 2010).

⁹ For example, the IRS has proposed to add a new Internal Revenue Manual (IRM) provision, which would limit the number of years of future income, in calculating offers in compromise (OICs) for a taxpayer with a lengthy CSED extension, to a maximum of the original CSED or five years. See IRM 5.8.5.25, *Deferred Payment Offer in Compromise Received After Collection Statute Expiration Date Extension* (Oct. 22, 2010).

¹⁰ National Taxpayer Advocate 2009 Annual Report to Congress 224-225.

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However, until the IRS develops a centralized unit to identify and correct CSED errors, the process creates an unacceptably high risk of harm to taxpayers.

The IRS has considerable trouble correctly computing CSEDs on accounts with multiple events such as bankruptcies, divorces, and OICs. For example, as part of the National Taxpayer Advocate's 2009 Annual Report to Congress, TAS analyzed 3,105 tax modules where the accounting procedures to separate joint accounts were done incorrectly and created erroneous CSEDs.¹¹ As a result, the IRS reviewed these modules but only where they had a balance due or the module was fully paid and the statutory period for refund was open.¹² The IRS determined 1,033 of the 3,105 modules, representing 681 taxpayers, had incorrect CSEDs, resulting in refunds or credits for 44 taxpayers averaging approximately \$2,200 per taxpayer. The National Taxpayer Advocate is particularly troubled with this discovery in light of the stringent statutory time limitations placed on taxpayers to claim a refund. In many cases, the statute prohibits a taxpayer who does not claim a refund within two years of payment from receiving a refund.¹³

Current procedures permit IRS employees to reverse the CSED expiration code to apply subsequent payments on a balance due tax year module, even though the taxpayer is under no legal obligation to make payments on a CSED-expired account.¹⁴ The procedures call for the IRS to send a letter to the taxpayer explaining the IRS has received a payment for a CSED-expired tax period and that the taxpayer may receive a refund, but if he or she does not respond, the IRS will apply the payments to the expired account rather than refund them.¹⁵ The taxpayers in at least three TAS cases had payments applied to accounts with expired CSEDs.¹⁶ In these instances, IRS employees may have mistakenly disregarded systemic CSED calculations or the taxpayers may not have received the letters, further highlighting the need for improvement in CSED handling.¹⁷

In the 2009 Annual Report, the National Taxpayer Advocate recommended the IRS develop a CSED calculator for employees to improve the accuracy of CSED calculations.¹⁸ The National Taxpayer Advocate is pleased that the IRS has recently established a cross-functional team, including TAS, to address this issue. The CSED Calculator Project had its

¹¹ *Id.* at 275-276.

¹² IRC § 6511 provides that claim for credit or refund must be made no later than three years after a return is required or two years from payment, whichever is later. IRC § 6402 limits the time that a credit may be made to the applicable limitations period under IRC § 6511. The IRS did not review about 900 of the modules where the balance was full paid or had a credit balance and the period for credit or refund expired.

¹³ See IRC §§ 6402 & 6511.

¹⁴ IRM 3.17.220.2.13.1 (Jan. 1, 2010).

¹⁵ The IRS maintains the credits on expired accounts in its excess collections file until the account is closed or seven years have passed. Credits removed from excess collections will usually have exceeded the statute of limitations for refund. IRM 3.17.220.2(9) (Jan. 1, 2010). The IRS will not apply the credit to another tax year unless requested by the taxpayer. IRM 3.17.220.2.13.1(5) (Jan. 1, 2010). See National Taxpayer Advocate 2006 Annual Report to Congress 157-171 (Most Serious Problem: *Excess Collections*).

¹⁶ TAS, Taxpayer Advocate Management Information System CF 4305244, 4255452, and 4495313.

¹⁷ See Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*, *supra*, for a discussion of problems with the IRS's handling of undelivered mail.

¹⁸ National Taxpayer Advocate 2009 Annual Report to Congress 226.

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initial meeting in late August 2010 to develop a spreadsheet-based calculator to assist employees in determining the correct CSEDs on accounts.¹⁹ The National Taxpayer Advocate is pleased with this development and looks forward to seeing an improved CSED tool for all IRS employees.

CONCLUSION

The IRS has joined TAS in establishing at least two teams focusing on CSEDs and is slowly moving forward to correct CSED problems. However, the National Taxpayer Advocate is concerned that the IRS's piecemeal approach to CSED problems will not fully resolve them. The National Taxpayer Advocate continues to urge the IRS to identify one function to take full responsibility for the accounting and management of CSED issues.

RECOMMENDATION

The National Taxpayer Advocate renews her recommendation from the 2009 Annual Report to Congress that the IRS designate a centralized CSED function whose mission is to identify and resolve CSED problems.

¹⁹ SB/SE, CSED Calculator (CCalc) – MS Excel Based Project Definition Form (approved Aug. 20, 2010).