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National Taxpayer Advocate Submits Mid-Year Report to Congress; Identifies Priority Challenges and Issues for Upcoming Year

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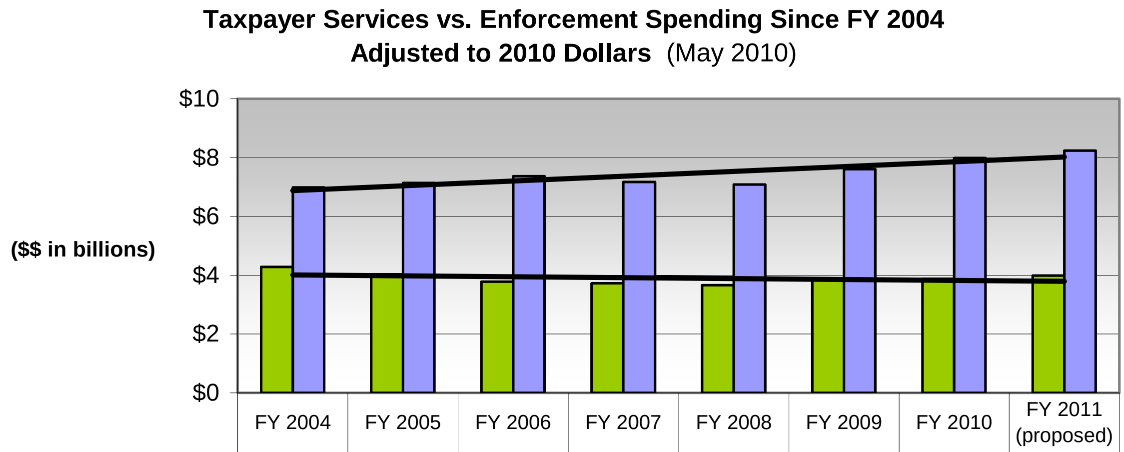
WASHINGTON — National Taxpayer Advocate Nina E. Olson today released a report to Congress that identifies the priority issues the Taxpayer Advocate Service (TAS) will address during the coming fiscal year. The report expresses concern about the adequacy of IRS taxpayer service, particularly as the IRS begins to implement health care reform, about new information reporting burdens facing small businesses and others, and about certain IRS collection practices.

Among the areas the report identifies for particular emphasis in FY 2011 are the following:

1. Taxpayer Services. Spending for IRS taxpayer service programs has been declining in recent years. At the same time, more taxpayers have been contacting the IRS for assistance as the IRS has been tasked with administering an increasing number of social benefit programs, including Economic Stimulus Payments, Making Work Pay credits, and First-Time Homebuyer credits. The report says that as a result of the imbalance between taxpayer demand and IRS resources, the IRS has fallen short of providing adequate taxpayer service in important areas. Most notably, after answering a high of 87 percent of its calls from taxpayers seeking to reach a telephone assistor in FY 2004, the IRS answered only 53 percent of its calls in FY 2008 and has set of goal of answering only 71 percent in the current fiscal year.

The report attributes much of the problem to inadequate funding for taxpayer services. While funding for the IRS overall has been increasing in recent years, the additional funding has been earmarked for enforcement programs. An analysis of IRS budget trends conducted by TAS shows that since FY 2004, inflation-adjusted funding for IRS enforcement activities has risen by 17.9 percent while spending for taxpayer service programs has declined by 6.8 percent, as shown in the following chart:



	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011 (proposed)
Taxpayer Services	$4.28	$4.03	$3.79	$3.73	$3.66	$3.85	$3.88	$3.99
Enforcement	$6.99	$7.14	$7.37	$7.18	$7.09	$7.61	$7.99	$8.24

Moreover, a substantial portion of the budget for taxpayer service includes the costs of processing tax returns, which is essentially an overhead function. Funding for core taxpayer service (known as “Pre-filing Taxpayer Assistance and Education”) now stands at only $685 million, or six percent of the IRS budget. The report notes further that the Administration’s FY 2011 budget proposal projects that funding for taxpayer services will decline by another 7.2 percent over the next two years (FY 2012 and FY 2013), while funding for enforcement will increase by an additional 13.7 percent.

The report asserts the cuts in taxpayer service spending are harmful both because they undermine tax compliance and because they undermine the IRS’s ability to successfully deliver social benefit programs. First, with respect to tax compliance, Ms. Olson states:

> There appears to be an implicit assumption built into existing budget procedures and projections that raising tax compliance requires ramping up enforcement and that taxpayer service is less important – perhaps even unimportant – for compliance. We think this implicit assumption is wrong. . . . Consider an individual without a college degree who becomes a successful plumber or electrician with a growing customer base. If he hires employees, he will face a host of employment, immigration verification, and state and federal tax requirements, including the need to withhold and pay over payroll taxes and to file employment tax and income tax returns on behalf of his business. For most taxpayers, these requirements would seem daunting or even impenetrable, and some taxpayers inevitably do not comply simply because they have no idea where to begin.

The report states that many noncompliant taxpayers are baffled by complex rules and states that additional taxpayer service, particularly outreach and education, could improve tax compliance.

Second, with respect to the IRS’s ability to deliver social programs, the report expresses concern that the IRS currently is neither structured nor funded to do the job effectively. “I have no doubt the IRS is capable of administering social programs, including health care,” Ms. Olson said. “But Congress must provide sufficient funding and the IRS itself must recognize that the skills and training required to administer social benefit programs are very different from the skills and training that employees of an enforcement agency typically possess. While some enforcement measures are required to prevent inappropriate claims, the overriding objective of agencies that administer social benefit programs is to help as many eligible persons qualify for the benefits as possible. That requires outreach and working one-on-one with potentially eligible individuals. If the IRS continues to ramp up enforcement while reducing taxpayer service programs, I would be concerned about its ability to administer the new health care credits and penalty taxes in a fair and compassionate way."

Ms. Olson suggests that the IRS mission statement be revised to explicitly acknowledge the agency's dual role as part tax collector and part benefits administrator. Such a revision would require the IRS to develop a strategic plan that gives sufficient attention to both roles and would underscore that the IRS requires sufficient funding to perform both functions effectively.

During FY 2011, TAS will continue to advocate for improved taxpayer services and will continue to make the case that taxpayer service is important not only as a courtesy but as a driver of tax compliance as well.

2. New Business and Tax-Exempt Organization Reporting Requirements. The report expresses concern that a new reporting requirement contained in the Patient Protection and Affordable Care Act may impose significant compliance burdens on businesses, charities, and government agencies. Beginning in 2012, all businesses, tax-exempt organizations, and federal, state and local government entities will be required to issue Forms 1099 to vendors from whom they purchase goods totaling $600 or more during a calendar year. To meet this requirement, these businesses and entities will have to keep track of all purchases they make by vendor. For example, if a self-employed individual makes numerous small purchases from an office supply store during a calendar year that total at least $600, the individual must issue a Form 1099 to the vendor and the IRS showing the exact amount of total purchases. The provision will have broad reach. According to a TAS analysis of 2009 IRS data, about 40 million businesses and other entities will be subject to the new requirement, including roughly 26 million non-farm sole proprietorships, four million S corporations, two million C corporations, three million partnerships, two million farming businesses, one million charities and other tax-exempt organizations, and more than 100,000 government entities. All of these nearly 40 million businesses and other entities are subject to the new reporting requirement.

TAS has not yet reached any conclusions regarding the benefits and burdens of the requirement, but the report expresses concern that the burdens "may turn out to be disproportionate as compared with any resulting improvement in tax compliance." During FY 2011, TAS will study the impact of the new reporting requirement more closely and, depending on what its study finds, may propose administrative or legislative recommendations to modify the provision or suggest that Congress consider less burdensome tax gap proposals, including a TAS proposal to require reporting of non-interest bearing bank accounts, to replace it.

3. IRS Collection Practices. The report expresses continuing concern that IRS collection practices emphasize collection of past-due liabilities even where doing so inflicts unnecessary or disproportionate harm on taxpayers and jeopardizes future tax collection.

“The conventional wisdom seems to be that more hard-core enforcement actions like liens and levies mean more revenue,” Ms. Olson said. “But the data don’t bear that out. Since FY 1999, the IRS has increased lien filings by about 475 percent and levies by about 600 percent, yet inflation-adjusted revenue raised by the IRS Collection function has actually declined by about seven percent over that period.”

Lien filings can badly damage a taxpayer’s financial viability because lien filings appear on credit reports, causing the taxpayer’s credit score to drop an average of about 100 points immediately and causing lasting harm because they typically remain on the taxpayer’s credit record for at least seven years. Many employers, mortgage companies, landlords, car dealerships, and credit card issuers check credit reports, so the filing of a tax lien can adversely affect the taxpayer’s ability to obtain and retain a job, purchase a home, rent an apartment, or obtain credit generally. Accordingly, a lien filing may reduce the taxpayer’s income or increase his expenses, thereby impairing his ability to pay tax in the future. Last year, the IRS filed nearly one million liens against taxpayers.

The report also notes that the IRS has issued at least four public statements over the past year-and-a-half pledging to assist financially struggling taxpayers who are having difficulty paying their tax bills. Yet the number of liens and levies has continued to rise, the number of offers-in-compromise the IRS is accepting is near an all-time low, and there is little evidence the IRS is changing its collection practices.

After publication of her 2009 Annual Report to Congress, Ms. Olson issued several Taxpayer Advocate Directives to the IRS on lien issues, including directives (i) to discontinue its policy of automatically filing tax liens in cases where the IRS has determined that the taxpayer’s account should be placed into “currently not collectible” status based on financial hardship and (ii) to require managerial approval for the filing of liens in cases where the taxpayer owns no assets. She has also urged the IRS to expand the availability of the offer-in-compromise program for financially struggling taxpayers who cannot reasonably pay their tax debts in full.

In response to these concerns, the IRS has convened a senior-level task force to conduct a comprehensive review of collection practices. Ms. Olson writes that she appreciates the IRS’s willingness to examine the issue. However, she remains concerned that it will take years to conduct the comprehensive review, and that in the interim, the IRS will continue both to damage taxpayers’ credit ratings and to undermine long-term tax compliance without any significant revenue gains to show for their actions. Accordingly, IRS collection practices will remain a key area of focus for TAS in FY 2011.

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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 (TAS) is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that 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 the TAS toll-free number at 1–877–777–4778 or TTY/TDD 1-800-829-4059. For more information, go to www.irs.gov/advocate. You can learn about your rights and responsibilities as a taxpayer by visiting our tax toolkit at www.taxtoolkit.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 http://www.facebook.com/YourVoiceAtIRS, or by following our tweets at http://twitter.com/YourVoiceatIRS.

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