

# IRS News Release

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## **National Taxpayer Advocate Delivers Annual Report to Congress; Focuses on Taxpayer Bill of Rights and IRS Funding**

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WASHINGTON — National Taxpayer Advocate Nina E. Olson today released her 2013 annual report to Congress, urging the Internal Revenue Service to adopt a comprehensive Taxpayer Bill of Rights – a step she said would increase trust in the agency and, more generally, strengthen its ability to serve taxpayers and collect tax. The Advocate also expressed deep concern that the IRS is not adequately funded to serve taxpayers, pointing out that the IRS annually receives more than 100 million telephone calls from taxpayers and that, in fiscal year 2013, the IRS could only answer 61 percent of calls from taxpayers seeking to speak with an IRS customer service representative.

“The year 2013 was a very challenging one for the IRS. Because of sequestration, the IRS’s funding was substantially cut, which translated into a reduction in taxpayer service,” Olson said in releasing the report. “Public trust in its fairness and impartiality was called into question because of reports the IRS subjected certain applicants for tax-exempt status to greater review based on political-sounding names. And because of the 16-day government shutdown, the agency could not complete preparations for the upcoming tax filing season on time, delaying the date on which taxpayers can first file returns and claim refunds.”

Olson continued: “From challenges can come opportunities, and this report presents a ‘21<sup>st</sup> century vision’ designed to meet taxpayer needs and enhance voluntary tax compliance.”

### **TAXPAYER BILL OF RIGHTS RECOMMENDED**

The report reiterates the Advocate’s longstanding recommendation that the IRS adopt a Taxpayer Bill of Rights (TBOR). In a prior report, Olson analyzed the IRS’s processing of applications for tax-exempt status and concluded its procedures violated eight of the ten taxpayer rights she has proposed. Today’s report argues that the rationale for a TBOR is much broader.

“Taxpayer rights are central to voluntary compliance,” the report says. “If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the tax system and be less likely to comply with the laws voluntarily. If taxpayers have confidence in the fairness and integrity of the system, they will be more likely to comply.”

The report emphasizes that the U.S. tax system is built on voluntary compliance. Ninety-eight percent of all tax revenue the IRS collects is paid timely and voluntarily. Only 2

percent results from IRS enforcement actions. For the taxpayer, voluntary compliance means not having to face IRS enforcement. For the government, voluntary compliance is cheapest, because enforced compliance requires the IRS to devote resources to detecting and collecting amounts that are not voluntarily reported or paid.

While arguing that knowledge of taxpayer rights promotes voluntary compliance, the report cites a survey of U.S. taxpayers conducted for TAS in 2012 that found less than half of respondents believed they have rights before the IRS and only 11 percent said they knew what those rights are.

“The Internal Revenue Code provides dozens of real, substantive taxpayer rights,” the report says. “However, these rights are scattered throughout the Code and are not presented in a coherent way. Consequently, most taxpayers have no idea what their rights are and therefore often cannot take advantage of them.”

The report calls on the IRS to take the taxpayer rights that already exist and group them into ten broad categories, modeled on the U.S. Constitution’s Bill of Rights. The report says the “simplicity and clarity” of a thematic, principle-based Taxpayer Bill of Rights would help taxpayers understand their rights in general terms.

“A Taxpayer Bill of Rights would serve as an organizing principle for tax administrators in establishing agency goals and performance measures, provide foundational principles to guide IRS employees in their dealings with taxpayers, and provide information to taxpayers to assist them in their dealings with the IRS,” the report says.

The ten rights the Advocate is proposing are detailed in the report. Olson has been in discussions with senior IRS officials about publishing a TBOR, and TAS has just completed a series of focus groups with taxpayers and preparers to gauge reaction to, and comprehension of, the proposed list. Olson said the IRS has been open to publishing a proposed TBOR, and she will continue to work with the IRS leadership to refine and publish a TBOR during the coming year.

## **IRS FUNDING INADEQUATE**

The report identifies the lack of adequate IRS funding as a top problem for taxpayers. Each year, more than 100 million taxpayers call the IRS for help and millions more visit IRS walk-in sites or send correspondence. Key metrics show the agency is increasingly unable to keep up with taxpayers’ demand for help in complying with their tax obligations.

“The requirement to pay taxes is generally the most significant burden a government imposes on its citizens,” the report says. “The National Taxpayer Advocate believes the government has a practical and moral obligation to make compliance as simple and painless as possible.” The report also points out that federal spending cuts, which are designed to reduce the budget deficit, have the effect of increasing the deficit when applied to the revenue collection agency.

**Impact on Taxpayer Service.** The report says the IRS's workload has increased over the past decade, and since FY 2010, IRS funding and staffing have been cut by 8 percent. The report highlights key areas in which the quality of taxpayer service has dropped to unacceptable levels:

- Last year, the IRS could only answer 61 percent of calls from taxpayers seeking to speak with a customer service representative (CSR). That's down from 87 percent ten years earlier, with half the decline occurring since FY 2010. In FY 2013, 39 percent of calls (some 20 million) simply did not get through.
- Taxpayers who did get through had to wait on hold approximately 17.6 minutes before speaking with a CSR. That's up from 2.6 minutes ten years earlier, a nearly six-fold increase, with nearly half the increase occurring since FY 2010.
- Millions of taxpayers visit IRS walk-in sites each year for assistance. Ten years ago, the IRS answered some 795,000 tax law questions in the sites during the filing season. Last year, it handled about 110,000 tax law questions during the filing season – a reduction of 86 percent.
- The IRS historically has prepared tax returns for taxpayers seeking its help, particularly for low income, elderly, and disabled taxpayers. Ten years ago, it prepared some 476,000 returns. That number declined significantly over the decade, and the IRS recently announced it will no longer prepare returns at all.
- Last year, the IRS received about 8.4 million letters from taxpayers responding to proposed adjustments to their tax liabilities. As of the end of the fiscal year, 53 percent of taxpayer letters in the IRS's "adjustments" inventory were considered "over age" (generally, more than 45 days old). That compares with "over age" percentages of 12 percent ten years earlier and 28 percent in FY 2010.
- The IRS recently announced it will only answer "basic" tax law questions on its telephone lines and in its walk-in sites during the upcoming filing season and it will not answer any tax law questions after the filing season, including questions from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.

Olson made clear that the deficiencies in taxpayer service are attributable primarily to a lack of resources. Regardless of cause, she wrote, "it is a sad state of affairs when the government writes tax laws as complex as ours – and then is unable to answer any questions beyond 'basic' ones from baffled citizens who are doing their best to comply."

The Advocate expressed particular concern about the magnitude and impact of cuts to the IRS's training budget. Since FY 2010, the IRS's training budget has been cut from \$172 million to \$22 million. "If IRS customer service representatives are not well trained, taxpayers calling for help are more likely to receive incorrect information or no information," the report says. "If IRS enforcement employees are not well trained, auditors may make inappropriate adjustments and assessments, and collection employees may issue inappropriate levies or file inappropriate liens."

**Impact on Voluntary Compliance and Revenue Collection.** The report notes that the cuts to IRS funding since FY 2010 have been made as part of across-the-board reductions to federal discretionary spending designed to reduce the budget deficit. But “the logic behind budget cuts simply does not apply to the funding of the IRS,” the report says. The IRS collected \$255 for each \$1 it received in appropriated funds in FY 2013. “If the Chief Executive Officer of a Fortune 500 company were told that each dollar allocated to his company’s Accounts Receivable Department would generate multiple dollars in return,” the report says, “it is difficult to see how the CEO would keep his job if he chose not to provide the department with the funding it needed. Yet that is essentially what has been happening with respect to IRS funding for years.”

Olson said IRS funding is shortchanged because the federal budget rules treat the IRS the same way they treat all spending programs – with no “credit” given for the revenue it collects. “This procedure makes little sense when applied to the IRS,” she wrote. “For virtually every other spending program, a dollar spent is just that – it increases the deficit by one dollar. But a dollar spent on the IRS generates substantially more than one dollar in return – it reduces the budget deficit.”

The report reiterates the Advocate’s longstanding recommendation that the relevant congressional committees work together to develop new procedures to fund the IRS, with the goal of maximizing tax compliance, particularly voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.

## **OTHER KEY ISSUES ADDRESSED**

Federal law requires the Annual Report to Congress to identify at least 20 of the “most serious problems” encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems. Overall, this year’s report identifies 25 problems, makes dozens of recommendations for administrative change, makes five recommendations for legislative change, and analyzes the 10 tax issues most frequently litigated in the federal courts.

Among the “most serious problems” addressed are the following:

**Need for Return Preparer Oversight.** In 2002, the National Taxpayer Advocate began advocating for regulation of unenrolled tax preparers to protect taxpayers from incompetent and unscrupulous preparers. In 2011, the IRS began implementing regulations to register, test, and require continuing education for unenrolled preparers. In 2013, a U.S. District Court invalidated regulations governing the IRS’s testing and continuing education requirements, holding that they exceeded the authority of the Treasury Department to impose absent authorizing legislation. If the district court’s decision is upheld on appeal, the Advocate urges the IRS to adopt a multi-pronged strategy to protect taxpayers by pursuing education and enforcement options that are unambiguously within its purview. Of particular note, the Advocate recommends that the IRS give unenrolled preparers an opportunity to earn a voluntary testing and continuing education certificate and limit the ability of unenrolled preparers who do not earn the certificate to represent taxpayers in audits of

returns they prepare. The Advocate also recommends Congress enact legislation to clarify that the IRS may regulate unenrolled paid preparers directly.

**The IRS's Conceptual Approach Toward Collection of Delinquent Tax Liabilities.** The report urges the IRS to fundamentally reassess its traditional approach toward Collection. In her preface to the report, Olson cites third-party studies that often use the number of levies served and liens filed as a measure of the Collection function's effectiveness. Contrary to this "conventional wisdom," she notes, IRS Collection revenue actually increased in the aftermath of the IRS Restructuring and Reform Act of 1998 when the IRS reduced levies served by 94 percent and liens filed by 47 percent. Similarly, she notes that Collection revenue has increased slightly over the last few years, despite a 51 percent reduction in levies since FY 2011 and a 45 percent reduction in liens since FY 2010. Olson says that earlier personal contacts with delinquent taxpayers and more flexible use of payment options for financially struggling taxpayers, such as installment agreements and offers in compromise, would be more effective than increasing the number of levies and liens filed by automation. The report acknowledges that the use of levies, liens, and seizures remains appropriate with respect to taxpayers who can afford to pay their tax liabilities but refuse to do so.

**The Impact of the IRS's Offshore Voluntary Disclosure Programs on Taxpayers Who Make Honest Mistakes.** The IRS has sought to increase enforcement of Foreign Bank and Financial Accounts (FBAR) reporting and similar information reporting requirements in recent years and has offered a series of offshore voluntary disclosure (OVD) programs to settle with taxpayers who have failed to file the required forms. However, the report says, the programs impose excessive penalties on taxpayers whose failure to file was not "willful." Analyzing results from the IRS's 2009 OVD program, the Advocate found the median offshore penalty was about 381 percent of the additional tax assessed for taxpayers with median-sized account balances, and 580 percent of the tax assessed for taxpayers with the smallest account balances (*i.e.*, the bottom 10 percent, with an average \$44,855 account balance). Taxpayers who "opted out" of the OVD program and agreed to subject themselves to audits fared better but still faced penalties of nearly 70 percent of the tax and interest. While FBAR penalties are computed as a percentage of account balances rather than tax liabilities, the report offers the comparison to illustrate that the penalties are often Draconian and may deter other taxpayers from coming into compliance.

**New TAS Research Studies on Tax Compliance.** Volume 2 of the report contains six research studies, including three that relate directly to tax compliance:

- An assessment of accuracy-related penalties imposed on Schedule C filers found that penalties do not increase future reporting compliance.
- A comparison of the effectiveness of Revenue Officers (ROs) and the IRS's Automated Collection System (ACS) in addressing employment tax liabilities found that ROs collected more dollars and resolved delinquencies more quickly than ACS, but neither channel was effective at promoting future tax compliance.

- A study regarding tax compliance by sole proprietors found that taxpayer service and social norms were the two most influential factors affecting compliance behavior. Contrary to expectation, the study found that traditional deterrence theory did not play a role in promoting compliance, possibly because sole proprietors were particularly motivated by short-term cash flow needs.

Volume 2 also contains an analysis designed to further the National Taxpayer Advocate's 2009 recommendation that the IRS develop a plan and timeline to achieve an accelerated third-party information reporting and document-matching system. The analysis describes the steps that must be taken and the benefits to taxpayers and the IRS of accelerating receipt and processing of third-party information reports, such as Forms W-2 and 1099.

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Please visit [www.TaxpayerAdvocate.irs.gov/2013AnnualReport](http://www.TaxpayerAdvocate.irs.gov/2013AnnualReport) for more information about this report, including an Executive Summary and downloadable infographics on the Most Serious Problems.

#### **Related Items:**

- [Executive Summary: 2013 Annual Report to Congress](#)
- [Complete Report: 2013 Annual Report to Congress](#)

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#### **About the Taxpayer Advocate Service**

The Taxpayer Advocate Service is an independent organization within the IRS and is the taxpayer's voice at the IRS. TAS employees help taxpayers who are experiencing financial difficulties, such as not being able to provide necessities like housing, transportation, or food; taxpayers who are seeking help in resolving problems with the IRS; and taxpayers who believe an IRS system or procedure is not working as it should. If you believe you are eligible for TAS assistance, you can reach TAS by calling 877-777-4778 (toll-free).