



Executive  
Summary

*Preface &  
Highlights*

**NATIONAL TAXPAYER ADVOCATE**

# **Annual Report to Congress**

2017

*This report is dedicated to several people  
who have made it their life's work  
to protect taxpayer rights,  
improve the IRS, and  
ensure a fair and just tax system:*

***Rena Girinakis,***

*retired Deputy National Taxpayer Advocate,  
and former Local Taxpayer Advocate for Indiana,  
whose leadership, passion, and courage  
have ensured the independence of TAS;*

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***Bill Wilde,***

*retiring Deputy Executive Director of Case Advocacy,  
and former Local Taxpayer Advocate for Arkansas,  
a fierce defender of taxpayers  
who held the IRS accountable  
and urged his employees to always go the extra mile;*

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***Chris Bergin,***

*IN MEMORIAM  
my dear friend, trusted counselor,  
his passing is a great loss for us all.*



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## PREFACE: Introductory Remarks by the National Taxpayer Advocate

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### HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate's 2017 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

As we enter the New Year, with the IRS facing the daunting challenge of interpreting and implementing major new tax legislation, this year's report is both a Baedaker of the current problems facing the IRS and taxpayers, and a roadmap to a better way of doing business. We have identified 21 Most Serious Problems affecting taxpayers, made 11 Legislative Recommendations, discussed the 10 Most Litigated Issues and significant stand-alone decisions, and published a Volume Two containing seven Research Studies.

We are also introducing a new publication with this Report — the National Taxpayer Advocate “Purple Book.”<sup>1</sup> Over the last two years, the House Ways and Means Committee has expressed interest in passing “IRS reform” legislation. The Purple Book is designed to assist the committee in its efforts, and we have aimed to make it as user friendly as possible. In it, we present a concise summary of 50 legislative recommendations that we believe will strengthen taxpayer rights and improve tax administration. Most of these recommendations have been made in detail in our prior reports, but others are presented here for the first time. Each proposal is presented in a format similar to the one used for congressional committee reports, with “Present Law,” “Reasons for Change,” and “Recommendation(s)” sections. We offer these up as an aid to Congress, as it considers taxpayer rights and IRS reform legislation in the coming year.<sup>2</sup>

### The IRS Funding Landscape and its “Present State”

In recent weeks, there has been considerable discussion about how the IRS has been beaten down by continuing funding cuts and about concerns the agency is stretched so thin it will not be able to properly implement tax reform.<sup>3</sup> I cede to no one in my advocacy for increased IRS funding. As the National Taxpayer Advocate, I see daily the consequences of reduced funding of the IRS and the choices made by the agency in the face of these funding constraints. These impacts are real and affect everything the IRS does. Funding cuts have rendered the IRS unable to provide acceptable levels of taxpayer service, unable to upgrade its technology to improve its efficiency and effectiveness, and unable to maintain compliance programs that both promote compliance and protect taxpayer rights. “Shortcuts” have become the norm, and “shortcuts” are incompatible with high-quality tax administration. There is no doubt that the IRS needs more funding.

At the same time, limited resources cannot be used as an all-purpose excuse for mediocrity. There is not a day that goes by inside the agency when someone proposes a good idea only to be told, “We don't have

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1 National Taxpayer Advocate Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration*, *infra*.

2 See Kat Lucero, *Tax Administration: House Panel Aims to Unveil IRS Restructuring Bill in April*, BNA DAILY TAX REPORT (Sept. 14, 2017); see also *IRS Reform: Lessons Learned from the National Taxpayer Advocate: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 115th Cong. (2017).

3 See, e.g., Editorial, *Don't Cheer as the I.R.S. Grows Weaker*, N.Y. TIMES, Dec. 30, 2017, at A22.

the resources.” In the private and nonprofit sectors, saying “we don’t have the resources” is the *beginning* of the discussion, not the *end*. Yet with the IRS, lack of resources often has become a reflexive excuse for not doing something, or worse, for doing things “to save resources” that harm taxpayers, foster noncompliance, and undermine taxpayer and employee morale.

In this report, even as we catalog the consequences of reduced IRS funding on taxpayers and the tax system, we propose reasonable and actionable steps that can reverse this decline. If the IRS were to take these steps, many of which *require no extra infusion of cash*, taxpayers would receive better service, compliance efforts would be better focused, and concrete evidence would be placed before Congress that additional investments in the IRS would yield positive and meaningful results.

In my opinion, the discussion about IRS funding has largely proceeded based on false choices — either “you can’t trust the IRS to administer the tax system so don’t fund it” or “because the IRS doesn’t have enough funding, it can’t do the things it needs to do to administer the tax system.” The truth lies somewhere in between. *The IRS absolutely needs more funding*. It cannot answer the phone calls it currently receives, much less the phone calls it can expect to receive in light of tax reform, without adequate funding. But within the budget it currently has, there are plenty of opportunities for the IRS to demonstrate that it can do a better job of using creativity and innovation to provide taxpayer service, encourage compliance, and address noncompliance.

In one of the Public Forums I held in 2016 on Taxpayer Needs and Preferences, a practitioner commented that before the IRS focuses so much effort on its “Future State,” there is plenty the IRS can do to improve its “Present State.”<sup>4</sup> This comment really struck me, because I had been feeling that the IRS, in response to budget cuts, was trying to shoe horn the taxpayers of the United States into the IRS’s picture of the Future State without paying sufficient attention to what taxpayers were needing today.<sup>5</sup> In the private sector, one must do both at the same time, or one loses market share. As someone who worked much of my life with and in the nonprofit sector, I am accustomed to never having enough funding to accomplish the often life-altering tasks nonprofits undertake. But we never said, “We don’t have the resources to do this.” We found a way.

With that in mind and as the IRS moves into the 2018 Filing Season and begins to implement tax reform, this report focuses on things the IRS can do to improve customer service and taxpayer compliance with the resources it now has. The first step in this endeavor is to level-set the Present State.

- The IRS has received more than 95 million calls each year since Fiscal Year (FY) 2008. Even before the enactment of Public Law 115-97, the IRS estimated that during the 2018 filing season it would only answer about six out of ten calls from taxpayers seeking to speak to a live assistor (*i.e.*, a 60 percent “level of service” or LOS). For the full 2018 fiscal year, the IRS estimated the LOS for calls seeking a live assistor would be *below 40 percent — that is, only 4 out of 10 calls would get through to a live assistor*.<sup>6</sup>
- Since 2014, the IRS has only answered “basic” tax-law questions during the filing season, and it has not answered *any* tax-law questions beyond the April 15th filing deadline either on the toll-free telephone lines or in its Taxpayer Assistance Centers, even though more than 15 million

4 See Oral Statement of Tamara Borland, National Taxpayer Advocate Public Forum 16 (May 5, 2016), [https://taxpayeradvocate.irs.gov/Media/Default/Documents/PublicForums/Transcripts/RedOakIA\\_Transcript\\_050516.pdf](https://taxpayeradvocate.irs.gov/Media/Default/Documents/PublicForums/Transcripts/RedOakIA_Transcript_050516.pdf)

5 For additional discussion, see National Taxpayer Advocate 2016 Annual Report to Congress 1-41 (Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*).

6 IRS, Wage & Investment (W&I), *Business Performance Review* 4 (Nov. 9, 2017).

taxpayers file returns later in the year. Thus, taxpayers who want to learn about how the tax law affects them are left searching about 140,000 web pages on IRS.gov or turning to paid professionals. This does not bode well for taxpayers seeking information about the major tax-law changes and their impact on 2018 federal income tax returns.

- A 2016-2017 TAS survey of U.S. taxpayers who had filed at least one tax return during the preceding year showed that 41 million taxpayers had no broadband access in their homes, and 14 million have no internet access at home.<sup>7</sup> Yet the IRS continues to direct taxpayers to create online accounts, even though taxpayers seeking to do so *have a “pass rate” of only about 30 percent — meaning that only about 3 out of 10 taxpayers attempting to create an online account are able to do so.*<sup>8</sup> Results from IRS pilots of taxpayer digital communication (TDC) show that while some taxpayers find submitting documents electronically during an audit to be very useful, the TDC audits tend to have longer cycle times. Moreover, many taxpayers simply do not want to go through the process of setting up an online account. In fact, TAS’s TDC pilot included unrepresented taxpayers with Earned Income Tax Credit (EITC) or levy cases. Fewer than ten taxpayers opened accounts out of the more than 700 taxpayers who were offered the opportunity to participate in the pilot. Preliminary results from the Small Business/Self-Employed Division’s TDC audit pilot show almost 24 percent of the taxpayers who were sent an invitation to participate in the pilot attempted to create an account (2,194 out of 9,149). Of those attempts, less than half (971 out of 2,194) succeeded in opening an account.<sup>9</sup> Thus, however meritorious, online accounts should not be counted on to provide significant resource savings any time soon.
- IRS staffing in key taxpayer-facing professions has declined precipitously since FY 2011. Of note is the 35 percent decline in the Stakeholder Liaison Outreach employees and Stakeholder Partnerships, Education, and Communication employees of the IRS workforce.<sup>10</sup> With only about 400 employees available for direct outreach and education to taxpayers, it is questionable whether the IRS can effectively assist taxpayers in understanding their obligations under the new tax law.<sup>11</sup>

7 Research Study: *A Further Exploration of Taxpayers’ Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs*, vol. 2, *infra*.

8 IRS response to TAS information request (Nov. 22, 2017).

9 For an in-depth discussion of the IRS online account and the Taxpayer Digital Communications (TDC) pilot, see Most Serious Problem: *Online Accounts: The IRS’s Focus on Online Service Delivery Does Not Adequately Take into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population*, *infra*.

10 The Stakeholder Liaison Outreach employees transferred to C&L on April 2, 2017.

11 Some IRS employees — although not specifically employees of an outreach and communication function — make local appearances or speeches.

**FIGURE 0.0.1, Locations With Specified Employees in the Last Pay Period of the Fiscal Year<sup>12</sup>**

Number of Locations, Employees, or Visitors	2011	2012	2013	2014	2015	2016	2017
IRS Offices (Cities)	541	523	510	499	479	470	454
Appeals Officers (AOs)	1,129	1,058	958	881	795	739	737
Revenue Officers (ROs)	4,402	4,035	3,703	3,441	3,191	3,072	2,962
Revenue Agents (RAs)	8,652	8,638	8,520	8,418	8,329	8,557	8,502
Stakeholder Liaison Outreach Employees (Communication Liaison Outreach Employees in FY 2017)	137	123	119	110	105	98	105
Stakeholder Partnerships, Education and Communication Outreach Employees (SPEC)	522	475	444	405	386	365	311
Taxpayer Assistance Centers (TACs)	401	401	398	382	378	376	371
TAC Service Reps	1,639	1,515	1,484	1,520	1,423	1,267	1,121
Taxpayer Advocate Service, Case Advocates	996	945	919	862	784	726	683

- The IRS has reduced its employee training budget by nearly 75 percent since FY 2009.<sup>13</sup> Not only has the budget for training drastically declined, the way in which employees receive that training has shifted from face-to-face training to virtual training. In FY 2017, the IRS spent \$489 per employee on training (over 0.3 percent of its budget), compared with nearly \$1,450 per employee in FY 2009.<sup>14</sup> The Wage and Investment (W&I) Division, which has the largest number of employees of any operating division, spends only \$87 per employee per year for training.<sup>15</sup> The IRS provides only 19 hours of training per employee in at least one key job series,

12 For fiscal years (FYs) 2011 through 2016, employee counts for Appeals Officers, Revenue Officers, Stakeholder Liaison Outreach, and SPEC Outreach are from the IRS response to the TAS fact check (Dec. 16, 2016). TAC Office figures for FYs 2011-2014 from the IRS response to the TAS fact check (Dec. 23, 2014), for FY 2015 from W&I analyst (Dec. 13, 2016), for FY 2016 from the IRS response to the TAS fact check (Dec. 20, 2016), and for FY 2017 from the IRS response to the TAS fact check (Nov. 3, 2017). The remaining data is obtained from a TAS query of non-supervisory positions and IRS Offices from the IRS Human Resources Reporting Center, *Position Report by Employee Listing for the ending pay period FY 2011 to FY 2017*. TAC Service representatives are non-supervisory employees in the 501 job series. Different from the data provided by the IRS that we published last year, Revenue Agent (RA) counts now only include field RAs (non-supervisory) in the TE/GE, SB/SE, and LB&I operating divisions. The RA data published last year from the IRS response to TAS fact check (Dec. 16, 2016) included duplicate counts of RAs in the Appeals function; and also included non-field RAs in the Whistleblower Office and in TAS. The counts of TAS caseworkers are from the Integrated Financial System. For 2017, the IRS responded that C&L had 105 employees assigned to outreach activities. However, the IRS response to the TAS fact check stated that these numbers only account for Small Business/Self-Employed (SB/SE) Stakeholder Liaison (SL) employees transferred to C&L on April 2, 2017. Therefore, we do not have details regarding any additional outreach employees. IRS response to TAS fact check (Nov. 20, 2017).

13 IRS response to TAS information requests (Nov. 22, 2013 and Nov. 7, 2017); IRS response to TAS fact check (Dec. 15, 2017). While the budget for training has increased by approximately \$17 million since a low point of approximately \$22.6 million in fiscal year (FY) 2013, the reduction from previous years of nearly \$115 million spent on training is drastic.

14 IRS response to TAS information request (Nov. 22, 2013 and Nov. 7, 2017). IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 15, 2017). The IRS had 105,783 employees as of the last week of FY 2009 and spent \$153,155,686 on training. Per employee, the IRS spent \$1,448 in FY 2009 and only \$489 in FY 2017. IRS response to TAS information requests (Nov. 22, 2013 and Dec. 7, 2017). IRS response to TAS fact check (Dec. 15, 2017).

15 IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017). IRS response to TAS information request (Nov. 7, 2017).

which includes nearly five hours of mandatory briefings, leaving only 14 hours of substantive training.<sup>16</sup>

The IRS estimates that it will need about \$495 million in FYs 2018 and 2019 to implement Public Law 115-97, including programming and systems updates, answering taxpayer phone calls, drafting and publishing new forms and publications, revising regulations and issuing other guidance, training employees on the new law and guidance, and developing the systems capacity to verify compliance with new eligibility and documentation requirements. The IRS has identified 131 filing season systems that will be impacted by the new legislative provisions which, among other things, include incorporating new individual and business tax rates, gradual inflation indexing changes for deductions and credits, threshold changes repeal, removing existing credits from systems, and updating fraud detection filters.

Following enactment of the last major tax reform legislation, the Tax Reform Act of 1986,<sup>17</sup> the IRS made changes to 162 existing forms, developed 48 new forms, and created 13 new publications. Call volume increased by 14 percent, and the IRS hired an additional 1,300 staff, increased phone capacity by 30 percent, and expanded hours and phone service to Saturdays. There was a two percent increase in tax returns that had to be corrected in processing. The IRS's recent experience implementing the Patient Protection and Affordable Care Act<sup>18</sup> suggests the additional work required by the Tax Reform Act of 1986 may be a reasonable predictor. After the passage of the ACA, calls and correspondence from taxpayers increased by eight percent from FY 2010 to 2011, and then increased by another 18 percent the following year.<sup>19</sup> However, the magnitude of taxpayer confusion and the number of inquiries a new law will generate are difficult to predict and can vary depending on the provisions in the law. After Congress authorized Economic Stimulus Payments in 2008, for example, the IRS was deluged with taxpayer telephone calls. Incoming calls on the Accounts Management telephone lines rose from about 66 million in FY 2007 to about 151 million in FY 2008 — an increase of over 125 percent.

### Rebuilding the IRS Customer Service Environment

As the discussion above clearly demonstrates, the IRS needs more employees simply to answer the volume of phone calls and correspondence it annually receives. But because the IRS has focused its technology efforts on creating an online account — an important development and long overdue — it has not kept up with telephone technology or the approaches the private sector has adopted to deliver better customer service.<sup>20</sup> Instead, it has cherry-picked the practices that suit its own goals — to limit person-to-person contact in favor of automated and digital applications. It is doing this from a pure short-term cost analysis. But what private sector practices show — as outlined in our Most Serious Problem and Literature Review on telephone assistance<sup>21</sup> — is that customers have multiple needs and

16 IRS response to TAS information request (Nov. 7, 2017). Employees in the Tax Exempt Government Entities (TE/GE) 0592 job series received 18.75 hours of training per employee, not even three full work days of training in an entire year. IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/> (last visited Nov. 17, 2017). All IRS employees in FY 2017 were required to take a series of briefing accounting for at least 4.83 hours of training. Those courses were: Information Systems Security Refresher, Unauthorized Access (UNAX) Awareness, Facilities Management and Security Services Physical Security Briefing, Notification and Federal Employee Antidiscrimination and Retaliation Act of 2002 (No FEAR Act) Briefing Refresher, Records Management Awareness, Privacy, and Information Protection & Disclosure Refresher.

17 Pub. L. No. 99-514, 100 Stat. 2085 (1986).

18 Pub. L. No. 111-148, 124 Stat. 119 (2010).

19 IRS, *TCJA Preliminary Implementation Cost Estimates* (Nov. 2017) (document on file with the National Taxpayer Advocate).

20 For example, the IRS does not have the capability to offer customer callback or scheduled call-back options.

21 Most Serious Problem: *Telephones: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment*, *infra*; *Literature Review: Improving Telephone Service Through Better Quality Measures*, vol. 2, *infra*.

choose the service option that best serves those needs.<sup>22</sup> Customers (taxpayers) are smart in that way, but the IRS service strategy seeks to override taxpayers' own assessment of how they need to receive assistance and replace it with the IRS's belief that it knows better than the taxpayers themselves.

What would it take for the IRS to provide 21st century customer service? First, it must acknowledge what the private sector clearly knows: If you don't serve customers in the way they want and need to be served, they will look somewhere else. Of course, the IRS, as the *only* federal tax agency in the United States, has a monopoly on tax administration. On the surface, it appears "customers" (taxpayers) don't have a choice about seeking another tax agency to work with — there are no competitors to which they can move their "business." In fact, however, there is a competitor, and it is the lure of noncompliance. If the IRS isn't going to provide you the assistance you need in the manner you need it, then why bother complying with the tax laws? Yes, taxpayers know there may be consequences for blatant noncompliance, but if and when the opportunity presents itself for a taxpayer not to comply in subtle ways that are hard to detect (*e.g.*, reporting cash-economy income), the taxpayer may be more likely to take the opportunity, because there is no "brand loyalty" to the IRS and tax compliance. Simply put, the IRS hasn't earned taxpayer loyalty.

Alternatively, taxpayers seek tax assistance from a variety of tax sources — which may be licensed professionals (*e.g.*, attorneys, certified public accountants, or Enrolled Agents) or unregulated persons or just random internet sites. As we discuss in the Purple Book, the quality of the assistance varies wildly.<sup>23</sup> And it is not free. Thus, because the IRS doesn't provide top quality service to the average taxpayer, he or she must pay for it. This increases the individual burden of tax compliance.

So how can we arrest this sad state of affairs and turn the IRS and taxpayers' fortunes around? As a first step, the IRS should do a better job of following the priorities its appropriators have repeatedly set. For example, the Appropriations Committees have pushed back against the IRS's plans to transition taxpayers to online services, directing the agency to embrace an omnichannel customer service strategy

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22 An omnichannel service environment "ensures the service level, responsiveness, and quality of service received on individual channels and across channels would be equally high." Aspect, *What is an Omnichannel Experience?*, <https://www.aspect.com/glossary/what-is-omni-channel-customer-service-experience>.

23 National Taxpayer Advocate Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration: Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers*, *infra*.

and provide it with the specifics about what it would take to deliver this approach.<sup>24</sup> To date, the IRS has not done so. If the IRS availed itself of this opportunity and set forth a plan — *with specifics* — that reflected an acceptance and understanding that taxpayers need ongoing access to *all* customer service methods — online, phone, in-person — instead of promoting the fiction of a Future State where almost everything is done online, the IRS would probably gain more credibility with the Appropriations Committees and would be more likely to receive additional funding. At the risk of vast understatement, a first step toward getting additional funding is complying with what your appropriators ask you to do.

### Restoring the Taxpayer Compliance Environment

In addition to concerns about the present state of customer service, there are also concerns about declining audit rates. As noted above, the number of field revenue agents has declined from 8,652 in year FY 2011 to 8,502 in FY 2017. But as we discuss in our Most Serious Problem on audit rates, this is only part of the story.<sup>25</sup> In fact, the IRS underreports much of its compliance activity, because it has shifted its resources into automated, centralized, or correspondence initiatives. When you count those initiatives, the individual “compliance contact” rate for FY 2016 rises from 7/10ths of 1 percent to 6.2 percent!<sup>26</sup>

But this is not just about numbers — it is about the way the IRS intends to do its compliance work in the future. Certainly, using correspondence to correct simple math or clerical errors makes sense — although no one would say IRS math error notices are a model of clarity.<sup>27</sup> But many tax return errors are attributable to the complexity of either the tax laws or taxpayers’ lives. For example, while one might think it is easy to determine whether you are eligible to claim your child for purposes of the dependency exemption, the child tax credit, or the Earned Income Tax Credit, these provisions are highly complex, and people’s family structures are increasingly diverse. Further, no matter how a business entity is

24 See, e.g., Senate Committee on Appropriations, *Explanatory Statement for Financial Services and General Government Appropriations Bill*, 2018, <https://www.appropriations.senate.gov/imo/media/doc/FY2018-FSGG-CHAIRMEN-MARK-EXPLANATORY-STM.PDF> (last visited Dec. 31, 2017).

*Future State Vision*. – IRS’s future state vision of the tax administration system is to promote and improve voluntary compliance by delivering better service to more people at a lower cost through less IRS-taxpayer personal interaction and greater online and third-party interactions. Security concerns aside, the IRS has not demonstrated that it has analyzed the consequences of its vision and the impact it will have on taxpayers. Additionally, it is unclear what research IRS conducted to understand taxpayer needs. *Id.* at 22

The Committee remains concerned about IRS’s Future State vision where taxpayers will rely on online services for their IRS interactions. The Committee expects the IRS to continue to improve telephone and face-to-face services and directs the IRS to submit a report on progress made in these areas to the Committees on Appropriations of the Senate and House of Representatives within 120 days of enactment. ... The Committee is concerned with a growing number [of] TAC closures and decline in the number of taxpayers served. The Committee agrees with the National Taxpayer Advocate that the elimination of a regular walk-in option for taxpayers raises significant concerns about access to IRS services. The Committee directs the IRS to report to the Committee within 120 days of enactment of this Act the steps being taken to prevent any closures of TAC locations, and the status of any proposed alternatives to fully staffed TACs (such as virtual customer service sites). The Committee directs the IRS to conduct a study on the impact of closing a Taxpayer Assistance Center and the adverse effects it has on taxpayers’ ability to interact with the IRS. Should the IRS choose to close a TAC location, the Committee directs the IRS to hold a public forum in the impacted community at least 6 months prior to the planned closure and notify the Committees on Appropriations of the Senate and House of Representatives. *Id.* at 25.

25 Most Serious Problem: *Audit Rates: The IRS is Conducting Significant Types and Amounts of Compliance Activities that It Does Not Deem to Be Traditional Audits, Thereby Circumventing Taxpayer Protections and Misrepresenting the Extent of Its Compliance Activity and Return on Investment*, *infra*.

26 In addition to audits, the IRS makes tax adjustments through its Automated Underreporter (AUR) system, through its use of math error authority, through its automated substitute for return (ASFR) program and its Taxpayer Protection Program and Income Wage Verification program.

27 For a legislative recommendation about the IRS’s “math error” authority, see National Taxpayer Advocate Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration: Continue to Limit the IRS’s Use of “Math Error Authority” to Clear-Cut Categories Specified by Statute*, *infra*.

organized, determining the deductibility of “ordinary and necessary” trade or business expenses is no easy matter — as Supreme Court Justice Cardozo noted, “life in all its fullness must supply the answer to the riddle.”<sup>28</sup>

In these instances, correspondence and automated audits just don’t work. There needs to be person-to-person communication, and one auditor needs to be assigned to the taxpayer’s case. This is essential if one looks at audits as an educational tool foremost and a revenue protection tool secondarily. The goal of any audit should be for the tax agency to understand the specific facts and circumstances of the taxpayer’s situation and apply the law in light of those facts and circumstances and for the taxpayer to understand what he did incorrectly and how to proceed going forward in compliance with the law. The IRS can’t do that without personal interaction in the context of family status or small business or sole proprietorship audits. And *why* you would want to avoid personal interaction with taxpayers is beyond me; this represents a missed educational opportunity and a waste of those precious audit resources.

In fact, a recent study of attitudes of sole proprietors and other taxpayers toward the tax system, included in this Report, found that only 38.8 percent of sole proprietors subject to a correspondence audit recalled they had had such an audit (compared to 67 percent for field audits and 73.7 percent for office audits).<sup>29</sup> This finding indicates there is not much of a “learning opportunity” with correspondence audits. Moreover, sole proprietors who had correspondence audits reported relatively low perceived levels of procedural, informational, interpersonal, and distributive justice, and feel less protected by the IRS. If taxpayer attitudes towards the tax system affect their willingness to comply with the tax laws, as I believe they do, then these findings undermine the IRS’s position that correspondence audits are efficient and effective.

### Problems of the IRS’s Own Making

In this report, many of our Most Serious Problems are a roadmap to the way in which the IRS’s implementation of congressional mandates as well as its own “Future State” vision are either actively harming taxpayers or are creating re-work for itself, thereby wasting resources. A few of them merit mention here.

**Private Debt Collection:**<sup>30</sup> Whatever one might think about Congress’s mandate that the IRS use private debt collectors to make a dent in the nearly \$400 billion owed, everyone can agree that if the program is going forward, we want it administered in a way that is “no more intrusive than necessary.”<sup>31</sup> In this Report, however, we show the IRS’s implementation of this program unnecessarily harms taxpayers and constitutes an end-run around the significant taxpayer rights protections that Congress has enacted in the collection arena.

To ensure the IRS does not collect tax debt if doing so would leave a taxpayer without enough money to meet his or her basic living expenses, Congress required the IRS to “develop and publish schedules of national and local allowances” that ensure taxpayers “have an adequate means to provide for basic

28 *Welch v. Helvering*, 290 U.S. 111 (1933).

29 Research Study: *Audits, ID Theft Investigations, and Taxpayer Attitudes: Evidence From a National Survey*, vol. 2, *infra*.

30 For an in-depth discussion of Private Debt Collection, see Most Serious Problem: *Private Debt Collection: The IRS’s Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with the Law, and Burdens Taxpayers Experiencing Economic Hardship*, *infra*.

31 The Taxpayer Bill of Rights includes *the right to privacy*, which the IRS describes as follows: “Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections, and will provide, where applicable, a collection due process hearing.” IRS Pub. 1, *Your Rights as a Taxpayer* (Sept. 2017).

living expenses.”<sup>32</sup> These Allowable Expense Standards, or ALEs, are a key component of the IRS’s determination of a taxpayer’s ability to pay a tax debt. If the IRS determines a taxpayer’s income is below the appropriate ALE amount, it will classify that taxpayer as “Currently Not Collectible — Hardship” and generally not levy or take enforced collection action.

While there is no Internal Revenue Code definition of “low income,” 250 percent of federal poverty level has been widely used as a proxy for “low income” by Congress in setting eligibility for *pro bono* representation by Low Income Taxpayer Clinics<sup>33</sup> and by the IRS in setting a carve-out level for Social Security recipients under the automated Federal Payment Levy Program. Yet, although the IRS has the legal authority and the capability to do so, the IRS has refused to screen out taxpayers whose incomes are so low that they would be eligible for “Currently Not Collectible-Hardship” status and, *by law*,<sup>34</sup> not subject to a levy on salary or wages.

IRS data bear out the impact of these decisions. Approximately 2,100 taxpayers entered into installment agreements while their debts were assigned to private collection agencies (PCAs), made payments on which the PCAs were paid commissions, and have filed recent returns.<sup>35</sup> *According to these taxpayers’ returns, more than 45 percent had income that was less than their ALEs.*<sup>36</sup> Thus, these taxpayers could not afford to pay their basic living expenses under the installment agreements organized by the PCAs.

Moreover, of the 4,905 taxpayers who made payments after their debts were assigned to a private collection agency, 4,141 had filed recent returns as of September 28, 2017.<sup>37</sup> The returns filed by the 4,141 taxpayers show:

- 19 percent had incomes below the federal poverty level; median income for these taxpayers was \$6,386;<sup>38</sup> and
- 25 percent had incomes above the federal poverty level but below 250 percent of the federal poverty level; median income for these taxpayers was \$23,096.<sup>39</sup>

It is extremely likely that these taxpayers do not have the ability to meet their basic living expenses and would be placed in CNC-hardship status if their accounts were handled by the IRS. By not screening out these taxpayers from going to PCAs — who do not conduct financial analysis — the IRS is allowing collection against taxpayers that Congress explicitly and specifically sought to protect.

No one is making the IRS make these bad decisions. The harm to these taxpayers is something IRS leadership consciously decided to do despite my personal efforts, and those of my organization, to stop it.

32 IRC § 7122(d)(2)(A).

33 See IRC § 7526(b)(1)(B)(i).

34 IRC § 6343 requires the IRS to release a levy in certain circumstances, including when the taxpayer and the IRS agree that the tax is not collectible. See IRC § 6343(e).

35 Individual Returns Transaction File (IRTF), Information Returns Master File (IRMF), Compliance Data Warehouse (CDW), data current through Sept. 28, 2017.

36 *Id.*

37 *Id.* TAS Research identified 4,018 taxpayers who made payments to the IRS more than ten days after their accounts were assigned to a PCA (and the payments were thus commissionable) and who filed a return for tax year 2014 or later.

38 U.S. Dept. of Health and Human Services, *Poverty Guidelines* (Jan. 31, 2017), <https://aspe.hhs.gov/poverty-guidelines>, showing that the poverty level for a single person in 2017 (for the 48 contiguous states and the District of Columbia) was \$12,060. Thus, 250 percent of the 2017 federal poverty level for a single person was \$30,150.

39 *Id.* As discussed below, for purposes of administering the IRS’s automatic levy program, the Federal Payment Levy Program (FPLP), the IRS adopted 250 percent of the federal poverty level as a measure that serves as a proxy for economic hardship.

**Form 1023-EZ:**<sup>40</sup> In 2014, in response to 18-month cycle times for applicants for tax-exempt status under IRC § 501(c)(3) to receive determination letters from the IRS, the IRS introduced a radically shortened Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. The IRS has touted this initiative as a poster child of its “Future State” vision — claiming that it has reduced taxpayer burden, resource demands, and cycle time for tens of thousands of new tax-exempt organizations. In reality, what this initiative has done is allowed thousands of organizations *that do not meet the statutory requirements for exemption* to operate unchecked and uninformed. Specifically, the new procedures do not require these applicants to submit their articles of incorporation or bylaws to ensure they are properly organized and have adopted the appropriate charitable purpose clause as well as protections against misuse of funds.

As a result, TAS research studies have shown that *for the last three years, between 26 and 42 percent of approved entities filing Form 1023-EZ did not meet the organizational test for qualification as an IRC § 501(c)(3) organization*. This finding is even more stunning when you consider that Form 1023-EZ applicants now outnumber applications on the full Form 1023. Improper grants of tax-exempt status come at a huge cost to *all* U.S. taxpayers, since these entities are receiving funds tax-free and donors are getting tax deductions for charitable contributions. Yet the IRS steadfastly refuses to either check the online registers of articles of incorporation or to require organizations to submit their organizing documents with their application. Instead of addressing compliance concerns upfront when the organization is applying for recognition of its exempt status, the IRS says it will audit itself out of a problem entirely of its own making. And it is not doing that either, as the IRS audits fewer than one percent of tax-exempt entities every year. If this program is the apotheosis of the Future State vision, well, no wonder Congress and other stakeholders have concerns about the agency’s direction.

**Passport Denial/Revocation:**<sup>41</sup> In early 2018, the IRS will begin implementing the congressionally mandated program that will lead to denial of passports to U.S. citizens who owe more than \$51,000 in aggregate federal tax debt and meet certain other criteria.<sup>42</sup> The IRS Office of Chief Counsel has opined that the IRS has significant flexibility in administering this program, with even more discretion to create exclusions under this program than under the PDC program. Yet as we discuss in this Report, the way the IRS is administering the program arguably violates constitutional due process protections by failing to give adequate notice to the affected taxpayers of the denial and provide them sufficient time after that notice to come in and correct the situation before the harm (passport denial) occurs.

The IRS procedures most certainly violate the *right to a fair and just tax system*, which the IRS itself says includes “the right to expect the tax system to consider facts and circumstances that might affect [taxpayers’] underlying liabilities, ability to pay, or ability to provide information timely” and “the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or

40 For an in-depth discussion of Form 1023-EZ, see Most Serious Problem: *Exempt Organizations: Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase*, *infra*.

41 For a detailed discussion of the IRS Passport Denial and Revocation program, see Most Serious Problem: *Passport Denial and Revocation: The IRS’s Plans for Certifying Seriously Delinquent Tax Debts Will Lead to Taxpayers Being Deprived of a Passport Without Regard to Taxpayer Rights*, *infra*.

42 See IRC § 7345. Under the statute, the federal tax debt must be an unpaid, legally enforceable federal tax liability of an individual, which has been assessed, is greater than \$50,000 (currently indexed for inflation to \$51,000), and meets either of the following criteria: (1) a notice of lien has been filed under IRC § 6323 and the Collection Due Process hearing rights under IRC § 6320 have been exhausted or lapsed; or (2) a levy has been made under IRC § 6331. Furthermore, there are statutory and discretionary exclusions from certification.

if the IRS has not resolved their tax issues properly and timely through its normal channels.”<sup>43</sup> Instead, the IRS has categorically refused to exclude those taxpayers who *currently* have cases in the Taxpayer Advocate Service. As of October 1, 2017, there were about 800 taxpayers who owe balances above \$50,000 in the aggregate, do not meet a statutory or discretionary exclusion criteria, and were actively working with TAS to resolve their tax issues. Of the TAS cases with balances due over \$50,000 that closed in FY 2017, more than 75 percent involve either exam or collection issues, and TAS closed 70 percent of these cases with full or partial relief. The IRS has the capability and authority to exclude these cases from the Passport program, yet it has refused to do so, for the “reason” that it would be treating these taxpayers differently from others. This is bizarre reasoning, since by statute, a taxpayer whose case is accepted in TAS has a “significant hardship” and TAS cases are treated differently as a matter of law, presumably because Congress believed taxpayers who approach TAS to try to resolve their problems deserve to be protected from most adverse actions while their cases are pending. This IRS decision also makes little sense from the standpoint of resource savings, because by certifying these cases to the Department of State, the IRS is creating additional work for TAS and for itself. Specifically, once TAS achieves a resolution of this case (which it usually does), we will also have to get the taxpayer “decertified.” To avoid this needless waste of resources, I will be issuing Taxpayer Assistance Orders<sup>44</sup> (TAOs) before the program commences with respect to every taxpayer with an assessed, unpaid federal tax debt over \$51,000 who has an open case in TAS and who does not otherwise meet an exception or exclusion from certification; the TAOs will order the IRS to not make the referral to the Department of State.

### Conclusion

I realize that after this high-speed road trip through the IRS Present and Future State, readers may come away somewhat dispirited. However, I hope that readers will see, notwithstanding all the challenges the IRS faces, that there are solutions to these problems. Some of those solutions require more funding — for example, the IRS simply needs more staff to answer telephone calls and conduct field outreach and education, audit, appeals, and collection activities. But for each of the problems we’ve identified and discussed in the pages of this Report, there are recommendations that do not require substantial monetary investment to achieve. What these recommendations require is a willingness on the part of IRS leadership to look at tax administration through the eyes of the taxpayer, to be open to new approaches, and to cultivate creativity. Challenges notwithstanding, with strong leadership of the IRS and support from Congress, this can happen. It won’t be easy, but the taxpayers of the United States deserve a better functioning IRS that understands and meets their needs, even as it ensures that all taxpayers comply with the tax laws.

Respectfully submitted,



Nina E. Olson  
National Taxpayer Advocate  
31 December 2017

<sup>43</sup> IRS Pub. 1, *Your Rights as a Taxpayer* (Sept. 2017).

<sup>44</sup> See IRC § 7811.

## TAXPAYER RIGHTS ASSESSMENT: IRS Performance Measures and Data Relating to Taxpayer Rights

In the 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that “... provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance.”<sup>1</sup>

In 2014, the IRS officially adopted the Taxpayer Bill of Rights (TBOR), a list of ten rights that the National Taxpayer Advocate recommended to help taxpayers and IRS employees alike gain a better understanding of the dozens of discrete taxpayer rights scattered throughout the multi-million word Internal Revenue Code (IRC).<sup>2</sup> In late 2015, Congress followed suit by adding the list of fundamental rights to the IRC.<sup>3</sup> While listing these rights in IRC § 7803(a)(3) is a significant achievement for increasing taxpayers’ awareness of their rights, the process of integrating taxpayer rights into all aspects of tax administration continues. The *Taxpayer Rights Assessment* contains selected performance measures and data organized by the ten taxpayer rights and is one step toward integrating taxpayer rights into tax administration.

This *Taxpayer Rights Assessment* is a work in progress. The following data provide insights into IRS performance; however, they are by no means comprehensive. In some instances, data is not readily available. In other instances we may not yet have sufficient measures in place to address specific taxpayer rights. And, despite what the numbers may show, we must be concerned for those taxpayers who still lack access to services and quality service even when performance metrics are increasing. This *Taxpayer Rights Assessment* will grow and evolve over time as data becomes available and new concerns emerge.

**1. THE RIGHT TO BE INFORMED** – Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

Measure/Indicator	Fiscal Year (FY) 2015	FY 2016	FY 2017
Individual Correspondence Volume (adjustments) <sup>a</sup>	4,358,447	4,817,708	4,598,654
Average cycle time to work Individual Master File (IMF) Correspondence <sup>b</sup>	80 days	84 days	69 days
Inventory Overage <sup>c</sup>	68.3%	49.1%	39.5%
Business Correspondence Volume (adjustments) <sup>d</sup>	2,952,329	2,940,925	2,736,451
Average cycle time to work Business Master File (BMF) Correspondence <sup>e</sup>	46 days	47 days	45 days
Inventory Overage <sup>f</sup>	18.8%	8.6%	11.7%
Total Correspondence (all types)	TBD	TBD	TBD
Quality of IRS Forms & Publications	TBD	TBD	TBD
IRS.gov Web Page Ease of Use	TBD	TBD	TBD
IRS Outreach	TBD	TBD	TBD

a IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016 and FY 2017). This correspondence data is also repeated under Right 4 – *The Right to Challenge the IRS’s Position and Be Heard*.

b IRS, Research Analysis and Data (RAD), *Accounts Management Reports: CIS Closed Case Cycle Time* (FY 2016 and FY 2017).

c IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2016 and FY 2017* (weeks ending Oct. 1, 2016 and Sept. 30, 2017).

d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016 and FY 2017).

e IRS, RAD, *Accounts Management Reports: CIS Closed Case Cycle Time* (FY 2016 and FY 2017).

f IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2016 and FY 2017* (weeks ending Oct. 1, 2016 and Sept. 30, 2017).

- 1 See National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface: *Taxpayer Service Is Not an Isolated Function but Must Be Incorporated throughout All IRS Activities, Including Enforcement*).
- 2 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).
- 3 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

**2. THE RIGHT TO QUALITY SERVICE** – Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Number of Returns Filed (projected, all types) <sup>a</sup>	245,821,318	246,945,921	251,046,000
Total Individual Income Tax Returns <sup>b</sup>	148,840,642	150,711,378	152,413,600
E-file Receipts, calendar year (Received by 12/04/15, 12/02/16, 12/01/17) <sup>c</sup>	128,784,000	131,851,000	132,319,000
E-file Receipts: Tax Professional (calendar year) <sup>d</sup>	61%	60%	60%
E-file Receipts: Self Prepared (calendar year) <sup>e</sup>	39%	40%	40%
Returns Prepared by:			
VITA / TCE / AARP (tax year) <sup>f</sup>	3,564,102	3,542,336	3,402,019
Free File Consortium (tax year) <sup>g</sup>	2,588,934	2,356,167	2,352,555
Fillable Forms (tax year) <sup>h</sup>	355,080	346,098	325,482
Number of Taxpayer Assistance (“Walk-In”) Centers (TAC) <sup>i</sup>	378	376	371
Number of TAC Contacts <sup>j</sup>	5.6 million	4.5 million	3.3 million
Total Calls to IRS <sup>k</sup>	116,679,405	117,479,981	95,618,714
Number of Attempted Calls to IRS Customer Service Lines <sup>l</sup>	101,507,150	104,275,387	74,471,676
Toll Free: Percentage of calls answered [Level of Service (LOS)] <sup>m</sup>	38.1%	53.4%	77.1%
Toll Free: Average Speed of Answer <sup>n</sup>	30.5 minutes	17.8 minutes	8.4 minutes
NTA Toll Free: Percentage of calls answered (LOS) <sup>o</sup>	43.7%	58.1%	76.7%
NTA Toll Free: Average Speed of Answer <sup>p</sup>	16.2 minutes	8.9 minutes	2.9 minutes
Practitioner Priority: Percentage of calls answered (LOS) <sup>q</sup>	47.6%	71.0%	81.9%
Practitioner Priority: Average Speed of Answer <sup>r</sup>	46.6 minutes	10.5 minutes	8.9 minutes
Tax Exempt/Government Entities Percentage of calls answered (LOS) <sup>s</sup>	60.2%	56.8%	69.5%
Tax Exempt/Government Entities: Average Speed of Answer <sup>t</sup>	23.4 minutes	15.9 minutes	9.2 minutes
Toll Free Customer Satisfaction <sup>u</sup>	87.0%	88.0%	90.0%
Awareness of Service (or utilization)	TBD	TBD	TBD
IRS Issue Resolution – Percentage of taxpayers who had their issue resolved as a result of the service they received	TBD	TBD	TBD
Taxpayer Issue Resolution – Percentage of taxpayers who reported their issue was resolved after receiving service	TBD	TBD	TBD

a IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2016-2023* 4 (Aug. 2016); IRS Pub. 6292, *Fiscal Year Return Projections for the United States: 2017-2024* 3 (Sept. 2017). The FY 2016 figure has been updated from what we reported in the 2016 Annual Report to Congress to report actual return counts. The FY 2017 figures are projected numbers. The number of returns and related metrics are proxies for IRS workload and provide context for the environment in which taxpayers seek Quality Service and other rights.

b IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2016-2023* 4 (Aug. 2016); IRS Pub. 6292, *Fiscal Year Return Projections for the United States: 2017-2024* 3 (Sept. 2017). The FY 2016 figure has been updated from what we reported in the 2016 Annual Report to Congress to report actual return counts.

c IRS, *E-File Reports*, <http://efile.enterprise.irs.gov/Progress.asp> (last visited Dec. 11, 2017).

d *Id.*

e *Id.*

f Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly, and AARP Tax-Aide programs. IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File. The FY 2015 and FY 2016 figures have been updated from what we reported in the 2016 Annual Report to Congress. The FY 2015 figure represents tax year 2014 returns. The FY 2016 figure represent tax year 2015 returns. The FY 2017 figure represent tax year 2016 tax returns.

g IRS, CDW, Electronic Tax Administration Marketing Database.

h *Id.*

i FY 2015 figure from Wage & Investment (W&I) analyst (Dec. 13, 2016). FY 2016 figure from W&I response to TAS fact check (Dec. 20, 2016). FY 2017 figure from IRS response to TAS information request (Nov. 3, 2017).

j W&I, Business Performance Review (BPR), 4th Quarter, FY 2017 7 (Nov. 9, 2017).

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k	IRS, JOC, Snapshot Reports: Enterprise Snapshot (weeks ending Sept. 30, 2016 and Sept. 30, 2017; reports generated Nov. 19, 2017).
l	<i>Id.</i>
m	Accounts Management calls answered include reaching live assistor or selecting options to hear automated information messages.
n	<i>Id.</i>
o	<i>Id.</i>
p	<i>Id.</i>
q	<i>Id.</i>
r	<i>Id.</i>
s	<i>Id.</i>
t	<i>Id.</i>
u	W&I, BPR, 4th Quarter, FY 2017 11 (Nov. 9, 2017).

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### 3. THE RIGHT TO PAY NO MORE THAN THE CORRECT AMOUNT OF TAX – Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Toll-Free Tax Law Accuracy <sup>a</sup>	95.0%	96.4%	96.7%
Toll-Free Accounts Accuracy <sup>b</sup>	95.5%	96.1%	96.0%
Scope of Tax Law Questions Answered	TBD	TBD	TBD
Correspondence Examinations			
No change rate <sup>c</sup>	17.3%	16.2%	14.7%
Agreed rate <sup>d</sup>	16.3%	20.6%	22.4%
Non-response rate <sup>e</sup>	48.3%	42.1%	40.6%
Percentage of cases appealed	TBD	TBD	TBD
Field Examinations			
No change rate <sup>f</sup>	15.3%	14.6%	14.3%
Agreed rate <sup>g</sup>	45.7%	45.4%	46.1%
Non-response rate <sup>h</sup>	0.3%	0.3%	0.3%
Percentage of cases appealed	TBD	TBD	TBD
Office Examinations			
No change rate <sup>i</sup>	13.5%	12.2%	14.4%
Agreed rate <sup>j</sup>	44.7%	43.4%	42.8%
Non-response rate <sup>k</sup>	19.8%	20.6%	19.0%
Percentage of cases appealed	TBD	TBD	TBD
Math Error Adjustments	TBD	TBD	TBD
Math Error Abatements	TBD	TBD	TBD
Number of Statutory Notices of Deficiency Issued	TBD	TBD	TBD
Number of Statutory Notices of Deficiency Appealed	TBD	TBD	TBD
Number of Collection Appeals Program Conferences	TBD	TBD	TBD
Number of Collection Appeals Program Conferences Reversing IRS position	TBD	TBD	TBD
Number of Collection Due Process Conferences	TBD	TBD	TBD
Number of Collection Due Process Conferences Reversing IRS position	TBD	TBD	TBD

*continued*

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- a W&I, BPR, 4th Quarter, FY 2017 4 (Nov. 9, 2017).  
 b *Id.*  
 c IRS, CDW, Audit Information Management System (AIMS), Closed Case Database.  
 d *Id.*  
 e *Id.*  
 f *Id.*  
 g *Id.*  
 h *Id.*  
 i *Id.*  
 j *Id.*  
 k *Id.*

**4. THE RIGHT TO CHALLENGE THE IRS'S POSITION AND BE HEARD** – Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Individual Correspondence Volume (adjustments) <sup>a</sup>	4,358,447	4,817,708	4,598,654
Average cycle time to work IMF Correspondence <sup>b</sup>	80 days	84 days	69 days
Inventory Overage <sup>c</sup>	68.3%	49.1%	39.5%
Business Correspondence Volume <sup>d</sup>	2,952,329	2,940,925	2,736,451
Average cycle time to work BMF Correspondence <sup>e</sup>	46 days	47 days	45 days
Inventory Overage <sup>f</sup>	18.8 %	8.6%	11.7%
Percentage of Math Error Adjustments Abated	TBD	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD	TBD
Number of Collection Appeal Program Conferences Requested by Taxpayers <sup>g</sup>	TBD	TBD	TBD
Percentage of CAP Conferences that Reversed the IRS Position	TBD	TBD	TBD
Number of Collection Due Process Hearings Requested by Taxpayers <sup>h</sup>	TBD	TBD	TBD
Percentage of Collection Due Process Hearings that Reversed the IRS Position	TBD	TBD	TBD

a IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016 and FY 2017).

b IRS, RAD, *Accounts Management Reports: CIS Closed Case Cycle Time* (FY 2016 and FY 2017).

c IRS, CDW, Audit Information Management System (AIMS), Closed Case Database.

d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2016 and FY 2017).

e IRS, RAD, *Accounts Management Reports: CIS Closed Case Cycle Time* (FY 2016 and FY 2017).

f IRS, *Weekly Enterprise Adjustments Inventory Report*, FY 2016 and FY 2017 (weeks ending Oct. 1, 2016 and Sept. 30, 2017).

g Taxpayers may request a Collection Appeals Process review as the result of IRS actions such as filing a notice of federal tax lien, an IRS levy or seizure of property, and termination, rejection, or modification of an installment agreement. See IRS Pub. 1660, *Collection Appeal Rights*.

h Taxpayers may request a Collection Due Process review when the IRS plans to take actions such as filing a federal tax lien or levy. See IRS Pub. 1660, *Collection Appeal Rights*.

- 5. THE RIGHT TO APPEAL AN IRS DECISION IN AN INDEPENDENT FORUM** – Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals’ decision. Taxpayers generally have the right to take their cases to court.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Number of Cases Appealed <sup>a</sup>	113,870	114,362	103,574
Appeals Staffing (On-rolls) <sup>b</sup>	1,569	1,449	1,345
Number of States without an Appeals or Settlement Officer <sup>c</sup>	11	11	11
Customer Satisfaction of Service in Appeals <sup>d</sup>	65%	67%	N/A
Average Days in Appeals to Resolution	TBD	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD	TBD

a Office of Appeals, BPR, 4th Quarter, FY 2017 10 (Oct. 27, 2017).

b *Id.*

c IRS, Human Resources Reporting Center, <https://persinfo.web.irs.gov/posrpt.htm>. Employee Position (OF8) Listing for weeks ending Oct. 3, 2015, Oct. 1, 2016, and Sept. 30, 2017. The FY 2016 figure has been updated from what we reported in the 2016 Annual Report to Congress. The IRS also has Appeals and Settlement Officers in the District of Columbia which are not included in these figures.

d Office of Appeals, BPR, 4th Quarter, FY 2017 10 (Oct. 27, 2017). The FY2017 figure not yet available.

- 6. THE RIGHT TO FINALITY** – Taxpayers have the right to know the maximum amount of time they have to challenge the IRS’s position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Average Days to Complete Correspondence Examination (non-EITC) <sup>a</sup>	231 days	196 days	204 days
Average Days to Complete Correspondence Examination (EITC) <sup>b</sup>	221 days	217 days	221 days
Average Days to Reach Determination on Applications for Exempt Status <sup>c</sup>	83 days	54 days	54 days
Average Days for Exempt Organization Function to Respond to Correspondence <sup>d</sup>	175 days	45 days	27 days

a W&I, BPR, 4th Quarter, FY 2017 8 (Nov. 9, 2017).

b *Id.*

c Tax Exempt and Government Entities (TE/GE), BPR, 4th Quarter, FY 2017 8 (Nov. 30, 2017).

d TE/GE, BPR, 4th Quarter, FY 2017 9 (Nov. 30, 2017).

- 7. THE RIGHT TO PRIVACY** – The right to privacy goes to the right to be free from unreasonable searches and seizures and that IRS actions would be no more intrusive than necessary. Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Number (or percentage) of Collection Due Process cases where IRS cited for Abuse of Discretion	TBD	TBD	TBD
Number of Offers in Compromise Submitted using ‘Effective Tax Administration’ as Basis	TBD	TBD	TBD
Percentage of Offers in Compromise Accepted that used ‘Effective Tax Administration’ as Basis	TBD	TBD	TBD
Number of cases where taxpayer received repayment of attorney fees as result of final judgment	TBD	TBD	TBD

- 8. THE RIGHT TO CONFIDENTIALITY** – Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Number of Closed Unauthorized Access of Taxpayer Account (UNAX) Investigations <sup>a</sup>	173	147	151
UNAX Investigations Resulting in Prosecution, Removal, Resignation or Suspension of Employee <sup>b</sup>	70	38	64
UNAX Investigations Resulting in other Administrative Dispositions <sup>c</sup>	83	81	74
UNAX Investigations Where Employee Cleared of Wrongdoing <sup>d</sup>	20	28	13

a IRS, Automated Labor and Employee Relations Tracking System (ALERTS). The number of IRS employees averaged 89,251 in FY 2015, 85,002 in FY 2016, and 83,775 in FY 2017. IRS, Human Resources Reporting Center, *Fiscal Year Population Report*.

b IRS, ALERTS.

c *Id.* Administrative dispositions includes alternative discipline in lieu of suspension; case cancelled or merged with another case; caution letter; last chance agreement; oral counseling; reprimand; written counseling; etc.

d *Id.*

- 9. THE RIGHT TO RETAIN REPRESENTATION** – Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Percentage of Power of Attorney Requests Overage (as of 9/26/15, 10/1/16, 9/30/17) <sup>a</sup>	0%	0%	18.2%
Number of Low Income Taxpayer Clinics Funded (calendar year) <sup>b</sup>	132	138	138
Funds Appropriated for Low Income Taxpayer Clinics <sup>c</sup>	\$10.0 million	\$12.0 million	\$12.0 million
Number of States with a Low Income Taxpayer Clinic (calendar year) <sup>d</sup>	49	49	49
Number of Low Income Taxpayer Clinic Volunteer Hours (calendar year) <sup>e</sup>	54,164	60,669	47,480

a IRS, JOC, *Customer Account Services, Accounts Management Paper Inventory Reports* (weeks ending 9/26/2015, 10/1/2016 and 9/30/2017).

b IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2015, Jan. 2017, and Dec. 2017).

c Consolidated and Further Continuations Appropriations Act, 2015, Pub. L. No. 113-235, enacted Dec. 16, 2014. Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, enacted Dec. 18, 2015. Consolidated Appropriations Act, 2017, Pub. L. No. 115-31, enacted May 5, 2017. The amounts actually awarded to Low Income Taxpayer Clinics (LITCs) differed from the appropriated amounts. The IRS contributed an additional \$0.25 million in FY 2015 bringing the total to \$10.25 million. The amount awarded to clinics in FY 2016 was over \$11.4 million based on the number of available grantees who met the requirements. The amount awarded to clinics in FY 2017 was approximately \$11.8 million based on the number of available grantees who met the requirements. The FY 2016 figure has been updated from what we reported in the 2016 Annual Report to Congress.

d IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2015, Jan. 2017, and Dec. 2017). Forty-nine states and the District of Columbia have at least one LITC. Currently there is no LITC in North Dakota.

e *Id.* The FY 2016 number (60,669) was confirmed by the LITC Program Director (Oct. 28, 2016). The FY 2016 Pub. 5066 reported a rounded number (60,000). The FY 2015 figure reflects volunteer hours from calendar year (CY) 2014. The FY 2016 figure reflects volunteer hours from CY 2015. The FY 2017 figure reflects volunteer hours from CY 2016.

**10. THE RIGHT TO A FAIR AND JUST TAX SYSTEM** – Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from TAS if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

Measure/Indicator	FY 2015	FY 2016	FY 2017
Offer in Compromise (OIC): Number of Offers Submitted <sup>a</sup>	66,600	64,479	62,243
OIC: Percentage of Offers Accepted <sup>b</sup>	42.5%	42.5%	38.1%
Installment Agreements (IA): Number of Individual & Business IAs <sup>c</sup>	2,986,121	3,115,404	2,924,780
Streamlined Installment Agreements Number of Individual & Business IAs <sup>d</sup>	2,567,623	2,630,811	2,236,434
Installment Agreements Collection Field Function (Cff): Number of Individual & Business IAs <sup>e</sup>	52,053	42,978	35,449
Streamlined Installment Agreements (Cff): Number of Individual & Business IAs <sup>f</sup>	10,679	8,477	6,936
Number of OICs Accepted per Revenue Officer <sup>g</sup>	7.4	7.7	7.6
Number of IAs Accepted per Revenue Officer <sup>h</sup>	14.0	12.0	10.6
Percentage of Cases in the Queue (Taxpayers) <sup>i</sup>	15.7%	15.5%	13.9%
Percentage of Cases in the Queue (Modules) <sup>j</sup>	24.7%	23.9%	21.8%
Percentage of Taxpayer Delinquent Accounts (TDAs) reported Currently Not Collectible – Tolerance <sup>k</sup>	16.3%	16.9%	32.3%
Age of Delinquencies in the Queue <sup>l</sup>	4.5 years	4.5 years	4.5 years
Percentage of Modules in Queue prior to three tax years ago <sup>m</sup>	79.2%	78.7%	78.2%
Percentage of cases where the taxpayer is fully compliant after five years <sup>n</sup>	44%	48%	48%

a IRS, Collection Activity Report No. 5000-108, FY 2015 (Oct. 4, 2015), FY 2016 (Oct. 7, 2016), and FY 2017 (Oct. 2, 2017).

b *Id.*

c IRS, Collection Activity Report No. 5000-6, FY 2015 (Dec. 9, 2015), FY 2016 (Oct. 3, 2016), and FY 2017 (Oct. 1, 2017).

d *Id.*

e *Id.*

f *Id.*

g *Id.* See also IRS Human Resources Reporting Center – number of revenue officers in Small Business/Self Employed as of the end of FY 2015, FY 2016, and FY 2017 (pay period 19).

h *Id.*

i IRS, Collection Activity Report No. 5000-2, FY 2015 (Dec. 5, 2015), FY 2016 (Oct. 3, 2016), and FY 2017 (Oct. 1, 2017).

j *Id.*

k *Id.* For FY 2017, the IRS shelves cases prior to potential transfer for the Private Collection Initiative.

l Accounts Receivable Dollar Inventory. Age of cases in the collection queue as of cycle 37 of 2015, 2016, and 2017.

m IRS, Collection Activity Report No. 5000-2, FY 2015 (Dec. 5, 2015), FY 2016 (Oct. 3, 2016), and FY 2017 (Oct. 1, 2017).

n Calculation by TAS Research. Percentage of taxpayers with tax delinquent accounts in 2010, 2011, and 2012, respectively, and who have no new delinquencies five years later. IRS, CDW, Individual Master File (IMF).

## THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

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Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2017, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 21 such problems.

## SIGNIFICANT CHALLENGES IN TAX ADMINISTRATION

### **MSP #1 PRIVATE DEBT COLLECTION: The IRS's Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with the Law, and Burdens Taxpayers Experiencing Economic Hardship**

#### **Problem**

In 2015, Congress enacted legislation requiring the IRS to outsource the collection of certain tax debt. The IRS began assigning tax debts to private collection agencies (PCAs) in April 2017. According to the IRS, for Fiscal Year 2017 the Private Debt Collection program generated \$6.7 million of payments from taxpayers, but cost \$20 million. At the same time, the IRS pays commissions to PCAs on payments from taxpayers that are attributable to IRS, rather than PCA, action.

The recent returns of approximately 4,100 taxpayers who made payments to the IRS after their debts were assigned to PCAs show:

- Median income was about \$41,000;
- 28 percent had incomes below \$20,000; and
- 44 percent had incomes below 250 percent of the federal poverty level.

#### **Analysis**

Among the 4,100 taxpayers were those who receive Social Security Disability Insurance (SSDI) benefits, even though the IRS agreed not to assign these taxpayers' debts to PCAs. Also included were Social Security retirement income recipients whose incomes are less than 250 percent of the federal poverty level. These taxpayers' Social Security retirement income would generally not be subject to levy under the Federal Payment Levy Program. Recent returns of taxpayers who entered into installment agreements (IAs) while their debts were assigned to PCAs and made payments on which the PCAs were paid commissions show that 45 percent had income that was less than their allowable living expenses. Thus, under the IRS's own procedures, these taxpayers could not afford the payments due under the IAs organized by the PCAs.

#### **Recommendations**

The National Taxpayer Advocate recommends that the IRS not pay commissions on payments taxpayers make that are the result of interaction with the IRS, rather than with PCAs; provide that the IRS will receive a credit for any improperly paid commissions; use available IRS data to exclude the debts of SSDI recipients from assignment to PCAs; adopt a definition of "potentially collectible inventory" that does not include debts of Social Security retirement recipients with incomes below 250 percent of the federal poverty level; require PCA employees to actively inquire of taxpayers whether a proposed IA will leave the taxpayer unable to pay reasonable basic living expenses, and to return such cases to the IRS; develop procedures for including a TAS representative in the process of monitoring or reviewing phone calls between taxpayers and PCAs; and develop procedures for sending letters to taxpayers soliciting payment of their past due taxes more frequently than annually.

## **MSP #2 TELEPHONES: The IRS Needs to Modernize the Way It Serves Taxpayers Over the Telephone, Which Should Become an Essential Part of an Omnichannel Customer Service Environment**

### **Problem**

The IRS is treating its telephone operations as a dying relic of taxpayer service as it moves forward with its “Future State” plan to reduce telephone interactions with taxpayers and rely instead on more web-based services and tax practitioners. This approach allows the IRS to focus on the channels of communication it prefers, but not where taxpayers might find the best form of assistance. However, as a part of the *right to quality service*, taxpayers should be able to contact the IRS over the channel that best meets their needs and have their inquiries fully addressed. The IRS has failed to follow the best practices used in other government agencies and the private sector to increase taxpayer loyalty and satisfaction. Because of the IRS’s archaic telephone technology and operations, taxpayers face long wait times with the worry that the IRS’s telephone assistors will not be able to answer their questions if they are able to get through. Failing to provide high quality service to taxpayers over the phone has the potential to reduce voluntary compliance, which can place an unnecessary burden on the compliance functions of the IRS in the future.

### **Analysis**

Telephone service is a vital part of an omnichannel service environment – one that enables taxpayers to engage with the IRS through the channel of their choice and be heard. To create an omnichannel environment, the IRS must ensure all channels of communication are alive, active, and interconnected, instead of advancing one means of communication while neglecting others. The IRS’s increasing reliance on software, online resources, and tax practitioners does not supplant or address the ongoing need for high quality telephone assistance, as the IRS continues to receive over 95 million telephone calls on its toll-free lines. TAS’s Service Priorities Project survey showed that over 20 percent of taxpayers choose the IRS’s telephone lines as their primary channel of communicating with the IRS. Even those that use online resources first may still need assistance over the phone, as the IRS’s 2016 Customer Satisfaction Survey results for Accounts Management show that 46 percent of all callers reported using irs.gov prior to calling its toll-free lines.

Taxpayers calling the IRS waited on average 13 minutes to speak with a telephone assistor in Fiscal Year (FY) 2017, with an average speed of answer on the IRS’s Consolidated Automated Collection System lines of over 30 minutes. Studies show that most callers are unwilling to wait on hold for more than two minutes, indicating that those taxpayers who do get through to the IRS have a great need to speak with the IRS and are enormously patient. While the IRS reported higher levels of service (LOS) during FY 2017, the IRS expects a much lower LOS in FY 2018, anticipating an overall LOS below 40 percent. This means that in FY 2018 only four out of ten taxpayers calling to reach a live assistor will succeed.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS develop a comprehensive strategy for improving its telephone service to be included in its next Strategic Plan and in its Annual Appropriation Requests, with specific initiatives to increase taxpayer satisfaction; incorporate qualitative measures, such as First Contact Resolution rate, used by other government agencies and in the private sector to measure a caller’s overall experience and satisfaction with a call rather than strictly quantitative measures of number of calls and speed of answer; provide telephone assistors additional issue-focused training to help resolve a caller’s inquiry directly in as few steps as possible; upgrade phone hardware technology to

provide virtual hold and scheduled callback options to callers; institute a system similar to a 311 system where an operator can transfer a taxpayer to the specific office within the IRS that handles his or her issue or case; and reinstate the capability for taxpayers to receive year-round tax law assistance over the telephone, including a second-tier of assistance for more complex tax law issues.

### **MSP #3 ONLINE ACCOUNTS: The IRS's Focus on Online Service Delivery Does Not Adequately Take into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population**

#### **Problem**

The National Taxpayer Advocate believes that the IRS should develop a multi-faceted omnichannel service strategy based on the needs and preferences of taxpayers. We fully support the IRS in its efforts to develop online accounts for individuals and their authorized representatives. However, with approximately 41 million U.S. taxpayers without broadband at home and almost 14 million with no internet access at all at home, the IRS must continue to fully staff other service channels and it needs to upgrade its telephone technology to 21st century. Taxpayers have a right to quality service and those taxpayers who want or need to interact with the IRS in a two-way conversation by telephone or face-to-face service should receive the same level of quality service as those who use the online self-help tools. As the IRS focuses on providing self-service tools for taxpayers, the National Taxpayer advocate has the following concerns:

- The IRS's decision to prioritize online services over other service channels is resource-driven rather than based on research on taxpayer needs and preferences and the impact on compliance;
- Secure Access e-Authentication is a critical fraud prevention measure, but the 30 percent verification rate proves that it creates a barrier to entry for all taxpayer populations, not just the elderly and low income;
- The low participation rates of the Taxpayer Digital Communications (TDC) pilot conducted by several IRS organizations illustrate the need to maintain and improve traditional service channels;
- The IRS should explore establishing a method for taxpayers to electronically submit documents or payments to the IRS which involves a less rigorous level of e-authentication; and
- The IRS has failed to make the policy decision to restrict third party access to current and future online applications.

#### **Analysis**

Digital interaction is not appropriate for certain populations, nor is it suitable for taxpayers with anything but simple and straightforward transactions and information needs. Once a taxpayer faces enforcement action, it is imperative that the IRS assist the taxpayer by learning the taxpayer's particular facts and circumstances to help bring him or her into compliance and to educate the taxpayer on how to avoid making similar mistakes in the future. The IRS can only accomplish this through in an omnichannel environment, one which allows the taxpayer to obtain assistance through the taxpayer's preferred method of interaction with the agency. Further, in TAS's 2016 and 2017 survey on Taxpayers' Varying Abilities and Attitudes, approximately 50 percent disagreed with the statement "I feel secure sharing personal financial information over the Internet." If taxpayers face too many obstacles in their attempted interactions with the IRS, their frustrations will mount and their willingness to voluntarily comply in the future may suffer. Thus, the IRS has developed a strategy that places too much emphasis on the online account, without addressing the service needs and preferences of taxpayers.

### Recommendations

The National Taxpayer Advocate recommends that the IRS maintain an omnichannel approach to taxpayer service delivery to meet the needs and preferences of taxpayers and representatives who either cannot or prefer not to use the online account application for their particular interaction with the agency; in collaboration with the Commissioner of Wage & Investment, the Director of Online Services, and the National Taxpayer Advocate, jointly undertake a collaborative and comprehensive study of taxpayer needs and preferences by taxpayer segment, using telephone, online, and mail surveys, focus groups, town halls, public forums, and research studies; explore establishing a method for taxpayers to electronically submit documents or payments to the IRS which involves a less rigorous level of e-authentication; and restrict third party access to those practitioners subject to Circular 230 oversight.

## **MSP #4     AUDIT RATES: The IRS Is Conducting Significant Types and Amounts of Compliance Activities that It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections**

### **Problem**

The IRS has the authority under IRC § 7602 to examine, in what can be termed a “real” or traditional audit, any books, papers, records, or other data that may be relevant to ascertain the correctness of any return. However, the IRS does not consider a significant number of compliance contacts with taxpayers to be “real” audits, including math error corrections, Automated Underreporter (AUR), identity and wage verification, and Automated Substitute for Return (ASFR). Yet these contacts, or “unreal” audits, require taxpayers to provide documentation or information to the IRS, comprise the majority of compliance contacts, and feel very much like a “real” examination to taxpayers. “Unreal” audits lack taxpayer protections typically found in “real” audits, such as the opportunity to generally seek an administrative review with the IRS Office of Appeals (“Appeals”) or the statutory prohibition against repeat examinations. As the IRS is planning for the increased use of “unreal” audits through automated means with its “Future State” Initiative, it is crucial that the IRS reevaluate and revise its current guidance through the lens of the Taxpayer Bill of Rights.

### **Analysis**

The current distinction between “real” and “unreal” audits results in the IRS publicly reporting misleading information, as the IRS only reports “real” audit statistics, which skew the audit rate and understate the IRS’s actual level of compliance contacts with taxpayers. It also causes the IRS to not completely and accurately report its return on investment (ROI) for compliance activities, as the IRS does not include all “unreal” audit programs in its ROI calculations. This distinction also limits a taxpayer’s ability to seek Appeals review, as a taxpayer who disagrees with an “unreal” audit’s proposed assessment generally receives a statutory notice of deficiency and does not have the opportunity for Appeals review. The issue is even more pronounced in math error cases, where a taxpayer must respond to an IRS notice in a limited time frame or lose the opportunity to go to Tax Court — the only prepayment forum available. In contrast, in “real” audits, a taxpayer generally receives a 30-day letter offering an opportunity to go to Appeals prior to the IRS’s issuance of a statutory notice of deficiency and petitioning the Tax Court. Finally, this distinction circumvents statutory taxpayer protections from unnecessary audits as, under the IRS’s current position, taxpayers subjected to an “unreal” audit may face additional “real” or “unreal” audits.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS, in collaboration with the National Taxpayer Advocate, conduct a comprehensive review of its audit definition under Revenue Procedure 2005-32 to reflect IRS compliance activity today, and the application of the Taxpayer Bill of Rights; include “unreal” audits in its audit rate and ROI calculations to properly reflect the actual compliance activity that it conducts; grant taxpayers the opportunity to seek Appeals review in certain “unreal” audit cases, such as in certain math error and AUR cases where Appeal rights do not already exist; and, where practicable, address all issues in a “real” audit rather than conducting an “unreal” audit and then subsequently conducting a “real” audit.

## **MSP #5 EXEMPT ORGANIZATIONS: Form 1023-EZ, Adopted to Reduce Form 1023 Processing Times, Increasingly Results in Tax Exempt Status for Unqualified Organizations, While Form 1023 Processing Times Increase**

### **Problem**

Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, was adopted in large part to reduce inventory backlogs for processing Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. Today, Form 1023-EZ applications exceed Form 1023 applications, and the IRS approves virtually all Form 1023-EZ applications it receives.

Taxpayer Advocate Service (TAS) studies carried out in 2015 and 2016 showed, respectively, that 37 percent and 26 percent of approved entities in one of 20 states that post articles of incorporation online did not meet the organizational test for qualification as an Internal Revenue Code (IRC) § 501(c)(3) organization. This year's TAS study of a representative sample of approved Form 1023-EZ applicants from those same 20 states found an erroneous approval rate of 42 percent. Meanwhile, the more detailed Form 1023 processing time, 96 days in Fiscal Year (FY) 2016, rose to 113 days for FY 2017. Thus, Form 1023-EZ as implemented created a new risk — erroneous grants of tax exemption — yet may not have solved the initial problem of long processing times for Form 1023.

### **Analysis**

In addition to sampling organizations from the same 20 states that were included in the 2015 and 2016 studies, for which the erroneous approval rate was 42 percent, this year we expanded the sample to include representative cases from four more states that now post articles of incorporation online. Of the combined organizations, 46 percent — or almost half — did not meet the organizational test. Another cause for concern is the absence of some organizations' articles of incorporation on state databases, in states that post articles of incorporation online. From our original sample, we excluded four percent of organizations in the original 20 states, and three percent of organizations in the additional four states because articles of incorporation were not found on the official site for the state in which, according to the application, the organization was formed.

### **Recommendations**

The IRS should require Form 1023-EZ applicants, other than corporations in states that make articles of incorporation publicly available online at no cost, to electronically submit their organizing documents, as well as summary financial information such as past and projected revenues and expenses; revise Form 1023-EZ to include a question about whether the organization has a conflicts of interest policy; and make a determination about qualification as an IRC § 501(c)(3) organization only after reviewing a Form 1023-EZ applicant's narrative statement of actual or planned activities, organizing documents, and any other supporting documents.

## **MSP #6 PASSPORT DENIAL AND REVOCATION: The IRS's Plans for Certifying Seriously Delinquent Tax Debts Will Lead to Taxpayers Being Deprived of a Passport Without Regard to Taxpayer Rights**

### **Problem**

A 2015 law requires the Department of State to deny an individual's passport application and allows it to revoke or limit an individual's passport if the IRS has certified the individual as having a seriously delinquent tax debt (*i.e.* tax debt exceeding \$50,000 (adjusted for inflation), including assessed interest and penalties). Although the IRS will not implement the program until early 2018, its proposed procedures and policies raise concerns. The failure to provide adequate notice and to exclude taxpayers exercising certain administrative rights will harm taxpayers. Although the Department of State will hold passport applications open for 90 days before rejecting them, this may not be enough time for taxpayers to resolve their debts and be decertified.

### **Analysis**

The IRS directly notifies taxpayers about passport certification in only two ways: information in Collection Due Process (CDP) hearing notices and a notice issued at the same time the IRS certifies the debt. Three quarters of taxpayers potentially eligible for certification received their CDP notices before this information was included. The stand-alone certification notice does not provide an opportunity to be heard prior to the certification occurring. Congress intended to allow passport certification only after a taxpayer's administrative rights were exhausted, but the IRS refuses to exclude from certification already open TAS cases and certain other administrative rights, such as Equivalent Hearings and Post Appeals Mediation. Taxpayers may not benefit from the 90-day period before the Department of State rejects a passport application because it may take up to 45 days (ten days for taxpayers who meet expedited criteria) for the certification to be cleared from the Department of State's systems after the taxpayer resolves the debt. The IRS's notice to taxpayers leaves out key information such as if the taxpayer is an identity theft victim or qualifies for currently not collectible hardship status, both of which may result in decertification. Neither the IRS's nor the Department of State's notice include information for taxpayers with an emergency or humanitarian reason to travel.

### **Recommendations**

The National Taxpayer Advocate recommends the IRS: provide a stand-alone notice to all taxpayers 30 days (90 days for taxpayers outside the United States) prior to certifying their seriously delinquent tax debts that discusses the specific harm that will occur and outlines all options available to taxpayers to avoid or reverse certification; exercise its discretionary authority to exclude from passport certification any taxpayers who already have an open case with TAS at the time they meet the criteria for a seriously delinquent tax debt; exercise its discretionary authority to exclude from passport certification any taxpayers who have requested an alternative administrative remedy, such as an Equivalent Hearing, a Collection Appeals Program Appeal, or Post Appeals Mediation, and delay certification for these taxpayers until they receive a final determination from these programs; revise its procedures for expedited decertification to transmit the decertification to the Department of State within two business days after the Collection Passport Policy Analyst receives the approved request form; and update Notice 508C to include information about all ways in which a taxpayer can become eligible for decertification and advise taxpayers to contact the Department of State if they have an emergency or humanitarian need to travel.

## THE RIGHT TO QUALITY SERVICE

### MSP #7 **EMPLOYEE TRAINING: Changes to and Reductions in Employee Training Hinder the IRS's Ability to Provide Top Quality Service to Taxpayers**

#### Problem

The IRS has reduced its employee training budget by nearly 75 percent since fiscal year (FY) 2009. Not only has the budget for training drastically declined, but the way in which employees receive that training has shifted from in-person face-to-face training to virtual training. IRS employees cannot be expected to provide competent advice and adequate service to taxpayers who present myriad issues when they do not receive training timely or effectively. The downstream consequences to the IRS and taxpayers, including rework, misleading or incomplete advice, improper compliance actions, and distrust in the IRS serve to further degrade the relationship between the IRS and taxpayers, and violate the taxpayer *rights to be informed, to quality service, and to a fair and just tax system*. Employees must receive timely, comprehensive, and effective training in order to protect taxpayer rights and provide top quality service to taxpayers.

#### Analysis

Taking actual dollars appropriated to the IRS, the IRS budget has declined just under \$300 million since FY 2009 or less than three percent, while at the same time, it has cut its training budget by nearly 75 percent. Time and money spent training IRS employees in key job series has continued to decline in some instances even though the IRS has restored nearly \$17 million in funding to its training budget since its low in FY 2013. In FY 2017, the IRS spent \$489 (less than a half percent of its budget) per employee on training compared to nearly \$1,450 per employee in FY 2009. At the same time, IRS employees in the Wage and Investment Division — those employees who interact directly with millions of individual taxpayers — received only \$87 of training per employee. In certain key job series, employees receive as few as 19 hours of training per year on average, which includes nearly five hours of mandatory security briefings, leaving only 14 hours per year, per employee, devoted to substantive training.

#### Recommendations

The National Taxpayer Advocate recommends that the IRS increase “train the trainer” in-person trainings to allow for more effective delivery of training to field offices; increase training hours per employee, particularly in mission critical job series; encourage employees to identify outside training relevant to their jobs and allow the employees to attend such trainings; and include outside experts in training to leverage knowledge gained from working with taxpayers who are impacted by IRS actions.

## **MSP #8 TAXPAYER RIGHTS: The IRS Does Not Effectively Evaluate and Measure Its Adherence to the Taxpayer's Right to a Fair and Just Tax System**

### **Problem**

In 2014, the IRS officially adopted the Taxpayer Bill of Rights (TBOR), and in late 2015, Congress amended Internal Revenue Code § 7803(a)(3) to state: “In discharging his duties, the Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title, including—.” This section then lists the ten fundamental rights that comprise the TBOR. This language shows Congress’s intent to ensure the IRS is held accountable for putting these rights into practice. The *right to a fair and just tax system* provides that taxpayers can expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. However, the IRS has not adequately incorporated the TBOR into its measures or quality review criteria, making it difficult to evaluate the extent to which IRS employees are considering a taxpayer’s *right to a fair and just tax system* in daily work.

### **Analysis**

Critical Job Elements (CJEs) and quality measures do not evaluate employees and measure quality based on whether employees considered the taxpayer’s facts and circumstances while determining penalties, figuring the correct amount of basic living expenses, and deciding whether to allow the taxpayer additional time to provide information in an examination. One CJE relevant to penalty determination only looks at whether the employee obtains and evaluates the taxpayer’s position, without also considering how the taxpayer’s facts and circumstances affect the liability, such as if the taxpayer received penalties but reasonably relied on a tax return preparer. To meet one CJE related to determining ability to pay, an employee merely needs to verify ownership, value and equity in assets, without looking at individual facts, such as if the forfeiture of assets would create an economic hardship. The timeliness CJEs and quality attributes focus on efficiency, but do not account for situations where taxpayers need additional time due to unique facts and circumstances. The IRS’s current fiscal year 2014-2017 strategic plan contains no taxpayer rights information outside of a discussion of TAS and the role of non-profit institutions.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS revise its CJEs and quality attributes to align with statutory, regulatory, case law, and IRM instructions for employees to consider the specific facts and circumstances that affect taxpayers’ underlying liabilities, ability to pay, and ability to provide information timely; update its guidance for developing commitments to provide examples and emphasize how commitments can further protection of taxpayer rights; and add information throughout its strategic plan to tie goals and objectives to taxpayer rights under the TBOR, including objectives to (1) evaluate employees’ performance with respect to and in accord with taxpayer rights, and (2) to train all employees on taxpayer rights.

## **MSP #9    OUTREACH AND EDUCATION: The IRS Is Making Commendable Strides to Develop Digitized Taxpayer Services, But It Must Do More to Maintain and Improve Traditional Outreach and Education Initiatives to Meet the Needs of U.S. Taxpayers**

### **Problem**

The IRS has held a longstanding position that taxpayer outreach and education is essential to voluntary compliance. Yet, it continues to shift outreach and education responsibilities to third-party partners. In addition, the IRS is increasingly relying on digital channels to distribute outreach and education information. While digital distribution channels and leveraging third-party partners may enable the IRS to reach large taxpayer populations in a cost-effective manner, it still leaves significant populations of taxpayers behind. It also eliminates the two-way exchange, and in conjunction with the trend away from geographic presence in the taxpayer communities, results in a one-way, filtered, education strategy as well as a remote, impersonal IRS.

### **Analysis**

Geographic presence among outreach and education staff is vital to understanding the local economy and culture. For example, the IRS may not understand the information needs of natural disaster victims in Puerto Rico or the U.S. Virgin Islands, unless it has employees, preferably Communication and Liaison employees assigned to outreach activities, on the ground and in the community. These employees can hear firsthand the local issues and concerns of the community. In addition, by engaging with the community, they will gain familiarity with the local norms and understand the best channels to deliver messages. Community engagement places the IRS in the best position to communicate targeted messages on issues relevant to that particular population, as opposed to general messages that are too vague for anyone to see themselves reflected in the information presented.

In order to give taxpayers what they need, when they need it, and in a manner they can access, the IRS must conduct and evaluate research into taxpayer information needs. For example, in 2016 and 2017, TAS conducted a nationwide survey of U.S. taxpayers about their needs, preferences, and experiences with IRS taxpayer service; this survey was conducted entirely by telephone (landline and cell phone) rather than online only. Without evaluating the results from this type of research, the IRS is developing an outreach strategy that may miss the mark and negatively impact taxpayer compliance.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS conduct research into the outreach and education needs of taxpayers, broken down by various demographics; evaluate and implement two-way digital communication models into the outreach and education strategy; incorporate into the strategy the findings of TAS research on taxpayer needs, preferences, varying abilities, and attitudes toward IRS taxpayer service; assign at least one employee to conduct outreach activities in each state and U.S. territory (and who resides in that state or territory); and establish a program in which the IRS provides various services, including traditional face-to-face outreach and education, through the use of mobile taxpayer assistance stations (vans) in rural and underserved communities.

## **MSP #10 TAXPAYER ASSISTANCE CENTERS (TACs): Cuts to IRS Walk-In Sites Have Left the IRS With a Substantially Reduced Community Presence and Have Impaired the Ability of Taxpayers to Receive In-Person Assistance**

### **Problem**

Taxpayer Assistance Centers (TACs), formerly called walk-in sites, became the primary local face of the IRS after it reorganized around central campus locations and business divisions, severely reducing presence in local communities. Furthermore, recent changes to TACs have chipped away at the services provided and the ability of taxpayers to receive prompt, in-person service, which negatively affected the image of the IRS in local communities. As the IRS moves towards online self-service it must consider taxpayers who cannot complete tasks online or prefer not to use the internet for interacting with the IRS. The strategy of reducing a service to the point that taxpayers can no longer easily access it, then declaring no one uses the service and eliminating it entirely has proven successful for the IRS in the past, and it appears the IRS is moving in the same direction with TACs.

### **Analysis**

The IRS currently operates 371 TACs in the 50 states, the District of Columbia, and Puerto Rico. Since fiscal year 2011 the IRS has closed 30 TACs, a reduction of over seven percent with TAC staffing down nearly 30 percent. The TACs provide the main source of in-person, face-to-face assistance from the IRS to taxpayers. Approximately 3.2 million taxpayers visited a TAC in FY 2017. The IRS has been reducing services offered in TACs for many years and recently switched to a mainly appointment-based service model for TACs. While the IRS has restricted the topics it will address at TACs, only answering tax law questions (both on the phones and in TACs) during the filing season, and no longer offering return preparation at the TACs, taxpayers continue to seek out TAC services. Reducing the IRS presence across the country at a time when the population is increasing, scammers abound, taxpayers are subject to recurrent information breaches that threaten their tax information, and natural disasters present immediate tax issues, does not protect taxpayer rights, particularly the *right to quality service*.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS reinstitute the dual appointment and walk-in structure at TACs, allowing the taxpayer to choose to walk-in or make an appointment; request the funding for, and in consultation with TAS, develop a pilot mobile van program; answer tax law questions throughout the year, at both TACs and on the phones; reinstate return preparation for amended disaster-based casualty loss returns; and staff TACs during peak times with co-located staff such as revenue officers or revenue agents to handle overflow and appointments.

## **MSP #11 VITA/TCE PROGRAMS: IRS Restrictions on Volunteer Income Tax Assistance (VITA) and Taxpayer Counseling for the Elderly (TCE) Programs Increase Taxpayer Burden and Adversely Impact Access to Free Tax Preparation for Low Income, Disabled, Rural, and Elderly Taxpayers**

### **Problem**

Restrictions and limitations the IRS imposes on Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites, compounded with the elimination of tax preparation services at Taxpayer Assistance Centers, increase taxpayer burden and may adversely impact low income, disabled, rural, and elderly taxpayers. Several IRS policies affect taxpayers' ability to obtain free tax return preparation services and meet their reporting obligations, including "out-of-scope" restrictions; income limits failing to account for family size; the lack of IRS tracking volunteers certified in specific "in-scope" law issues; the unavailability of most VITA and TCE sites after April 15 each year; and restrictions the IRS places on grant funds that cannot be used to compensate for services provided by screeners, quality reviewers, and Certified Acceptance Agents (CAAs).

### **Analysis**

The VITA program provides free basic income tax return preparation with electronic filing to taxpayers who generally make \$54,000 or less, including low-wage workers, persons with disabilities, taxpayers living in rural communities, Native Americans, and taxpayers with limited English proficiency. The TCE program offers free tax help for taxpayers 60 years of age and older, specializing in questions about pensions and retirement-related issues. IRS-certified volunteers in these programs are associated with IRS partners, which are often non-profit organizations that receive grants from the IRS. Of about 143 million individual tax return filers in processing year 2017, 108 million (approximately 75 percent) may be eligible to have their returns prepared at VITA and TCE sites. During fiscal year 2017, VITA and TCE programs prepared over 3.5 million individual income tax returns, with an accuracy rate of about 93 percent. This total does not reflect the number of taxpayers who sought assistance from VITA or TCE sites but were turned away because the issues they sought help with were deemed "out-of-scope." Moreover, current VITA program limitations exclude many taxpayers eligible for Low Income Taxpayer Clinic (LITC) assistance. A system similar to the LITC financial guidelines, which account for family size as well as income, using the Earned Income Tax Credit threshold as the income floor, would expand the reach of VITA services to the low income community.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS allow VITA and TCE partners, at their discretion, to prepare returns with issues that are currently out-of-scope, including the home office deduction, standard mileage or actual costs, casualty losses, cancellation of debt, and farm income; implement financial guidelines for VITA/TCE programs which account for both family size and income, similar to that used by the LITC program; create a tracking system for volunteers and their certifications; ensure that more volunteer tax sites are open until October 15 each year; and permit using grant funds to pay compensation for quality reviews, qualified tax experts, CAAs, and year-round services at select sites.

## THE RIGHT TO A FAIR AND JUST TAX SYSTEM: SPECIAL TAXPAYER POPULATIONS

### **MSP #12 EARNED INCOME TAX CREDIT (EITC): The IRS Continues to Make Progress to Improve Its Administration of the EITC, But It Has Not Adequately Incorporated Research Findings That Show Positive Impacts of Taxpayer Education on Compliance**

#### **Problem**

The Earned Income Tax Credit (EITC) is a tax credit targeted at low income workers (primarily workers with children). For Tax Year (TY) 2015 returns filed during 2016, over 27 million taxpayers received about \$67 billion in EITC. However, as a result of its complex rules and the ever-changing population of eligible taxpayers, the EITC is associated with a high improper payment rate. Despite reaching out to a broad array of experts via its two EITC Summits and working jointly with TAS on the EITC Audit Improvement team, the IRS's primary tool to combat the improper payment rate thus far has been the audit process.

#### **Analysis**

To its credit, the IRS hosted its first EITC Summit in 2016, which opened a conversation between the IRS and representatives from various sectors, such as the tax profession industry, state and federal agencies, and consumer advocates. The IRS held its second EITC Summit in 2017 and identified more opportunities to expand its outreach. Yet the IRS has conducted very little research into the needs of low income taxpayers.

This year TAS continued to study how pre-filing season correspondence can help EITC taxpayers. Updated results show that when it comes to the relationship test, the sample group broke the same rule 72 percent of the time compared to 77 percent of taxpayers in the control group, a statistically significant reduction of five percentage points that, if projected to the entire 2015 population, would result in a savings of over \$51 million in erroneous EITC claims. In this year's study, the IRS added an Extra Help line for EITC taxpayers. Taxpayers who received this letter broke the same rule related to residency 67 percent of the time compared to 74 percent of the taxpayers in the control group who broke the same rule, an improvement of about seven percentage points. Taxpayers who received the TAS residency letter without the Extra Help line number, broke the same residency rules 74 percent of the time, which is not statistically different from the control group. If projected to the entire 2015 population, sending the TAS letter with the available Extra Help telephone line would result in a savings of over \$44 million in erroneous EITC claims. Based on a review of calls received on the help line, TAS identified two areas that received repeat questions: the rules of claiming a dependent versus the EITC, and the rules that are involved when parents have shared custody of a qualifying child. This can drive IRS education and outreach efforts.

#### **Recommendations**

The National Taxpayer Advocate recommends that the IRS send out pre-filing season letters to taxpayers who break certain return filters. These letters should be written in plain language and be tailored to the taxpayer's particular needs; staff a dedicated toll-free helpline for EITC taxpayers during the filing season; continue to expand the list of acceptable documentation under Internal Revenue Manual 4.19.14-1 and train staff on the importance of this list; and continue to expand the use of third-party affidavits.

## **MSP #13 MILITARY ASSISTANCE: The IRS's Customer Service and Information Provided to Military Taxpayers Falls Short of Meeting Their Needs and Preferences**

### **Problem**

There are about 1.3 million active duty service members and over 800,000 Reserves and National Guard personnel in the United States. Those in uniform have undergone repeated deployments to war zones and many have endured extreme, and often invisible, psychological pain. Tax issues pertaining to the military are complex and very few military tax experts outside the IRS are available to assist the tens of thousands of active and reserve military taxpayers with preparing returns and other tax issues. However, the IRS does not have employees assigned solely to assist service members or dedicated telephone lines for military taxpayers to call with questions. The IRS's service to the military population is generally limited to posting information on the web, and providing tax software and training to military partners who prepare tax returns at installations around the world. Because of the challenging situations and unique tax issues they face, members of the military and their families face unusual difficulties in meeting their tax obligations and need specialized assistance.

### **Analysis**

Military tax issues are diverse, including extensions of tax filing deadlines, especially for those serving overseas; combat zone income exclusions; tax abatement for service members who die in combat zones or qualified hazardous duty areas; individual retirement account (IRA) contributions from tax-free combat pay; tax return signature authority without a power of attorney; unique capital gains exclusions for service members who sell their homes; deductions for relocation expenses, travel expenses for reservists, and military uniforms; waivers for early withdrawals from IRAs; rules pertaining to the choice of service members to include their nontaxable combat pay as earned income for purposes of Earned Income Tax Credit; and refund claims under the Combat-Veterans Tax Fairness Act of 2016. To better address the complexity of these issues, service members need up-to-date and sufficient tax information including online IRS resources, IRS employees assigned solely to assist them, overseas Volunteer Income Tax Assistance (VITA) training, and a dedicated toll-free telephone line, both in and out of tax season.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS assign a dedicated IRS employee to routinely update the military information on the irs.gov website; create a special unit of Stakeholder Partnerships, Education & Communication (SPEC) staffed with veterans whose responsibilities are to develop and conduct outreach, education, and assistance to current military taxpayers, including National Guard and Reservists, and to those organizations that provide tax assistance to these taxpayers; allocate ample funding for SPEC to provide face-to-face training for military VITA volunteers in overseas locations; and provide a year-round dedicated toll-free telephone line for service members and their families to answer tax law and filing questions, and to resolve their tax account and compliance issues.

## **MSP #14 SHARING ECONOMY: Participants in the Sharing Economy Lack Adequate Guidance From the IRS**

### **Problem**

The “sharing” economy (also known as the gig economy) links a willing provider to a consumer of goods or services (coordinated through a community-based online service). Nearly a quarter of the U.S. population earns money from the sharing economy. However, many of the service providers are not familiar with tax filing and recordkeeping requirements. The majority of them do not receive any tax information from the sharing economy platform they used to earn their income. This demonstrates both the need for guidance from the IRS and the opportunity to create a culture of tax compliance among participants in the sharing economy from the outset.

### **Analysis**

Service providers in the sharing economy may not fit the mold of the traditional employee who works “9 to 5” and receives a Form W-2 from an employer. Rather, they may view themselves as contingent workers or freelancers, serving hundreds of service recipients with no set schedule. Understandably, many of the new service providers in a sharing economy may not fully comprehend their tax filing obligations or have any experience with the requisite tax record-keeping. The vast majority of gig workers — 85 percent — make less than \$500 per month. When taxpayers take on multiple gigs to help make ends meet, it makes tax compliance even more difficult; they receive information returns from multiple sources, so it may be difficult to track and allocate expenses. If we operate under the premise that most taxpayers want to comply with the law, the IRS needs to expand its presence within the sharing economy to enable such compliance. Sharing-economy entrepreneurs need to be educated about certain basic tax obligations (*i.e.*, making required quarterly estimated payments throughout the year to avoid penalties).

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS develop new guidance for sharing economy participants, including a new publication; create a one-page brochure outlining basic points relevant to service providers in a sharing economy; require third-party service coordinators to provide this one-page brochure to service providers; partner with TAS to develop an online wizard for taxpayers in the sharing economy; and designate liaisons to participate in online forums to identify emerging issues for sharing economy participants.

## **MSP #15 INTERNATIONAL: The IRS's Approach to Credit and Refund Claims of Nonresident Aliens Wastes Resources and Burdens Compliant Taxpayers**

### **Problem**

IRS policy is that nonresident aliens (1042-S filers) are only entitled to credits and refunds when the information on Forms 1040NR, *U.S. Nonresident Alien Income Tax Return*, substantially matches the information on Forms 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, issued directly to the IRS by withholding agents. This approach, however, does not appear to be firmly grounded in comprehensive statistical analysis. Rather than using available data to focus compliance and enforcement efforts on high-risk taxpayers, the IRS has adopted an undifferentiated approach to 1042-S filers that wastes resources, needlessly burdens compliant taxpayers, and treats 1042-S filers inconsistently from analogous domestic taxpayers. Additionally, the IRS has demonstrated a reluctance to enforce compliance among Form 1042-S withholding agents, even though it generally has the ability to do so.

### **Analysis**

Prompted by generalized concerns about fraud, the IRS has adopted a broad-brush approach, which generates tax administration prone to inequities, inefficiencies, and inaccurate assumptions. By contrast, TAS analysis indicates that the bulk of 1042-S filers actually appear to be substantially more compliant than a comparable portion of the overall U.S. taxpayer population. These 1042-S filers present little risk of noncompliance or revenue loss. For example, nearly 80 percent of 1042-S filers claim relatively small dollar amounts of withholding (an average of approximately \$1,100). This analysis demonstrates no reason to treat withholding credits of 1042-S filers differently from those of domestic taxpayers. Instead, the IRS should concentrate on high-risk taxpayer categories and on noncompliant withholding agents. Focusing on withholding agents, 86 percent of which are domestic, would maximize revenue collection and reduce burden on 1042-S filers, who are not well-positioned to enforce withholding agent compliance.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS compile and share data relating to the results of manual review of frozen Form 1042-S credits and use this data to better understand and identify the sources and income stratifications generating increased risks of noncompliance; implement a policy that relies on data as the basis for developing effective programs and systems for validating the credit and refund claims of those relatively few Chapter 3 and Chapter 4 filers for whom such scrutiny is statistically justified; energetically enforce the withholding, reporting, and remittance obligations of withholding agents, rather than attempting to shift this obligation to nonresident taxpayers in ways that create hazards of litigation; and consider more effective ways of discouraging noncompliance by, and collecting unremitted funds from, foreign withholding agents, including exploring cooperative agreements with foreign jurisdictions.

## **MSP #16 INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS (ITINs): The IRS's Failure to Understand and Effectively Communicate With the ITIN Population Imposes Unnecessary Burden and Hinders Compliance**

### **Problem**

Individuals who are ineligible for Social Security numbers need Individual Taxpayer Identification Numbers (ITINs) to file required returns and pay taxes. The IRS fails to adequately analyze the characteristics of the ITIN population, including where they live, how they file taxes, what language they speak, and what community resources are available to help them meet their tax obligations. Nor does the IRS communicate effectively with ITIN taxpayers by providing sufficient notices in the taxpayer's language and targeted outreach to underserved taxpayers. The IRS continues to overlook necessary changes and make others that prevent taxpayers from obtaining ITINs, filing their returns, and receiving tax benefits to which they may be entitled. Furthermore, without using its understanding of the ITIN population when developing its communication strategy, the IRS risks any positive changes not being effective because taxpayers do not understand or are not aware of them.

### **Analysis**

The Protecting Americans from Tax Hikes Act of 2015 required the IRS to conduct a study on the ITIN application process. The IRS has refused to include TAS on the study team or share its draft report. In 2017, the IRS mailed 874,657 ITIN deactivation notices, but only two were issued in Spanish, despite the prevalence of Spanish-speaking ITIN taxpayers. Although the IRS projected it would receive 450,000 ITIN renewal applications for ITINs expiring in late 2016, it had received only 176,000 at the close of the filing season and over 152,000 returns have had a math error for not renewing an expired ITIN. Taxpayers may be unaware of the requirement to have ITINs issued by the tax return due date to claim certain credits, as evidenced by the more than 50,000 returns with math errors for failure to have an ITIN issued timely. Taxpayers face difficulty receiving their original documents from the IRS. In 2016, the IRS sent over five thousand passports to embassies because it could not find a better address to return them to taxpayers.

### **Recommendations**

The National Taxpayer Advocate recommends the IRS develop a comprehensive study of ITIN applicants and ITIN holders from the last five years that includes data such as geographical location, distance to a Certified Acceptance Agent (CAA), Taxpayer Assistance Center (TAC), or Volunteer Income Tax Assistance (VITA) site, country of origin, language usage, paid preparer usage, and filing characteristics; create a comprehensive outreach plan with materials for preparers, local community organizations, non-profit organizations, and local, state, and federal government agencies, focusing on communities with high concentrations of ITIN filers; create a list of underserved communities in need of greater CAA, TAC, and VITA sites and apply resources to add services in these locations; use data regarding ITIN taxpayers who incorrectly claimed refundable credits via a paid preparer to provide targeted outreach to segments of the preparer community; update its systems to provide that when a limited English proficiency indicator is placed on a taxpayer's account, all IRS notices will be issued in the taxpayer's preferred language when available; update Form W-7 instructions and CAA outreach materials to emphasize the importance of informing the IRS about a change of address; update Form W-7 instructions to explain on the first page the requirement to apply for an ITIN by the tax return due date in order to receive certain refundable credits; and develop a system for tracking missing document requests and the actions the IRS has taken to address the missing document.

## THE RIGHT TO AN INDEPENDENT ADMINISTRATIVE APPEAL

### **MSP #17 APPEALS: The IRS Office of Appeals Imposes Unreasonable Restrictions on In-Person Conferences for Campus Cases, Even As It Is Making Such Conferences Somewhat More Available for Field Cases**

#### **Problem**

Appeals changed its policies in 2016 to establish a default telephone conference rule, remove taxpayers' right to choose an in-person conference, and restrict the circumstances under which a Hearing Officer could elect to hold such a conference. These changes negatively impacted the ability of many taxpayers to adequately present their cases. After an outcry from stakeholders, Appeals recently announced that it would return to making in-person Appeals conferences available in Field cases, a step which the National Taxpayer Advocate applauds. Nevertheless, a number of important restrictions on in-person conferences are still in place, such as those for Campus Appeals. These prohibitions raise serious equity and due process concerns, as many Campus cases involve lower income and unrepresented taxpayers. These limitations on in-person Appeals conferences are unnecessary in light of prevailing trends, should be replaced by quality conference alternatives, and could do substantial harm to taxpayers and the IRS while they remain in place.

#### **Analysis**

The number of in-person Appeals conferences has dropped by 61 percent between Fiscal Year (FY) 2013 and FY 2017, while Appeals' case receipts have fallen by only sixteen percent during this same period. Given this trend, the sheer passage of time and some much-needed improvements to in-person alternatives likely would achieve Appeals' goal of reducing unnecessary in-person conferences in a taxpayer-friendly manner. These conferences, however, often are indispensable in a range of cases, such as those involving complex issues, witness credibility, hazards of litigation, or matters requiring familiarity with local context. Teleconferences, virtual service delivery (VSD), WebEx, and case assistance can be worthwhile alternatives to an in-person conference, but must be options, not substitutions. One of the hallmarks of top-quality customer service is choice, and the choice regarding conference method should be left to taxpayers regardless of whether their case is assigned to a Campus or Field office. If taxpayers are denied access to an in-person conference when they feel that such a conference is essential to the presentation of their case, this unavailability could lead to perceived inequity, increased litigation, and reduced tax compliance in the long run.

#### **Recommendations**

The National Taxpayer Advocate recommends that Appeals honor all good-faith requests for an in-person Appeals conference; continue improving VSD (or its successor) and telephone conferences so that taxpayers have access to a range of quality options for interacting with Appeals; and through the use of attrition and other strategies, staff local Appeals offices so as to have a permanent Appeals office in every state, the District of Columbia, and Puerto Rico that provides effective in-person coverage for the full range of Appeals cases.

## **MSP #18 APPEALS: The IRS's Decision to Expand the Participation of Counsel and Compliance Personnel in Appeals Conferences Alters the Nature of Those Conferences and Will Likely Reduce the Number of Agreed Case Resolutions**

### **Problem**

Effective October 2016, Appeals implemented guidance explicitly allowing Hearing Officers to invite IRS Counsel and Compliance to participate in Appeals conferences. This step, however, may have far-reaching negative consequences for Appeals' effectiveness in resolving cases with taxpayers. Among other things, Appeals' emphasis on expanding participation of Counsel and Compliance in conferences will fundamentally change the nature of conferences, jeopardize both the real and perceived independence of Appeals, and generate additional costs for taxpayers and the government.

### **Analysis**

Appeals' mission is to settle cases with taxpayers, not negotiate with Counsel and Compliance. By allowing Hearing Officers to include these parties even over the taxpayer's objection, Appeals is changing the power dynamic and jeopardizing its role as an unbiased decision maker. Even if a Hearing Officer is able to arrive at an independent determination in these circumstances, many taxpayers will not perceive the outcome as having been objectively reached, given the additional opportunity for Counsel and Compliance to advocate for their respective positions. As a result, taxpayers are less likely to feel that their cases have been fully heard, that they have been treated fairly, and that the ultimate decision of Appeals should be respected. Instead, more litigation and less long-term tax compliance will likely be the unintended consequences of such an initiative. Cases should be factually and legally developed before arriving at Appeals and, once the pre-conference concludes, Appeals should be preserved as a separate domain in which taxpayers, their representatives, and a Hearing Officer can develop a rapport and together seek an independent settlement.

### **Recommendations**

The National Taxpayer Advocate recommends that Appeals preserve its actual and perceived independence by adopting Internal Revenue Manual procedures that separate Counsel and Compliance from Appeals conferences unless their inclusion is mutually agreeable to the taxpayer and Hearing Officer involved; Appeals continue to involve Counsel and Compliance in pre-conference hearings and if, after the Appeals conference itself is complete, additional information from Counsel and Compliance proves necessary, explain the need to taxpayers and convene a post-conference call or meeting in conformity with *ex parte* rules; Appeals track and analyze data relating to cycle times, outcomes, and subsequent litigation activity regarding conferences in which Counsel and Compliance participate so as to provide quantitative insight into the impact of such participation on Appeals proceedings; and Appeals seek and carefully consider comments from tax practitioners and other stakeholders regarding when, and to what extent, the participation of additional IRS personnel in Appeals proceedings would contribute to case resolution.

## CHALLENGES IN REVENUE PROTECTION

### **MSP #19 IDENTITY THEFT: As Tax-Related Identity Theft Schemes Evolve, the IRS Must Continually Assess and Modify Its Victim Assistance Procedures**

#### **Problem**

Tax-related identity theft is an invasive crime that has significant impact on its victims and the IRS. The IRS has made significant strides in revamping its identity theft victim assistance procedures, including centralizing its identity theft victim assistance units. Yet cyber criminals are continually evolving their schemes, figuring out more creative methods of committing tax-related identity theft.

#### **Analysis**

Tax-related identity theft has been on the decline in recent years. Through September 30, 2017, there was a 36 percent drop in identity theft case receipts compared to the prior year, and a 65 percent drop compared to 2015. We believe that improvements to the IRS's identity theft filters and earlier access to information return data, coupled with the IRS's changed approach to identity theft victim assistance, have led to this decline. However, the IRS's Identity Theft Global Report underrepresents the volume of unresolved identity theft cases — for instance, it omits certain identity theft cases that are worked outside of the Identity Theft Victim Assistance (IDTVA) unit. Recently, the IRS changed its procedures to designate a single employee as the sole contact person for an identity theft victim, from beginning to end. However, this privilege does not extend to identity theft victims facing multiple issues and dealing with multiple IRS functions — the taxpayers most likely to have their cases fall between the cracks. As the IRS evolves its various filters, rules, and data mining models to combat identity theft schemes, the IRS continues to ensnare too many legitimate filers in their fraud filters — 62 percent of the 1.9 million suspicious returns selected by the Taxpayer Protection Program were falsely detected.

#### **Recommendations**

The National Taxpayer Advocate recommends that the IRS include identity theft cases received IRS-wide — including Return Integrity & Compliance Services and Submission Processing receipts — in its Global Identity Theft Report; expand its procedures so that all identity theft victims — including those with multiple tax issues and needing to interact with IRS functions outside of the IDTVA function — are assigned a sole contact person to assist them until all identity theft-related issues are resolved; set a limit of 35 percent for the false detection rate for its Taxpayer Protection Program identity theft filters for 2018 and 20 percent for 2019 and thereafter; expand the Identity Protection Personal Identification Number program by offering it all taxpayers; and develop procedures to address large-scale data breaches while minimizing the burden on victims.

## **MSP #20 FRAUD DETECTION: The IRS Has Made Improvements to Its Fraud Detection Systems, But a Significant Number of Legitimate Taxpayers Are Still Being Improperly Selected by These Systems, Resulting in Refund Delays**

### **Problem**

The IRS fraud detection system identifies illegitimate returns and prevents improper refunds from being issued. Over the past 14 years, the National Taxpayer Advocate has consistently advocated for taxpayers whose legitimate refunds have been unreasonably delayed by the IRS, and recommended improvements to reduce taxpayer burden while preventing refund fraud. Despite some improvements in recent years, this system remains highly inaccurate with a false positive rate (FPR) of about 66 percent. This resulted in about 60,000 legitimate returns being improperly selected and refunds being delayed. These delays are exacerbated by the inability of taxpayers to reach a live assistor in the IRS unit dealing with income and wage verification. The National Taxpayer Advocate is concerned that lingering problems with the IRS's fraud detection system continue to create economic burden and violate taxpayer rights.

### **Analysis**

The Return Review Program (RRP) which the IRS currently uses to detect refund fraud has the capacity to adjust filters in real-time. The IRS, however, did not make any fraud filter changes between January 1, 2017 and September 30, 2017. In the first nine months of 2017, the FPR increased from 54 to 66 percent compared to the same period in 2016. As a result, almost 60,000, or 66 percent of 90,410 returns were improperly selected resulting in refund delays, and analysis from TAS Research shows that more than 37 percent of these refunds were delayed 11 weeks or beyond. Moreover, in Calendar Years (CYs) 2014-2017 (through September 30, 2017), the IRS held about 24,000 refunds for which a notice of disallowance was sent to the taxpayer on average 31 weeks after the return selection. During CYs 2014-2017, the IRS has not ever issued a notice of disallowance for about 5,800 held refunds. Holding refunds for an extended period of time before sending a notice of disallowance, or holding the refund and never sending a notice of disallowance, resembles the practices under the previous, highly criticized IRS Questionable Refund Program, and raises significant taxpayer rights and due process concerns.

### **Recommendations**

The National Taxpayer Advocate recommends the IRS expand the Security Summit by including participants from the financial, banking, commercial, and consumer and privacy advocate sectors; revise the Summit's charter to broaden its scope to include non-identity theft refund fraud; reinstate the 11-week process thereby requiring the IRS to either release refunds or issue a notice of disallowance to the taxpayer; and establish a direct phone line to the Integrity & Verification Operation unit and provide information via the "Where's My Refund" application to those taxpayers whose refunds are held because of suspected fraud.

## **MSP #21 REFUND ANTICIPATION LOANS: Increased Demand for Refund Anticipation Loans Coincides with Delays in the Issuance of Refunds**

### **Problem**

Demand for refund anticipation loans (RALs) has more than tripled over the past year. Over 90 percent of the returns filed with RAL indicators were filed by February 15. This substantial increase in demand coincides with the effective date of the provision in § 201 of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act) that requires the IRS to hold all refunds that include Earned Income Tax Credit and Additional Child Tax Credit until February 15. Such delay in refund issuance improves tax administration, but taxpayers are absorbing the costs of these short-term loans and, in many cases, they might not even realize the true cost due to the hidden nature of the indirect fees. In addition, the National Taxpayer Advocate is concerned about the noncompliance risk associated with these products.

### **Analysis**

In the wake of the PATH Act, some lenders are now offering “no-fee” RALs. During Filing Season 2017, the loans were limited to amounts up to \$1,300, depending on the lender. With no-fee RALs, the taxpayer does not directly pay a fee or incur any interest charges for the loan. The preparer pays the loan fee to the financial institution. The no-fee RAL differs from those offered in the past as they are now nonrecourse loans. On its face, it appears that the financial institution takes the greatest risk with this new refund product. However, the taxpayer does not necessarily walk away from the deal without any consequences if the IRS fails to release part or all of the refund, because the taxpayer may be subject to cancellation of debt income. It is also inevitable that the banks and preparers are recouping the costs indirectly. Banks often charge preparers a fee for the RAL. Preparers can also recoup the costs by increasing return preparation fees. While some taxpayers facing an immediate financial hardship may be willing to incur any additional costs associated with RALs, all taxpayers would benefit from a detailed breakdown of fees incurred.

The Taxpayer Advocate Service will evaluate the compliance rates of RAL returns into the future as awareness of and demand for the product continues to increase. Our concern stems from past noncompliance associated with these products. For example, a 2007 study conducted by IRS Research found a significant correlation between taxpayers using RALs and noncompliance.

### **Recommendations**

The National Taxpayer Advocate recommends that the IRS survey the RAL products currently on the market, including detailed analysis of direct and indirect fees, to understand how taxpayers and tax administration are impacted; conduct a consumer education campaign before the filing season about RALs and refund anticipation checks (RACs), including tips on how to identify indirect costs associated with these products; and require all e-file participants offering RAL and RAC products to provide a standard “truth-in-lending” statement to help the taxpayer better understand the terms of the loan product, including any “hidden” or “indirect costs of the loan product.”

## LEGISLATIVE RECOMMENDATIONS

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Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress considers a taxpayer perspective.

## LR #1 **TIMING OF REFUNDS: Direct the IRS to Study the Impact of Delaying the Issuance of Refunds to Allow Sufficient Time to Process Information Returns and Perform Document-Matching**

### Problem

There is a constant tension between the desire to get refunds out to taxpayers quickly and the need to protect against refund error or fraud. Not only do fraudulent refund claims impose a large financial burden on the government, but it also causes innocent taxpayers to become entangled in a complex and time-consuming set of procedures to resolve the issue. In December 2015, Congress enacted the Protecting Americans from Tax Hikes Act of 2015, which contained two key provisions that became effective in 2017 intended to help combat tax refund fraud — the law (1) accelerated the due date for filing certain information returns, and (2) delayed the issuance of tax refunds for taxpayers claiming certain refundable credits. However, due in part to delays in transcribing data from a large volume of paper-filed information returns, the IRS completed verification on only a small portion of the wage information before it started paying out refunds in the 2017 filing season.

### Analysis

Upfront matching would reduce tax refund fraud, identity theft, and inadvertent errors by stopping the refund associated with a mismatch. However, despite having received 87 percent of the information documents by February 15, the IRS was able to verify by February 15 only 35 percent of the wage information for returns where the taxpayer claimed refundable credits during the 2017 filing season. One reason for the difficulties verifying the wage information is the volume of paper-filed information returns, which takes weeks for the Social Security Administration to process and transmit to the IRS. Generally, information returns are required to be electronically filed only when 250 or more are submitted, a threshold that has not changed since 1989 despite significant advances in digital recordkeeping practices. One drastic way for the IRS to ensure it has sufficient time to determine the validity of refund claims is to push back the date the IRS will start to issue tax refunds. If the IRS did not begin to issue refunds until March of each year, it would have sufficient time to cross-check the reported income before releasing refunds. However, such a significant shift in the timeframe for refund issuance would have great impact on taxpayers, the tax practitioner community, the IRS, and other stakeholders.

### Recommendations

The National Taxpayer Advocate recommends that Congress require employers with more than five employees to electronically file Forms W-2 and Forms 941, and require payors who issue more than five Forms 1099-MISC with nonemployee compensation to electronically file Forms 1099-MISC; direct the IRS to create fillable Forms 941 and Forms 1099-MISC that can be electronically filed at no cost directly from the [irs.gov](https://www.irs.gov) website; and in collaboration with the National Taxpayer Advocate, require the IRS to conduct a comprehensive study on the benefits and burdens of delaying the issuance of refunds until March, and then submit a report to Congress with its findings and recommendations.

**LR #2      ELECTRONIC MAILBOX RULE: Revise the Mailbox Rule to Include All Time-Sensitive Documents and Payments Electronically Transmitted to the IRS****Problem**

Currently, the “statutory mailbox rule” in Internal Revenue Code (IRC) § 7502 does not apply to the electronic transmission of time-sensitive documents and payments to the IRS. The rule provides that if a document or payment arrives late but is postmarked on or before the due date, the postmark date is treated as the date the IRS receives the document. The rule applies to documents and payments sent through the U.S. Postal Service, designated private delivery services, and electronic return transmitters. However, the statute and regulations thereunder do not extend the rule to other forms of electronic transmission, such as fax, posting a document on an online account, or making a credit card payment online.

**Analysis**

The IRS is moving forward with plans to provide more opportunities for taxpayers to use self-service tools and interact with the IRS digitally. In addition, the IRS is currently changing its policy to accept more documents by fax. While taxpayers will continue to have the option to submit documents and payments through traditional methods to invoke the statutory mailbox rule, some taxpayers may electronically submit their documents and payments completely unaware the statutory mailbox rule does not apply to protect them. The IRS may even encourage such electronic submission to save resources. This issue will only be exacerbated when the IRS enhances the taxpayer online account application to enable taxpayers to perform “self-correct” actions which include electronic submission of documents.

Both taxpayers and the IRS will realize many benefits with increased digital interaction. Taxpayers will benefit from the availability of more modern, fast, and convenient methods to submit documents and payments. The IRS will benefit from quicker processing times and reduced resources devoted to answering phones and opening mail. However, the IRS needs to plan for the risks associated with the electronic submission of documents and payments. In particular, there is a risk that the IRS will not properly receive the digital transmission, due to technological or human error. In such case, the taxpayer may have the burden to prove that the IRS received the document or payment by a certain deadline. As currently enacted, the statutory mailbox rule in IRC § 7502 does not apply to these electronic transmissions of documents and payments to the IRS. In order to encourage taxpayers to use digital methods of document and payment submission, taxpayers should have the same protections when they submit electronically as they do when they mail the document or payment through a designated delivery service.

**Recommendations**

To encourage taxpayers to electronically submit documents and payments to the IRS while receiving the same protections as if they mailed them, the National Taxpayer Advocate recommends that Congress amend IRC § 7502(c)(2) to authorize the Secretary to provide by regulation the extent to which the statutory mailbox rule applies to the electronic submission of documents and payments directly to the IRS.

**LR #3      **EQUITABLE DOCTRINES: Make the Time Limits for Bringing Tax Litigation Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling, and Clarify That Dismissal of an Untimely Petition Filed in Response to a Statutory Notice of Deficiency is Not a Decision on the Merits of a Case****

**Problem**

The periods for petitioning the Tax Court or bringing tax suits in other federal courts are prescribed in Internal Revenue Code (IRC) provisions. The sanction for failing to commence suit within those times is severe: taxpayers lose their day in that court, which may be the only prepayment forum, or the only forum at all, with jurisdiction to hear their claim. There are judicial doctrines pursuant to which a court may excuse a late suit, but the Tax Court has held, and courts of appeal have agreed, that the time limits for petitioning the Tax Court are jurisdictional requirements that cannot be eliminated by applying equitable doctrines. The courts do not agree as to whether the time limits for filing tax suits in United States district courts or the Court of Federal Claims are jurisdictional or are instead statutes of limitation subject to judicial doctrines that could excuse late suits.

**Analysis**

Treating the IRC time limits for commencing a judicial proceeding as jurisdictional leads to unfair outcomes. Jurisprudence in non-tax contexts demonstrates that even where equitable doctrines are considered, courts do not commonly excuse an untimely filing. There is no reason to suppose that taxpayers would succeed, or expect to succeed, more often if they were allowed to raise equitable doctrines to excuse a late filing in tax litigation. Allowing courts to consider judicial doctrines of forfeiture, waiver, estoppel and equitable tolling that could, where appropriate, avert harsh and unfair results would support taxpayers' rights to appeal an IRS decision in an independent forum and their right to a fair and just tax system.

**Recommendation**

Provide that the following time limits are not jurisdictional and are subject to the judicial doctrines of forfeiture, waiver, estoppel, and equitable tolling: the periods within which taxpayers may petition the Tax Court; and the periods set out in the IRC within which taxpayers may commence suit in United States district courts or the Court of Federal Claims. Additional clarification would ensure that taxpayers whose petitions in response to a statutory notice of deficiency are dismissed as untimely (rather than for lack of jurisdiction) would be allowed to pay the deficiency and seek a refund.

**LR #4      COLLECTION DUE PROCESS (CDP): Amend IRC § 6330 to Allow the Tax Court Jurisdiction to Determine Overpayments****Problem**

Internal Revenue Code (IRC) § 6330 grants the U.S. Tax Court jurisdiction to review issues properly raised in a Collection Due Process (CDP) hearing, including challenges to the underlying liability. This review of the taxpayer's underlying liability could also show that a taxpayer has made an overpayment for the same taxable year. However, unlike in deficiency proceedings under IRC § 6213, the Tax Court lacks jurisdiction to determine the extent to which the taxpayer made an overpayment and order the IRS to credit or refund that amount to the taxpayer. To receive a refund or credit, the taxpayer will be required to file a separate administrative refund claim with the IRS and, if unsuccessful, bring a refund suit in a United States district court or the Court of Federal Claims.

**Analysis**

The inability of the Tax Court to determine overpayments in CDP cases forces taxpayers to resolve a single tax controversy in multiple forums, undermining the taxpayers' right to finality, and creates unnecessary costs and delay while impeding the efficient use of judicial resources. The scope of the Tax Court's jurisdiction also continues to be challenged in litigation, causing confusion for taxpayers and creating a trap for the unwary. Extending the Tax Court's jurisdiction to determining an overpayment and ordering a refund by incorporating the requirements already existing under IRC § 6512 in deficiency cases is unlikely to produce a flood of additional cases to the Tax Court, and may reduce litigation in other forums, conserving judicial resources. The proposed amendment will protect taxpayer rights, reduce taxpayer burden, and ensure a complete resolution is achieved in one court proceeding.

**Recommendation**

Amend IRC § 6330 to grant the Tax Court jurisdiction to determine overpayments for the tax periods at issue and to order refunds or credits if the court determines the amount of the taxpayer's underlying tax liability for a taxable year is less than the amounts paid or credited for that year.

**LR #5      COLLECTION DUE PROCESS AND INNOCENT SPOUSE NOTICES: Amend IRC §§ 6320, 6330, and 6015 to Require That IRS Notices Sent to Taxpayers Include a Specific Date by Which Taxpayers Must File Their Tax Court Petitions, and Provide That a Petition Filed by Such Specified Date Will Be Treated As Timely**

**Problem**

The U.S. Tax Court is an important pre-payment forum which taxpayers can access without having to pay the disputed tax in advance. The Tax Court has jurisdiction over a variety of issues, including appeals from Collection Due Process (CDP) hearings and relief from joint and several liability. The current language in several IRS CDP and innocent spouse notices of determination confuses taxpayers, especially *pro se* taxpayers, and causes them to misinterpret the deadline to file a petition with the Tax Court. If a taxpayer misses the deadline, the U.S. Tax Court does not have jurisdiction to review the IRS's determination and the taxpayers are deprived of their rights *to be informed, to appeal the IRS's decision in an independent forum, and to a fair and just tax system.*

**Analysis**

Current law does not require the IRS to include a specific date by which a taxpayer must file his or her request for a CDP hearing with the IRS and his or her CDP or innocent spouse petition in the U.S. Tax Court. Several recent court cases demonstrate that taxpayers misinterpret the calculation of the file-by date to file a request for a CDP hearing or to file a CDP or innocent spouse petition with the Tax Court. Furthermore, U.S. taxpayers residing abroad need to overcome barriers (such as delays in international mail, language differences, time zones, and the lack of access to tax professionals) to meet the deadlines prescribed in the CDP and innocent spouse notices. In contrast, the Code requires the IRS to specify the last date for filing a Tax Court petition in a notice of deficiency and provides an additional 60 days to file a petition for taxpayers residing abroad.

**Recommendations**

The National Taxpayer Advocate recommends that Congress amend IRC §§ 6320, 6330, and § 6015 to require the IRS to include a specific date, similar to the “last date” to file on the statutory notice of deficiency, by which a taxpayer must file his or her request for a CDP hearing with the IRS, and his or her CDP or innocent spouse petition in the U.S. Tax Court; to deem CDP and innocent spouse petitions filed by the later of the date on the IRS notice or the last statutory date (if the IRS miscalculates the last date on the notice) as timely filed; and to allow an additional 60 days for taxpayers outside the U.S. to request for a CDP hearing, or to file a CDP or innocent spouse petition in the U.S. Tax Court.

## LR #6      **USER FEES: Prohibit User Fees That Reduce Revenue, Increase Costs, or Erode Taxpayer Rights**

### Problem

Due to budget constraints, the IRS has recently increased (or proposed to increase) a wide range of fees including the fees for installment agreements (IAs), offers in compromise (OICs), pre-filing agreements, private letter rulings, and special enrollment examinations. Unlike services provided by other agencies, the government is the primary beneficiary of the IRS's services, which help people pay taxes. Thus, the IRS's fees may cost the government more — in lost tax revenue and increased enforcement costs — than they bring in.

In addition, charging taxpayers to exercise their rights creates a pay-to-play system that seems inconsistent with the *right to a fair and just tax system*. Such fees may reduce trust in government and faith in the legitimacy of the tax system, thereby reducing the revenue that the government collects from other taxpayers by reducing voluntary compliance overall.

### Analysis

The IRS has an incentive to push the envelope by raising fees and imposing new ones. Unlike other federal agencies, it may retain and spend certain user fee revenue. Indeed, the IRS proposed increasing the fees for IAs and OICs due to “constraints on IRS resources,” and has sometimes proposed to set fees above its costs to “reduce the number and frequency” of requests for service — services that promote voluntary compliance.

Without additional legislative direction, resource constraints could prompt the IRS to begin charging for all kinds of fundamental tax services such as: filing an appeal, receiving assistance from the Taxpayer Advocate Service, asking for an audit reconsideration, entering a closing agreement, visiting a taxpayer assistance center, calling the IRS, receiving a communication (*e.g.*, a call, letter, or notice), making a payment, submitting a tax form, using the “where’s my refund” website, or asking the IRS to withdraw a lien.

### Recommendations

To ensure the IRS adequately considers the consequences of increasing fees, the National Taxpayer Advocate recommends that Congress prohibit it from increasing fees for tax-related services unless it first determines, after considering public comments, that the proposed fee (or increase) will not: reduce government revenue (*e.g.*, by directly or indirectly discouraging voluntary tax compliance); increase government expenses (*e.g.*, by increasing enforcement costs or noncompliance); or undermine taxpayer rights or discourage taxpayers from claiming their protections.

**LR #7      INTERNATIONAL PENALTIES: Provide Uniformity for the Reasonable Cause Exception to Initial and Continuation Penalties for the Failure to File Information Returns Under IRC §§ 6038, 6038A, 6038D, 6677, and 6679**

**Problem**

A taxpayer who fails to timely file certain foreign information returns using the required forms may be penalized by Internal Revenue Code (IRC or the Code) §§ 6038, 6038A, 6038D, 6677, and 6679. Each section generally imposes a \$10,000 initial penalty and additional continuation penalties, which generally accrue every thirty days if the taxpayer does not file the required return within ninety days after being notified by the IRS and continue until the required return is filed, or until the penalties reach statutory maximum. These Code sections may cause confusion for taxpayers, practitioners, and IRS employees alike because: 1) some Code provisions provide the reasonable cause exception for the initial penalty only, while others do not explicitly provide it for both the initial and the continuation penalties; 2) reasonable cause language contained in the various Code sections imposing penalties for the failure to file certain information returns is inconsistent; and 3) the reasonable cause exception language contained in the Code for some of these penalties does not specifically address facts and circumstances of taxpayers residing abroad and foreign taxpayers with tax filing obligations in the United States.

**Analysis**

The international information return penalty provisions do not contain uniform language regarding the reasonable cause exception. IRC §§ 6038D and 6677 allow for a reasonable cause as an exception to both the initial penalty and the continuation penalties, whereas, IRC § 6679 *only* allows reasonable cause as an exception for the initial penalty. Furthermore, under IRC §§ 6038 and 6038A, the start of the ninety day period after the IRS mails a notice of failure to file, upon expiration of which continuation penalties are imposed, is delayed until the last day on which reasonable cause existed for the initial penalty. However, after the ninety day period starts to run and the taxpayer does not furnish the required information return within ninety days, continuation penalties imposed under IRC §§ 6038 and 6038A cannot be abated due to reasonable cause. Finally, the reasonable cause exception language does not specifically take into consideration whether there is a mismatch in filing requirements or filing deadlines between foreign jurisdictions and the U.S., and does not consider such mismatch as a factor negating “willful neglect.”

**Recommendations**

To provide consistent and uniform rules for a reasonable cause exception for both the initial and continuation penalties for failure to file certain information returns and to take into account taxpayers’ facts and circumstances, the National Taxpayer Advocate recommends that Congress amend IRC §§ 6038(c)(4)(B), 6038A(d)(3), and IRC § 6679(a)(1) to insert the reasonable cause language contained in IRC §§ 6038D(g) and 6677(d). The National Taxpayer Advocate further recommends that Congress clarify IRC §§ 6038(c)(4)(B), 6038A(d)(3), and IRC § 6679(a) to explicitly state that the reasonable cause exception applies to both the initial and continuation penalties. Finally, the National Taxpayer Advocate recommends that Congress amend IRC §§ 6038, 6038A, 6038D, 6677, and 6679 to provide that the term “willful neglect” does not include a taxpayer’s first time failing to file the required U.S. information returns if the filing deadline in the foreign country differs from that in the U.S.

## LR #8 NATIONAL RESEARCH PROGRAM (NRP) AUDITS: Compensate Taxpayers for “No Change” NRP Audits and Waive Assessment of Tax, Interest, and Penalties Resulting from NRP Audits

### Problem

The IRS conducts random audits of taxpayers through its National Research Program (NRP). This random audit program benefits tax administration by gathering strategic information about taxpayer compliance behavior, assisting the IRS in developing and updating its workload selection formulas, collecting data about the causes of reporting errors, and providing estimates of the tax gap, which measures taxpayer noncompliance with the tax laws. In addition, NRP studies benefit Congress by providing taxpayer compliance information that is useful in formulating tax policy and also ensure that the IRS is auditing the right taxpayers, thereby building trust in the tax system. Yet NRP audits are burdensome for tens of thousands of individual taxpayers (or businesses) that are subject to these audits. Affected taxpayers, even if they are fully compliant, must contend with a random and intensive audit that consumes their time, drains resources, including representation costs, and may impose an emotional and reputational toll. Taxpayers are not currently compensated for any costs they incur relating to NRP audits and the IRS may assess tax, interest, and penalties as it does during a regular audit. This undermines taxpayers’ *right to a fair and just tax system*, as taxpayers selected for NRP audits are performing a public service by being subject to audits that are more comprehensive and significantly more intrusive than standard audits.

### Analysis

Taxpayers who are selected for NRP audits may be fully compliant with the tax laws but are randomly selected to serve as test subjects (*i.e.*, “guinea pigs”) for tax administration purposes, which has a future benefit for the IRS, Congress, and the taxpaying public as a whole. In 1995, Congress held a hearing on the NRP’s predecessor, the Taxpayer Compliance Measurement Program (TCMP). Testimony during the hearing and subsequent responses to questions noted how burdensome TCMP audits were for taxpayers and how they were selected for a research project that benefits the tax system as a whole. Proposals mentioned at the hearing included compensating taxpayers selected for TCMP audits, as well as possibly waiving tax, interest, and penalties assessed during the audit. After the TCMP hearing, Congress acknowledged the burden that TCMP audits placed on taxpayers and proposed legislation to compensate individual taxpayers by providing a tax credit of up to \$3,000 for TCMP-related expenses. The proposal to compensate taxpayers for NRP audits as well as to waive tax, interest, and penalty assessments during these audits has also been suggested by academic commentators. Compensating compliant taxpayers selected for an NRP audit through a tax credit or other means when no change is made to the taxpayer’s tax liability would demonstrate fundamental fairness in the tax system and promote taxpayer rights. In addition, waiving a tax assessment during an NRP audit might encourage transparency from taxpayers who made errors on their returns, thereby providing greater insight into taxpayer behavior.

### Recommendation

The National Taxpayer Advocate recommends that Congress amend the Code to provide compensation to taxpayers who are selected for NRP audits where the IRS does not make a change to the taxpayer’s tax liability (“no change audits”), and relieve taxpayers from the assessment of tax, penalties, and interest as a result of NRP audits absent fraud or an intent to evade federal taxes.

**LR #9 VOLUNTARY WITHHOLDING AGREEMENTS: Amend Internal Revenue Code (IRC) Section 3402(p) to Allow Voluntary Withholding for Independent Contractors****Problem**

The sharing economy (also known as the gig economy) links a willing provider to a consumer of goods or services. Many service providers consider themselves as independent contractors, rather than employees of their service coordinator. As such, withholding is not required on payments made by the service coordinator to the service provider. However, some service providers may desire to have service coordinators withhold taxes for them, just as if they were employees. With the prevalence of gig workers in a sharing economy, voluntary withholding agreements would benefit both the IRS (which would be ensured of receiving timely payment of taxes) and service providers (who would be able to avoid the burdens of making or missing quarterly estimated tax payments).

**Analysis**

Payments to employees are subject to withholding and subject the payor to liability for employment taxes. In contrast, payors are not required to withhold income tax on payments to independent contractors. Tax gap data shows that 99 percent of payments subject to third-party information reporting and income tax withholding are reported by taxpayers to the IRS. Congress should permit independent contractors to enter into voluntary withholding agreements even if the payments are not wages. By explicitly allowing voluntary withholding agreements, Congress will make it easier for independent contractors to meet their tax compliance obligations. Service providers such as those in the sharing economy may not be accustomed to making periodic estimated tax payments to the IRS, and may prefer to have the option of asking the service coordinator to withhold income taxes as a way of reducing taxpayer burden. If Congress clarifies that payors and payees who do not have an employer-employee relationship may enter into voluntary withholding agreements, it will help independent contractors (including many gig economy workers) meet their income tax payment obligations and reduce compliance burdens.

**Recommendation**

The National Taxpayer Advocate recommends that Congress amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service recipients.

**LR #10 CANCELLATION OF STUDENT LOANS: Amend IRC §§ 108(a) and 6050P to Provide That Gross Income Does Not Include, and Creditors Are Not Required to Report, Income From the Cancellation of Certain Student Loans****Problem**

Pursuant to a statutory framework in the Internal Revenue Code (IRC), creditors that forgive a debt are generally required to report the forgiveness to the IRS and taxpayers are generally required to include the amount of the forgiven debt in income. Canceled debt may be excluded from income where the taxpayer was insolvent, a case-by-case determination.

Pursuant to statutory provisions outside of the IRC, creditors may be required to forgive certain debts. These required discharges arise in circumstances that strongly suggest the taxpayer is insolvent or otherwise eligible to exclude the forgiven debt from income. However, the IRC does not contain any exclusions that correspond to discharges of debt pursuant to these non-IRC provisions.

**Analysis**

The IRS has already identified two instances in which students whose loans were forgiven pursuant to the Defense to Repayment discharge process were likely eligible to exclude the forgiven debt from income, which led it to determine not to assert that those taxpayers recognized gross income from the debt cancellation. In order for student loans to be forgiven pursuant to income-driven repayment provisions, the student must have been unable to fully repay the loan after making payments, calculated with reference to the poverty level, for at least 20 years. Student loans may also be forgiven due to the borrower's inability to earn due to total and permanent disability. If the IRC were amended to recognize these limited provisions as exclusions from income, and clarify that lenders are not required to report these discharge to the IRS, taxpayers who qualified for the exclusion would not be required to file a separate form to claim it, and the IRS would not be required to process these forms and make unnecessary facts and circumstances determinations.

**Recommendation**

Amend IRC §§108(a) and 6050P to provide that gross income does not include, and creditors are not required to report, income from forgiveness of student loans discharged under the following provisions of the Higher Education Act of 1965 as amended and related regulations:

- The Defense to Repayment process;
- The income-driven repayment provisions; or
- The total and permanent disability of the borrower provisions.

**LR #11 VICTIMS OF TERRORIST ATTACKS: Amend IRC § 692 To Grant the President the Authority to Issue a Declaration That An Event Qualifies As a “Specified Terrorist Attack”**

**Problem**

Internal Revenue Code (IRC) § 692 provides tax benefits to victims of terrorist attacks with respect to three enumerated events: the April 19, 1995 Oklahoma City bombing of the Alfred P. Murrah Federal Building, the September 11, 2001 attacks, and anthrax attacks occurring between September 11, 2001 and January 1, 2002. IRC § 692(d) has not been amended to take into account terrorist attacks that have occurred after September 11, 2001.

**Analysis**

Congress has recognized that the President may be best positioned to make determinations in this area. The Disaster Relief Act of 1950 authorizes the President to declare a major disaster area, and the 1974 Stafford Act authorizes the President to declare an emergency. However, a terrorist attack may not meet the definition of a major disaster or qualify for a declaration under the Stafford Act. Congress has amended IRC § 692 on an *ad hoc* basis in response to specific events, while acknowledging the need for a more comprehensive approach to determining the tax benefits available to victims of terrorism.

**Recommendation**

Amend IRC § 692(d) to grant the President the authority to issue a declaration that an event qualifies as a “specified terrorist attack.”

## THE MOST LITIGATED ISSUES

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Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(x) requires the National Taxpayer Advocate to include in her Annual Report to Congress the ten tax issues most litigated in the federal courts, classified by the type of taxpayer affected. The cases we reviewed were decided during the 12-month period that began on June 1, 2016, and ended on May 31, 2017.

### **MLI #1 Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)**

Internal Revenue Code (IRC) § 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations causes an underpayment of tax required to be shown on a return, or if an underpayment exceeds a computational threshold called a substantial understatement, respectively. IRC § 6662(b) also authorizes the IRS to impose the accuracy-related penalty on an underpayment of tax in six other circumstances.

### **MLI #2 Trade or Business Expenses Under IRC § 162 and Related Sections**

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998. We identified 99 cases involving a trade or business expense issue that were litigated in federal courts between June 1, 2016, and May 31, 2017. The courts affirmed the IRS position in 65 of these cases, or about 66 percent, while taxpayers fully prevailed in only two cases, or about two percent of the cases. The remaining 32 cases, or about 32 percent, resulted in split decisions.

### **MLI #3 Summons Enforcement Under IRC §§ 7602, 7604, and 7609**

Pursuant to Internal Revenue Code (IRC) § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability. To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information. If a person summoned under IRC § 7602 neglects or refuses to obey the summons; to produce books, papers, records, or other data; or to give testimony as required by the summons, the IRS may seek enforcement of the summons in a United States District Court.

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it. Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because often the government, rather than the taxpayer, initiates the litigation. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons. Generally, the burden on the taxpayer to establish the illegality of the summons is heavy. When challenging the summons's validity, the taxpayer generally must provide "some credible evidence" supporting an allegation of bad faith or improper purpose. The taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons only when the taxpayer can point to specific facts or circumstances that plausibly raise an inference of bad faith. Naked allegations of improper purpose are not enough, but because direct evidence of IRS's bad faith "is rarely if ever available," circumstantial evidence can suffice to meet that burden.

TAS identified 89 federal cases decided between June 1, 2016, and May 31, 2017 involving IRS summons enforcement issues. The government was the initiating party in 65 cases, while the taxpayer

was the initiating party in 24 cases. Overall, taxpayers fully prevailed in three cases, while three cases were split. The IRS prevailed in the remaining 83 cases.

#### **MLI #4 Appeals from Collection Due Process (CDP) Hearings Under IRC §§ 6320 and 6330**

The IRS Restructuring and Reform Act of 1998 (RRA 98) created Collection Due Process (CDP) hearings to provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court. Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.

Since 2001, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 85 opinions on CDP cases during the review period of June 1, 2016 through May 31, 2017, which is a decrease of 14 percent since last year's report. Taxpayers prevailed in full in four of these cases (nearly five percent) and, in part, in three others (nearly four percent). The eight percent success rate (rounded) for the taxpayers is lower than last year's success rate of 16 percent, which was one of the highest success rates since the inception of CDP hearings. Of the seven opinions where taxpayers prevailed in whole or in part, four taxpayers appeared *pro se* and three were represented.

The cases discussed demonstrate that CDP hearings serve an important role in providing taxpayers with a venue to raise legitimate issues before the IRS deprives the taxpayer of property. Many of these decisions shed light on substantive and procedural issues.

CDP hearings are particularly valuable because they provide taxpayers with an enforceable remedy with respect to several rights articulated in the Taxpayer Bill of Rights (TBOR), which was adopted by the IRS in 2014 and was subsequently incorporated in the IRC in response to the National Taxpayer Advocate's recommendations. In particular, by providing an opportunity for a taxpayer to challenge the underlying liability and raise alternatives to the collection action, the CDP hearing enables the taxpayer's *right to challenge the IRS's position and be heard*. If the taxpayer does not agree with Appeals' determination, he or she may file a petition in Tax Court, which furthers the taxpayer's *right to appeal an IRS decision in an independent forum*. Lastly, since the Appeals Officer (AO) must consider whether the IRS's proposed collection action balances the overall need for efficient collection of taxes with the legitimate concern that the IRS's collection actions are no more intrusive than necessary, the CDP hearing protects a taxpayer's *right to privacy* while also ensuring the taxpayer's *right to a fair and just tax system*.

**MLI #5      Gross Income Under IRC § 61 and Related Sections**

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress. For this report, we reviewed 85 cases decided between June 1, 2016, and May 31, 2017. The majority of cases involved taxpayers failing to report items of income, including some specifically mentioned in Internal Revenue Code (IRC) § 61 such as wages, interest, dividends, and annuities.

**MLI #6      Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654**

We reviewed 60 decisions issued by federal courts from June 1, 2016, to May 31, 2017, regarding the additions to tax for:

- i. Failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1);
- ii. Failure to pay an amount shown on a tax return under IRC § 6651(a)(2);
- iii. Failure to pay installments of the estimated tax under IRC § 6654; or
- iv. Some combination of the three.

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Eight cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; six cases involved the estimated tax penalty and either the failure to file penalty or the failure to pay penalty; 46 cases involved the failure to file or failure to pay penalties without the estimated tax penalty; there were no cases involving the estimated tax penalty as the only issue.

A taxpayer can avoid the failure to file and failure to pay penalties by demonstrating the failure is due to reasonable cause and not willful neglect. The estimated tax penalty is imposed unless the taxpayer falls within one of the statutory exceptions. Taxpayers were unable to avoid a penalty in 57 of the 60 cases.

**MLI #7      Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403**

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or to subject any of the delinquent taxpayer's property to the payment of tax. Therefore, lien enforcement cases are different from cases described in other Most Litigated Issues because it is always the government, rather than the taxpayer, initiating the litigation. We identified 60 opinions issued between June 1, 2016, and May 31, 2017 that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 58 of these cases, a taxpayer prevailed in one case, and one case resulted in a split decision.

## MLI #8 Charitable Contribution Deductions Under IRC § 170

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes (AGIs) for contributions of cash or other property to or for the use of charitable organizations. To take a charitable deduction, taxpayers must contribute to a qualifying organization and substantiate contributions of \$250 or more. Litigation generally occurred in this reporting cycle in the following three areas:

- Substantiation of the charitable contribution;
- Valuation of the charitable contribution; and
- Requirements for a qualified conservation easement.

TAS identified and reviewed 28 cases decided between June 1, 2016, and May 31, 2017, with charitable deductions as a contested issue. The IRS prevailed in 20 cases, taxpayers prevailed in two cases, and the remaining six cases resulted in split decisions. Taxpayers represented themselves (appearing *pro se*) in 14 of the 28 cases (50 percent). In *pro se* cases, no taxpayers prevailed in full, the IRS prevailed in 11 cases, and three cases resulted in split decisions.

## MLI #9 Family Status Issues Under IRC §§ 2, 24, 32, and 151

Because family status issues center on interrelated exemptions, credits, and filing statuses claimed on federal tax returns, cases litigated in this area often involve multiple issues with similar factual determinations. This report combines the following issues into a single “family status” category:

- Head of household filing status;
- Child Tax Credit (CTC);
- Earned Income Tax Credit (EITC); and
- Dependency exemption.

We reviewed 24 federal court opinions issued between June 1, 2016, and May 31, 2017. Many of these opinions cover multiple family status issues, with the determination of one often affecting others. For example, a denial of the dependency exemption will lead to the summary denial of the CTC and may impact eligibility for head of household filing status. In tax year (TY) 2015, over 21 million taxpayers filed as head of household, nearly 28 million received the EITC, and almost 50 million sought some form of dependency exemption.

## MLI #10 Relief from Joint and Several Liability Under IRC § 6015

A married person can elect to file a federal income tax return separately from his or her spouse, or both spouses can choose to file jointly on one return. Filing a joint return establishes joint and several liability for the spouses, for the full amount of any deficiency or tax due.

Accordingly, IRS can collect the entire amount due on the joint return from either spouse, without regard to the respective tax liabilities each would have accrued if they filed separately.

Internal Revenue Code (IRC) § 6015 provides three ways for a taxpayer to obtain partial or full relief from an IRS debt resulting from a return filed jointly with a spouse or ex-spouse. Section 6015(b) provides complete relief for deficiencies arising from a jointly filed return. Section 6015(c) provides limited relief from a joint liability for spouses who are divorced, separated, widowed, or not living

together, by allocating the liability between the spouses. If relief is unavailable under IRC § 6015(b) or (c), subsection (f) provides a third opportunity for “equitable” relief from both deficiencies and underpayments.

There were 24 federal opinions identified involving relief under IRC § 6015 that were issued between June 1, 2016, and May 31, 2017. The IRS prevailed in 16 of the cases and the taxpayers prevailed in eight of the cases. Significant issues that arose this year include whether the U.S. Tax Court has exclusive jurisdiction under IRC § 6015(e) and whether the period of limitations prescribed in IRC § 6015(e)(1)(A) is jurisdictional. Additionally, the Tax Court applied the seven-factor test from Revenue Procedure 2013-34 to determine whether the taxpayer should be granted equitable relief under IRC § 6015(f).

## VOLUME 2

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### TAS RESEARCH AND RELATED STUDIES

#### **#1 Study of Financial Circumstances of Taxpayers Who Entered Into Installment Agreements and Made Payments While Their Debts Were Assigned to Private Collection Agencies**

Pursuant to its private debt collection (PDC) initiative, since April 2017 the IRS has outsourced the collection of certain tax debt to private collection agencies (PCAs). PCAs may offer taxpayers who cannot pay their debts in full an installment agreement (IA), not to exceed five years. PCAs do not gather any financial information from taxpayers and have no obligation or incentive to inquire whether taxpayers are in economic hardship. The Taxpayer Advocate Service (TAS) studied the financial circumstances of 2,102 taxpayers who, between April 10, 2017 and September 28, 2017, entered into an IA while their debts were assigned to a PCA and made a payment on which the PCA received a commission. Among our findings:

- Almost fifty percent of these taxpayers agreed to make payments even though their incomes were less than their Allowable Living Expenses (ALEs), according to IRS measures; if these cases were worked by the IRS, these taxpayers could be put into “Currently Not Collectable” status;
- More than a fifth had incomes less than the federal poverty level, yet these taxpayers paid \$544 on average; and
- Virtually all (94 percent) of taxpayers who receive Social Security Administration (SSA) retirement income and entered into these IAs have incomes below 250 percent of the poverty level. The IRS does not seek to collect these taxpayers’ debts pursuant to an automatic levy program, the Federal Payment Levy Program (FPLP), yet it assigns their debts to PCAs for collection.

The National Taxpayer Advocate recommends that the IRS exclude the debts of SSA retirement income recipients whose incomes are less than 250 percent of the federal poverty level from assignment to PCAs and require PCA employees, before offering taxpayers an IA, to: inform taxpayers that they are not required to enter into an IA for an amount that would leave them unable to pay their reasonable basic living expenses; and refer them to the IRS webpage that sets out the ALEs that would apply to them, or, if the taxpayer prefers, print and mail them that information.

## #2 Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC

This study corroborates and expands upon a 2016 study, described in the National Taxpayer Advocate's 2016 Annual Report to Congress, of taxpayers who were sent an educational letter from TAS in January of 2016. The letter was sent to taxpayers who appeared to have erroneously claimed the Earned Income Tax Credit (EITC) on their 2014 returns. The letter explained the requirements for claiming EITC and identified the error the taxpayer appeared to have made. The 2016 study explored the extent to which the letter affected taxpayers' subsequent compliance.

This year, TAS sent the same letter to taxpayers who appeared to have erroneously claimed EITC on their 2015 returns, except that this year's letter also reminded taxpayers they could be eligible for the childless-worker EITC. In addition, TAS sent a separate letter to a group of taxpayers who appeared to have erroneously claimed EITC because the residency test for claiming EITC was not met. The letter to this group was the same as the letter sent to other taxpayers who appeared to not have met the residency test, except that it included a toll-free number taxpayers could call to speak to a TAS employee about their eligibility for EITC. This study explores the effect of both letters on taxpayers' subsequent compliance.

Among the study findings:

- Overall, the TAS letter averted erroneous EITC claims among taxpayers who claimed EITC in 2016, mostly because taxpayers who were sent TAS letters were less likely to repeat on a 2015 return the same error that appeared to have been made on the 2014 return compared to unaudited taxpayers who did not receive a TAS letter;
- For taxpayers who appeared to not meet the *residency requirement*, the TAS letter with an extra help telephone number averted erroneous EITC claims more effectively than not sending a letter, sending a letter without the additional phone number, or auditing the taxpayer. Sending the TAS letter with the extra help phone number to all taxpayers whose 2015 returns appeared to be erroneous because the residency test was not met would have averted more than \$44 million in erroneous EITC claims;
- For taxpayers who appeared to not meet the *relationship requirement*, the TAS letter averted erroneous EITC claims more effectively than not sending a letter. Sending the TAS letter to all taxpayers whose 2015 returns appeared to be erroneous because the relationship test was not met would have averted nearly \$53 million of erroneous EITC claims;
- For audited taxpayers who appeared to have claimed the same qualifying child as another taxpayer (*i.e.*, there were duplicate claims) who then claimed EITC in the subsequent year, the audit were the least effective in modifying their behavior; and
- This year's TAS letter sent to taxpayers who appeared not to have met the residency test that included the extra help phone line (as opposed to the letter sent to all taxpayers reminding them of the childless-worker EITC) resulted in more taxpayers claiming the childless-worker EITC on their 2016 returns, compared to those taxpayers who received the last year's TAS letter without the notification that the taxpayer may still be entitled to the childless-worker EITC.

### #3 A Study of the IRS Offer In Compromise Program

Internal Revenue Code (IRC) section 7122 authorizes the IRS to accept less than the full amount of tax, penalties, or interest due. As a condition of acceptance for an offer in compromise (OIC), the taxpayer must agree to remain compliant with his or her filing and paying requirements for the five years following the acceptance of the OIC. Therefore, although the IRS agrees to settle a tax debt for less than the full amount due, the IRS secures future filing and payment compliance for the next five years. As a result, the IRS benefits by obtaining an extensive period of compliance, hopefully developing better taxpayer habits, which extend into the foreseeable future, while also collecting an amount that it is unlikely to collect otherwise. On the other hand, the taxpayer is no longer saddled with a debt that cannot be satisfied.

In 2004, the Office of Program Evaluation and Risk Analysis (OPERA) completed a study of the IRS OIC program. The study found:

- Low rates of taxpayers submitting multiple offers in a relatively short period of time;
- High rates of subsequent compliance among taxpayers with accepted offers; and
- An often overly optimistic IRS view of the collection potential from taxpayers with rejected offers.

This current study of the IRS OIC program was designed to be similar to the 2004 OPERA study. The specific objectives of this study were to:

- Quantify the number of taxpayers who have submitted multiple OICs in a short amount of time (churning);
- Examine the subsequent filing and payment compliance for the five years after the IRS accepts a taxpayer's OIC;
- Determine if subsequent compliance continues beyond the five years required as part of the accepted OIC agreement;
- Compare the amount the IRS could have collected per the terms of a rejected or returned OIC to the amount actually collected subsequent to the offer; and
- Determine if the IRS realizes its estimation of the reasonable collection potential when it rejects an offer.

This study shows that fewer than ten percent of taxpayers “churn,” defined as submitting multiple OICs within a six-month period. Furthermore, nearly half of the taxpayers who churn ultimately receive an accepted OIC, suggesting that taxpayers are not trying to game the system, but are legitimately seeking an acceptable offer. This also raises the question of whether the IRS could save resources by engaging more with taxpayers on their original offers rather than creating additional burden for both IRS and taxpayers by rejecting or returning offers.

Taxpayers with accepted OICs were significantly more likely (16 percent) to *timely* file their subsequent income tax returns for the next five years when compared to taxpayers whose OICs were not accepted. For the first five years after the offer, taxpayers with accepted offers are also much more likely to pay their subsequent income taxes than taxpayers whose OICs were not accepted (72 percent compared to 52 percent).

Taxpayers with accepted OICs continued to be more compliant with filing and payment requirements even after the five years the taxpayer is required to remain compliant under the terms of the accepted OIC. Most notably, taxpayers are 11 percent less likely to file a late return and 20 percent less likely to file an unpaid balance due return.

The IRS secures at least as much (often more) than the offered amount in 60 percent of the OICs it rejects. However, in the remaining 40 percent, the IRS has only collected a third of the amount offered through subsequent payments. *Overall, even after we factor in refunds offset to satisfy the delinquent liabilities, the IRS still collects significantly less than the amount offered on rejected or returned OICs.*

In fact, when examining rejected OICs, the IRS determined reasonable collection potential was over 15 times the amount offered, and over 40 times the amount actually collected. While the rejection of the OIC is sometimes appropriate, in many instances, the IRS often has an exaggerated view of the taxpayer's reasonable collection potential, with the dollars collected being less than the amount offered, and significantly less than the amount the IRS determined as the taxpayer's reasonable collection potential.

In view of the findings in this study, the National Taxpayer Advocate has made the following recommendations:

- The IRS should consider devoting more resources to obtaining acceptable OICs from taxpayers who seek to compromise their liabilities. Securing acceptable OICs could save IRS money by preventing resources from being spent collecting the uncompromised delinquency and by obtaining the increased filing and payment compliance that generally accompanies accepted OICs. Such an approach could also decrease the resources wasted as a result of taxpayers submitting multiple OICs within a short period of time.
- The IRS should study a sample of returned and rejected OICs to determine factors which indicate that the IRS is likely to actually collect an amount less than what has been offered to compromise the liability. Given the huge differential between Reasonable Collection Potential and the amount offered for rejected OICs, taxpayers may become discouraged, distrustful, and unwilling to amend their OICs upward. As part of this study, the IRS should also determine what factors lead to an inflated reasonable collection potential, so that in future situations with similar circumstances, the IRS could determine a more realistic amount of reasonable collection potential, which may result in more accepted OICs.

#### **#4 A Further Exploration of Taxpayers' Varying Abilities and Attitudes Toward IRS Options for Fulfilling Common Taxpayer Service Needs**

Since fiscal year 2010, the National Taxpayer Advocate has expressed concerns that the overall quality of the Internal Revenue Service's (IRS) taxpayer service has eroded. Over the long term, this erosion could increase taxpayer burden, weaken taxpayers' faith in the tax system, and undermine voluntary compliance. To help the IRS operate in a challenging budget environment, TAS and the Wage & Investment Division developed a service priorities matrix to identify where the IRS should focus its limited service resources.

Critical to the success of the matrix was acquiring survey data from different kinds of taxpayers to determine what they need and prefer in terms of service. Unfortunately, the data required to develop the matrix was not readily available and thus project implementation was delayed. For a report in the 2016 Annual Report to Congress, TAS acquired a dataset of survey respondents, but due to its limited size, we were incapable of thoroughly analyzing the needs and preferences of taxpayers. However, for this report, we used a complete dataset and were able to develop our analyses further.

The basic purposes of this report are to:

- Determine the population's access and use of the internet and broadband;
- Determine the ability and desire of taxpayers to use different services and delivery channels; and
- Identify how issue resolution affects taxpayer satisfaction.

TAS based the analysis in this report on 3,375 survey responses obtained as of February 2017. Our design used Random Digit Dialing to contact and recruit eligible survey respondents. For analyses of services and delivery channels, we re-weighted the data by demographic criteria to more closely mirror IRS service users.

Our most notable research results were the following:

- Overall, we estimate that more than 11 million taxpayers never use the Internet, with a minimum of at least six million in any one of the vulnerable groups (that is, seniors, taxpayers with disabilities, and low income taxpayers). Nearly 14 million are unlikely to have Internet access at home. Taxpayers indicated that about 28 percent did not have broadband, which translates to over 41 million taxpayers without this type of access. A lack of broadband was more prevalent among vulnerable groups. Approximately half of taxpayers reported they did not feel comfortable sharing personal financial information over the Internet and nearly forty percent did not like sharing personal information with the government.
- Personal circumstances, preferences, and abilities affect the delivery channels that individuals choose to use to obtain IRS services (for instance, those without broadband or Internet are less likely to use the IRS website). Taxpayers preferred the first channel that they used to receive service. Given options about delivery channels, taxpayers did not attempt to use the same delivery channel for every service issue. The most frequently cited service need was to get a form or publication, which one of every three taxpayers needed. More than one of every four taxpayers reported a need for answers to tax law questions. The next most frequently needed services were to: 1) get information about a refund; and 2) obtain transcripts or a copy of a prior year tax return. We also noted that a sizeable group reported needing help with an IRS notice or letter. This group is larger than we would expect to need this service and suggests that there may be a greater need for assistance with notices or letters than the IRS might anticipate. Roughly one in

five taxpayers wants to talk with an IRS employee about a notice or letter (either on the phone or face to face). Only one in twenty prefers that service online. The most preferred way to set up a payment plan was in person contact.

- Resolution was a key factor in driving channel choice and taxpayer satisfaction. Regardless of delivery channel used, approximately one of every three individuals who sought help from the IRS were not successful at completely resolving their issue. Resolution ratings for the automated phone service were lower than Taxpayer Assistance Centers (TACs), the website, and other IRS information sources, but were not statistically different from phone representative ratings. TAC locations and the IRS website received the highest customer satisfaction ratings. The primary drivers of the lower telephone satisfaction rating were the amount of time it took to get through on the phone and the number of steps required to get to someone that could help the caller.

Our findings show that millions of taxpayers — particularly among the vulnerable taxpayer groups—are still reliant on personal services to address their taxpayer service needs. Moreover, the finding that only a minority of all taxpayers feels secure sharing personal financial information over the internet has serious implications for IRS “Future State” expectations that taxpayers will engage with an online IRS account. Just as taxpayers have differing requirements for IRS Services, delivery channel options are not equally suited for providing each type of service. Service needs as well as individual circumstances (including access to communication tools, technical abilities, and prior experiences) influence how service users seek help. These needs range from simple to complex, varied to repetitive, one-time to recurring. Our findings also show a need for the IRS to monitor its assistance programs. Studies of taxpayers’ needs, use of services, abilities, and willingness to use various delivery channels should be gathered on a regular basis to enhance the effectiveness of IRS service offerings and taxpayers’ understanding of their tax obligations.

Given these circumstances, it is readily apparent that taxpayers need more robust tax assistance platforms and multiple help options — that is, an omnichannel service environment.

## #5 Audits, ID Theft Investigations, and Taxpayer Attitudes: Evidence from a National Survey

This report presents preliminary results from a study of taxpayer attitudes and how they are influenced by IRS audits and ID theft investigations. The analysis explores how attitudes among self-employed taxpayers are shaped by different types of audits and different audit outcomes. It also investigates how taxpayer attitudes differ among wage earners who have experienced an ID theft investigation and those who have not. The results are preliminary, and the analysis will need to be further refined to understand how attitudes regarding interactions with the IRS ultimately impact future taxpayer behavior.

To address these questions, we surveyed 3,486 tax filers comprised of 757 wage earners and 2,729 Schedule C filers. Among the Schedule C filers, 1,363 were audited and 1,366 were not audited. Our analysis reveals that nearly 39 percent of audited Schedule C filers do not seem to recall being audited, including about 45 percent of those who received a refund as a result of their examination. Audit recollection is especially poor among taxpayers who have experienced a correspondence examination, which suggests that correspondence examinations may not be perceived as actual audits. For field and office audits, the majority of participants do remember being audited, suggesting that these types of examinations might have a stronger effect on taxpayer attitudes and behavior.

When comparing different types of taxpayers, we find that self-employed taxpayers are more prone to think about cheating. This finding is in line with the literature on the link between opportunity to cheat and noncompliant behaviors. Moreover, we find that self-employed taxpayers perceive higher audit probabilities and higher fines for noncompliance. Consequently, they sense a greater threat of deterrence. Compared to non-audited Schedule C filers, we find that audited Schedule C filers perceive a higher risk of being audited and thus higher levels of coercive power. Surprisingly, audited self-employed taxpayers indicate a stronger sense of procedural justice, information justice, interpersonal justice, and distributive justice than those who have not been audited. This indicates that those who have actually experienced an IRS audit process are more likely to view IRS procedures as transparent, respectful, and appropriate in their outcomes than those who have not. However, this result might be driven by the relatively large share of taxpayers who received either no adjustment or a tax refund as a result of the audit. Under our sampling design, less than half (44 percent) of audited taxpayers in our sample received a positive tax adjustment (*i.e.*, owed additional tax as a result of the audit).

When exploring how attitudes vary across different audit types and outcomes, we find lowest levels of perceived justice among taxpayers who have received a positive adjustment to their taxes. Similarly, these taxpayers report the lowest levels of trust in the IRS, the strongest perceptions of enforced compliance, and the greatest audit risk. Moreover, they indicate higher levels of anger and perceived threat when thinking of the IRS. Interestingly, we observe the strongest contrast between different audit outcomes for distributive justice, where taxpayers who receive no tax adjustment score higher than taxpayers who experience either a positive adjustment or a refund. Likewise, we observe the highest levels of positive sentiments among individuals who receive no audit adjustment in either direction. This suggests that receiving a tax refund does not necessarily induce positive opinions about the IRS. Further analysis on the dynamics between audit outcomes, perceptions of the IRS, and subsequent reporting behavior might contribute to the understanding of differential responses to audits found in prior research (Beer, Kasper, Kirchler, & Erard, 2015).

Survey responses of taxpayers who experienced an IRS investigation involving a potentially fraudulent refund claim by someone improperly using their identification reveal that only about one-third of these victims recall the incident. To gain a better understanding of how IRS investigative procedures of

alleged, or suspected ID theft or other suspected fraudulent refund claims impact taxpayer attitudes, more research is needed to understand why so many respondents seem unable to recall either being a victim of ID theft or the IRS questioning the legitimacy of their refund claim. Further research is also warranted on how the duration and effectiveness of IRS ID theft or potentially fraudulent refund investigations affects taxpayer attitudes and behavior.

Finally, following the reasoning of the Slippery Slope Framework (Kirchler, 2007), we have analyzed correlations between the survey scales and found that perceptions of audit risk and penalties are closely related to perceived coercive power. Perceptions that the IRS exercises power in legitimate ways and feelings of trust in the tax authority are highly related to tax knowledge, justice perceptions, and social norms. Perceptions of coercive power and trust elicit different emotions, which are related to enforced or voluntary compliance. While enforced compliance correlates positively with thoughts about cheating on taxes, voluntary compliance is negatively related to these thoughts.

## **#6 Do Taxpayers Respond to the Substantial Understatement Penalty Threshold? A Research Prospectus for an Analysis of Bunching Below the Penalty Threshold**

The “economic deterrence” model of tax compliance suggests that higher penalties should produce more compliance. However, there is relatively little real-world evidence that marginal changes to tax penalty rates affect compliance. TAS plans to fill this gap by studying the extent to which taxpayers respond to the economic incentive provided by the substantial understatement penalty.

The substantial understatement penalty generally may apply to understatements on a return that exceed a threshold. For individuals, the threshold is the greater of \$5,000 or 10 percent of the tax required to be shown on the return. If the penalty affects compliance behavior, some taxpayers whose understatements would otherwise be just over the threshold should adjust their reporting so that their understatements are just below it. If they do, we should see relatively more understatements concentrated or “bunching” just below it, and fewer (*i.e.*, a crater) just above the threshold. TAS plans to analyze bunching to determine if taxpayers are responsive to the substantial understatement penalty threshold, and to identify the taxpayer segments that are most and least responsive.

## #7 An Analysis of Tax Settlement Programs As Amnesties

Research generally suggests that broad and frequent one-size-fits-all amnesties can reduce government revenues in the long run. They can reduce future compliance by eroding perceptions of fairness, revealing noncompliance norms, or diluting economic deterrence. However, the IRS and tax agencies around the world routinely adopt amnesties, such as programs to address mass-marketed tax schemes or undisclosed and untaxed funds held in other countries (*i.e.*, offshore voluntary disclosure programs or OVDPs). This discussion reviews amnesty research to identify when and how tax administrators can use settlement programs to minimize unnecessary burden, disputes, and improve future compliance.

Narrowly-tailored settlement programs aimed at specific objectives are less likely to threaten future compliance than broad amnesties aimed at accelerating short-term revenues. More importantly, settlement programs should be coupled with other compliance-enhancing measures. For example, they may help smooth the transition from widespread noncompliance to compliance norms, provided the agency can credibly commit to maintain the new norms (*e.g.*, by increased service, monitoring, or enforcement). Increases in penalties and new automated information exchanges (including third-party reporting) provide opportunities for tax agencies to make credible commitments to improve compliance norms, provided the agencies can also assure taxpayers that penalties will be applied fairly and their private financial information will not be used inappropriately.

In addition, settlement programs should take into account the motivational posture of the taxpayer (*i.e.*, were they trying to comply or game the system?). When those who made honest mistakes have a reasonable and easy way to correct them without facing unexpectedly harsh consequences designed for bad actors, the program may promote compliance by improving trust for the agency. An analysis of the IRS's OVDPs suggests there are risks to a one size-fits-all approach.

## LITERATURE REVIEWS

### #1 Improving Telephone Service Through Better Quality Measures

To provide telephone service that meets the needs of taxpayers in the twenty-first century, the IRS should follow the best practices used in the private sector and other government agencies and evaluate its telephone service in terms of taxpayer satisfaction. Telephone service should become an essential part of an omnichannel service environment, which would allow taxpayers to contact the IRS through the channel of their choice and receive a consistently high quality of service. TAS's review of the relevant literature shows that metrics assessing call quality, such as First Contact Resolution, are more indicative of caller satisfaction than call efficiency metrics. Call quality metrics can also identify ways to better engage telephone assistors in their work. Taking a relationship-oriented approach to taxpayer service, rather than simply a transactional approach, will help bolster the IRS's reputation and improve voluntary compliance.

### #2 Fostering Taxpayer Engagement Through Geographic Presence

A prior TAS research study showed that local norms were the most influential factors of tax compliance. Thus, geographic presence in local communities and in-person two-way communication are particularly important in outreach activities. Even though digital communications may appear to be a low-cost option in the short-term, this literature explores how it has disadvantages, including a greater use of shortcuts such as browsing for keywords and multitasking on a larger scale. Organizations including large business entities, domestic government agencies, and foreign tax administrations have acknowledged the importance of in-person outreach initiatives. The literature review shows that face-to-face and telephone communications are optimal, however, social media and mobile vans may provide additional opportunities to engage in an effective two-way communication. IRS employees need to be on the ground and in the community to understand local issues, local concerns, and local norms. By being a part of the community and displaying a desire to work with and educate local taxpayers, particularly in low-compliance communities, the IRS can build taxpayer trust and confidence, provide quality taxpayer service, and promote understanding of the tax system.

## **NATIONAL TAXPAYER ADVOCATE PURPLE BOOK: Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration**

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The National Taxpayer Advocate Purple Book presents a concise summary of 50 legislative recommendations intended to strengthen taxpayer rights and improve tax administration. Most of the recommendations have been made in detail in our prior reports, but others are presented in this report for the first time.

During the last two years, Congress has shown renewed interest in improving the operations of the IRS. Most notably, the House Ways and Means Subcommittee on Oversight has held several hearings to consider “IRS reform,” and Chairman Buchanan has said he plans to introduce and seek to move legislation on a bipartisan basis during 2018 in collaboration with Ranking Member Lewis.

The Purple Book is designed to assist them in their efforts, and we have aimed to make it as user friendly as possible. Each proposal is presented in a format similar to the one used for congressional committee reports, with “Present Law,” “Reasons for Change,” and “Recommendation(s)” sections. Most of our recommendations have been introduced at one time or another as freestanding bills, and some have been reported favorably by the House Committee on Ways and Means or the Senate Committee on Finance. A few have been approved by the full House or Senate.

At the end of each recommendation, we identify bills that have been introduced in the House or Senate that are our consistent with our proposal. In a separate chart, we list additional reference material to assist those interested in learning more about a recommendation. The reference material includes prior bills and committee report descriptions and National Taxpayer Advocate recommendations presented in prior annual reports, congressional testimony, or other forums.

It has now been almost 20 years since the enactment of the IRS Restructuring and Reform Act of 1998, and over that period, we have had ample time to assess the impact of its provisions. Most changes have stood the test of time well, but some require tweaking. In addition, tax administration has changed in many ways, partly due to the increasing use of automation by the IRS and the increasing use of the internet and other digital services by taxpayers.

For these reasons, we are very much encouraged by the congressional interest in examining the current state of tax administration and developing legislation to improve it. We believe most of the recommendations presented in the Purple Book are non-controversial, common sense reforms that will strengthen taxpayer rights and improve tax administration. We hope that Members of Congress and their staffs find this compilation useful.



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