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National Taxpayer Advocate Identifies Challenges and Issues for Upcoming Year in Mid-Year Report to Congress

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WASHINGTON — National Taxpayer Advocate Nina E. Olson today released a report to Congress that identifies the priority issues the Taxpayer Advocate Service (TAS) will focus on during the upcoming fiscal year. The report expresses particular concern about the taxpayer impact of expired and expiring tax provisions, the rise in tax fraud and tax-related identity theft, and attempts to limit the National Taxpayer Advocate's formal input on issues that affect taxpayer rights and taxpayer burden via "Taxpayer Assistance Orders" and "Taxpayer Advocate Directives."

Impact of Changes in Tax Law on Taxpayers and the IRS. "The continual enactment of significant tax law and extender provisions late in the year has led to IRS delays in handling millions of taxpayers' returns and caused many taxpayers to underclaim benefits because they did not know what the law was," Olson wrote. "Because of the magnitude of these challenges and the uncertainty about such a large number of important provisions, the 2013 filing season is already at risk. The 2013 filing season is likely to pose problems for many (if not most) taxpayers and the IRS if Congress does not address the many provisions that have already expired or soon will."

Expired Tax Provisions. Among tax provisions that expired at the end of 2011 are the following:

- The so-called "AMT patch." As result, an estimated 27 million more taxpayers are subject to the Alternative Minimum Tax this year.
- The deduction for state and local taxes. About 11 million taxpayers claimed this deduction last year.
- The deduction for mortgage insurance premiums. About four million taxpayers recently claimed this deduction.
- A provision allowing persons over age 70-1/2 to make tax-free withdrawals from their Individual Retirement Accounts (IRAs) to make charitable contributions.

Congress is likely to extend many of these and other expired provisions retroactive to January 1, 2012, but neither taxpayers nor the IRS know for certain what will happen and therefore cannot make plans. For example, a homebuyer trying to decide whether to utilize a

loan package that includes mortgage insurance now lacks important information. So does a pensioner trying to decide whether to tap his IRA to make a charitable donation.

Expiring Tax Provisions. In addition to the provisions that expired at the end of 2011, an even larger number of provisions are set to expire at the end of 2012, including the Bush-era cuts in marginal tax rates, reduced tax rates on dividends and long-term capital gains, various marriage penalty relief provisions, certain components of the child tax credit, the earned income tax credit, and the adoption credit, and the moratoria on the phase-outs of itemized deductions and personal exemptions.

“An aura of uncertainty prevails as the IRS and taxpayers wait for word about what will be the law governing us this year and for the near future,” Olson wrote. “This uncertainty affects the IRS’s ability to smoothly administer the filing season and taxpayers’ ability to make plans.”

Impact of Tax Fraud and Tax-Related Identity Theft. Tax fraud and tax-related identity theft, although distinct problems, often overlap and present similar challenges for taxpayers and the IRS. Both problems are growing. In FY 2011, the IRS’s Electronic Fraud Detection System (EFDS) identified more than one million returns as potentially fraudulent, a 72 percent increase from the previous year. The IRS blocked nearly one million additional refund claims using other means. While not all fraudulent returns involve identity theft, many do. The IRS recently reported an inventory of more than 450,000 identity theft cases.

Tax Fraud. The report notes that the IRS’s automated fraud-detection filters are inherently imperfect. Among the roughly two million refund claims the IRS held, tens of thousands were legitimate. “As the IRS develops [its] filters,” the report says, “it must also create procedures that would allow honest taxpayers with legitimate refund claims to receive their money without unnecessary delay.”

Where the IRS seeks to verify suspect wage and withholding information, its procedures until recently required it to make a final determination within 11 weeks or release the claimed refund. Because of the combination of more cases and budget limitations, the IRS is now placing “hard freezes” on cases it cannot handle within that time, meaning that claimed refunds must be manually released or will not be paid. The report expresses concern that the IRS has little incentive to prioritize a case once a hard freeze has been imposed, resulting in harm to honest taxpayers whose returns inadvertently tripped a filter.

Identity Theft. Resource constraints also are limiting the IRS’s ability to assist victims of tax-related identity theft. Tax-related identity theft typically arises when an identity thief uses the Social Security number of another person to file a false tax return with the intent of obtaining an improper refund. Identity theft can impose a significant burden on its victims, whose legitimate refund claims are blocked and who often must spend months or longer trying to convince the IRS that they are, in fact, victims and then working with the IRS to untangle their account problems.

Balancing Speedy Refunds, Fraud Prevention, and Victim Assistance. The report notes the IRS faces competing pressures to issue refunds quickly and investigate suspicious claims. Last year, the IRS processed about 145 million returns, including some 109 million claims for refund. The average refund paid was nearly \$3,000. Many families depend on these funds and need them quickly, sometimes to pay rent or high winter heating bills. At the

same time, the IRS needs time to investigate the more than two million potentially fraudulent claims it identifies.

The IRS now notifies certain affected taxpayers by letter when it has a problem processing their returns and instructs them to call the new Taxpayer Protection Unit (TPU) to provide more information. However, this unit has been unable to answer about two out of every three calls it has received from taxpayers so far this year. At times during the filing season, it was answering only about one out of every nine calls it received – and those who managed to get through waited an average of over an hour to speak with an employee.

“While Congress and taxpayers rightfully demand that the IRS stop payment on fraudulent refund claims, Congress and taxpayers also rightfully demand that the IRS pay refunds out to legitimate taxpayers immediately,” Olson wrote. Tax fraud and identity theft will continue to be key areas of focus for TAS during the upcoming fiscal year.

Taxpayer Assistance Orders (TAOs) and Taxpayer Advocate Directives (TADs). The report also raises concerns about the level of attention the IRS has given recently to TAOs and TADs. To ensure that the concerns of the National Taxpayer Advocate and Taxpayer Advocate Service are adequately addressed, Congress gave the Advocate the authority to issue TAOs to the IRS ordering it to take an action or refrain from taking an action in taxpayer cases. The Advocate has also been given parallel administrative authority to issue TADs to the IRS, directing it to take action on systemic issues to “protect taxpayer rights, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.” Over the past year, the report says, the IRS has ignored and sought to limit the Advocate’s authority to issue TADs.

IRS Has Yet to Comply with Proposed and Final TAD Designed to Assist Victims of Preparer Fraud. In June 2011, the National Taxpayer Advocate issued a proposed TAD to the head of an IRS operating division directing him to issue guidance and implement a procedure for adjusting the accounts of taxpayers who have been victimized by fraudulent return preparers. The official did not comply, prompting the Advocate to issue a final TAD on the same issue in January 2012. The operating division still has not issued comprehensive guidance or implemented procedures to assist taxpayer victims of preparer fraud.

TAD to Improve Audit Process Challenged. In January 2012, the National Taxpayer Advocate issued a TAD to address problems taxpayers were facing in connection with the correspondence examination process as described in a TAS study, including problems caused by obsolete regulations. The IRS challenged the National Taxpayer Advocate’s authority to issue a TAD to the Chief Counsel or to interpret the law. Interpreted broadly, this conclusion would severely limit the National Taxpayer Advocate’s authority to issue TADs generally. “Because nearly everything the IRS does is governed by law, it is very difficult for a TAD to address problems that taxpayers are facing without making a recommendation as to how the law should be interpreted,” the report says. “For example, if a TAD seeks to prevent the IRS from infringing taxpayer rights, which are embodied in law, the IRS may decline to respond to the TAD on the basis that it interprets law. The IRS’s position significantly reduces the utility of these directives and undermines the purpose for which they were created.”

TAOs and TADs Are Important Tools to Elevate Taxpayer Rights Issues to the IRS Leadership.

TAS generally uses TAOs and TADs as part of a strategic approach to issues that arise in multiple TAS cases, are the focus of projects and teams, and for which TAS has repeatedly sought solutions from the IRS, the report says. The report points out that the IRS Commissioner and Deputy Commissioner may overturn any TAO or TAD, which in practice means that TAOs and TADs are primarily vehicles the National Taxpayer Advocate may use to raise priority concerns to the IRS leadership.

“The purpose of TAOs and TADs is to ensure that issues that may impinge on taxpayer rights or impose excessive taxpayer burden are elevated for consideration to the highest levels of the IRS leadership in a formal way that requires a written response, so that the issues and competing considerations are made transparent to Congress and other stakeholders,” Olson wrote. “For that reason, it is utterly mystifying to me why the IRS would seek to squelch the authority of the National Taxpayer Advocate to raise taxpayer rights and taxpayer burden issues to the senior IRS leadership in this way, and we certainly will not accede to attempts to constrain our advocacy efforts of behalf of our nation’s taxpayers.”

Other Areas of Focus. Additional areas on which the National Taxpayer Advocate intends to focus in the coming year include:

- The IRS’s increasing use of automated examination and other tax adjustment procedures, which limit opportunities for taxpayers to interact directly with an IRS employee and often do not provide the taxpayer rights protections traditionally associated with audits.
- The impact of the IRS’s crackdown on persons with offshore accounts, which often subjects individuals who were not engaged in tax evasion to draconian penalties, and the related issue of modifying the terms of the Offshore Voluntary Disclosure Program so that individuals who made honest mistakes can correct them without fear of excessive penalties.
- Collaborating with the IRS to improve taxpayer service options for international taxpayers to help alleviate their compliance challenges.
- Examining the application and taxpayer impact of the IRS’s new “fresh start” initiative, which is designed to allow financially struggling taxpayers to remain in or come into compliance based on their ability to pay.
- Improving coordination with the IRS and other government agencies to protect taxpayer rights and minimize taxpayer burden. In recent years, the Taxpayer Advocate Service has been asked to assist taxpayers who had been clients of several tax-resolution or tax-preparation firms that were sued by government entities, including the Law Firm of Roni L. Deutch, Mo’ Money Taxes, and Taxmasters; taxpayers who received disaster-related assistance overpayments from the Federal Emergency Management Agency; and taxpayers who received payments from the U.S. Department of Agriculture in settlement of discrimination claims.

The National Taxpayer Advocate is required by statute to submit two annual reports to the House Committee on Ways and Means and the Senate Committee on Finance. The statute requires these reports to be submitted directly to the Committees without any prior review or comment from the Commissioner of Internal Revenue, the Secretary of the Treasury, the IRS Oversight Board, any other officer or employee of the Department of the Treasury, or the Office of Management and Budget. The first report is submitted mid-year and must identify the objectives of the Office of the Taxpayer Advocate for the fiscal year beginning in that calendar year. The second report, due on December 31 of each year, must identify at least 20 of the most serious problems encountered by taxpayers, discuss the ten tax issues most frequently litigated in the courts, and make administrative and legislative recommendations to resolve taxpayer problems.

About the Taxpayer Advocate Service

The Taxpayer Advocate Service is an independent organization within the IRS. TAS employees help taxpayers who are experiencing economic 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 1-877-777-4778 (toll-free). For more information, go to www.TaxpayerAdvocate.irs.gov or www.irs.gov/advocate.

You can learn about your rights and responsibilities as a taxpayer by visiting our tax toolkit at www.TaxpayerAdvocate.irs.gov. You can get updates on hot tax topics by visiting our YouTube channel at www.youtube.com/tasnta and our Facebook page at www.facebook.com/YourVoiceAtIRS, or by following our tweets at twitter.com/YourVoiceatIRS.

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- National Taxpayer Advocate's [FY 2013 Objectives Report to Congress](#)
- Tax Toolkit: www.TaxpayerAdvocate.irs.gov