Introduction

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 chart immediately following this Introduction summarizes congressional action on legislative recommendations the National Taxpayer Advocate proposed in her 2001 through 2008 Annual Reports to Congress.[1] The Office of the 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 a taxpayer perspective receives due congressional consideration. The following discussion details recent legislative activity incorporating proposals made by the National Taxpayer Advocate.

- **Amend IRC § 6707 Penalty for Listed Transactions.** In 2008, the National Taxpayer Advocate raised concerns regarding the impact of IRC § 6707A.[2] Section 6707A imposes a penalty of $100,000 per individual per year and $200,000 per entity per year for failure to make special disclosures of a "listed transaction." The penalty *must* be imposed where a taxpayer fails to make the special disclosures – even if he or she had no knowledge that the transaction was listed or even questionable, even if the taxpayer derived no tax savings from the transaction, and even if the transaction is not "listed" until years after the taxpayer entered into it and filed a return on which the transaction was reflected. The requirement that this penalty be imposed without regard to culpability may have the effect of bankrupting middle class families who had no intention of entering into a tax shelter. The National Taxpayer Advocate recommended that Congress amend IRC § 6707A so that the amount of the penalty bears a proportional relationship to the amount of any tax savings realized. In November 2009, companion bills were introduced in the House and Senate to limit the penalty for failure to disclose reportable transactions.[3]
- **Require Form 1099 Reporting for Incorporated Service Providers.** As part of a 2008 legislative recommendation on worker classification, the National Taxpayer Advocate recommended that Congress require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.

1 An electronic version of the chart is available on the TAS website at http://www.irs.gov/advocate.

2 National Taxpayer Advocate 2008 Annual Report to Congress 414-18; 419-22.

3 S. 2771, 111th Cong. (2009); H.R. 4068, 111th Cong. (2009). In the Senate, Senator Baucus subsequently introduced S. 2917, which provides relief that is substantively identical to the earlier bills but also contains revenue offsets.

The health care bill recently approved by the Senate would eliminate the reporting exemption with respect to payments to corporate providers of property and services.[4]

- **Establish Standard Deduction for Home Office Expenses.** Although it is estimated that over half of all small businesses are home-based, only a small percentage of small business owners claim the home office deduction. Private industry has argued that the rules regarding the home office deduction are too complex. In 2007, the National Taxpayer Advocate recommended that Congress amend IRC § 280A to create an optional standard home office deduction.[5] In 2009, at least five bills were introduced that would provide for a standard home office deduction.[6]
- **Repeal Private Debt Collection Authority.** In 2006, the National Taxpayer Advocate called for the repeal of the IRS's private debt collection authority.[7] We raised concerns that the private debt collection program was not cost efficient, added unnecessary costs and burdens for taxpayers, diminished the improved image of the IRS, and surrendered too many valuable components of our tax administration system. In February 2009, a bill to repeal the authority of the IRS to enter into private debt collection contracts was introduced and referred to the House Committee on Ways and Means.[8] In March 2009, the IRS announced that it would not renew its contracts with private collection agencies.[9]
- **Improve Offer in Compromise Program Accessibility.** In 2006, the National Taxpayer Advocate recommended that Congress modify IRC § 7122(c) so that taxpayers are not required to include a partial payment with certain applications to the offer in compromise program.[10] In May 2009, the chairman and ranking member of the House Ways and Means Subcommittee on Oversight jointly introduced legislation to repeal the 20 percent down payment requirement for submissions of offers in compromise.[11]
- **Allow Self-Employed Taxpayers to Deduct Health Insurance Premiums.** In 2004, the National Taxpayer Advocate recommended a suite of proposals to alleviate some of the significant burdens that the tax code imposes on small businesses.[12] Our recommendations included allowing self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes. In March 2009, two bills were introduced to allow self-employed individuals to deduct health insurance costs in computing self-employment taxes.[13]

4 H.R. 3590, § 9006, 111th Cong. (2009) (as passed by the Senate on Dec. 24, 2009).

5 National Taxpayer Advocate 2007 Annual Report to Congress 503-11.

6 *See* H.R. 1509, 111th Cong. (2009); H.R. 3056, 111th Cong. (2009); H.R. 3615, 111th Cong. (2009); S. 1349, 111th Cong. (2009); S. 1754, 111th Cong. (2009).

7 National Taxpayer Advocate 2006 Annual Report to Congress 458-62.

8 H.R. 796, 111th Cong. (2009).

9 *See* IRS, IR-2009-19, *IRS Conducts Extensive Review, Decides Not to Renew Private Debt Collection Contract* (Mar. 5, 2009).

10 National Taxpayer Advocate 2006 Annual Report to Congress 507-19.

11 H.R. 2343, 111th Cong. (2009).

12 *See* National Taxpayer Advocate 2004 Annual Report to Congress 386-402; National Taxpayer Advocate 2001 Annual Report to Congress 223.

13 H.R. 1470, 111th Cong. (2009); S. 725, 111th Cong. (2009).

- **Repeal or Index the Alternative Minimum Tax.** In 2003, the National Taxpayer Advocate designated the alternative minimum tax (AMT) as the most serious problem faced by taxpayers.[14] The AMT, originally designed to prevent wealthy taxpayers from escaping taxation through the use of tax-avoidance transactions, has morphed into a second layer of taxation that increasingly affects middle-income taxpayers. In 2008, the National Taxpayer Advocate reiterated her earlier recommendations that Congress repeal the AMT or revamp it substantially to achieve its original objective.[15] In 2009, a number of bills called for either the outright repeal of the AMT[16] or for the AMT to be indexed for inflation.[17]

SUMMARY OF 2009 LEGISLATIVE RECOMMENDATIONS

We continue to advocate for the proposals we have made previously. In this report, we present 11 legislative recommendations (including a suite of five collection-related protections), which are summarized below.

1. **Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing.** The IRS currently processes income tax returns before it has a chance to process information returns, including Forms W-2, *Wage and Tax Statement*, and Forms 1099. This sequence creates opportunities for inadvertent error and fraud, requires tax payment and refund decisions to be made on the basis of unverified information, and prevents the government from making pre-populated returns available to taxpayers. The National Taxpayer Advocate recommends that Congress direct the Treasury Department to prepare a report identifying the administrative and legislative steps required to allow the IRS to receive and process information reporting documents before it processes tax returns. The Treasury Department should be given a full year to prepare its report in light of the complexity of the issue and the actions that would be required of the IRS, the Social Security Administration, private employers, and financial institutions. The goal should be to fully implement the required changes within six years.
2. **Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State.** The IRS Restructuring and Reform Act of 1998 (RRA 98) provided that the IRS Office of Appeals (Appeals) should be independent from the IRS, should eliminate prohibited *ex parte* communications with the IRS, and should ensure that an appeals officer is regularly available within each state. Recently, Appeals has eliminated offices in several states and substituted a system of traveling Appeals officers. At the end of FY 2009, taxpayers in nine states had no appeals or settlement officer located within their states. The National Taxpayer

14 National Taxpayer Advocate 2004 Annual Report to Congress 5-19.

15 National Taxpayer Advocate 2008 Annual Report to Congress 356-62 (and prior reports cited therein).

16 *See* H.R. 240, 111th Cong. (2009); H.R. 728, 111th Cong. (2009); S. 932, 111th Cong. (2009).

17 *See* H.R. 719, 111th Cong. (2009); S. 722, 111th Cong. (2009).

Advocate recommends enacting legislation requiring Appeals to have at least one appeals officer and settlement officer located and regularly available within every state, the District of Columbia, and Puerto Rico, and allowing taxpayer access to telephonic, correspondence, or face-to-face hearings with a local Appeals office upon request. Further, the National Taxpayer Advocate recommends that each Appeals office be required to maintain separate office space and office equipment (*e.g.,* fax machines) and a separate mailing address from any IRS office co-located with the Appeals office.

3. **Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income.** Although the medical community increasingly believes that mental illness is caused by physical/chemical abnormalities or changes in the body and may produce physical symptoms as well – effectively blurring the line between physical suffering and mental suffering – the tax code continues to treat taxpayers differently according to their illnesses. Under current law, if a taxpayer is awarded compensation for depression or anxiety resulting from sexual harassment in the workplace, for example, the award would be includable in gross income (*i.e.,* it generally would be taxable) because current law provides an exclusion only for awards received on account of physical injury or sickness. The National Taxpayer Advocate recommends that Congress amend IRC §104(a)(2) to exclude from gross income any payments received as a settlement or judgment for mental anguish, emotional distress, or pain and suffering.

Collection-Related Recommendations (Legislative Recommendations 4 to 8)

4. **Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens.** The tax code authorizes the IRS to file a Notice of Federal Tax Lien (NFTL) in the public record when a taxpayer owes past-due taxes. The purpose is to protect the government's interests in the taxpayer's property. However, the filing of a tax lien can significantly harm the taxpayer's credit and affect his or her ability to obtain financing, find or retain a job, secure affordable housing or insurance, and ultimately pay the outstanding tax debt. For these reasons, the National Taxpayer Advocate believes that the IRS should not automatically file NFTLs but instead should carefully consider and balance these competing interests when determining whether a lien filing is appropriate. Moreover, the current inconsistent NFTL reporting of different federal tax lien events by credit reporting agencies may create unnecessary financial distress for taxpayers without furthering the government's overriding and compelling interest in ensuring the taxpayers' future compliance. The National Taxpayer Advocate recommends that Congress amend the tax code to provide clear and specific guidance about the factors the IRS must consider in making NFTL filing determinations. The National Taxpayer Advocate also recommends requiring pre-filing administrative review of IRS lien determinations by the IRS Office of Appeals, permitting taxpayers to bring civil actions for damages in connection with improper NFTL filings or the IRS's failure to make the required NFTL determinations, and amending the Fair Credit Reporting Act to set specific timeframes for reporting derogatory lien information on credit reports.

5. **Impose Collection Protections on Refund Offsets for EITC Recipients.** Under current law, the IRS can offset the full amount of any future federal income tax refunds, including the portions attributable to the earned income tax credit (EITC), to satisfy a debt owed to the government. Thus, the IRS ordinarily will retain the full amount of EITC benefits (designed to pull taxpayers out of poverty) to satisfy a debt even though the taxpayer remains low income, is otherwise eligible for low income tax benefits, and is relying on the EITC to pay basic living expenses. The National Taxpayer Advocate recommends that Congress limit the portion of the tax refund attributable to the EITC that the IRS may offset to 15 percent.

6. **Apply Uniform Limits and Extensions to Levy Actions on Social Security Benefits.** The IRS has disparate rules to levy Social Security benefits that lead to disparate treatment of taxpayers. The IRS may levy up to 15 percent of a taxpayer's Social Security benefits systemically through the Federal Payment Levy Program (FPLP). The FPLP requires no human involvement to levy on a taxpayer's Social Security benefits, and at present, it has no filter to spare from levies taxpayers whose incomes are at or near the poverty level, nor does it exempt a minimum amount from levy. Alternatively, the IRS may levy up to 100 percent, less a minimum exempt amount, of Social Security benefits through a manual paper-levy process. Moreover, the IRS may use a single paper levy to attach a taxpayer's fixed and determinable right to future Social Security benefits beyond the collection statute expiration date (CSED), potentially turning taxpayers into debtors for life. To establish a uniform set of rules for levying Social Security benefits, the National Taxpayer Advocate recommends limiting *all* levies on Social Security benefits to 15 percent of the benefits (subject to the minimum exemption under IRC § 6334(a)(9)); prohibiting post-CSED paper levies of Social Security benefits (unless the taxpayer has exhibited flagrant conduct); requiring release of FPLP levies on the CSED; and exempting all taxpayers whose incomes are at or below 250 percent of the poverty level from FPLP levies.

7. **Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions.** Several district courts have held that taxpayers cannot raise relief from joint and several liability under the IRC § 6015 innocent spouse provisions as a defense in district court collection suits, sometimes noting that the taxpayer may nevertheless raise the defense in another forum. The U.S. Tax Court, however, may not have jurisdiction over the taxpayer's claim. Other statutory provisions and judicial precedent make clear that taxpayers may raise IRC § 6015 in a variety of contexts, such as collection due process proceedings, bankruptcy proceedings, deficiency proceedings, and refund suits. The National Taxpayer Advocate believes that taxpayers should also be entitled to raise relief under Sections 6015 and 66 as a defense in collection actions in U.S. district courts and therefore recommends that Congress expressly provide that taxpayers may raise relief under those sections as a defense in any proceeding brought under Title 26 or any case arising under Title 11 of the United States Code.

8. **Eliminate the Suspension of the Collection Statute During Qualified Hospitalization Resulting from Service in a Combat Zone.** IRC § 7508(a) generally provides for the suspension of the CSED under IRC § 6502 while a taxpayer is continuously hospitalized from an injury sustained during service in a combat zone. The IRS has administrative discretion to suspend collection activity against civilians during periods of hospitalization but is not required to suspend the CSED for these taxpayers. As a result, U.S. military personnel may be placed at a disadvantage as compared with civilians, because civilians may receive the benefit of deferred collection action without having to agree to an extension of the CSED beyond ten years, while the CSED is statutorily extended beyond ten years for military personnel. To protect individuals serving in combat activities for the United States from an unnecessary suspension of the CSED and to treat these individuals consistently with civilian taxpayers, the National Taxpayer Advocate recommends amending IRC § 7508(a) to eliminate the suspension of the CSED.

9. **Provide a Uniform Definition of a Hardship Withdrawal from Qualified Retirement Plans.** The tax code contains over a dozen tax-advantaged plans and arrangements to encourage taxpayers to save for retirement. While these tax-advantaged retirement planning vehicles help taxpayers save, they are subject to differing sets of rules regulating eligibility, contribution limits, taxation of contributions and distributions, withdrawals, availability of loans, and portability. Particularly confusing are the rules governing certain distributions from qualified plans that are made before age 59½. While some retirement plans allow for an early distribution when a hardship event occurs, the various plans do not uniformly apply these so-called "hardship withdrawal" provisions. Further, even if a plan allows for a hardship withdrawal, participants must deal with inconsistent rules for triggering the ten percent additional tax for early withdrawal imposed by IRC § 72(t). The National Taxpayer Advocate recommends that Congress establish uniform rules regarding the availability and tax consequences of hardship withdrawals from qualified retirement plans. The National Taxpayer Advocate further recommends that such hardship distributions be exempt from the ten percent additional tax imposed by IRC § 72(t).

10. **Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers.** Many U.S. citizens who are residents of the U.S. Virgin Islands (USVI) have an unexpectedly long statute of limitations (SOL) period on tax assessments or none at all. The IRS reached different conclusions at least two times about the extent to which USVI residents have the benefit of a SOL. The end result is that the IRS has singled out a small group of USVI taxpayers for special treatment – the very types of taxpayers that federal tax incentives are seeking to attract to the USVI – by eliminating the SOL applicable to them but not the SOL applicable to other similarly situated taxpayers. In addition, audits of these USVI taxpayers are inefficient – taking 82.7 percent longer than comparable audits nationwide and being disputed by taxpayers 41 percent of the time (compared to the national average of 14 percent for non-USVI cases). The National Taxpayer Advocate recommends clarifying the law so that the filing of a return with the USVI

by a person claiming to be a bona fide USVI resident starts the SOL period to the same extent as filing with the IRS.

11. **Increase the Threshold for the Election to Claim the Foreign Tax Credit Without Filing Form 1116 for Individuals and Index It for Inflation.** An individual taxpayer may elect to claim the foreign tax credit (FTC) for any tax year without filing Form 1116, *Foreign Tax Credit*, if his or her creditable foreign taxes for the year relate exclusively to qualified passive income, are not more than $300 ($600 if filing a joint return), and certain other criteria are met. Had the threshold been indexed for inflation, it would have risen to more than $404 (more than $808 for jointly filed returns) in 2009. The National Taxpayer Advocate recommends that Congress amend IRC § 904(k)(2)(B) to increase the threshold amount for creditable foreign taxes on qualified passive income to $500 ($1,000 if filing a joint return) and index this amount for inflation in $50 increments. By increasing the amount to $500 for individual taxpayers and $1,000 for joint filers, this recommendation would reduce burden for 152,404 taxpayers (over five percent of all Form 1116 filers) based on tax year 2008 data.

Legislative Recommendations

National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82-100; National Taxpayer Advocate 2004 Annual Report to Congress 383-385.	Repeal the AMT outright.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111h Congress	HR 240	Garrett	1/7/2009	Referred to the Ways & Means Committee
	HR 728	Paul	1/28/2009	Referred to the Ways & Means Committee
	S 932	Shelby	4/30/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	S 55	Baucus	1/4/2007	Referred to the Finance Committee
	S 14	Kyl	4/17/2007	Referred to the Finance Committee
	S 1040	Shelby	3/29/2007	Referred to the Finance Committee
	HR 1365	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
	S 2293	Lott	11/1/2007	Placed on Senate Legislative Calendar under General Orders. Calendar No. 464
Legislative Activity 109th Congress	HR 1186	English	3/9/2005	Referred to the Ways & Means Committee
	S 1103	Baucus	5/23/2005	Referred to the Finance Committee
	HR 2950	Neal	6/16/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 43	Collins	1/7/2003	Referred to the Ways & Means Committee
	HR 1233	English	3/12/2003	Referred to the Ways & Means Committee
	S 1040	Shelby	5/12/2003	Referred to the Finance Committee
	HR 3060	N. Smith	9/10/2003	Referred to the Ways & Means Committee
	HR 4131	Houghton	4/2/2004	Referred to the Ways & Means Committee
	HR 4164	Shuster	4/2/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 437	English	2/6/2001	Referred to the Ways & Means Committee
	S 616	Hutchinson	3/26/2002	Referred to the Finance Committee
	HR 5166	Portman	7/18/2002	Referred to the Ways & Means Committee
Index AMT for Inflation National Taxpayer Advocate 2001 Annual Report to Congress 82-100.	If full repeal of the individual AMT is not possible, it should be indexed for inflation.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	HR 719	Lee	1/27//2009	Referred to the Ways & Means Committee
	S 722	Baucus	3/26/2009	Referred to Finance Committee
Legislative Activity 110th Congress	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	HR 703	Garrett	2/9/2005	Referred to the Ways & Means Committee
	HR 4096	Reynolds	10/20/2005	12/7/2005–Passed House; 12/13/2005–Placed on Senate Legislative Calendar
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	1/3/2003	Referred to the Ways & Means Committee

Eliminate Several Adjustments for Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82-100.	Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	S 102	Kerry	1/4/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1861	Harkin	10/7/2005	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 1939	Neal	5/12/2003	Referred to the Ways & Means Committee
Private Debt Collection (PDC)				
Repeal PDC Provisions National Taxpayer Advocate 2006 Annual Report to Congress 458-462.	Repeal IRC § 6306, thereby terminating the PDC initiative.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	HR 796	Lewis	2/3/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	S 335	Dorgan	1/18/2007	Referred to the Finance Committee
	HR 695	Van Hollen	1/24/2007	Referred to the Ways & Means Committee
	HR 3056	Rangel	7/17/2007	10/15/2007–Referred to Senate Committee
Tax Preparation and Low Income Taxpayer Clinics (LITC)				
Matching Grants for LITC for Return Preparation National Taxpayer Advocate 2002 Annual Report to Congress vii-viii.	Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	**Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).**			
	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
	S 1967	Clinton	8/2/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	S 476	Grassley	2/27/2003	Referred to the Finance Committee
	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House w/ an amendment–referred to Senate
	HR 3991	Houghton	3/19/2001	Referred to the Ways & Means Committee
	HR 7	Baucus	7/16/2002	Reported by Chairman Baucus, with an amendment referred to the Finance Committee

Regulation of Income Tax Return Preparers National Taxpayer Advocate 2002 Annual Report to Congress 216-230; National Taxpayer Advocate 2003 Annual Report to Congress 270-301.	Create an effective oversight and penalty regime for return preparers by taking the following steps: ◆ Enact a registration, examination, certification, and enforcement program for federal tax return preparers; ◆ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return-preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight; ◆ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and ◆ Require the IRS to take steps within its existing administrative authority, including requiring a check-box on all returns in which preparers would enter their category of return preparer (*i.e.*, attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5716	Bercerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Referrals to LITCs National Taxpayer Advocate 2007 Annual Report to Congress 551-553.	Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance.			
Legislative Activity 110th Congress	**Bill Number**	**Sponsor**	**Date**	**Status**
	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Public Awareness Campaign on Registration Requirements National Taxpayer Advocate 2002 Annual Report to Congress 216-230.	Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5716	Bercerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614

Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Increase Preparer Penalties National Taxpayer Advocate 2003 Annual Report to Congress 270-301.	Strengthen oversight of all preparers by enhancing due diligence and signature requirements, increasing the dollar amount of preparer penalties, and assessing and collecting those penalties, as appropriate.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 4318	Crowley/ Ramstad	12/6/2007	Referred to the Ways & Means Committee
	S 2851	Bunning	4/14/2008	Referred to the Finance Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Taxpayer Bill of Rights National Taxpayer Advocate 2007 Annual Report to Congress 481-482, 486-489.	Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5716	Bercerra	4/8/2008	Referred to the Ways & Means Committee
Small Business Issues				
Health Insurance Deduction/Self-Employed Individuals National Taxpayer Advocate 2001 Annual Report to Congress 223; National Taxpayer Advocate 2004 Annual Report to Congress 388-389.	Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S725	Bingaman	3/26/2009	Referred to the Finance Committee
	HR 1470	Kind	3/12/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	S 2239	Bingaman	10/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 663	Bingaman	3/17/2005	Referred to the Finance Committee
	S 3857	Smith	9/16/2006	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 741	Sanchez	2/12/2003	Referred to the Ways & Means Committee
	HR 1873	Manzullo Velazquez	4/30/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	S 2130	Bingaman	4/15/2002	Referred to the Finance Committee

Married Couples as Business Co-owners National Taxpayer Advocate 2002 Annual Report to Congress 172-184.	Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of subchapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.			
Legislative Activity 110th Congress	**Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).**			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	S 842	Kerry	4/9/2003	Referred to the Finance Committee
	HR 1640	Udall	4/3/2003	Referred to the Ways & Means Committee
	HR 1558	Doggett	4/2/2003	Referred to the Ways & Means Committee
Income Averaging for Commercial Fishermen National Taxpayer Advocate 2001 Annual Report to Congress 226.	Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).**			
Election to be treated as an S Corporation National Taxpayer Advocate 2004 Annual Report to Congress 390-393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, U.S. Income Tax Return for an S Corporation.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Regulation of Payroll Tax Deposits Agents National Taxpayer Advocate 2004 Annual Report to Congress 394-399.	Require payroll services to meet certain qualifications to protect businesses that use payroll service providers from tax deposit fund misappropriation or fraud.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Committee on Finance. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Tax Gap Provisions				
Corporate Information Reporting National Taxpayer Advocate 2008 Annual Report to Congress 388.	Require businesses that pay $600 or more during the year to non-corporate and corporate providers of property and services to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 1796	Baucus	10/19/2009	10/19/2009 Placed on Senate Legislative Calendar under General Orders. Calendar No. 184

Reporting on Customer's Basis in Security Transaction National Taxpayer Advocate 2005 Annual Report to Congress 433-441.	Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B.			
	Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 878	Emanuel	2/7/2007	Referred to the Ways & Means Committee
	S 601	Bayh	2/14/2007	Referred to the Finance Committee
	S 1111	Wyden	4/16/2007	Referred to the Finance Committee
	HR 2147	Emanuel	5/3/2007	Referred to the Ways & Means Committee
	HR 3996 PCS	Rangel	10/30/2007	11/14/2007–Placed on Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision
Legislative Activity 109th Congress	S 2414	Bayh	3/14/2006	Referred to the Finance Committee
	HR 5176	Emanual	4/25/2006	Referred to the Ways & Means Committee
	HR 5367	Emanual	5/11/2006	Referred to the Ways & Means Committee
IRS Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS) National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Committee on Finance. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Study of Use of Voluntary Withholding Agreements National Taxpayer Advocate 2004 Annual Report to Congress 478-489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Committee on Finance. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336. 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Joint and Several Liability				
Tax Court Review of Request for Equitable Innocent Spouse Relief National Taxpayer Advocate 2001 Annual Report to Congress 128-165.	Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.			
Legislative Activity 109th Congress	**Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).**			

Collection Issues				
Improve Offer In Compromise Program Accessibility National Taxpayer Advocate 2006 Annual Report to Congress 507-519.	Repeal the partial payment requirement, or if repeal is not possible, it should: (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee
Return of Levy or Sale Proceeds National Taxpayer Advocate 2001 Annual Report to Congress 202-214.	Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006–Committee on Finance. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House
	HR 586	Lewis	2/13/2001	4/18/02–Passed the House w/ an amendment–referred to Senate
Reinstatement of Retirement Accounts National Taxpayer Advocate 2001 Annual Report to Congress 202-214.	Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343: ◆ § 401 – Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans ◆ § 408 – Individual Retirement Account, and SEP-Individual Retirement Account ◆ § 408A – Roth Individual Retirement Account			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Committee on Finance. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in H.R. 1528 an amendment and HR 1528 passed in lieu of S 882

Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House w/ an amendment–referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in House
Consolidation of Appeals of Collection Due Process (CDP) Determinations National Taxpayer Advocate 2004 Annual Report to Congress 451-470.	Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.			
Legislative Activity 109th Congress	**Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).**			
Partial Payment Installment Agreements National Taxpayer Advocate 2001 Annual Report to Congress 210-214.	Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the Service.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 833, 118 Stat. 1589-1592 (2004).**			
Penalties and Interest				
Interest Rate and Failure to Pay Penalty National Taxpayer Advocate 2001 Annual Report to Congress 179-182.	Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Interest Abatement on Erroneous Refunds National Taxpayer Advocate 2001 Annual Report to Congress 183-187.	Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 726	Sanchez	2/9/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
First Time Penalty Waiver National Taxpayer Advocate 2001 Annual Report to Congress 188-192.	Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House

Federal Tax Deposit (FTD) Avoidance Penalty National Taxpayer Advocate 2001 Annual Report to Congress 222.	Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2//2005	Referred to the Ways & Means Committee
	S 1321RS	Santorum	6/28/2005	9/15/2006–Committee on Finance. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House w/ an amendment–referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in House
Family Issues				
Uniform Definition of a Qualifying Child National Taxpayer Advocate 2001 Annual Report to Congress 78-100.	Create a uniform definition of "qualifying child" applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	**Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).**			
Means Tested Public Assistance Benefits National Taxpayer Advocate 2001 Annual Report to Congress 76-127.	Amend the IRC §§ 152, 2(b), and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or "not married" status.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
Credits for the Elderly or the Permanently Disabled National Taxpayer Advocate 2001 Annual Report to Congress 218-219.	Amending IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 107th Congress	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee
Electronic Filing Issues				
Direct Filing Portal National Taxpayer Advocate 2004 Annual Report to Congress 471-477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee

Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Referred to Committee on Finance; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Free Electronic Filing For All Taxpayers National Taxpayer Advocate 2004 Annual Report to Congress 471-477.	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	S 2861	Schumer	4/15/2008	Referred to the Finance Committee
Office of the National Taxpayer Advocate				
Confidentiality of Taxpayer Communications National Taxpayer Advocate 2002 Annual Report to Congress 198-215.	Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the TAS or any information provided by a taxpayer to TAS.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Access to Independent Legal Counsel National Taxpayer Advocate 2002 Annual Report to Congress 198-215.	Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of amicus briefs.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	Referred to the Senate
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Other Issues				
Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact National Taxpayer Advocate 2008 Annual Report to Congress 419-422	Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact. Section 6707A of the IRC imposes a penalty of $100,000 per individual per year and $200,000 per entity per year for failure to make special disclosures of a "listed transaction."			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 111th Congress	S 2771	Baucus	11/16/2009	Referred to Finance Committee
	HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
	S 2917	Baucus	12/18/2009	Referred to the Finance Committee
Disclosure Regarding Suicide Threats National Taxpayer Advocate 2001 Annual Report to Congress 227.	Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, w/ an amendment
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in HR 1528 an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

Attorney Fees National Taxpayer Advocate 2002 Annual Report to Congress 161-171.	Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees "above the line." Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 703, 118 Stat. 1546-1548 (2004).**			
Attainment of Age Definition National Taxpayer Advocate 2003 Annual Report to Congress 308-311.	Amend IRC § 7701 by adding a new subsection as follows: "Attainment of Age. An individual attains the next age on the anniversary of his date of birth."			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 108th Congress	HR 4841	Burns	7/15/2004	7/21/2004–Passed House; 7/22/2004–Received in the Senate
Home-Based Service Workers (HBSW) National Taxpayer Advocate 2001 Annual Report to Congress 193-201.	Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.			
	Bill Number	**Sponsor**	**Date**	**Status**
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Legislative Activity 107th Congress	S 2129	Bingaman	4/15/2002	Referred to the Finance Committee

LR #1 Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing

PROBLEM

The IRS currently processes income tax returns before it has a chance to process information returns, including Forms W-2, *Wage and Tax Statement*, and Forms 1099, which report interest, dividends, and other payments. This sequence makes little logical sense. It requires the IRS to make tax payment and refund decisions on the basis of unverified information, creates opportunities for fraud, and prevents the government from making pre-populated returns available as an option to taxpayers. Moreover, the processing of tax returns and refund claims before the processing of information returns limits the IRS's ability to effectively administer refundable credits. Most significantly, this system can result in the IRS making improper payments or unreasonably delaying the payment of refunds to eligible taxpayers.[1]

EXAMPLES

The following examples illustrate the problems that arise because the IRS cannot verify information before it processes tax returns and issues refunds:

Example 1: Inadvertent Misreporting.

A taxpayer files a return and inadvertently fails to report $1,500 in interest income received from a bank account. The IRS has not yet received and processed Forms 1099-INT, *Interest Income*, so it processes the return as filed. Later, the IRS processes Forms 1099-INT, discovers the underpayment, and sends the taxpayer a notice requesting payment of $525 in additional tax, plus interest and penalties. From the taxpayer's perspective, this creates unnecessary burden and requires him to pay more than the tax owed. From the government's perspective, the IRS must devote resources to recovering refunds that should not have been paid, and it is often unable to recover delinquent liabilities, reducing revenue collected.

Example 2: Fraudulent Refund Claims.

A criminal files a fraudulent tax return on January 20, 2009, showing a tax liability of $10,000 and income tax withholding of $15,000. On the face of the return, the "taxpayer" is entitled to a refund of $5,000. However, the IRS does not gain access to Form W-2 information until later in the year, so it must determine whether to pay the refund before it can "document match" the return against the Form W-2 filed by the employer (which

1 *See Running Social Programs Through the Tax System*, vol. 2, *infra*.

would show both the taxpayer's total wages and the tax withheld). While the IRS uses fraud detection software to try to identify fraudulent claims, the software cannot detect all improper claims. The IRS could avoid paying out false and fraudulent claims involving Form W-2 information, without unreasonably delaying legitimate refunds, if it had access to this information when it processes the claims.

Example 3: Feasibility of Pre-Populated Tax Returns.

During the 2008 presidential campaign, President Obama's tax plan included a proposal to "giv[e] taxpayers the option of pre-filled tax forms to verify, sign and return."[2] In light of the significant amount of time and money Americans spend on tax preparation,[3] this idea is worth considering, but it is not feasible at this time. The tax filing season begins in mid-January each year, and many taxpayers, especially those who file simple returns and are owed refunds, file in January or early February. However, the IRS currently does not receive Forms 1099 from financial institutions until later in the filing season and does not begin receiving Form W-2 data from the Social Security Administration (SSA) until late March.[4] Therefore, the IRS cannot create a pre-filled return until much later than most eligible taxpayers would be willing to wait.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress direct the Treasury Department to prepare a report identifying the administrative and legislative steps required to allow the IRS to receive and process information reporting documents before it processes tax returns. The Treasury Department should be given a full year to prepare its report in light of the complexity of the issue and the actions that would be required of the IRS, the SSA, private employers, and financial institutions. The goal should be to fully implement required changes within five years from the time the report is completed.

PRESENT LAW

Forms W-2

IRC § 6051(a) requires employers to provide employees with a written statement each year showing, among other things, the amount of wages paid and the amount of tax deducted and withheld. The statement must be furnished to the employee no later than January 31 of the year following the year in which the wages were paid.

2 *See Barack Obama's Comprehensive Tax Plan* at http://www.barackobama.com/pdf/taxes/Factsheet_Tax_Plan_FINAL.pdf (last visited Dec. 15, 2009).

3 A TAS analysis of IRS data shows that the costs of complying with federal income tax requirements comes to about $193 billion a year and that U.S. taxpayers and businesses spend about 7.6 billion hours a year complying with the filing requirements of the Internal Revenue Code (IRC). For a discussion of these burden estimates, see National Taxpayer Advocate 2008 Annual Report to Congress 3-14 (Most Serious Problem: *The Complexity of the Tax Code*).

4 IRS response to TAS information request (Sept. 29, 2009).

IRC § 6051(d) provides that a copy of the statement must be filed with the Secretary "in accordance with regulations prescribed by the Secretary." Significantly, the regulations prescribed by the Secretary direct employers to file Forms W-2 not with the IRS but with the SSA.[5] The deadline for filing Forms W-2 with SSA is the last day of February for paper returns and the last day of March for returns filed electronically.[6]

Under current procedures, SSA receives all Forms W-2 – most electronically, some on paper – and then compares the name/Social Security number (SSN) combination on each Form W-2 against its SSN database to determine whether the name and number match. Name/SSN mismatches may arise for a variety of reasons. In some cases, the earnings should be attributed to the worker listed on Form W-2 (*e.g.*, when "Robert Jones" uses "Bob Jones" on his employment paperwork or when a woman marries and takes her husband's surname but fails to inform SSA). In other cases, the earnings should not be attributed to the worker listed on Form W-2 (*e.g.*, when an undocumented worker illegally uses another person's SSN to obtain employment). When SSA receives Forms W-2 with names and SSNs that do not match, it uses a variety of automated processes in an attempt to correct mismatches that likely are inadvertent.[7]

SSA sends relevant information extracted from Forms W-2 to the IRS in electronic form. SSA begins to send the data extracts to the IRS on a weekly basis in late March (*i.e.*, the deadline for employers to submit Form W-2 information electronically to SSA) and continues to send them on an ongoing basis as it completes its validation processes. The IRS generally holds the information until mid-May, when it begins to build its Information Returns Master File (IRMF) database for the preceding year. Once the IRMF database is built, all validated data extracts received from SSA are processed within one week and loaded onto the IRMF. Significantly, the IRS does not receive information from some Forms W-2 until the second half of the calendar year.[8]

For tax year (TY) 2007, the IRS received 244 million Form W-2 records from SSA. Of those, SSA reported that 8.9 million (less than four percent of the total) contained name/SSN mismatches that it could not correct using its automated processes. The IRS accepts without further verification all Form W-2 information that SSA has validated but applies its own automated processes (known as "Taxpayer Identification Number ferreting") to try to validate the records that SSA reports as containing name/SSN mismatches. In TY 2007,

5 Treas. Reg. § 31.6051-2(a). Prior to 1978, employers filed Forms W-2 with the IRS. In 1978, regulations were issued instructing employers to begin filing Forms W-2 with SSA as part of a set of changes designed to implement the Combined Annual Wage Reporting (CAWR) program. *See* T.D. 7580, 1979-1 C.B. 378.

6 Treas. Reg. § 31.6071(a)-1(a)(3)(i).

7 For a detailed discussion of the SSA's processes, see Government Accountability Office, GAO-06-458T, *Social Security Numbers: Coordinated Approach to SSN Data Could Help Reduce Unauthorized Work* (Feb. 16, 2006) (testimony before the House Ways and Means Subcommittees on Social Security and on Oversight).

8 IRS response to TAS information request (Sept. 29, 2009).

the IRS was able to "perfect" about 100,000 of the 8.9 million records reported by SSA as containing name/SSN mismatches.[9]

Forms 1099

The tax code generally requires payors of interest, dividends, and other income to provide recipients with a written statement each year showing, among other things, the aggregate amount of the payments.[10] The statement generally must be furnished to the recipient no later than January 31 of the year following the year in which the income was paid.[11]

The tax code generally provides that a copy of the statement must be filed with the Secretary "according to the forms or regulations prescribed by the Secretary."[12] Treasury regulations generally direct payors of income to file Forms 1099 with the IRS no later than the last day of February for paper returns and the last day of March for returns filed electronically.[13] Thus, unlike the process for Forms W-2, the IRS receives Forms 1099 directly and processes them itself.

As with W-2 information received from SSA, the IRS loads Form 1099 information received from payors of income onto its Information Returns Master File database. The IRS, as noted above, builds the IRMF database in mid-May for the preceding year. Therefore, Form 1099 information is not processed until after the filing season has ended.

REASONS FOR CHANGE

The current system of "pay refunds first, verify eligibility later" is essentially an upside-down sequence that makes little sense, harms taxpayers, and undermines tax compliance. From a taxpayer perspective, the process leads to millions of cases where taxpayers inadvertently make overclaims that the IRS does not identify until months later, exposing the taxpayer not only to a tax liability but to penalties and interest charges as well.[14] This is a burden that can and should be prevented.

Similarly, from a tax compliance perspective, the sequence leads to the payment of unwarranted refunds that the IRS must devote resources to recovering. In FY 2009, the IRS reports that it collected $4.6 billion through its document-matching program.[15]

9 IRS response to TAS information request (Sept. 29, 2009).

10 *See, e.g.*, IRC § 6049(a) & (c) (relating to interest payments); IRC § 6042(a) & (c) (relating to dividend payments).

11 *See, e.g.*, IRC § 6049(c)(2)(A) (relating to interest payments); IRC § 6042(c) (relating to dividend payments). However, IRC § 6045(b) gives brokers until February 15 of the year following the year in which income is paid or recognized to furnish customers with information statements.

12 *See, e.g.*, IRC § 6049(a) (relating to interest payments); IRC § 6042(a) (relating to dividend payments).

13 *See, e.g.*, Treas. Reg. § 1.6049-4(g)(1) (relating to interest payments); Treas. Reg. § 1.6042-2(c) (relating to dividend payments).

14 For TY 2005, the IRS document-matching program (known as the Automated Underreporter (AUR) program) made 2.3 million tax assessments amounting to $5.5 billion dollars. IRS Compliance Data Warehouse, Individual Master File (TY 2005). While many taxpayers voluntarily pay the amounts assessed, the IRS often must resort to enforcement action. The IRS reports that it received approximately 265,000 levy payments resulting from its TY 2005 tax assessments. *Id.*

15 *See* IRS, Fiscal Year 2009 Enforcement Results *at* http://www.irs.gov/pub/irs-drop/fy_2009_enforcement_results.pdf (last visited Dec. 23, 2009).

Additional amounts are assessed but not collected.[16] On the criminal side, the IRS Criminal Investigation division blocked $1.5 billion in false and fraudulent refund claims in calendar year 2009, but was unable to stop known claims of about $500 million that were not detected as false or fraudulent until paid, plus an unknown volume of additional improper claims.[17] Thus, the current system requires the IRS to devote significant resources to recovering refunds that should never have been paid out and makes it impossible for the IRS to retrieve all excess payments, even with its extensive collection tools.

Current processes also preclude the creation of pre-populated tax returns on a timely basis, or even making third-party data available for taxpayers to download to tax software programs. While the logistics of creating pre-populated returns requires further study, a decision should be made on the merits of the proposal – not by default simply because the IRS lacks the ability to create them.

If the IRS were to process information returns before it processes tax returns and claims for refund, honest taxpayers would be spared from unnecessary IRS assessment and collection action, more fraudulent claims would be stopped, and revenue collection would rise.

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that Congress direct the Treasury Department to develop a report identifying the administrative and legislative steps required to allow the IRS to receive and process information reporting documents before it processes tax returns.

In light of the complexity of the issue and the actions that would be required of the IRS, SSA, private employers, and financial institutions, the Treasury Department should be given a full year to develop its report. The IRS and Congress should then aim to implement the required changes within five years from the time the report is completed.

Two potential changes should be evaluated carefully. One is to move up the deadline by which employers and payors of income must file information reporting documents with the government. The other is to move back the date on which the IRS begins to process tax returns and claims for refund. In both cases, the burden these changes would impose requires study. Employers and financial institutions need time to prepare information returns after the close of the year, and taxpayers who are entitled to refunds should not be forced to wait for an extended time to receive them. Low income taxpayers, in particular,

16 For TY 2005, more than 300,000 taxpayers still owe about $1.5 billion (including interest and penalties) where the major source of assessment was the AUR program. IRS Compliance Data Warehouse, Individual Master File (TY 2005).

17 During calendar year 2009 (through Dec. 2), the IRS's Questionable Refund Program identified about 280,000 false and fraudulent returns claiming refunds of about $1.9 billion. Of that total, the IRS disallowed about 192,000 claims, preventing the payment of about $1.4 billion. The IRS reports that the vast majority of false and fraudulent refund claims involves income and/or withholding amounts ordinarily reported on Form W-2. IRS response to TAS information request (Dec. 16, 2009).

may have difficulty, at least initially, adjusting to any changes in their accustomed time-frame for receiving refunds.

The following is a partial list of issues that the report should address:

1. ***Moving up the deadlines by which employers must file Forms W-2 and financial institutions must file all or at least the most common Forms 1099.*** As described above, Forms W-2 and most Forms 1099 must be issued to the taxpayer by January 31. Under present law, issuers who file these forms electronically have another two months (until March 31) to file the forms with the government. With the advancements in automation and sufficient lead time, it seems reasonable to expect that employers and financial institutions will be able to file reports with the government at the same time they issue them to employees and customers – namely, by January 31.
2. ***Mandating that virtually all information returns be filed electronically.*** When the government receives information on paper returns, its ability to process the information is delayed by the need to route the returns and to transcribe the data manually. Manual data entry unavoidably results in transcription errors as well. Some e-filing mandates are already in place, but consideration should be given to imposing more extensive mandates for the filing of information returns, including requiring e-filing by anyone who uses a tax return preparer or tax software. Carve-outs should be limited to employers or payors of income who are issuing information returns to less than a specified number of recipients (*e.g.*, an elderly person without a computer who employs a single household employee or nurse).
3. ***Working with SSA to expedite the processing and transmission of Form W-2 data.*** As discussed above, employers file Forms W-2 with SSA – not with the IRS – and SSA screens the forms to identify name/SSN mismatches before it transmits data extracts to the IRS. The length of time between SSA's receipt of W-2 data and its transmission of data extracts to the IRS should be assessed. If there is a significant lag, the report should consider various options to reduce the delay, including processing improvements within SSA and whether the IRS could receive Form W-2 data directly from employers and perform the screens itself, as it did prior to 1978.[18] If there is a significant lag, the IRS should also conduct a test to determine whether it can screen W-2s as effectively as SSA. While SSA "owns" the SSN database, the IRS has considerable data of its own and may be able to use this data as effectively to clear up mismatches.
4. ***Expediting the IRS's ability to process information returns.*** As discussed above, the IRS does not begin building its IRMF database until after the filing season. The report should assess ways for the IRS to build the database in real time, as information returns are received.

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18 The IRS and SSA both need Form W-2 data, albeit for different reasons. Therefore, if the IRS develops the capacity to screen for name/SSN mismatches and can complete the task more quickly than SSA, consideration should be given to creating a joint processing center. Employers could be directed to submit Forms W-2 to the joint processing center, and the IRS and SSA would both have immediate access to the data. Alternatively, a portal could be created to give the IRS direct access to the SSA database, and both agencies could make use of the data in that way.

5. ***Developing or refining the IRS's ability to run income tax returns and claims for refund against the IRMF database to identify disparities before paying refunds.*** Even if the IRS is able to load complete information onto the IRMF database, it does not follow automatically that the IRS could screen all refund claims against the database in a timely manner. To the extent it cannot do so, its return processing systems would have to be modified so that the IRS can run an IRMF screen simultaneously with its other screens.

6. ***Delaying the start of the filing season without unduly delaying the delivery of refunds to taxpayers.*** While our preference would be to accelerate the development of the IRMF database to the point where a delay in the start of the filing season is not necessary, the tight timeframe makes that implausible. Therefore, consideration should be given to delaying the start of the filing season without imposing undue burden on taxpayers. At present, more than 80 percent of taxpayers overpay their taxes each year (usually due to overwithholding) and are entitled to refunds.[19] For some, including low income taxpayers, these refunds amount to several thousand badly needed dollars. If the IRS delays the processing of tax returns, these taxpayers will have to wait another month or possibly more to receive their refunds. The IRS should think creatively about ways to prevent undue burden. One area of focus should be on ways to reduce overwithholding by adjusting the withholding tables. Another option would be to revamp the Advance Earned Income Tax Credit (which has seen very low usage rates) or pay out other benefits ratably during the year to reduce the size of refund payments.

7. ***Evaluating how other countries approach the filing season.*** The United States, of course, is not the only country that faces the challenge of collecting taxes after the close of a tax year. The National Taxpayer Advocate has met with tax administrators from numerous countries, and they utilize a wide variety of approaches, including setting earlier deadlines for information reporting and starting the filing season substantially later in the year. The IRS should study some of these approaches to develop best practices that balance the goals of (a) processing tax returns only after information returns are received and (b) limiting any burden that delays may impose on taxpayers.

8. ***Making use of information returns to create pre-populated returns for taxpayers with simple tax situations.*** As discussed above, pre-populated returns could substantially simplify tax preparation for millions of Americans. California offers pre-populated returns for some taxpayers (*i.e.*, the "ReadyReturn" program)[20] as do some other countries (*e.g.*, Sweden and Australia). The IRS should study these programs and test a pilot program of pre-populated returns with a small group of taxpayers.

9. ***Making data from information returns available for taxpayers to download.*** Once the IRS has received and processed Form W-2 and Form 1099 information returns, it

19 *See* IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2009).

20 For information on the pre-populated return program implemented in California, see Joseph Bankman, *Simple Filing for Average Citizens: The California Ready Return*, 107 Tax Notes 1431 (2005); State of California Franchise Tax Board, *ReadyReturn General Information*, *available at* http://www.ftb.ca.gov/readyreturn/about.shtml (last visited Dec. 22, 2009).

should be able to make the data available for taxpayers to download to their software programs. The IRS should explore the feasibility of making this data available, balancing taxpayer convenience and data security concerns.

As this list illustrates, the task of moving the processing of information returns ahead of the processing of tax returns is not simple. With proper planning and sufficient lead time for implementation, however, we believe it could provide significant benefits for both taxpayers and the IRS.

LR #2

Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State

PROBLEM

The IRS Restructuring and Reform Act of 1998 (RRA 98) provides for an "independent appeals function" within the IRS, including the prohibition of *ex parte* communications between appeals officers and other IRS employees to the extent that such communications "appear to compromise the independence of the appeals officers."[1]

Section 3465(b) of RRA 98 provides that the IRS shall ensure that an appeals officer "is regularly available within each State."[2] Congress believed all taxpayers should enjoy convenient access to Appeals, regardless of their locality.[3] However, the Office of Appeals does not have an appeals officer or settlement officer in nine states.[4] Appeals generally holds face-to-face hearings at the Appeals office closest to the taxpayer's residence or business.[5] However, Appeals may hold conferences at other sites when feasible and necessary to provide a convenient conference opportunity.[6] Appeals does not provide telephonic or correspondence hearings at the offices closest to the taxpayers when requested.[7]

As a result of recent hiring initiatives, the IRS has required all business units, including Appeals, to permit new employees from other business units to share any available workstations.[8] In at least one situation, the IRS required new employees from its compliance function to use workstations in shared space with Appeals employees.[9] Such an arrangement fosters the perception of a lack of independence and may compromise the *ex parte* provisions.

1 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998). IRC §§ 6159(e) and 7122(e) also provide for an "independent administrative review" of installment agreements and offers in compromise that the IRS has construed as meaning an opportunity for a hearing with Appeals. Internal Revenue Manual (IRM) 8.24.1.1.1 (May 27, 2004).

2 RRA 98, Pub. L. No. 105-206, § 3465(b), 112 Stat. 685 (1998).

3 S. Rep. No. 105-174, at 92 (1998).

4 IRS, Human Resources Reporting Center, *Organizational Location Reports* (Sept. 26, 2009). *See* Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Taxpayer Satisfaction or Confidence in Appeals, supra.*

5 IRM 8.4.2.3 (Oct. 30, 2007); IRM 8.22.2.2.6.4 (Mar. 11, 2009); IRM 8.23.2.2.1 (Aug. 28, 2009).

6 IRM 8.6.1.3.1 (Nov. 6, 2007).

7 *See* Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Taxpayer Satisfaction or Confidence in Appeals, supra.*

8 IRS, Memorandum from Deputy Commissioner, Services and Enforcement, *PeopleTrak and Workspace Assignment Guidelines for FY 2010 and FY 2011 Hiring* (Aug. 20, 2009).

9 Similarly, TAS has been approached to share space with other IRS employees, but has raised its independence mandate to avoid such arrangements.

EXAMPLE 1

A taxpayer in Arkansas grows cotton. He has been successful in past years and has earned a modest living from his crops. In 2001, one of his tractors broke down. Due to the large repair bill, the taxpayer was unable to pay his taxes that year. He entered into an installment agreement (IA) and made monthly payments until September 2003, when boll weevils destroyed his entire crop. The IRS terminated his IA and issued a notice of intent to levy. The taxpayer requested a face-to-face collection due process (CDP) hearing, proposing an offer in compromise (OIC) as an alternative to collection. Because there is no Appeals office in Arkansas, the request went to an appeals officer in Dallas who was unfamiliar with farming or the problems facing farmers in Arkansas. The taxpayer could not afford transportation to attend a face-to-face hearing in Dallas. The appeals officer rejected the taxpayer's OIC, believing the taxpayer could earn as much in the future as he did in the past.

EXAMPLE 2

Appeals approves the placement of an IRS compliance employee in Appeals workspace in Dallas. The compliance employee overhears telephone calls and discussions about Appeals dispositions of cases from compliance. The compliance employee hears an appeals officer, who formerly worked with her in compliance, speaking with the taxpayer from Example 1, and she tells the appeals officer the farmer will probably default on any OIC just as he defaulted on his installment agreement.

EXAMPLE 3

A graphics designer in Los Angeles has been successful in past years and has earned a modest living from her business. In 2007, the economy goes into recession. The taxpayer cannot generate enough income to cover her mortgage, utility and food bills, and pay her taxes. Her business continues to decline and she accepts a part-time job in sales, but does not earn enough to satisfy her 2007 income tax liability. In late 2008, a revenue officer contacts the taxpayer and visits her office. The revenue officer informs the taxpayer that an OIC is not an option because a forced sale of her equipment would more than satisfy her tax liability. However, the taxpayer believes that due to the recession, the forced sale will not cover the debt. The IRS sends the taxpayer a notice of intent to levy; she then requests a face-to-face Appeals hearing. The taxpayer proposes an OIC as an alternative to collection. On the hearing day, she arrives at the Los Angeles Appeals office and while being escorted to the hearing room she runs into the revenue officer, who tells her "good luck" on the hearing. She notices the revenue officer's name on the same set of cubicles as her hearing officer. The appeals officer rejects the

OIC, believing the taxpayer could satisfy her tax liability by selling her equipment. The taxpayer does not believe she received a fair hearing.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress pass legislation to:

1. Require that Appeals have at least one appeals officer and settlement officer located and regularly available within every state, the District of Columbia, and Puerto Rico, and allow taxpayers access to telephonic, correspondence, or face-to-face hearings with the local office when requested.
2. Provide that each Appeals office maintain separate office space, separate phone, facsimile, and other electronic communication access, and a separate post office address from any IRS office co-located with the Appeals office.

PRESENT LAW

Section 1001(a)(4) of RRA 98 provides that the Commissioner's plan to reorganize the IRS shall "ensure an independent appeals function within the Internal Revenue Service." An independent Appeals function includes the prohibition of *ex parte* communications between appeals officers and other IRS employees "to the extent that such communications appear to compromise the independence of the appeals officers."[10] The prohibition of *ex parte* communication – communication between Appeals and the IRS where the taxpayer does not have a "reasonable opportunity to participate" – provides that an appeals officer will not discuss the substance of a case with IRS personnel while a hearing is pending.[11]

A continuous theme during the congressional hearings precipitating RRA 98 "was that the taxpayers who get caught in the IRS hall of mirrors have no place to turn that is truly independent and structured to represent their concerns."[12] Congress intended that RRA 98 would establish an Office of Appeals that would not "be influenced by tax collection employees and auditors."[13] Further, Congress intended that Appeals "provide a place for taxpayers to turn when they disagree with the determination of frontline employees" by taking "a fresh look at taxpayers' cases, rather than merely rubber-stamping the earlier determination."[14]

Section 1102(a) of RRA 98 also established the National Taxpayer Advocate's authority to appoint at least one independent Local Taxpayer Advocate (LTA) in each state. Congress specified that LTAs have discretion in not disclosing taxpayer information to the IRS and

10 RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

11 *See* Rev. Proc. 2000-43, 2000-2 C.B. 404.

12 144 Cong. Rec. S4182 (1998) (statement of Sen. Roth).

13 *Id*.

14 144 Cong. Rec. S7639 (1998) (statement of Sen. Jeffords).

they "maintain a separate phone, facsimile, and other electronic communication access, and a separate post office address."[15]

Section 3465(b) of RRA 98 provides, "The Commissioner of Internal Revenue shall ensure that an appeals officer is regularly available within each State."[16] Before RRA 98, Appeals offices were generally located in the same area as the IRS district director's offices.[17] Congress believed that making appeals officers available in each state would provide a place for taxpayers to turn when they disagreed with the IRS.[18]

REASONS FOR CHANGE

Nine years ago, the GAO reported that the IRS was actively assigning Appeals officers to each state and considering video conferencing in rural or remote areas to implement § 3465(b) of RRA 98.[19] However, Appeals has yet to adopt either requirement. At the end of FY 2009, taxpayers in nine states had no appeals or settlement officer located within their states. These taxpayers may have to travel far or face longer case delays to receive a face-to-face hearing. Further, appeals officers or settlement officers who are "circuit riding" may not be aware of local issues that affect a taxpayer's case.[20]

Appeals' independence protects taxpayers' rights to fair and impartial hearings to redress their concerns and resolve their cases.[21] Appeals' customer satisfaction rating for taxpayers' perception of fairness has declined by nine percent to 61 percent from October 2005 through September 2008, and its rating for independence has declined by two percent to 63 percent in the same period.[22] These low ratings may cause taxpayers to feel that pursuing an appeal is hopeless, especially from Campus Appeals, because they perceive IRS compliance functions and Appeals are not separate.[23] Further, *ex parte* communication due to Appeals dependence on IRS compliance functions erodes taxpayer confidence in Appeals.[24]

In *Moore v. Commissioner*,[25] the U.S. Tax Court remanded an individual's case to Appeals for a remedy to avoid prejudice to the taxpayer. Before issuing an adverse CDP determination, the appeals officer received prohibited *ex parte* communication from IRS compliance

15 RRA 98, Pub. L. No. 105-206, § 1102(a), 112 Stat. 685 (1998)(codified as IRC §7803(c)).

16 RRA 98, Pub. L. No. 105-206, § 3465(b), 112 Stat. 685 (1998).

17 S. Rep. No. 105-174, at 92 (1998).

18 144 Cong. Rec. S7639 (1998) (statement of Sen. Jeffords).

19 IRS, Human Resources Reporting Center, Organizational Location Reports (Sept. 26, 2009).

20 *See* Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Taxpayer Satisfaction of Confidence in Appeals, supra.*

21 National Taxpayer Advocate 2003 Annual Report to Congress 41; National Taxpayer Advocate 2004 Annual Report to Congress 265.

22 IRS, *Appeals Customer Satisfaction Survey National Report FY 2008 Results* 28, 31 (Feb. 2009); Customer Satisfaction Survey Results for FY 2009 were not available at the time this report was published.

23 National Taxpayer Advocate 2005 Annual Report to Congress 149-50.

24 National Taxpayer Advocate 2006 Annual Report to Congress 280-81. *Ex parte* communications are prohibited when the communication would appear to compromise the independence of Appeals. Rev. Proc. 2000-43, 2000-2 C.B. 404, § 3.

25 T.C. Memo. 2006-171, *nonacq.*, 2007-13 I.R.B., *action on dec.*, 2007-2 (Feb. 27, 2007).

employees who had been involved in the taxpayer's collection case. The court held that the IRS conducted *ex parte* communications that were covered by the prohibition under RRA 98.

In *Drake v. Commissioner*,[26] the Tax Court held that *ex parte* communications between an IRS insolvency unit advisor and an Appeals settlement officer may have damaged the taxpayer's credibility in future administrative proceedings. The case was remanded to Appeals for a new hearing with an independent Appeals officer.

In *Industrial Investors v. Commissioner*,[27] the IRS sent the taxpayer a Notice of Intent to Levy, and the taxpayer requested a CDP hearing. When the revenue officer who had worked the case in Collection transferred the case to Appeals, she included a cover letter describing in some detail why she felt the levy should be sustained. The Tax Court found the revenue officer's cover letter was an impermissible *ex parte* communication.

Appeals' independence in appearance and in fact is necessary to protect a taxpayer's right to a fair and impartial hearing. Recent intrusions by IRS employees on Appeals workspace threaten independence and a taxpayer's ability to detect *ex parte* communications. Appeals' declining independence may cause taxpayers to bypass Appeals altogether in favor of noncompliance or litigation.

EXPLANATION OF RECOMMENDATION

The Office of Appeals is directed to modify its geographic structure to have at least one appeals officer and one settlement officer located in and regularly available in each state, the District of Columbia, and Puerto Rico. Further, the Office of Appeals is directed to permit taxpayers to request hearings with their local appeals officer or settlement officer whether by telephone, by correspondence, or face-to-face.

The Office of Appeals is directed to maintain its independence by requiring each of its offices to maintain separate office space, separate phone, facsimile, and other electronic communication access, and a separate post office address from any IRS office co-located with the Appeals office.

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26 125 T.C. 201 (2005).

27 T.C. Memo. 2007-93.

LR #3 Exclude Settlement Payments for Mental Anguish, Emotional Distress, and Pain and Suffering from Gross Income

PROBLEM

Damages or payments received as a result of a lawsuit or settlement agreement on account of personal physical injury or physical sickness are excluded from income tax.[1] However, damages or payments awarded for mental anguish, emotional distress, and pain and suffering, and not awarded on account of physical injury or physical sickness, are includible in gross income.[2] The difference in the tax treatment between physical suffering and mental suffering was codified in 1996 when Congress amended IRC § 104(a)(2) to authorize an exclusion from gross income solely of payments attributed to physical injury or physical sickness.[3] Thus, under current law, if a taxpayer is awarded compensation for depression experienced due to sexual harassment in the workplace, the award attributable to that compensation would be included in gross income because it would not be received on account of physical injury or sickness.

Since the 1996 change in law, the medical community has learned more about severe mental and emotional suffering and has gained greater insight into its physical cause and symptoms. As one result of this insight, Congress passed legislation in 2008 that generally requires health insurance plans that offer both medical/surgical benefits and mental health/substance abuse benefits to provide for parity in treatment limitations and financial requirements.[4]

Medical professionals now widely recognize that mental suffering (*e.g.*, depression and anxiety) can lead to physical symptoms and, conversely, that physical injuries (*e.g.*, a broken neck) that leave a person hospitalized and non-functional for an extended period can lead to mental suffering. Because mental suffering often is more difficult to prove and its financial impact harder to quantify, victims of mental anguish sometimes find it more difficult to win judgments or reach settlements. But once a settlement or judgment is reached, there is little reason to impose different tax consequences depending on whether the settlement papers attribute damages to physical suffering or to mental suffering. If anything, the current legal distinction provides an incentive for plaintiffs' lawyers to push to attribute as much of a judgment to physical injuries as possible for no reason other than to minimize the victim's tax liability.

1 Internal Revenue Code (IRC) § 104(a)(2).

2 *Id.*

3 Pub. L. No. 104-188, § 1605(a).

4 *See* Pub. L. No. 110-343, Division C §§ 511 & 512 (known as the Paul Wellstone and Pete Domenici Mental Health Parity and Addition Equity Act, 122 Stat. 3765, 3881 (2008).

EXAMPLE

A taxpayer was unjustly terminated from his position after submitting a whistleblower tip to the IRS that his employer has been hiding income in cash transactions for the last 15 years. The taxpayer brought a tort-type claim against his former employer for employment discrimination, where he was awarded a settlement. In the time between being terminated and settling his case, the taxpayer was unable to find work in his field at a similar pay scale and sank into a severe depression, which led to insomnia, grinding of the teeth, gastrointestinal problems, and an ulcer. In negotiating the settlement, the taxpayer's attorney argued that the taxpayer should be compensated for the mental anguish and physical problems stemming from his unjust termination. The settlement award specified damages for mental anguish and employment discrimination. Despite experiencing severe physical problems as a result of depression, the taxpayer is not entitled to exclude the damages for mental anguish from his gross income because the damages were not for a physical injury or sickness as defined by current law.

RECOMMENDATION

Amend IRC §104(a)(2) to exclude from gross income payments received as settlement for mental anguish, emotional distress, and pain and suffering.

PRESENT LAW

Under IRC § 104(a)(2), any award other than punitive damages is excludible from gross income if the award is compensation for damages resulting from a physical injury or sickness.[5] It makes no difference whether the award is received by suit or settlement agreement, or whether the award is paid as a lump sum or in periodic payments, because all such awards are excludible unless they represent punitive damages.

In 1996, Congress amended IRC § 104(a)(2) to clarify the conditions under which a damage award may be excluded from income, making an award excludible only if the damages are received on account of personal physical injury or physical sickness.[6] The change was effective for amounts received after the enactment on August 20, 1996,[7] but not for amounts received under a written, binding agreement, court decree, or mediation award in effect (or issued on or before) September 13, 1995.[8] Prior to 1996, the word "physical" did not appear in the statute. The legislative history to the 1996 amendment to IRC § 104(a)(2) provides that "[i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow there from are treated as payments received on account of physical injury or physical sickness. . . [but] emotional distress is not considered a

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5 IRC § 104(a)(2).

6 Pub. L. No. 104-188, § 1605(a).

7 Pub. L. No. 104-188, § 1605(d)(1).

8 Pub. L. No. 104-188, § 1604(d)(2).

physical injury or physical sickness."[9] Some have suggested that the true intent behind the 1996 amendment was to discourage litigation and provide some relief to the court system.[10]

Prior to this 1996 amendment, the inclusion of damages was analyzed by applying a two-prong test established in *Commissioner v. Schleier.*[11] The two independent prongs of the test that must be met before a recovery could be excluded from income were as follows: "The underlying cause of action giving rise to the recovery must be 'based upon tort or tort type rights,' and the damages must have been received 'on account of personal injuries or sickness.'"[12]

In recent years, the issue of inclusion of damage awards in gross income has been hotly contested, most notably in *Murphy v. IRS.*[13] In Murphy, the taxpayer sued the New York National Guard for employment discrimination and entered into a settlement agreement allocating $45,000 of her award to emotional distress and mental anguish and the remaining $25,000 to injury to professional reputation.[14] She and her husband filed a joint return, in which they reported the entire $70,000 as gross income, and subsequently filed a claim for a refund, which the IRS denied. The taxpayer then initiated a refund suit in the United States District Court for the District of Columbia. The district court found for the government on all counts and the taxpayers appealed the decision. The Court of Appeals agreed the award was not for physical injuries or physical sickness under IRC § 104(a)(2). The court also determined that IRC § 104(a)(2) was "unconstitutional insofar as it permits the taxation of an award of damages for mental distress and loss of reputation" because "damages received solely in compensation for a personal injury are not 'income' within the meaning of that term in the Sixteenth Amendment."[15] Consequently, the taxpayers had no income from the settlement award.

The Court of Appeals vacated its decision *sua sponte* and reheard the case on April 23, 2007.[16] In its second decision, the Court of Appeals reasoned that when Congress amended IRC § 104(a)(2) in 1996 to tax compensatory damages not received on account of physical injury or sickness, it implicitly expanded the definition of income under IRC § 61 to include such damages. This time, the court sidestepped the issue of whether compensation awards are "income" under the Constitution. Instead, it held that the tax on compensatory damages was an excise tax on an involuntary conversion transaction (*i.e.*, Murphy had to surrender part of her mental health and reputation in return for monetary damages), and

9 H.R. Rep. No. 104-586, at 143-44 (1996).

10 Margarita R. Karpov, *To Tax or Not to Tax – That Is the Question*, 23 Akron Tax J. 143 (2008).

11 *Comm'r v. Schleier*, 515 U.S. 323 (1995).

12 *Comm'r v. Schleier*, 515 U.S. 323, 323 (1995).

13 *Murphy v. IRS*, 460 F.3d 79 (D.C. Cir. 2006).

14 *Murphy v. IRS*, 460 F.3d 79 (D.C. Cir. 2006), judgment vacated.

15 *Murphy v. IRS*, 460 F.3d 79, 92 (D.C. Cir. 2006), judgment vacated. The quotations surrounding the word income were added and not originally part of the quote.

16 *Murphy v. IRS*, 460 F.3d at 81 (D.C. Cir. 2006).

as such was not subject to the constitutional requirements for a tax on "income."[17] Thus, although the definition of income under IRC § 61 may be broader than the definition under the Constitution, IRC § 61 is nonetheless constitutional. Consequently, Murphy's entire settlement award of $70,000 ($45,000 of which was allocated to "emotional distress and mental anguish" and $25,000 of which was allocated to "injury to professional reputation") was not excludible from gross income.[18] On December 13, 2007, Murphy filed a petition for Writ of Certiorari with the United States Supreme Court. The Court refused to hear the case, denying the petition on April 21, 2008.[19]

REASONS FOR CHANGE

Physical elements of depression

Mental anguish, emotional distress, and pain and suffering can be caused by a physical condition in the body and also cause physical symptoms. Over the past few years, doctors and researchers have made significant advances in identifying changes that occur in the brain when a person is plagued with mental illness. Now, many scientists believe mental illnesses are caused by a breakdown in communication in the brain.[20] This breakdown in communication in the brain may be due to damage within the brain itself, thereby causing the miscommunication and resulting in severe mental illness.[21] For example, levels of serotonin, a chemical in the brain, are lower in individuals who have depression. This discovery helped to create medications for the illness.[22] Through this research, much of it conducted by federal agencies such as the National Institutes of Health and the National Institute of Mental Health,[23] there have been discoveries linking many types of mental illness and emotional distress to the physical change in a person's brain. In 1994, the American Psychological Association's fourth edition of the Diagnostic and Statistical Manuel of Mental Disorder (DSM-IX) was revised to acknowledge that mental disorders may have a biological basis. Previously the DSM disorders characterized mental illness ether as being of "functional" or "organic" etiology. Organic disorders were identified as disorders where there was, or could be, impaired brain tissue causing the disorder, and functional identified disorders where the primary causes of the mental disorder was psychological or social factors, or both. However, in the DSM-IX the term organic was removed

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17 *Murphy v. IRS,* 460 F.3d 79, 179-80 (D.C. Cir. 2006), *rev'g* 362 F. Supp. 2d 206 (D.D.C. 2005), *vacated*, 2007-1 U.S.T.C. (CCH) ¶ 50,228 (D.C. Cir. 2006), *case reheard*, 493 F.3d 170 (D.C.) Cir. 2007), *aff'g* 362 F. Supp. 2d 206 (D.D.C. 2005), *reh'g en banc denied*, 2007 U.S. App. LEXIS 22173 (D.C. Cir. Sept. 14, 2007).

18 *Murphy v. IRS*, 460 F.3d at 81.

19 *Murphy v. IRS*, 128 S. Ct. 2050 (Apr. 21, 2008).

20 National Institutes of Health (NIH), *The Science of Mental Illness, available at* http://science.education.nih.gov/supplements/nih5/mental/guide/info-mental-b.htm (last visited Oct. 13, 2009); Nancy C. Andreasen, The Broken Brain: The Biological Revolution in Psychiatry 277 (1984).

21 Nancy C. Andreasen, The Broken Brain: The Biological Revolution in Psychiatry 277 (1984).

22 NIH, *The Science of Mental Illness, available at* http://science.education.nih.gov/supplements/nih5/mental/guide/info-mental-b.htm (last visited Oct. 13, 2009).

23 *See* NIH, http://grants.nih.gov/grants/oer.htm (last visited Dec. 3, 2009). National Institute of Mental Health (NIMH), http://www.nimh.nih.gov/research-funding/grants/index.shtml (last visited Dec. 3, 2009). NIH and NIMH, both federal agencies, distribute grants to research institutions to conduct research on a number of mental health issues.

because it incorrectly implied that other disorders did not have a biological basis.[24] This change demonstrates that many members of the mental health profession acknowledge the biological cause of mental disorders.

Additionally, in the same way that a physical injury or sickness may have emotional side effects, mental anguish may have physical symptoms, such as fatigue.[25] In fact, many mental illnesses manifest themselves as physical symptoms. For instance, many people who have severe depression experience the following physical symptoms: stomach aches, indigestion, constant headaches, tightness in the chest, and difficulty breathing.[26] Physical symptoms occur in other mental disorders, such as Post-Traumatic Stress Disorder (PTSD), which affects people who have experienced a traumatic event like a violent crime, harassment, or a natural disaster. A person who suffers from PTSD may have ongoing physical symptoms such as a racing heart or sweating.[27] It is now widely accepted in the mental health profession that many mental disorders show up in the form of physical symptoms.

Disparate treatment of similarly-situated taxpayers

Although it is becoming increasingly accepted in the medical community that mental illness is caused by physical changes in the body and produces physical symptoms – effectively blurring the line between physical and mental suffering – the law continues to treat taxpayers differently according to their illness. Damages received on account of mental anguish, stemming from a physical injury or sickness under a tort or tort-type claim, are excludible from gross income. However, damages received on account of mental anguish stemming from a "non-physical" injury, still under a tort or tort-type claim such as a discrimination claim, are not excludible even though the mental anguish itself is widely viewed as a physical sickness often manifesting itself in physical symptoms. Treating taxpayers differently based on their type of sickness results in inconsistent application of the law. At least one litigant has questioned whether the distinction is constitutional under the equal protection clause.[28]

Not only does this law treat similarly situated taxpayers differently, but it also seems to conflict with Congress's intent and public policy motives in other legislation. For instance, the Civil Rights Act of 1991 authorizes the recovery of compensatory damages.[29] When

24 Arben, Philip D., *Are Mental Illnesses Biological Diseases? Some Public Policy Implications*, Health & Social Work; Vol. 21, Issue 1, 66 (Feb. 1996).

25 NIH, *The Science of Mental Illness, available at* http://science.education.nih.gov/supplements/nih5/mental/guide/info-mental-b.htm (last visited Oct. 13, 2009).

26 NIMH, http://www.nimh.nih.gov/health/topics/depression/men-and-depression/signs-and-symptoms-of-depression/persistent-physical-symptoms.shtml (last visited Dec. 3, 2009).

27 NIMH, http://www.nimh.nih.gov/health/publications/post-traumatic-stress-disorder-ptsd/what-are-the-symptoms-of-ptsd.shtml (last visited Dec. 3, 2009).

28 The plaintiff asserted that the distinction in IRC § 104(a)(2) between physical injury or sickness or non-physical injury or sickness for purposes of determining gross income was unconstitutional because it violated the equal protection clause of the Fifth Amendment. The court held the statute had to have only a rational basis because it did not "interfere with the exercise of a fundamental right, such as freedom of speech, or employ a suspect classification, such as race[.]" Therefore, the distinction in the statute was deemed constitutional because it bore a rational relationship to a legitimate government purpose. *Young v. U.S.*, 332 F.3d 893 (6th Cir. 2003) (quoting *Regan v. Taxation with Representation of Washington,* 461 U.S. 540, 547(1983)).

29 Discrimination on the basis of race, sex, and national origin are covered under this Act. H.R. Rep. No. 102-40, pt. 1, 64-65 (1991).

the Act was passed, these damages were believed to be nontaxable and were intended to make the injured plaintiff "whole." However, when Congress amended IRC § 104(a)(2) in 1996, the award for these injuries became taxable and thereby ceased to make the plaintiff "whole." Moreover, as noted above, mental health parity legislation passed last year reflects Congress's recent desire to ensure that mental suffering is treated on a par with physical suffering.

Ease of administration

The 1996 change in law has led to continuous litigation, ongoing confusion surrounding the issue, and creative structuring of settlement agreements by taxpayers' lawyers. Over the past six years, the National Taxpayer Advocate has identified 83 cases litigating the IRC § 104(a)(2) issue.[30] The different treatment of taxpayers under the law continues to confuse taxpayers and drains IRS and judicial resources. The complexity of the current law creates another inequity, as represented taxpayers can have their attorneys structure a settlement agreement to comply with the law and minimize the tax consequences, often making the settlement agreements more complicated in the process. *Pro se* taxpayers (taxpayers representing themselves) may not be aware of this approach and are more likely to get entangled in the complexity and receive less beneficial tax treatment.[31]

EXPLANATION OF RECOMMENDATION

Since the amendment of IRC § 104(a)(2) in 1996, the scientific and medical community has demonstrated that mental illnesses can have associated physical symptoms. Accordingly, conditions like depression or anxiety are a physical injury or sickness and damages and payments received on account of this sickness should be excluded from income. Including these damages in gross income ignores the physical manifestations of mental anguish, emotional distress, and pain and suffering. Failure to recognize the physical causes and consequences of these conditions results in disparate treatment of taxpayers. Further, as illustrated by the number of cases litigated on the issue, it leads to taxpayer confusion as to when and when not to exclude these damages from gross income. Taxpayers in similar situations should be treated equally under the tax code, for the purposes of fairness and ease of administration of tax law.

30 *See* Most Litigated Issue: *Gross Income Under Internal Revenue Code Section 61 and Related Sections, infra*; National Taxpayer Advocate 2008 Annual Report to Congress 470; National Taxpayer Advocate 2007 Annual Report to Congress 582; National Taxpayer Advocate 2006 Annual Report to Congress 575; National Taxpayer Advocate 2005 Annual Report to Congress 488; National Taxpayer Advocate 2004 Annual Report to Congress 512. The cases reported in the National Taxpayer Advocate's Annual Report to Congress identify only federally-litigated cases; cases that are settled at any point are not reported.

31 *See* Most Litigated Issue: *Gross Income Under Internal Revenue Code Section 61 and Related Sections, infra.*

LR #4 Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens

PROBLEM

The Internal Revenue Code (IRC) authorizes the IRS to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes to protect the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders.[1] However, the filing of an NFTL can significantly harm the taxpayer's credit and thus negatively affect his or her ability to obtain financing, find or retain a job, secure affordable housing or insurance, and ultimately pay the outstanding tax debt.[2] Consequently, the imprudent filing of an NFTL has the potential to badly damage the financial welfare of the taxpayer and the taxpayer's family and simultaneously reduce federal revenue.

For these reasons, the IRS should not automatically file NFTLs but instead should carefully consider and balance these competing interests before determining that filing an NFTL is the appropriate next action. Yet under current procedures, the IRS files many NFTLs systemically, pursuant to "business rules" that require automatic lien filing without substantive human review.[3]

In addition, while limiting the reporting of "paid tax liens" to seven years from the date of payment, the Fair Credit Reporting Act (FCRA)[4] does not specifically address the reporting of unpaid tax liens or lien events contemplated by the IRC, such as lien withdrawals,[5] lien releases,[6] lien discharges,[7] and self-releasing[8] or erroneous liens.[9] As a result, inconsistent treatment of different tax lien events by consumer reporting agencies may create unnecessary financial distress for taxpayers affected by NFTLs, without achieving the intended public policy effect: to provide creditors with information about the taxpayer's potential credit risk. Moreover, the current NFTL reporting structure does not adequately reflect the government's overriding and compelling interest in ensuring taxpayers' future tax compliance.

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1 IRC §§ 6321, 6322, and 6323(a).

2 *See* Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers, supra.*

3 *Id.*

4 The Fair Credit Reporting Act (FCRA), § 605(a)(3), 15 U.S.C. § 1681c(a)(3). *See also* Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the Fair Credit Reporting Act, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be notated on the credit report but does not necessarily impact the credit score in a significant way.

5 IRC § 6323(j)(1).

6 IRC § 6325(a).

7 IRC § 6325(b).

8 Internal Revenue Manual (IRM) 5.19.12.2.7.4 (Dec. 16, 2008).

9 *See, e.g.*, IRC § 6326(b).

EXAMPLE

The taxpayer, a small construction business, incurred a payroll tax liability of about $5,500 as a result of embezzlement by the firm's payroll service company, against which the IRS Criminal Investigation (CI) function opened an investigation. Although the taxpayer timely paid the required employment taxes to the payroll service company, the company failed to make the required employment tax deposits to the IRS. As soon as the taxpayer became aware of the delinquency, it asked the IRS to abate the penalties and accept an offer in compromise (OIC). Following IRS business rules for liability of $5,000 or more, however, the revenue officer filed a lien against the taxpayer.[10] As a result, the factoring company[11] terminated the taxpayer's factoring agreement, which impaired the taxpayer's ability to maintain its business operations.[12] The IRS eventually accepted the OIC and released the lien,[13] but it still remained on the construction firm's credit report for seven years from the date of payment. The taxpayer's credit score dropped by almost 100 points and lenders began charging extra fees and higher interest rates. The existence of the lien on the taxpayer's credit report resulted in the taxpayer paying three times the amount of the tax debt in higher interest rates and extra fees.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress:

1. Amend the Internal Revenue Code to:
   - a) Require that prior to filing an NFTL, the IRS must review the taxpayer's information (including IRS and available third party information) concerning the taxpayer's assets, income, and the value of the equity in the assets; and make a determination, weighing all facts and circumstances, that (1) the NFTL will attach to property, and (2) that the benefit to the government of the NFTL filing outweighs the harm to the taxpayer and that the NFTL filing will not jeopardize the taxpayer's ability to comply with the tax laws in the future.
   - b) Allow a taxpayer to appeal any lien filing determination to the IRS Office of Appeals before the NFTL is filed. The IRS must notify taxpayers of their right to have an appeals officer review an NFTL determination.[14]
   - c) Explicitly provide under IRC § 7432 for civil damages for improper NFTL filing or failure to make the required NFTL determination described above.

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10 *See* IRM 5.12.2.4 (Oct. 30, 2009); IRM 5.19.4.5.2 (Apr. 26, 2006).

11 Factoring companies provide financing to businesses under the collateral of accounts receivable.

12 *See, e.g.*, GMAC Factoring Agreement, *at* http://contracts.onecle.com/arbinet/gmac.factor.2003.02.01.shtml (last visited Oct. 9, 2009). *See also* CTG Financial, Inc. Factoring Agreement, *at* www.ctgfinancial.com/pdf/Factoring_Contract%20_3_20_09.pdf (last visited Oct. 9, 2009).

13 The IRM allows release of liens when the underlying tax liability is paid in full, the IRS accepts an OIC, abated the tax, penalties or interest, or the statute of limitations on collection has expired. IRM 5.19.12.2.7 (Dec. 16, 2008).

14 Similar to IRC §§ 6159(e) and 7122(e).

d) Clarify that under IRC § 7433, a taxpayer may bring an action for improper lien filing or failure to make the required lien determination described above.

2. Amend § 605(a)(3) of the Fair Credit Reporting Act to:

a) Require removal of derogatory lien filing information from credit reports six years from the "refile by" date on the lien unless the lien is refiled.[15]

b) Require immediate removal of derogatory lien filing information from credit reports if the lien is released within two years from the date of filing.

c) Require removal of derogatory lien filing information from credit reports within two years from the date of release if released more than two years from the date of the NFTL filing.

d) Require immediate removal of all information about the NFTL filing if the IRS withdraws such a notice under IRC § 6323(j).

PRESENT LAW

A federal tax lien (FTL) arises when the IRS assesses a tax liability, sends the taxpayer notice and demand for payment, and the taxpayer does not fully pay the debt within ten days of the notice and demand.[16] An FTL is effective as of the date of assessment and attaches to all of the taxpayer's property and rights to property, whether real or personal, including those acquired by the taxpayer after that date.[17] This lien continues against the taxpayer's property until the liability either has been fully paid or is legally unenforceable.[18] This statutory lien is sometimes called the "secret" lien, because third parties – and usually the taxpayer – have no knowledge of the existence of this lien or the underlying tax debt.[19] To put third parties on notice and establish the priority of the government's interest in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders, the IRS must file an NFTL in the appropriate location, such as a county register of deeds.[20] It is IRS policy not to use the NFTL as a negotiating tool.[21] The IRS is required to release a lien not later than 30 days after the underlying liability either is fully satisfied through full payment of tax or is legally unenforceable (typically, by expiration of the statutory period for collecting the tax).[22] Once the certificate of release is issued and filed in the same office

15 Most adverse items cannot remain on the credit report for more than seven years. Even Title 11 bankruptcies cannot antedate the report by more than ten years. 15 U.S.C. § 1681c(a). For example, in California, all liens, released and open, are removed from credit histories ten years after the filing date. Cal. Civ. Code § 1785.13(d).

16 IRC §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed. IRC § 6303 provides that within 60 days of the assessment the IRS must provide notice and demand for payment to any taxpayer liable for an unpaid tax.

17 *See* IRC § 6321; IRM 5.12.2.2 (May 20, 2005).

18 IRC § 6322.

19 IRC § 6321.

20 IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.2.8 (Oct. 30, 2009).

21 IRM 5.12.2.1 (May 20, 2005).

22 IRC § 6325(a)(1).

as the related NFTL, the tax lien is conclusively extinguished.[23] Under certain circumstances, the IRS may withdraw an NFTL, in which case the provisions of "this chapter [chapter 64 of subtitle F, relating to collection] shall be applied as if the withdrawn notice had not been filed."[24]

Current law does not require that the IRS make any inquiry into whether the lien is appropriate or will protect the government's interest prior to the NFTL being filed, nor does it specifically provide for pre-filing administrative review of NFTL determinations by the IRS Office of Appeals.[25]

Section 7432 allows a taxpayer to seek monetary damages in United States District Court in connection with the IRS's failure to release a lien under IRC § 6325 if an IRS employee knowingly or by reason of negligence fails to release a lien on the property of a taxpayer.[26] Under IRC § 7433, a taxpayer may also seek monetary damages in U.S. District Court in connection with the collection of federal tax if an IRS employee recklessly or intentionally, or by reason of negligence, disregarded any provision of the Code or IRS regulations.[27]

The FCRA provides that the period for reporting "paid tax liens" is seven years from the date of payment.[28] However, it does not address the reporting period for unpaid tax liens or lien events contemplated by the IRC, such as lien withdrawals,[29] lien releases,[30] lien discharges,[31] and self-releasing[32] or erroneous liens.[33]

REASONS FOR CHANGE

As noted above, an NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders when past due taxes are owed.[34] The NFTL filing and the information contained on the notice are

23 IRC § 6325(f).

24 IRC 6323(j)(1). An NFTL may be withdrawn if the lien was filed prematurely or not in accordance with IRS procedures, the taxpayer entered into an installment agreement that did not by its terms require the filing of a lien, the withdrawal will facilitate collection, or the withdrawal is in the best interests of both the taxpayer (as determined by the National Taxpayer Advocate) and the government.

25 *Cf., e.g.*, IRC §§ 6159(e) and 7122(e), specifically providing for independent administrative review of IRS's adverse actions regarding OICs and IAs by the IRS Office of Appeals.

26 *See generally* IRC § 7432.

27 *See generally* IRC § 7433.

28 FCRA, § 605(a)(3), 15 U.S.C. § 1681c(a)(3). *See also* Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the Fair Credit Reporting Act, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be notated on the credit report but does not necessarily impact the credit score in a significant way.

29 IRC § 6323(j)(1).

30 IRC § 6325(a).

31 IRC § 6325(b).

32 IRM 5.19.12.2.7.4 (Dec. 16, 2008).

33 *See, e.g.*, IRC § 6326(b).

34 IRC §§ 6321 and 6323.

included in consumer (credit) reports[35] and therefore may impair a taxpayer's ability to obtain financing, find or keep a job, and secure affordable housing or insurance.[36] When a taxpayer has little or no ability to pay and has no assets from which to collect, an NFTL filing may further impede the taxpayer's financial viability and ultimately can undermine tax revenue and future compliance. In addition, the government has a secondary interest at stake. If the NFTL badly damages the taxpayer and the taxpayer's family by driving up the taxpayer's costs or renders him or her unemployed or underemployed, the government may be forced to provide a social safety net in the form of unemployment benefits, food stamps, and the like, thus increasing societal cost and raising everyone's share of taxes.

However, current law does not require the IRS to verify the existence or the value of the taxpayer's property before filing an NFTL, nor does it require determining whether the taxpayer is likely to acquire assets in the future. Moreover, IRS business rules require or incentivize automatic lien filing after a simple verification that the amount due is correct.[37] For example, in fiscal year (FY) 2009, the IRS filed about 51 percent of all liens via its Automated Collection System (ACS).[38] Of the NFTL requests that ACS tracks, 61.7 percent were systemic (*i.e.*, IRS systems both made lien filing determinations and filed the liens without the IRS first inquiring whether the taxpayer has any assets, or is likely to acquire assets, to which a lien could attach).[39]

In its response to the Most Serious Problem, *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers,* herein, the IRS insists that filing an NFTL is a necessity in all cases because it increases compliance and results in more revenue. The IRS's own data suggest otherwise. Over the past decade, the IRS has increased its lien filings by nearly 475 percent – from about

35 The term "consumer report" is defined in the FCRA, § 603(d), 15 U.S.C. § 1681a(d). Hereinafter, we will use the more commonly used term "credit report." On average, the filing of an NFTL reduces a taxpayer's credit score by 100 points. Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

36 *See* Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of Law, Fail to Promote Future Tax Compliance and Unnecessarily Harm Taxpayers, supra.* TAS teleconferences with the major consumer reporting agencies (CRAs) – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009). *See also* IRS Pub. 594, *What You Should Know About the IRS Collection Process* (Jan. 2006) (recognizing the taxpayer may not be able to get a loan to buy a house or a car, get a new credit card, or sign a lease as result of the NFTL filing).

37 IRM 5.19.4.6.4(1) (Oct. 26, 2007); IRM 5.19.4.5.2 (Apr. 26, 2006); IRM 5.19.4.5.1(7) & (8) (Dec. 22, 2005); IRM 5.19.5.5.7(3) (Feb. 23, 2009). For example, when the account is in currently not collectible (CNC) status, the lien should be filed for any unpaid balance of $5,000 or more and the IRS is unable to locate or contact the taxpayer, or the taxpayer is experiencing an economic hardship. IRM 5.12.2.4.1(1) (Oct. 31, 2009); IRM 5.19.4.5.2 (Apr. 26, 2006).

38 IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009). Of the 965,618 NFTLs filed in FY 2009, 491,822 were filed by ACS.

39 ACS, *Customer Service Activity Reports (CSAR), FY 2009 BOD report. See also* IRS response to TAS research request (Oct. 30, 2009). ACS systemic programming retrieves cases with expired follow-ups in R7 (accounts with a 25-day follow-up where the system generated an LT39, *Reminder Notice*), determines whether the aggregate assessed balance is greater than $5,000, and determines whether there are any modules without a lien. If all three of these criteria are met, the system generates a history code FM10 on the account. The input of the FM10 sends a message to the Automated Lien System to file an NFTL against the taxpayer. When conditions exist that would allow for manual lien filing, the systemic program can also generate a lien. E-mail from IRS subject matter expert (Nov. 2, 2009); IRS response (Nov. 19, 2009). *See also* IRM 5.19.5.3.7, *Reminder Notices* (Dec. 1, 2007); IRM 5.19.5.5.7, *R7 – Lien Determinations (Follow-Up to LT39)* (May 29, 2008).

168,000 in FY 1999 to nearly 966,000 in FY 2009.[40] Yet overall inflation-adjusted Collection revenue has declined by approximately 7.4 percent during this period.[41] Sound tax administration requires a careful, case-by-case analysis of a taxpayer's specific facts and circumstances. It does not mean an arbitrary, automatic decision to file an NFTL without consideration of the existence of assets and the likelihood that the taxpayer will acquire assets during the remaining statutory period for collection.

Thus, there is a vital need for a clear, explicit statutory provision specifying the factors the IRS must consider while making lien filing determinations. Taxpayers should also be able to have a statutory right to review by the IRS Office of Appeals of these lien filing determinations before the NFTL is filed. Although taxpayers can currently apply for a truncated review of a proposed lien filing by filing an appeal with the IRS Office of Appeals under the IRS Collection Appeal Program (CAP), such a review is very narrow and does not take into consideration the factors to be included in the proposed lien determination process.[42] The National Taxpayer Advocate believes that the IRS should be statutorily bound to provide taxpayers with a meaningful review of NFTL filing determinations as opposed to the current *pro forma* review. A proposed statutory administrative appeal process would not increase the IRS Office of Appeals workload since it currently handles CAP appeal requests in an expedited timeframe of five work days.[43]

To provide relief to taxpayers harmed by improper lien filing or the IRS's failure to make the required lien filing determination, Congress should amend IRC § 7432 to allow taxpayers to bring a civil action for damages in connection with the IRS's negligent violation of the proposed NFTL determination and administrative review provisions. Additionally, although IRC § 7433 and regulations thereunder provide for civil action for damages "in connection with any collection of federal tax," including when an IRS officer or employee recklessly or intentionally, or by the reason of negligence disregards "any provision of the [Internal Revenue Code], or any regulation" thereunder,[44] IRC § 7433 should be amended to clarify that a civil action may be brought for violation of NFTL provisions of the IRC, including economic damages for reckless or intentional actions which are capped at

40 IRS, *Statistics of Income (SOI) Data Books, Table 16, Delinquent Collection Activities, 1999-2008*; IRS, Collection Activity Report NO-5000-C23, *Collection Workload Indicators Reports* (Oct. 13, 2009). *See also* SB/SE response to TAS research request (Nov. 13, 2009). In FY 2009, the IRS filed 965,618 NFTLs.

41 IRS, *SOI Data Books, Table 16, Delinquent Collection Activities, 1999-2008*. SB/SE response to TAS research request (Nov. 13, 2009). The SOI data is not available for FY 2009. For a more detailed discussion of IRS Collection data, see *Preface: Introductory Comments of the National Taxpayer Advocate, supra.*

42 Under CAP, a taxpayer can generally appeal denied requests to withdraw a NFTL filing and denied discharges, subordinations, and nonattachments of lien, third party claims to property, and alter ego and nominee liens before or after an NFTL is filed. IRM 8.24.1.2 (Oct. 16, 2007).

43 IRS Office of Appeals generally resolves CAP cases within five business days unless there are case complexities that require more time for quality case consideration. Appeals also attempts to hold a conference with the taxpayer within two days of receipt of the case. IRM 5.1.9.4.2 (Mar. 22, 2001).

44 For example, in *Sande v. United States*, 323 Fed. Appx. 812 (11th Cir. 2009), the United States Court of Appeals for the Eleventh Circuit found that the act of filing an NFTL was actionable under IRC § 7433 so long as the taxpayer alleged that the IRS failed to follow the proper procedures in either the IRC or Treasury regulations with respect to the filing of the lien notice. The government also took the position that IRC Chapter 64, "Collection," "deal[ing] with payment and collection of taxes owed, including enforced *collection by lien* or levy," is generally actionable under IRC § 7433. *Sande v. U.S.*, 2009 WL 1258588 (Appellate Brief for the Appellee (11th Cir. 2009). *See also* IRC §§ 7433; 6301-6344.

$1 million.[45] Section 7433 should specifically indicate that it provides relief for reckless, intentional, or negligent disregard of the proposed lien filing determination and administrative review provisions of the Code.

The FCRA[46] does not address the reporting of unpaid tax liens or lien events contemplated by the IRC, such as lien withdrawals, releases, and discharges; and self-releasing, or erroneous liens. For example, most NFTLs are self-releasing,[47] *i.e.,* the notice indicates that unless the IRS refiles it by the listed date, the notice operates as a certificate of release under IRC § 6325(a).[48] However, IRC § 6325(a) does not only address cases where the tax liability was fully paid off. It also provides for a release of liens because the underlying liability became legally unenforceable or the IRS accepted a bond.[49] However, the FCRA covers only "paid" tax liens. As a result, an unpaid tax lien may remain on the taxpayer's credit report indefinitely, even when the underlying lien becomes unenforceable (*e.g.*, because the statute of limitations for collection has expired) and the lien self-releases.[50] Another example of inconsistent treatment of tax lien events is the difference between a "lien withdrawal" and a "lien release." When consumer reporting agencies receive a notice of a "withdrawal" of a lien, they delete any references to the tax lien from the taxpayer's credit report.[51] The agencies also delete the lien from the report when the IRS issues a letter of apology.[52] In contrast, a "released" lien typically remains on the report for seven years from the date of the release.[53]

Although there is a public policy reason that the creditors have a right to know whether a particular taxpayer poses a credit risk at the time of making credit decisions, the government has a powerful and in most cases overriding interest in taxpayers being able to pay taxes. In addition, the creditors currently have no knowledge of the credit risk posed by

45 *See* IRC § 7433(b); Treas. Reg. §§ 301.7433-1 and 301.7433-2.

46 FCRA, § 605(a)(3), 15 U.S.C. § 1681c(a)(3). *See also* Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the Fair Credit Reporting Act, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be notated on the credit report but does not necessarily impact the credit score in a significant way.

47 Self-releasing liens are liens that do not have a release issued systemically. These are liens in which the statutory period for refiling for each module on the lien has expired and no refile was filed. IRM 5.19.12.2.7.4 (Dec. 16, 2008).

48 Form 668(Y)(C), *Notice of Federal Tax Lien* (Oct. 1999), contains the following statement: "IMPORTANT RELEASE INFORMATION: With respect to each assessment listed below, unless notice of lien is refiled by the date given in column (e), this notice shall, on the day following such date, operate as a certificate of release as defined in IRC 6325(a)."

49 IRC § 6325(a).

50 As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years and Equifax for ten years, while Transunion credit reports reflect them indefinitely. Self-releasing liens are generally reported for ten years after the filing date unless the lien is refiled by the IRS. California requires that all liens, released and open, be removed from credit histories ten years after the filing date. *See* Cal. Civ. Code § 1785.13(d).

51 TAS teleconferences with the major CRAs – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009). IRC § 6323(j)(1) provides "this chapter [chapter 64 of subtitle F, relating to collection] shall be applied as if the withdrawn notice had not been filed." *See also* Treas. Reg. § 301.6323(j)-1(a). The IRS should promptly notify credit reporting agencies and financial institutions or creditors identified by the taxpayer of the withdrawal of the notice upon a written request. IRC § 6323(j)(2).

52 TAS teleconferences with the major consumer reporting agencies (CRAs) – Experian (Oct. 1, 2009), Equifax (Sept. 1, 2009), and Transunion (Sept. 3, 2009). *See also* IRS Letter 544.

53 FCRA § 605(a)(3), 15 U.S.C. § 1681c(a)(3). At the same time, the FCRA limits reporting of Title 11 bankruptcies to ten years from the date of discharge and civil judgments to the longer of seven years from the date of adjudication or until the expiration date of the statute of limitations. FCRA, § 605(a)(1) and (2), 15 U.S.C. § 1681c(a)(1) and (2).

taxpayers who have an outstanding tax liability, have no NFTL filed, but have a "secret" lien in place.[54] Both creditors and the general public will benefit from the regulation of lien reporting practices consistent with lien events contemplated by the IRC.

EXPLANATION OF RECOMMENDATIONS

The difference between the statutory or the "secret" lien and the NFTL is significant and is not well understood. Third parties – and usually the taxpayer – have no knowledge of the existence of the "secret" lien or the underlying tax debt, and the taxpayer may not understand the significance of this statutory lien. However, when the IRS files an NFTL in the appropriate location, such as a county register of deeds, the public filing of the underlying tax lien may unnecessarily harm the taxpayer and the taxpayer's credit record for many years.

These legislative recommendations will give the IRS clear and specific guidance about the factors it must consider when making NFTL filing determinations. The recommendations will provide for administrative review of IRS lien determinations by the Office of Appeals, similar to the offer-in-compromise and installment agreement provisions under IRC §§ 6159(e) and 7122(e).[55]

The proposal to allow taxpayers to bring civil actions for damages in connection with improper NFTL filing, or the IRS's failure to make the required NFTL determinations under both IRC § 7432 and IRC § 7433, will provide the taxpayer with further remedies if an IRS employee does not follow the lien filing procedures required by law.

The legislative recommendations regarding the FCRA will set timeframes for reporting of derogatory tax lien information on taxpayers' credit reports, specific to particular lien events contemplated by the IRC. These recommendations will provide incentives for taxpayers to fully pay the tax liability rather quickly – within two years from the date of NFTL filing. These recommendations will also codify current credit reporting agencies' practices regarding lien "withdrawals."

54 *See generally* IRC § 6321. *See* IRM 5.12.2.2 (May 20, 2005).

55 "Procedures for reviews of rejections of offers-in-compromise and installment agreements.–The Senate amendment requires that the IRS implement procedures to review all proposed IRS rejections of taxpayer offers-in-compromise and requests for installment agreements prior to the rejection being communicated to the taxpayer. The Senate amendment requires the IRS to allow the taxpayer to appeal any rejection of such offer or agreement to the IRS Office of Appeals. The IRS must notify taxpayers of their right to have an appeals officer review a rejected offer-in-compromise on the application form for an offer-in-compromise." Internal Revenue Service Restructuring and Reform Act of 1998, P.L. No. 105-206, H. Rep. No. 105-599, *at* 288 (1998) (Conf. Rep.).

LR #5

Impose Collection Protections on Refund Offsets for EITC Recipients

PROBLEM

The Earned Income Tax Credit (EITC) is a significant federal means-tested anti-poverty program.[1] Yet the complexity involved in claiming this refundable credit can undercut the program's intended purpose by leading well-intentioned taxpayers into financial hardship. Because the EITC is designed to benefit low income taxpayers, many taxpayers whose EITC claims are initially paid and then denied on audit have already spent their refunds. If the taxpayer has no means of paying the tax owed, the IRS will offset future refunds, potentially including the entire EITC portion of these refunds.[2] Thus, the taxpayer could lose 100 percent of the EITC to which he or she would otherwise be entitled in a given year, due to the refund offset to satisfy a previous debt.

EXAMPLE

A taxpayer incorrectly claimed the EITC in Tax Year 1 because she misunderstood the "qualifying child" rules[3] and claimed her son as a "qualifying child" even though he only lived with her after she gained custody in the last three months of the tax year. The IRS audited the return by correspondence and disallowed the EITC for TY 1. The taxpayer continued to file returns after TY 1, correctly claiming her son as a qualifying child since he now lived with her full-time. However, she was unable to pay the balance due for TY 1 and the IRS placed her in "currently not collectible (CNC) – hardship" status.[4] To partially satisfy the accruing liability, the IRS offset her refunds, comprised entirely of the EITC, for TYs 2 and 3, when the taxpayer had expected to use the refunds to pay for basic living expenses.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6402 by adding language to limit the amount of the tax refund attributable to the EITC that the Secretary can offset pursuant to IRC §§ 6402(a) through (e). The provision should prohibit the Secretary from offsetting the refund by more than 15 percent of the portion attributable to the EITC.

1 In tax year (TY) 2007, taxpayers claimed a total of $48.5 billion in EITC benefits on 24.6 million returns. IRS, Statistics of Income, Tax Statistics, Individual Income Tax Returns, Table 4: *Returns with Earned Income Credit, by Size of Adjusted Gross Income, Tax Year 2007*, *available at* http://www.irs.gov/pub/irs-soi/07in04ic.xls (last visited Dec. 10, 2009).

2 Internal Revenue Code (IRC) § 6402(a).

3 IRC §§ 32(c)(3) and 152(c).

4 If a taxpayer is unable to pay his or her tax liability, and collection activity would create a financial hardship, the IRS will consider placing the account in currently not collectible (CNC) status. Internal Revenue Manual (IRM) 5.16.1 (May 5, 2009).

PRESENT LAW

IRC § 32 authorizes the EITC, a refundable income tax credit for low to moderate income working individuals and families. The eligibility determination and the credit calculation are complex, but generally, the amount of the credit is based on the taxpayer's marital status, the amount of reported earned income, and the number of qualifying children claimed by the taxpayer.

IRC § 6402 authorizes the IRS to offset federal income tax refunds to satisfy outstanding delinquent and legally enforceable debts owed to government entities, as follows:[5]

- **Tax Debts.** IRC § 6402(a) authorizes the Secretary to offset federal income tax refunds, including any interest accrued thereon, against a federal tax liability owed by that taxpayer.[6]
- **Past-Due Support Obligations.** IRC § 6402(c) authorizes the Secretary to offset federal income tax refunds against the amount of any past-due support.[7]
- **Nontax Debts Owed to Federal Agencies.** IRC § 6402(d) authorizes the Secretary to offset refunds against the amount of a past-due legally enforceable nontax debt (other than the aforementioned past-due support under IRC § 6402(c)) owed by the taxpayer to a federal agency.[8]
- **State Income Tax Obligations.** IRC § 6402(e) authorizes the Secretary to offset refunds against past-due, legally enforceable state income tax obligations.[9]

REASONS FOR CHANGE

The EITC, a large federal means-tested anti-poverty program,[10] was created in 1975 to benefit low income working families.[11] The refundable credit has been found to substantially decrease poverty, increase employment, and reduce welfare payments to parents. Research

5 For more information on nontax debts subject to administrative offset under the Treasury Offset Program (TOP), see 31 C.F.R. §§ 5.9, 5.10, and 285.12.

6 Treas. Reg. § 301.6402-1.

7 31 C.F.R. § 285.3. Effective January 1, 1999, administration of IRC § 6402(c) was merged into the TOP. The regulations concerning the manner in which Treasury's Financial Management Service will administer the collection of past-due support are in 31 C.F.R. § 285.3 for refunds payable after January 1, 1998. T.D. 8837, 1999-38 I.R.B. 426 (Sept. 20, 1999). Prior to the publication of 31 C.F.R. § 285.3, Treas. Reg. § 301.6402-5 contained the guidance for how the IRS made offsets pursuant to IRC § 6402(c).

8 31 C.F.R. § 285.2. Effective January 1, 1999, administration of IRC § 6402(d) was merged into the TOP. The regulations concerning the manner in which Treasury's Financial Management Service will administer the collection of nontax federal debt are in 31 C.F.R. § 285.2 for refunds payable after January 1,1998. T.D. 8837, 1999-38 I.R.B. 426 (Sept. 20, 1999). Prior to the publication of 31 C.F.R. § 285.2, Treas. Reg. § 301.6402-6 contained the guidance for how the IRS made offsets pursuant to IRC § 6402(d).

9 31 C.F.R. § 285.8.

10 In TY 2007, taxpayers claimed a total of $48.5 billion in EITC benefits on 24.6 million returns. IRS, Statistics of Income, Tax Statistics, Individual Income Tax Returns, Table 4: *Returns with Earned Income Credit, by Size of Adjusted Gross Income, Tax Year 2007, available at* http://www.irs.gov/pub/irs-soi/07in04ic.xls (last visited Dec. 10, 2009).

11 *See* Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (1975).

indicates that families use the refundable credit to pay for necessities, maintain homes, repair vehicles needed to commute to work, and obtain additional education or training.[12]

Despite the legislative intent of the provision to pull working families out of poverty, complex eligibility criteria and credit calculations, coupled with high dollar values, can transform the otherwise beneficial refundable credit into a trap for the unwary. For example, because the EITC is so complex and inadvertent mistakes are common, taxpayers who claim the credit are at least twice as likely to be audited as other taxpayers.[13] Yet, because the EITC is a low income tax benefit, many taxpayers whose EITC claims are initially paid and then denied on examination have already spent their refunds. IRS collection procedures require that a Notice of Federal Tax Lien be filed whenever a taxpayer with a tax debt of $5,000 or more is placed in CNC status.[14] This notice badly damages the taxpayer's credit rating and can result in loss of employment, high interest rates on loans, and denial of housing applications.

The IRS can also offset the full amount of any future federal income tax refunds, including the portions attributable to the EITC, to satisfy both tax and nontax debts owed to the government. The IRS can offset income tax refunds to satisfy federal tax debts pursuant to IRC § 6402(a). Furthermore, the Treasury Offset Program, administered by the Department of Treasury's Financial Management Service, manages the offset of delinquent nontax debts against federal income tax refunds pursuant to IRC §§ 6402(c) through (e), relating to past-due support obligations, debts owed to federal agencies, and state income tax obligations.[15] Thus, either the IRS or FMS can grab the social benefit meant to pull taxpayers out of poverty even though the taxpayer remains low income, is otherwise eligible for the EITC, and is relying on the EITC to pay for necessities. IRS data shows that over 1.3 million TY 2008 returns claiming the EITC were subject to refund offset procedures.[16]

Congress has attempted to protect EITC funds from offset of nonfederal debts. Specifically, Senate bill 324 of the 109th Congress included a provision to amend

12 Robert Greenstein, Executive Director of the Center on Budget and Policy Priorities, *The Earned Income Tax Credit: Boosting Employment, Aiding the Working Poor* (Aug. 17, 2005), *available at* http://www.cbpp.org/cms/index.cfm?fa=archivePage&id=7-19-05eic.htm (last visited Dec. 8, 2009).

13 *See IRS Data Book, 2008*, Table 9a (showing an average audit rate of slightly more than two percent for taxpayers claiming the EITC as opposed to about one percent for taxpayers overall).

14 IRM 5.19.4.5.2(3) (Apr. 26, 2006).

15 The TOP also administers offsets amounting to up to 15 percent of monthly disposable income for Office of Personnel Management annuity payments, 15 percent of monthly disposable income for Social Security Administration payments, and 15 percent of monthly disposable income for non-Department of Defense Federal Salary Offset. Debt Collection Act of 1982, Pub. L. No. 97-365, 96 Stat. 1751 (Oct. 25, 1982), and Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321-358, 1321-369 (Apr. 26, 1996).

16 IRS Compliance Data Warehouse (CDW) IMF Transaction History and Indiv. Returns Transaction Form 1040 tables (filing season statistics through Sept. 2009).

IRC § 32 to protect EITC benefits from offset of debts other than outstanding federal obligations.[17]

Congress has also recognized the need to restrict government and private entities from offsetting Social Security benefits, another social benefit well- known to assist low and moderate income individuals. For example, § 207 of the Social Security Act protects Social Security benefits from assignment, levy, or garnishment with exceptions for the enforcement of debts related to child support, alimony, federal taxes, and nontax debts owed to another federal agency.[18] Furthermore, the levy of Social Security benefits to satisfy federal income tax debts pursuant to the Federal Payment Levy Program (FPLP) is limited to 15 percent of the monthly benefit, and the IRS has recently agreed to screen out low income individuals from such levies.[19]

Finally, Congress has already provided a mechanism to protect payments made pursuant to means-tested programs in the provisions governing federal administrative offsets. Chapter 37 of Title 31 of the United States Code provides the authority for collection of claims owed to the United States. For debts other than those related to taxes, Social Security benefits, and tariffs, 31 U.S.C. § 3716(c)(3)(B) authorizes the Secretary of Treasury to exempt from administrative offset certain payments made under means-tested programs upon the written request of the head of the payment certifying agency.[20] Upon making the exemption determination, the Secretary is directed to "give due consideration to whether administrative offset would tend to interfere substantially with or defeat the purposes of the payment certifying agency's program."[21]

17 Taxpayer Abuse Prevention Act, S. 324,109th Cong. § 2 (Feb. 9, 2005). Section 2(a) of the bill proposed to amend IRC § 32 by adding the following new subsection:

> (n) Prevention of Diversion of Credit Benefits- The right of any individual to any future payment of the credit under this section shall not be transferable or assignable, at law or in equity, and such right or any moneys paid or payable under this section shall not be subject to any execution, levy, attachment, garnishment, offset, or other legal process except for any outstanding Federal obligation. Any waiver of the protections of this subsection shall be deemed null, void, and of no effect.

18 Section 207 of the Social Security Act was codified at 42 U.S.C. § 407(a), which provides the general rule that Social Security benefits are not subject to assignment, levy, or garnishment. 42 U.S.C. § 659 provides an exception to the general rule, and allows Social Security benefits to be garnished to enforce child support or alimony obligations. IRC § 6334(c) allows the IRS to levy benefits to collect unpaid federal taxes. IRC § 3402(P) allows beneficiaries to elect to have a percentage of their benefits withheld and paid to the IRS to satisfy their federal income tax liability for the current year. The Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321-358 (Apr. 26, 1996), allows Social Security benefits to be withheld and paid to another Federal agency to pay a nontax debt the beneficiary owes to that agency. *See also* http://www.ssa.gov/deposit/DDFAQ898.htm (last visited Dec. 23, 2009).

19 Section 1024 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788, 923 (Aug. 5, 1997) added IRC § 6331(h), which authorizes the IRS to collect overdue federal tax debts of Social Security beneficiaries by continually levying up to 15 percent of each monthly payment until the debt is paid. For purposes of this program, low income individuals are those whose incomes do not exceed 250 percent of the federal poverty level. *See Federal Payment Levy Program: IRS Agrees to Low Income Taxpayer Filter, supra*. In addition, for an in-depth analysis of these levies on low income taxpayers, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2 45-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program);* Legislative Recommendation: *Apply Uniform Limits and Extensions to Levy Actions on Social Security Benefits, supra.*

20 *See also* 31 C.F.R. § 901.3(b)(6). The administrative offset provisions of 31 U.S.C. § 3716 do not apply to debts payable under the IRC (Title 26), Social Security Act (42 U.S.C. § 301 et seq.), or U.S. tariff laws. 31 U.S.C. § 3701(d).

21 31 U.S.C. § 3716(c)(3)(B).

EXPLANATION OF RECOMMENDATION

The United Kingdom (UK) has enacted protections to prevent the government from offsetting tax refunds attributable to certain tax credits. Rather than have a large credit like the EITC, the UK broke the credit into component parts – the Working Tax Credit and the Child Tax Credit.[22] Her Majesty's Revenue and Customs is generally restricted in the amount it can offset a credit to satisfy a previous year tax debt, with exception. Specifically, if HMRC determines that a taxpayer overclaimed a tax credit in a previous year that is still open for examination, the agency will collect the overpayment by reducing the claimant's payment for the current year, subject to the following limits:

- Ten percent for claimants receiving the maximum award;
- One hundred percent for claimants receiving only the family element of the Child Tax Credit (CTC); and
- Twenty-five percent for all other claimants.[23]

Thus, the UK placed a low ten percent offset limit on taxpayers presumably in most need of the credit proceeds – those claiming the maximum amount of credit. It seems the UK raised the allowable offset percentage as the perceived need for such funds decreased.

The National Taxpayer Advocate recommends that, like the UK, Congress should limit the amount of the current year federal income tax refund attributable to EITC that the IRS can offset to satisfy a governmental debt pursuant to the provisions of IRC § 6402. Specifically, Congress should prohibit the Treasury Department from offsetting more than 15 percent of the portion of the refund attributable to the EITC. The amounts and approach of the proposed limitation are different than those of the UK, which set graduated levels with the default limit set at 25 percent. However, graduated levels would confuse taxpayers and create an administrative burden on the IRS. Further, Congress has already determined the 15 percent limit to be an appropriate limitation for Social Security payments in the FPLP program. In fact, the EITC population is analogous to the population receiving Social

22 For more information on the tax credits in the UK, see Her Majesty's Revenue & Customs, *Tax Credits*, http://www.hmrc.gov.uk/taxcredits/index.htm (last visited July 28, 2009). The National Taxpayer Advocate has recommended a similar approach to reforming all of the family status provisions in the Internal Revenue Code. *See* National Taxpayer Advocate 2008 Annual Report to Congress 363-369 (Legislative Recommendation: *Simplify the Family Status Provisions*).

23 *See HM Revenue and Customs, Tax Bulletin Issue 74, available at* http://www.hmrc.gov.uk/bulletins/tbissue74.htm (last visited Oct. 12, 2009). The family element of the CTC is made up of the three elements: (1) the family element, (2) the child element, and (3) the disability element. The family element is a basic element for families responsible for one or more children. A higher rate of family element, often known as the baby element, is paid to families with one or more children under one year old. There is only one family element for each family, regardless of how many children usually live with the taxpayer. *See* http://taxcredits.hmrc.gov.uk/ntchelp/helppane.aspx?H_VER=1.7&helpTopic=Glossarychildtaxcredit&helpType=undefined&v1=http%3A//taxcredits.hmrc.gov.uk&v2=&tmt=_12603685197810.303337239697248 (last visited Dec. 9, 2009).

Security benefits.[24] Thus, the 15 percent limitation deemed appropriate for FPLP is equally appropriate in refund offsets of EITC proceeds.

Congress should initially limit the offset restrictions to the portion of federal income tax refunds attributable to EITC funds. As Congress increasingly utilizes the IRC to deliver social benefits to low income individuals, the issues regarding refund offsets will apply to other refundable credits.[25] Once the IRS has successfully implemented the offset restrictions for EITC funds, with a carefully designed research plan to track the impact of such protections on EITC recipients, it can protect other means-tested benefits, if appropriate. If the program limiting EITC offsets is deemed successful, Congress should amend IRC § 6402 to apply the refund offset protections to any other existing or future means-tested tax benefits. In the alternative, Congress could authorize the Secretary of the Treasury to apply restrictions on offset in a manner similar to the protections afforded in the administrative offset provisions in 31 U.S.C § 3716(c)(3)(B). Accordingly, the Secretary would have the authority to apply such restrictions on offset to certain payments made under means-tested programs after giving due consideration to whether a refund offset would substantially defeat the legislative purpose of the means-tested benefit.

24 To illustrate the similarity in the two populations, the average adjusted gross income (AGI) for EITC taxpayers for TY 2008 was $16,343.45. Individual Returns Transaction File Tax Year 2008 (includes returns processed through the 39th week of 2009). The median income for nonmarried persons ages 65 or older was $15,858 in 2007. Social Security Administration, *Fast Facts & Figures About Social Security,* 2009 at 4 (July 2009). We acknowledge that the EITC income is based on family units and the Social Security data is based on individuals, but believe that the data shows similar income levels and need for protection.

25 *See Volume 2: Running Social Programs Through the Code, infra.*

LR #6

Apply Uniform Limits and Extensions to Levy Actions on Social Security Benefits

PROBLEM

A levy is a legal seizure of property to satisfy a tax debt.[1] The IRS levy is a fundamental component of tax enforcement. If a taxpayer does not pay a tax liability in full or otherwise come to an agreement to resolve the matter, the IRS may levy against any property (or rights to property) belonging to the taxpayer or subject to a federal tax lien, unless it is exempt.[2]

The IRS interprets current law as permitting levy of Social Security benefits by either issuing a paper levy on Form 668-W, *Notice of Levy on Wages, Salary, and Other Income*, to the Social Security Administration (SSA), for up to 100 percent of the taxpayer's stream of payments (less any exemptions), or a levy to the Department of Treasury's Financial Management Service (FMS) to receive 15 percent of the benefits through the Federal Payment Levy Program (FPLP) (without an exemption under IRC § 6334(a)(9)).[3] Social Security provides at least half of the total income for 64 percent of beneficiaries aged 65 or over, and provides *90 percent or more* of total income for 35 percent of these beneficiaries.[4] These facts alone mandate that the IRS be circumspect when issuing levies on Social Security benefits. Taxpayers whose incomes are at or below 250 percent of the poverty level may suffer economic hardship due to FPLP levies, according to TAS research.[5] At the urging of the National Taxpayer Advocate, the IRS has plans to implement a filter to exclude low income taxpayers from the FPLP but such filter is not required by law.[6] Current law still provides insufficient protections and clarity for Social Security beneficiaries with tax liabilities. The current rules regarding levy actions against Social Security benefits are leading to disparate treatment among similarly situated taxpayers.

The IRS generally has ten years from the date of the assessment to collect the tax by levy.[7] However, in practice, the IRS can collect these payments well after the expiration of the statutory period for collection (the collection statute expiration date or CSED). For example, streams of payments (such as retirement and Social Security benefits, pensions, royalties, bond interest payments, and fixed trust payments) may be seized by a levy that

1 Internal Revenue Code (IRC) § 6331 provides the IRS with statutory authority to levy funds held by a third party.

2 *See* IRC § 6334 for an enumeration of property exempt from levy.

3 Internal Revenue Manual (IRM) 5.11.7.2.1 (Aug. 24, 2007). Form 668-W, *Notice of Levy on Wages, Salary, and Other Income*, is used to levy an individual's wages, salary or other income, *e.g.*, benefit or retirement income. IRM 5.11.2.1.2 (June 1, 2007).

4 SSA, *Fast Facts & Figures About Social Security*, 2009 (July 2009).

5 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72.

6 *See* Status Update: *Federal Payment Levy Program: IRS Agrees to Low Income Taxpayer Filter, supra.*

7 *See* IRC § 6502.

attaches to all future payments to which the taxpayer is entitled, so long as there is a fixed and determinable right to these payments at the time of levy.[8] Under current procedures, the IRS releases FPLP levies upon the CSED.[9] The IRS may, however, continue collection post-CSED by issuing a paper levy before the CSED expires.

Furthermore, under the IRS's interpretation of current law, a levy served prior to the CSED may be updated post-CSED to reflect the full amounts of tax, penalty, and interest due as of the date of the final payment, as though the CSED had not expired, for any period listed on the levy.[10] The IRS needs a comprehensive approach with uniform rules to levy Social Security benefits.

EXAMPLES

Example 1

The IRS assessed $50,000 in taxes and penalties against a taxpayer in April 2000. In January 2009, the IRS served a paper Form 668-W levy on the SSA. The taxpayer began receiving $1,161 a month from the SSA in September 2009.[11] By this time, he owed the IRS $72,000 in back taxes, penalties, and interest. Each month, the IRS receives $265 of the taxpayer's Social Security benefits.[12] If we assume an interest rate of five percent, more than $10 of interest will accrue daily (over $300 per month) on the $72,000 liability. Because the IRS served the levy prior to the expiration of the ten-year period for collection, it may continue to receive the taxpayer's Social Security payments until the taxpayer's death, even beyond the ten-year period, as the $265 levy is less than the monthly interest accrual.

Example 2

Assume the same facts as in Example 1, except that in September 2009, the IRS places the taxpayer into the FPLP. Each month, the IRS receives $174 of the taxpayer's Social Security benefits.[13] It may only continue to receive the taxpayer's Social Security payments until the ten-year period ends, and the taxpayer keeps $91 more per month than he would under the paper levy.

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8 *See* Treas. Reg. § 301.6343-1(b)(1)(ii) (levy on a fixed and determinable right to payment includes payments to be made after and does not become unenforceable upon the collection statute expiration date (CSED)); Rev. Rul. 55-210, 1955-1 C.B. 544 (only one notice of levy needs to be served to effectively reach vested benefits subsequently payable in other contexts).

9 *See* IRM 5.19.9.3.7(2) (July 1, 2008); IRM Exhibit 5.11.7-3 (Aug. 24, 2007).

10 National Taxpayer Advocate 2006 Annual Report to Congress 527.

11 The average monthly payment for a retiree is $1,161 per month. SSA, Office of Policy, Research, Evaluation and Statistics, *Monthly Statistical Snapshot*, Table 2, Social Security Benefits (Aug. 2009).

12 The levy amount equals the taxpayer's monthly Social Security income ($1,161) less the exclusion under IRC § 6334(a)(9) with respect to a "paper levy" for the taxpayer's monthly exemption ($779) and an additional exemption for being over age 65 ($117) under a paper levy.

13 The levy amount equals the taxpayer's monthly Social Security income ($1,161) multiplied by 15 percent under the FPLP.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress amend the Internal Revenue Code to:

1. Codify IRS administrative policy of exempting all taxpayers with incomes at or below 250 percent of the poverty level from FPLP levies under IRC § 6331(h);
2. Modify "specified payments" under IRC § 6331(h) to exclude amounts exempt under IRC § 6334(a)(9) due to a taxpayer's standard deduction and personal exemptions for all levies on Social Security benefits;
3. Limit both FPLP and paper levies of Social Security benefits to 15 percent of these payments;
4. Codify existing IRS administrative practice to require the release of FPLP levies upon expiration of the CSED; and
5. Prohibit the IRS's post-CSED collection by paper levy upon a taxpayer's fixed and determinable right to future Social Security benefits unless:
   a. the taxpayer has exhibited flagrant conduct within three months of the CSED as determined by IRS personnel; and
   b. the levy is limited to the balance due at the CSED.

PRESENT LAW

Pursuant to IRC § 6331(a), the IRS may levy against any property (or right to property) that belongs to the taxpayer or is subject to a federal tax lien if a taxpayer does not pay a tax liability in full or otherwise come to an agreement to resolve the matter, unless it is exempt.[14] If the IRS has levied prior to the expiration of this statutory period, the IRS may receive payments in the future. Each tax assessment has a CSED.

The Taxpayer Relief Act of 1997 (TRA 97) added IRC § 6331(h)(1), which permits the IRS to continuously levy up to 15 percent of a taxpayer's specified payments to satisfy a tax liability.[15] Congress believed that, by enacting this provision, Social Security benefits, which were already subject to levy, "would become subject to continuous levy."[16] Specified payments under IRC § 6331(h)(2) include federal payments other than those for which eligibility is based upon the payee's income, assets, or both; property exempt from levy under IRC § 6334(a)(4), (7), (9), and (11); and certain Railroad Retirement Act payments and Railroad Unemployment Insurance Act benefits.[17] Levies issued pursuant to IRC § 6331(h)

14 See IRC § 6334 for an enumeration of property exempt from levy.

15 Pub. L. No. 105-34, § 1024(a)(1), 111 Stat. 788 (1997) (codified as IRC § 6331(h)).

16 H.R. Rep. No. 105-220, at 549 (1997) (Conf. Rep.).

17 The SSA makes payments for Retirement, Survivors, and Disability Insurance ("RSDI") and Supplemental Security Income (SSI). RSDI payments are not based on need and can be levied. However, SSI payments are for people who are low income and have few resources, and are aged, blind, or disabled. SSA, Publication No. 05-11000 (June 2007). SSI payments are exempt from levy pursuant to IRC § 6334(a)(11).

do not allow the taxpayer to claim the exemption amounts under IRC § 6334(a)(9). IRC §§ 6334(a)(9) and 6334(d) provide that any amount received by an individual as income shall be exempt from levy to the extent that such amounts received by him or her during any period does not exceed an amount equal to the sum of the individual's standard deduction and aggregate personal exemptions for the tax year divided by the number of such periods in the year.

The IRS established the FPLP in July 2000 to administer IRC § 6331(h),[18] but did not levy Social Security payments under the program until it had sent initial notices of levy to taxpayers in October 2001.[19] Prior to TRA 97, the IRS issued Form 668-W to levy a taxpayer's fixed and determinable rights to future Social Security payments under IRC § 6331(a).[20] If the taxpayer had an income source other than Social Security, of an amount at least equal to the exemption amount under IRC § 6334(a)(9), the IRS could levy 100 percent of the taxpayer's Social Security payments.[21] This practice has not changed since Congress enacted TRA 97.[22] IRS Counsel believed that issuing paper levies to collect a series of Social Security payments carried litigation hazards, because before enacting TRA 97, Congress "simply did not consider the fact that a social security payment is a fixed right to a future benefit attachable by a single levy".[23]

Treas. Reg. § 301.6343-1(b)(1)(ii) provides that a levy reaches all property rights at the time the levy is made, including the right to receive payments at some point in the future and will not be released under this condition unless the liability is satisfied. Thus, certain streams of payments can be seized by a single levy that attaches to all future payments, so long as there is a fixed and determinable right at the time of levy. The liability remains enforceable to the extent of the value of the levied upon property. As such, a levy on Social Security benefits continues until the liability is satisfied even after the ten-year period for collection has run.[24] However, current IRS procedures provide that FPLP levies on Social Security should be released upon the CSED due to systematic limitations.[25] IRC §§ 6601(e)

18 Pub. L. No. 105-34, § 1024(a)(1), 111 Stat. 788 (1997). *See* IRM 5.19.9.3.1 (July 1, 2008).

19 IRS Fact Sheet No. 2001-11 (Oct. 2001). For an in-depth discussion of FPLP, see Status Update: *Federal Payment Levy Program: IRS Agrees to Low Income Taxpayer Filter, supra*; National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72; National Taxpayer Advocate 2007 Annual Report to Congress 324-36; National Taxpayer Advocate 2006 Annual Report to Congress 43-44, 114-17, 123-24, 127-28, 146-50, 154-56; National Taxpayer Advocate 2005 Annual Report to Congress 123-35, 466-67; National Taxpayer Advocate 2004 Annual Report to Congress 246-63; National Taxpayer Advocate 2003 Annual Report to Congress 206-12; and National Taxpayer Advocate 2002 Annual Report to Congress 108-09.

20 IRM 5.11.6.1.1 (May 5, 1998). *See U.S. v. Cleveland*, 74 A.F.T.R.2d (RIA) 5677 (N.D. Ill. 1994) (holding that Social Security benefits are specifically subject to levy under IRC § 6334(c)). *See also McCoy v. U.S.*, 71 A.F.T.R.2d (RIA) 3744 (N.D. Tex. 1992) (IRS properly levied on the taxpayer's Social Security payments using Form 668-W).

21 IRM 5.11.5.4.4 (May 5, 1998).

22 *See* IRM 5.11.6.1.1 (Mar. 15, 2005); IRM 5.11.5.4.4 (Jan. 1, 2006).

23 IRS, *Non Docketed Service Advice Review,* 2000 IRS NSAR 11574 (July 16, 2000).

24 Once the levy is served, the SSA will continue to honor it, until the levy is released (under IRC § 6343). IRM 5.11.6.1.1(4) (Mar. 15, 2005).

25 *See* IRM 5.19.9.3.7(2) (July 1, 2008); IRM Exhibit 5.11.7-3 (Aug. 24, 2007). In at least four of 17 cases with fixed and determinable levies sampled by TAS, the IRS blocked the FPLP so that it could issue a paper levy resulting in the IRS's ability to collect from the taxpayer's fixed and determinable rights to Social Security payments indefinitely.

and 6665 provide that interest and penalties, respectively, shall be assessed, collected, and paid in the same manner as taxes.

REASONS FOR CHANGE

Current Rules for Levies Against Social Security Benefits Lead to Disparate Treatment

The current regime for levies on Social Security benefits, involving paper and FPLP levies, are inconsistent and can potentially harm low income Social Security recipients. From the time the IRS started to levy SSA payments as part of the FPLP until 2005, the IRS used a filter to prevent FPLP levies on low income taxpayers. However, the IRS abandoned this filter due to a General Accounting Office (now Government Accountability Office) report that questioned the IRS's method of filtering out these taxpayers.[26] Through the advocacy efforts of the National Taxpayer Advocate and congressional interest, the IRS Wage and Investment division has agreed to adopt a filter employing an income and allowable expense analysis that will shield low income taxpayers from automatically having their Social Security payments levied to satisfy tax liabilities.[27] The IRS is under no legal requirement to maintain this filter.

The IRS has two methods to levy Social Security benefits. Table 2.6.1 below illustrates the difference between IRS paper levies and FPLP levies on these benefits.

TABLE 2.6.1, Comparison of Paper Levies and FPLP Levies on Social Security Benefits

Type of Levy	Maximum Percentage of Benefits Levied (%)	Minimum Exemption for Standard Deduction and Personal Exemptions Applies (Yes/No)	Levy Release upon CSED Expiration (Yes/No)
Paper Levy	100%	Yes	No
FPLP Levy	15%	No	Yes

Under current law, the IRS may issue a paper levy to reach all of a taxpayer's Social Security benefits, whereas it is limited to 15 percent under FPLP. For nontax debts, Congress enacted the Debt Collection Improvement Act of 1996 (DCIA), a safeguard against excessive collection from those who are suffering from economic hardship and cannot afford to pay.[28] The DCIA, among other things, exempted up to $750 per month of Social Security benefits from the collection of nontax debts owed to federal agencies.[29] However, the IRS has no statutory prohibition on which method it may use to levy low income taxpayers' Social Security benefits. Absent a cap on the percentage of benefits that

26 General Accounting Office, GAO 03-356, *Tax Administration, Federal Payment Levy Program Measures Performance and Equity Can Be Improved* 11 (Mar. 6, 2003).

27 *See* Status Update: *Federal Payment Levy Program: IRS Agrees To Low Income Taxpayer Filter, supra.*

28 Pub. L. No. 104-134 (1996); 31 U.S.C. § 3701 *et seq.*

29 The DCIA provides that $9,000 ($750 times 12 months) of the debtor's annual Social Security benefit is exempt from offset. 31 U.S.C. § 3716(c)(3)(A)(ii). The regulations further limit the offset amount to the lesser of "(i) The amount of the debt . . . ; (ii) An amount equal to 15% of the monthly covered benefit payment; or (iii) The amount, if any, by which the monthly covered benefit payment exceeds $750.00." 31 C.F.R. § 285.4(e).

may be levied, low income taxpayers may experience the very harm Congress sought to avoid under the FPLP. On the other hand, in the FPLP regime, taxpayers do not have the benefit of the minimum exemption under IRC § 6334(a)(9) prior to applying the 15 percent levy. Thus, the minimum exemption and the 15 percent limit should be uniform for FPLP and paper levies of Social Security benefits to minimize harm and eliminate inconsistent treatment.

The IRS will not levy under IRC § 6331(a) on accumulated funds (the corpus) in retirement assets, such as an Individual Retirement Arrangement (IRA), unless the taxpayer has engaged in "flagrant" conduct. The IRS does not apply the "flagrant" standard to the stream of payments from retirement assets, such as an IRA.[30] Instead, IRM 5.11.6.1(1) provides that "discretion" should be used before levying retirement income. When the IRS issues paper levies on Social Security benefits the IRS does not use the "flagrant" standard, because it is not seeking accumulated funds from the levy source. Moreover, the IRS does not appear to use discretion with respect to FPLP levies on these benefits.[31]

In September 2009, the IRS received over 80 percent of approximately 225,000 FPLP payments from the SSA.[32] While the IRS has accurate data on Social Security levies from the FPLP program, the IRS presently does not have a consistent method to track paper levies on Social Security payments. As for paper levies, TAS recently reviewed a sample of 195 paper levies on taxpayers' fixed and determinable rights in place since 2008. Seventeen of these levies, or approximately nine percent, were issued to the SSA.[33] In at least one case, the IRS levied on 100 percent of the taxpayer's Social Security payments without exemptions because the revenue officer identified other sources of income and assets to pay, but the taxpayer would not work with the revenue officer or remain compliant to resolve his or her tax liability; thus, the paper levy seemed appropriate in that case. However, in six of these cases, Social Security income was 90 percent or more of the taxpayer's income as reported to the IRS.

The IRS continues using its discretion to issue paper levies on collecting the Social Security benefits of low income taxpayers outside of the FPLP post-CSED. The release of FPLP levies on the CSED is appropriate because there is no human involvement in tracking the levies. However, post-CSED enforcement of paper levies harms low income taxpayers who have a fixed income. Further, the IRS is not required to determine if taxpayers' conduct warrants unlimited collection of their Social Security benefits prior to issuing the paper

30 IRM 5.11.6.2(1) (Mar. 15, 2005) states, "These instructions cover money accumulated in a pension or retirement plan, as well as Individual Retirement Arrangements (IRAs). They do not deal with levying retirement income."

31 Since 2005, the FPLP has been an automated process with no filter for impoverished taxpayers. *But see Status Update: Federal Payment Levy Program: IRS Agrees to Low Income Taxpayer Filter, supra*; National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

32 IRS, Collection Activity Report NO-5000-245-A, *FPLP Weekly Inventory Report* (Sept. 30, 2009).

33 TAS selected its sample of 195 from a total of 392 accounts identified in the Individual Master File with codes associated with fixed and determinable rights levies (transaction code 971, action code 687, and miscellaneous code 001).

levy. Taxpayers who are otherwise in compliance but are unable to pay their tax liabilities should not be subject to levy of their Social Security benefits post-CSED.

Post-CSED Accruals Can Turn Taxpayers into Debtors for Life

When the IRS levies on fixed and determinable rights, such as Social Security benefits, taxpayers may be financially unable to make payments that exceed the interest accrual associated with their underlying tax liabilities. Unless circumstances change to enable a taxpayer to pay down the tax debt, such taxpayers would be indebted to the IRS forever.

Limiting the amount subject to levy to the balance due at the CSED may provide taxpayers the opportunity to satisfy their liabilities. Congress intended to provide the IRS a finite window of time to collect assessed taxes by virtue of the CSED (generally ten years from the date of assessment). It seems fundamentally unfair to subject taxpayers who have fixed and determinable rights to Social Security payments to IRS collection until death.

EXPLANATION OF RECOMMENDATION

Under current law, the IRS collects 15 percent of taxpayers' Social Security payments under the FPLP regardless of their expenses or needs. Some taxpayers will not contact the IRS regarding economic hardship because they want to fulfill their obligations, do not want others to know they are suffering, or fear repercussions. This recommendation exempts taxpayers whose incomes are less than 250 percent of the poverty level from the FPLP. While we applaud the IRS for agreeing to implement a filter for the FPLP to eliminate levies against impoverished taxpayers, the IRS has removed a similar filter in the past and without legislation would have the discretion to remove a new filter in the future. Further, this recommendation proposes a comprehensive approach with uniform rules for paper levies and FPLP levies on Social Security Benefits as shown in Table 2.6.2, below.

TABLE 2.6.2, Comparison of Paper Levies and FPLP Levies on Social Security Benefits After Recommended Legislation

Type of Levy	Maximum Percentage of Benefits Levied (%)	Minimum Exemption for Standard Deduction and Personal Exemptions Applies (Yes/No)	Levy Release upon CSED Expiration (Yes/No)
Paper Levy	15%	Yes	Yes*
FPLP Levy	15%	Yes	Yes

*Levy will be released absent taxpayer's flagrant conduct

With respect to both FPLP and paper levies of Social Security benefits, this proposal establishes a 15 percent limit on the amount of SSA benefits subject to levy, and it provides for IRC § 6334(a)(9) exemptions. It leaves in place the IRS's ability to collect on Social Security benefits post-CSED with respect to paper levies, but only in flagrant conduct cases, and even then limits the collection action to the balance due on the CSED.

LR #7

Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions

PROBLEM

Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due.[1] Spouses who live in community property states and file separate returns are generally required to report one-half of the community income on their separate returns. IRC §§ 6015 and 66, sometimes referred to as the "innocent spouse" rules, provide relief from joint and several liability and from the operation of community property rules. As discussed in the Most Litigated Issues section of this report, a United States District Court's refusal to allow a taxpayer to raise IRC § 6015 as a defense in a collection suit may create hardship because a taxpayer may be left without a forum in which to raise IRC § 6015 as a defense before losing her home to foreclosure by the IRS.[2]

EXAMPLE

In *United States v. Pollock*,[3] the government filed a collection suit in district court under IRC § 7403 seeking, among other things, to foreclose its lien on a principal residence W obtained as part of her divorce settlement. W raised as a defense her entitlement to relief under IRC § 6015. The district court stayed the proceeding, holding that the taxpayer could raise her IRC § 6015 defense in Tax Court. The Tax Court, however, held that it lacked jurisdiction over W's claim.[4]

RECOMMENDATION

Amend IRC §§ 6015 and 66 to clarify that taxpayers may raise relief under those sections as a defense in a proceeding brought under any provision of Title 26 (including §§ 6213, 6320, 6330, 7402, and 7403) or any case under title 11 of the United States Code.

CURRENT LAW

IRC § 6015(e)(1)(A) provides that an individual who seeks relief from joint liability may, "in addition to any other remedy provided by law," petition the Tax Court to determine the appropriate relief available. Other statutory provisions and judicial precedent make clear that

1 Internal Revenue Code (IRC) § 6013(d)(3).

2 *See* Most Litigated Issue: *Relief From Joint and Several Liability Under Internal Revenue Code Section* 6015, *infra*.

3 No. 06-80903, (S.D. Fla. filed Sept. 27, 2006).

4 132 T.C. No. 3 (2009), *appeal docketed*, No. 09-12610 (11th Cir. May 21, 2009), discussed *infra*.

taxpayers may raise IRC § 6015 in a variety of contexts.[5] However, as the National Taxpayer Advocate noted in the 2007 Annual Report to Congress, several district courts have held that taxpayers could not raise relief from joint and several liability as a defense in district court collection suits.[6]

At least two district courts that refused to allow the IRC § 6015 defense in collection suits asserted that the claim could still be raised in another forum.[7] In *United States v. Feda*,[8] an action to reduce federal tax assessments to judgment, the district court held that "district court is not the proper location to introduce an innocent spouse theory," but noted that "[a]lthough, relief may not be obtained through this Court, Mrs. Feda may attempt to seek the little relief that is still available before the period for the 2003 tax return assessments also expires [by requesting relief from the IRS]." The district court in *United States v. Boynton*,[9] an action under IRC § 7402 to reduce the taxpayer's joint income tax liability to judgment, relied on *Feda* and held that it did not have jurisdiction to decide the taxpayer's IRC § 6015 claim. The court in *Boynton* added that

> [G]ranting summary judgment in favor of the United States — accompanied by a finding that the Court lacks jurisdiction to consider the § 6015 defense — does not inhibit the taxpayer's ability to seek innocent spouse relief first with the Secretary and then, if appropriate, with the Tax Court and the Court of Appeals.[10]

A separate statutory provision that these district court decisions did not explore is IRC § 6015(g)(2), which provides that a final court decision in a prior proceeding for the same taxable year is conclusive with respect to the qualification of a taxpayer as an innocent spouse if the taxpayer meaningfully participated in the prior proceeding. If the taxpayers in *Feda* or *Boynton* had sought IRC § 6015 relief in Tax Court after the district court decisions became final, they would have faced the possibility that the Tax Court would also have refused to hear their IRC § 6015 claims. Indeed, the Tax Court, in *Thurner v. Commissioner*,[11] had already held that a taxpayer could have raised the IRC § 6015 claim as a defense to a suit to reduce federal tax assessments to judgment in district court. Because the taxpayer did not do so, yet meaningfully participated in the district court proceeding, he was barred by IRC § 6015(g)(2) from raising the claim in Tax

5 *See* IRC §§ 6320(c) and 6330(c)(2)(A)(i) (pertaining to collection due process proceedings); IRC § 6213 and *Corson v. Comm'r*, 114 T.C. 354, 363 (2000) (pertaining to deficiency proceedings); 11 U.S.C.A. § 505(a) (pertaining to bankruptcy proceedings); and IRC § 7422 (pertaining to refund suits).

6 *See* National Taxpayer Advocate 2007 Annual Report to Congress 549 (Additional Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*).

7 Other district courts have held that they lack jurisdiction to hear the taxpayer's IRC § 6015 claim in a collection suit without explicitly stating that relief might nevertheless still be available. *See, e.g., U.S. v. Cawog*, 97 A.F.T.R.2d (RIA) 3069, 3072 (W.D. Pa. 2006), *appeal dismissed* (3d Cir. 2007) and *U.S. v. Bucy*, 100 A.F.T.R.2d (RIA) 6666, 6670 (S.D. W. Va. 2007).

8 97 A.F.T.R.2d (RIA) 1985, 1989 (N.D. Ill. 2006).

9 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007).

10 *Boynton at* 923. The court also based its holding that it did not have jurisdiction to hear the taxpayer's IRC § 6015 claim in a suit brought by the government to reduce tax assessments to judgment on the absence of an express statutory provision giving district courts such jurisdiction.

11 121 T.C. 43 (2003).

Court. In the *Pollock* case in 2009, a district court collection suit, the taxpayer raised the IRC § 6015 defense, and the district court stayed the case to allow the taxpayer to petition the Tax Court to seek review of the IRS's denial of the IRC § 6015 claim. The Tax Court, however, held that it lacked jurisdiction to review the IRC § 6015 determination because the petition was filed beyond the 90-day period for filing a Tax Court petition and that the 90-day period is jurisdictional and cannot be equitably tolled. The taxpayer appealed the Tax Court's decision to the Court of Appeals for the Eleventh Circuit; to date, the appellate court has not issued its decision.

REASONS FOR CHANGE

Notwithstanding IRC § 6015(e)(1)(A), which provides that an individual who seeks relief from joint liability may petition the Tax Court, "in addition to any other remedy provided by law," some district courts have held that taxpayers cannot raise IRC § 6015 as a defense in a district court collection suit. The *Pollock* case is a recent example of the confusion that exists as to whether the defense is allowable in district court. Even if the taxpayer in *Pollock* prevails in her appeal from the Tax Court's decision, and the Tax Court is thereby obliged to consider her IRC § 6015 claim, the Eleventh Circuit's decision will not necessarily clarify that taxpayers in district courts may raise IRC § 6015 as a defense in a collection action. Even if the Eleventh Circuit were to decide that taxpayers may raise IRC § 6015 as a defense in district court collection suits, its decision would be binding precedent only with respect to district courts within the Eleventh Circuit.[12] Taxpayers need clarification that the defense may be raised in collection suits in any district court.

EXPLANATION FOR RECOMMENDATION

The National Taxpayer Advocate's recommendation will clarify that, consistent with the statutory language of IRC § 6015 and with other statutory and judicial provisions, taxpayers may raise IRC § 6015 as a defense in district court collection suits. Clarification will avert further confusion as to whether the defense is allowable in district court collection suits, and will provide uniformity among district courts.

12 *See Generali v. D'Amico*, 766 F.2d 485, 489 (11th Cir. 1985); *Hialeah v. Fla. Horsemen's Benev. & Protective Ass'n, Inc.*, 899 F.Supp. 616, 623 (S.D. Fla. 1995).

LR #8

Eliminate the Suspension of the Collection Statute During Qualified Hospitalization Resulting from Service in a Combat Zone

PROBLEM

The IRS generally has ten years from the date of assessment to collect a tax liability.[1] However, the IRS may not collect the liability, and the ten-year period is suspended, for taxpayers serving in a combat zone or performing combatant activities in a contingency operation, and during any period of continuous hospitalization attributable to injuries sustained from such activity plus 180 days.[2] Although the IRS is not statutorily barred from collecting while a civilian is in the hospital, it often defers collection. However, the period for collection is not suspended during this hospitalization. Thus, the statutory period may run on the hospitalized civilian's tax liabilities but not on a taxpayer hospitalized due to combat service.

EXAMPLE ONE

The IRS assesses $15,000 in taxes and penalties against a taxpayer in April 2003, but he is unemployed and the IRS deems his account currently not collectible (CNC). The taxpayer enlists in the military in January 2007 and in September 2007 is sent into combat in Afghanistan. While there, the taxpayer is injured in a mortar attack and is returned to the United States, where he is hospitalized from March 2008 to March 2009.

By this time, the taxpayer owes the IRS $25,000 in back taxes, penalties, and interest. The taxpayer can pay $200 per month due to his Veterans' Administration benefits (net of his basic living expenses). The IRS enters a partial payment installment agreement with the taxpayer, who must make monthly payments until April 2015. The IRS's period for collection is extended two years, *i.e.*, six months due to his combat activities, one year due to his hospitalization, plus 180 days.

EXAMPLE TWO

The IRS assesses $15,000 in taxes and penalties against a taxpayer in April 2005, but he is unemployed and the IRS deems his account CNC. The taxpayer enrolls in a technical college and earns several technician certifications, then reenters the workforce in September 2007. In October 2008, the IRS begins to levy his wages for payment of the past due taxes. In January 2009, the taxpayer is severely injured in an auto accident and is hospitalized until March 2009, but receives disability payments for two-thirds of his salary from his

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1 *See* Internal Revenue Code (IRC) § 6502.

2 *See* IRC § 7508(a).

employer. Immediately after the accident, the taxpayer's spouse contacts the IRS. The IRS releases the levy because the taxpayer cannot meet his basic living expenses with his reduced income and additional expenses from his injury.[3] The IRS once again deems his account CNC. The IRS's period for collection has not been suspended during any of this time and will expire in April 2015.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 7508(a) to eliminate the suspension of the collection statute during any period of qualified hospitalization after service in a combat zone or performance of combatant activities in a contingency operation.

PRESENT LAW

IRC § 6502 provides, generally, that the IRS can collect tax by levy or a proceeding in court, but only if the levy is made or the proceeding begun within ten years after the date of assessment.

Pursuant to IRC § 7508(a), the IRS will suspend collection activity against an individual serving in the armed forces, or serving in support of the armed forces, in an area designated by the President by executive order as a "combat zone." The IRS will also suspend collection against a taxpayer deployed outside the United States away from his or her permanent duty station while participating in an operation designated by the Secretary of Defense as a contingency operation, or which became such a contingency operation at any time during the period designated by the President by executive order. The IRS must disregard the period of combatant activities in such a zone or operation or the period hospitalized as a result of injury received while serving in such an area or operation, *plus the period of continuous qualified hospitalization attributable to such injury*, and the next 180 days thereafter.[4] Qualified hospitalization means any hospitalization outside or inside the United States for up to five years.[5]

REASONS FOR CHANGE

Under present law, the IRS is not entitled to more time to collect from taxpayers who are hospitalized for activities not related to combat activities. The IRS generally has the discretion to suspend collection administratively if it finds the taxpayer's liability is currently not

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3 A levy shall be released if the IRS determines that the levy is creating an economic hardship due to the financial condition of the taxpayer. IRC § 6343(a)(1)(D). Economic hardship applies if the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses and will vary according to the unique circumstances of the taxpayer. Treas. Reg. § 301.6343-1(b)(4).

4 IRC § 7508(a).

5 IRC § 7508(g). Further, this section shall not apply for purposes of applying IRC § 7508(a) to the spouse of an individual entitled to relief under this section. For a discussion of problems attributable to the IRS's handling of taxpayers' accounts with different statutory periods of collection, see Most Serious Problem: *IRS Policies and Procedures for Collection Statute Expiration Dates Adversely Affect Taxpayers, supra.*

collectible.[6] The IRS will place the taxpayer's account in CNC status when he or she has no income or assets subject to levy, but may also place the account in CNC status if levy action would create a hardship. A hardship exists if the levy prevents the taxpayer from meeting necessary living expenses, as distinguished from mere inconvenience.[7] However, this does not extend the period for collection. Thus, the IRS has more time to collect from hospitalized troops, who have served the United States in combat, than it would have to collect against similarly situated civilians.

EXPLANATION OF RECOMMENDATION

This recommendation protects individuals serving in combatant activities for the United States from an unnecessary extension of IRS collection activity if an individual undergoes a period of qualified hospitalization from those activities. The IRS interprets the current provisions affecting these individuals as providing a suspension of the statutory period for collection, even during hospitalization. The recommended change treats the statutory period for collection of these taxpayers consistently with those of civilian taxpayers who the IRS may place in CNC status due to hospitalization.

6 *See* Internal Revenue Manual (IRM) 5.16.1.1 (May 5, 2009). The IRS can also deem an account CNC if there is an inability to contact a taxpayer although his or her address is known or an inability to locate the taxpayer, and there are no means to enforce collection.

7 Policy Statement 5-71, IRM 1.2.14.1.14 (Nov. 19, 1980).

LR #9

Provide a Uniform Definition of a Hardship Withdrawal from Qualified Retirement Plans

PROBLEM

The Internal Revenue Code (IRC) contains over a dozen tax-advantaged plans and arrangements[1] to encourage taxpayers to save for retirement.[2] While these tax-advantaged retirement planning vehicles help taxpayers save for retirement, they are subject to differing sets of rules regulating eligibility, contribution limits, tax treatment of contributions and distributions, withdrawals, availability of loans, and portability. We have discussed in prior reports the problems that such complexity may cause to both retirement plan administrators and participants.[3]

Particularly confusing are the rules governing certain distributions from qualified plans that are made before age 59½. While some retirement plans allow for an early distribution upon the event of a hardship, the various plans do not uniformly apply these so-called "hardship withdrawal" provisions. For example, 401(k) plans are permitted to allow participants to take an early distribution of their elective deferrals while still employed with the employer maintaining the plan "upon hardship of the employee,"[4] but such distributions may be subject to the ten percent additional tax on early distributions if made before age 59½.[5] Participants in 457(b) plans (which cover state and local government employees) are permitted to take an early distribution of their entire benefit for "unforeseeable emergencies," and those distributions, like all 457(b) distributions, are exempt from the ten percent additional tax.[6] Individual retirement accounts (IRAs) are not required to limit early distributions to the account beneficiary. Therefore, an individual could receive an IRA distribution for events that would be a hardship under the 401(k) or 457(b) rules. However, these distributions, unlike distributions from IRAs that are made for first-time home purchases and certain education expenses, are subject to the ten percent additional tax to the extent taxable to the IRA beneficiary.[7]

1 The term "tax-advantaged" includes the ability to defer the taxation of income by making an elective deferral, the tax-deferred growth of account assets, or the tax-free withdrawals available to plan participants.

2 Types of retirement plans available under the IRC include traditional IRAs, nondeductible IRAs, nonworking spousal IRAs, Roth IRAs, rollover IRAs, SIMPLE IRAs, 401(k) plans, profit-sharing plans, employee stock ownership plans, money purchase plans, defined benefit plans, Simplified Employee Pensions, SARSEPs, and SIMPLE 401(k) plans for small employers, 403(b) tax-sheltered annuity plans for 501(c)(3) organizations and public schools, and 457(b) deferred compensation plans for state and local governments.

3 *See* National Taxpayer Advocate 2008 Annual Report to Congress 373-74; National Taxpayer Advocate 2004 Annual Report to Congress 423-32. *See also* National Taxpayer Advocate 2008 Annual Report to Congress 5-6.

4 IRC § 401(k)(2)(B)(i)(IV).

5 IRC § 72(t).

6 IRC § 457(d)(1)(A)(iii).

7 IRC § 72(t)(2)(E) and (F).

EXAMPLE

Taxpayer A opened a Roth IRA account three years ago and has contributed the maximum each year. The taxpayer's current balance includes $12,000 attributable to earnings. Taxpayer A, who is 42 years old, currently works full-time for Employer B, a for-profit company that maintains a 401(k) plan for its employees. Taxpayer A participates in Employer B's 401(k) and as of July 1, 2009, had $60,000 in the plan attributable to his elective contributions and contributions made by Employer B. Taxpayer A used to work for Employer C, a state agency, and made pre-tax contributions to a 457(b) plan while employed with Employer C. Taxpayer A's account balance with Employer C's 457(b) plan is $18,000 as of July 1, 2009.

During 2009, Taxpayer A is faced with a medical emergency that will require surgery and will force him to miss six months of work. Because his health insurance will cover only 70 percent of his estimated $50,000 medical expenses, Taxpayer A will have out-of-pocket costs of $15,000 for his surgery. Moreover, Taxpayer A estimates he will need an additional $20,000 to cover living expenses for his family during the next six months while he is on unpaid leave.

Taxpayer A recalls that some co-workers from Employer B were allowed to make hardship withdrawals from their retirement plans for occasions such as a home purchase. Taxpayer A would like to know whether he can receive a distribution from his IRA or his two employer-based plans to help pay medical and living expenses for the next six months. After spending two weeks reading through plan documents and talking with friends, colleagues, and plan administrators, Taxpayer A comes to the following conclusions:

1. First-time home purchases and certain education expenses are considered to be "qualified distributions" from his Roth IRA and therefore not subject to the ten percent additional tax. However, distributions for medical expenses may not be afforded the same treatment and therefore the amount of the distribution in excess of his contributions to the Roth IRA will be includible in taxable income and subject to the ten percent additional tax. To the extent it does not exceed the amount allowable as a deduction under IRC § 213, a distribution for medical expenses will not be subject to the ten percent additional tax. However, any distribution that does not qualify as a "qualified distribution" and is used for living expenses while he is unable to work will be includible in taxable income to extent the distribution exceeds his contributions to the Roth IRA and subject to the ten percent additional tax.
2. His 401(k) plan with Employer B allows hardship withdrawals in instances of "immediate and heavy financial need" and uses the safe harbor rules to determine whether an employee has had an immediate and heavy financial need. Medical expenses, but not living expenses for the period he is unable to work, fall under the safe harbor definition of immediate and heavy financial need. Hardship distributions are included in taxable income, subject to the ten percent additional tax for early withdrawal.

3. His 457(b) plan with Employer C allows hardship withdrawals for "unforeseeable emergencies" for in-service distributions. Severe financial hardship resulting from an illness or accident is considered an instance of unforeseeable emergency. The ten percent additional tax does not apply to a hardship withdrawal from a 457(b) plan. However, since he is not a current employee with Employer C, he does not need to rely on the unforseeable emergency for the 457(b) plan and may be eligible to receive a distribution, depending on the particular plan's rules.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress establish uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged retirement plans and arrangements.

Hardship withdrawals should be permitted when a participant is faced with an "unforeseeable emergency." Examples of an unforeseeable emergency may include:

1. expenses for medical care incurred by the employee, the employee's spouse or dependents;
2. payments necessary to prevent the eviction of the employee from his or her principal residence or foreclosure on the mortgage on that residence;
3. loss of property due to casualty; or
4. severe financial hardship resulting from an extended period of unemployment.

The National Taxpayer Advocate further recommends that such hardship distributions be made exempt from the ten percent additional tax imposed by IRC § 72(t).

PRESENT LAW

401(k) Plans

In general, a participant in a 401(k) plan may receive a distribution of his or her plan benefits (including elective contributions) upon reaching the age of 59½ or upon separation of service, death, or disability.[8] However, an early distribution of the employee's elective contributions may be made to the employee before his or her separation, death, disability or attainment of age 59½ "upon hardship of the employee."[9] Applicable Treasury regulations provide that a distribution is made due to hardship only if (1) the distribution is made due to an immediate and heavy financial need of the employee and (2) the distribution is necessary to satisfy the immediate and heavy financial need.[10]

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8 IRC § 401(k)(2)(B).

9 IRC § 401(k)(2)(B)(i)(IV).

10 Treas. Reg. § 1.401(k)-1(d)(3)(i).

Whether an employee has an immediate and heavy financial need and the amount necessary to meet such need is determined by the plan administrator based on a consideration of all relevant facts and circumstances.[11] However, the regulations provide a safe harbor under which a distribution may be deemed to be an immediate and heavy financial need in the following six circumstances:

1. expenses for medical care incurred by the employee, spouse, or certain dependents;
2. costs directly related to the purchase of a principal residence for the employee;
3. payment of tuition, related educational fees, and room and board expenses for the employee, spouse, children, or certain dependents;
4. payments necessary to prevent the eviction of the employee from his or her principal residence, or foreclosure on the mortgage of that residence;
5. payments for burial or funeral expenses for the employee's deceased parent, spouse, children or dependents; or
6. expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under § 165.[12]

The regulations also provide that a distribution is deemed necessary to satisfy an immediate and heavy financial need if:

1. the employee has obtained all other currently available distributions and nontaxable loans under the plan and all other plans maintained by the employer; and
2. the employer is prohibited from making elective deferrals to the plan and all other plans maintained by the employer for at least six months following the hardship distribution.[13]

Hardship withdrawals are not eligible for rollover treatment and are generally includible in the participant's gross income in the taxable year in which paid to the participant and are taxed as ordinary income.[14] In addition, hardship withdrawals are subject to the ten percent additional tax imposed under IRC §72(t) if no exception applies.[15]

11 Treas. Reg. § 1.401(k)-1(d)(3)(iii).

12 Treas. Reg. § 1.401(k)-1(d)(3)(iii)(B).

13 Treas. Reg. § 1.401(k)-1(d)(3)(iv)(A); Treas. Reg. § 1.401(k)-1(d)(3)(iv)(E)(1); Treas. Reg. § 1.401(k)-1(d)(3)(iv)(E)(2).

14 IRC § 402(a).

15 Exceptions to the ten percent additional tax include distributions: (1) made on or after the date on which the employee attains age 59½, (2) made to a beneficiary on or after the death of the employee, (3) attributable to the employee's being disabled, (4) part of a series of substantially equal periodic payments, (5) made to an employee after separation from service after attainment of age 55, (6) dividends paid with respect to stock of certain corporations, or (7) made on account of a levy on the qualified plan.

457(b) Plans

In general, a 457(b) plan participant may not receive a distribution until he or she reaches age 70½ or separates from service, whichever is earlier.[16] However, a 457(b) plan may permit an early distribution to a participant faced with an "unforeseeable emergency."[17]

The Treasury regulations define unforeseeable emergency as:

1. a severe financial hardship resulting from an illness or accident;
2. loss of property due to casualty; or
3. other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.[18]

The regulations provide several examples of unforeseeable emergencies, such as the imminent foreclosure of or eviction from a primary residence, the need to pay for medical expenses, or the need to pay for the funeral expenses of a spouse or dependent.[19] However, the regulations specifically note that the purchase of a home or the payment of tuition are not unforeseen emergencies for purposes of this exception.[20]

The ten percent additional tax imposed by IRC § 72(t) does not apply to 457(b) plans because a 457(b) plan is not a "qualified retirement plan" as defined in IRC § 4974(c).

Roth IRAs

In general, the taxability of a distribution from a Roth IRA depends on whether the distribution exceeds the IRA owner's basis in the IRA and whether the distribution is a "qualified distribution." A qualified distribution, for purposes of a Roth IRA, includes a distribution that is both:

1. Made after a five-taxable-year period; and
2. Made on or after the date on which the owner attains age 59½, made to a beneficiary or the estate of the owner on or after the date of the owner's death or disability, or to which IRC § 72(t)(2)(F) applies (exception for first-time home purchase).

Distributions from a Roth IRA that are not qualified distributions are generally includible in taxable income to the extent the distribution exceeds the contributions to the Roth IRA and are generally subject to a ten percent tax in addition to the ordinary income taxes on the distribution.[21] There are several statutory exceptions to the ten percent additional tax.

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16 IRC § 457(d).

17 IRC § 457(d)(1)(A)(iii). If certain requirements are met, participants in 457(b) plans may be eligible to receive an in-service distribution of $5,000 or less. IRC § 457(e)(9)(A).

18 Treas. Reg. § 1.457-6(c)(2)(i).

19 *Id.*

20 *Id.*

21 *See* IRC § 408(d)(1); IRC § 72(t).

The ten percent tax does not apply if the distribution is made in cases of death or disability, certain medical expenses, first-time homebuyer expenses, qualified higher education expenses, health insurance expenses of unemployed individuals, or as part of a series of substantially equal periodic payments.[22]

There is no provision in the Code that prohibits Roth IRA beneficiaries from receiving an early distribution for a hardship.

TABLE 2.9.1, Early Withdrawal Provisions of Certain Tax-Advantaged Retirement Plans & Arrangements

	401(k)	457(b) governmental plans	Roth IRA
Who is eligible?	Employees of all non-governmental employers	Employees and independent contractors of state & local governments	Individuals (subject to income limitations if covered by employer-provided retirement plan)
Hardship withdrawal allowed while employed or before age 59½?	Yes, if distribution is necessary to satisfy "immediate and heavy financial need"	Yes, for "unforeseeable emergency"	Yes
10% additional tax assessed?	Yes	No	Yes, to the extent the distribution exceeds the Roth contributions, except in cases of death or disability, certain medical expenses, first-time homebuyer expenses, qualified higher education expenses, health insurance expenses of unemployed individuals, or as part of a series of substantially equal periodic payments

REASONS FOR CHANGE

Some retirement plans allow participants to receive an early distribution in cases of financial hardship, such as a medical emergency. However, there is no uniform definition of "hardship" among the various retirement plans that would enable a participant to easily determine when an early withdrawal is allowable. Further, even if a plan allows for a hardship withdrawal, participants must deal with inconsistent rules for triggering the ten percent additional tax for early withdrawal imposed by IRC § 72(t).

In tax year 2008, approximately 5.2 million tax returns reported tax on early distributions (generating a total tax of nearly $4.3 billion).[23] It is not known what percent of these early distributions were in cases of financial hardship.

EXPLANATION OF RECOMMENDATIONS

The rules covering tax-advantaged retirement plans and arrangements are among the most intricate and complex rules of the tax code and associated regulations.[24] In particular, the hardship withdrawal provisions for certain tax-advantaged retirement plans and

22 IRC § 72(t)(2).

23 IRS, Compliance Data Warehouse, Individual Returns Transaction File (2008).

24 Part of this complexity stems from the fact that retirement plans fall under the jurisdiction of three federal agencies – the IRS, the Department of Labor, and the Pension Benefit Guaranty Corporation.

arrangements lack uniformity and may cause confusion among plan participants. By establishing uniform rules regarding the availability and tax consequences of hardship withdrawals from tax-advantaged plans, Congress will reduce complexity and eliminate meaningless distinctions between the types of plans that may be offered by different types of employers.

LR #10 Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers

PROBLEM

The statute of limitations (SOL) on tax assessments is a fundamental component of due process in tax administration. It provides taxpayers with closure even as it prompts the IRS to focus its limited audit resources on recently filed returns rather than old ones. Examining recent returns enables the IRS to educate taxpayers and prevent future noncompliance while the issues are current and likely to reoccur. It also maximizes audit efficiency and minimizes taxpayer burden. If the IRS were to focus on old returns, the IRS and taxpayers would need to apply old laws to old facts after memories have faded, documents have been lost, and witnesses have become unavailable. In the American legal system all but the most serious violations are generally subject to a SOL.[1] Thus, it would not be consistent to expect all taxpayers to stand ready to defend every tax return they have ever filed. Finally, without the benefit of a SOL, even the most compliant taxpayer would be ill advised to discard any tax document, regardless of its age.

Nonetheless, as a practical matter many U.S. citizens who believe they are residents of the U.S. Virgin Islands (USVI) have an unexpectedly long SOL on tax assessments or none at all, at least with respect to tax years ending before December 31, 2006. This is so even for taxpayers who have done nothing wrong other than file their annual tax returns with the USVI Bureau of Internal Revenue (BIR), as residents of the USVI are required to do. Moreover, if the IRS audits a return and assesses additional tax after the expiration of the SOL to file a refund claim with the BIR, the taxpayer could be subject to double tax on the same income. Any such double taxation could only be addressed through the competent authority process.[2]

The IRS reached different conclusions on at least two occasions about the extent to which those claiming USVI residency have the benefit of an SOL.[3] Its latest reversal came after some taxpayers improperly claimed tax benefits designed by Congress to attract businesses to the USVI, but the IRS did not alert the public to this reversal for over a year.[4] The end result is that the IRS has singled out a small group of USVI taxpayers for special treatment – the very types of high income taxpayers that federal tax incentives are seeking to

1 As the Supreme Court once noted: "In a country where not even treason can be prosecuted after a lapse of three years, it could scarcely be supposed that an individual would remain forever liable for a pecuniary forfeiture." *Adams v. Woods*, 6 U.S. (2 Cranch) 336, 341 (1805).

2 *See* Rev. Proc. 2006-23, 2006-1 C.B. 900 (competent authority process).

3 *See* Field Service Advice 1992 WL 1354833 (July 21, 1992) (no SOL); Field Service Advice 199906031 (Feb. 12, 1999) (SOL); Chief Counsel Advice Memorandum 200624002 (June 19, 2006) (no SOL); Notice 2007-19, 2007-1 C.B. 689 (certain persons have a SOL).

4 Chief Counsel Advice Memorandum 200624002 (June 16, 2006) (issued February 16, 2005, but not released to the public until June 16, 2006).

attract to the USVI – by effectively eliminating the SOL applicable to them but not the SOL applicable to other similarly situated taxpayers.

This action, thus, unintentionally sends the message that the IRS might arbitrarily eliminate the benefit of any SOL by singling out those who take advantage of legitimate tax incentives. Perceptions of arbitrary and unfair tax administration not only undermine the purpose of tax incentives designed to attract business to the USVI, but may also increase controversy and diminish the public's willingness to comply with the law, potentially reducing federal tax receipts.[5]

EXAMPLES

Example 1: No SOL

On April 15, 2004, a U.S. citizen who is a *bona fide* resident of the USVI, earning $20,000 in taxable income in tax year 2003 and at least $75,000 in gross income, timely filed a non-fraudulent return for 2003 with the BIR as required by law. The three-year SOL on assessments by the IRS for tax year 2003 will never begin (and therefore will never expire). By contrast, the normal three-year SOL would begin with respect to a similarly situated taxpayer whose gross income is less than $75,000.[6]

Example 2: Unusually long SOL

Assume the same facts as Example 1, except that the taxpayer learns about Notice 2007-19, which would allow him to start the SOL by filing another 2003 Form 1040 with the IRS that reports no federal gross or taxable income.[7] Assume further that he filed it with the IRS on March 30, 2007.[8] Although the taxpayer filed his USVI tax return with the BIR in April 2004, the three-year SOL for the taxable year 2003 will not expire until March 30, 2010, nearly six years after the taxpayer first filed his return.

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5 *See, e.g.*, Richard Lavoie, *Cultivating a Compliance Culture: An Alternative Approach for Addressing the Tax Gap*, U. of Akron Legal Studies Research Paper No. 08-05, 5-7 (Sept. 1, 2008) (discussing the role of fairness in promoting compliance); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

6 Notice 2007-19, 2007-1 C.B. 689.

7 However, the instructions on Form 1040 regarding where to file a return with the IRS state that "permanent residents of the Virgin Islands should use: VI Bureau of Internal Revenue, 9601 Estate Thomas, Charlotte Amalie, St. Thomas, VI 00802." Form 1040, *Instructions* (2008) (last page under "Where Do You File?").

8 Notice 2007-19, 2007-1 C.B. 689, as amended and supplemented by Notice 2007-31, 2007-1 C.B. 971, provides that for tax years ending before December 31, 2006, non-covered persons – those individuals claiming to be *bona fide* residents of the USVI with gross incomes of $75,000 or more – could start the SOL by filing an income tax return with the IRS reporting no federal gross or taxable income. As a practical matter, this would not have benefited the IRS because it would routinely forward U.S. tax returns received from USVI residents to the BIR without processing them. *See* Internal Revenue Manual (IRM) 5.19.2.6.4.5.5 (Apr. 5, 2007). Moreover, as noted above, pursuant to the Form 1040 instructions, a filing with the IRS by a permanent USVI resident should be sent to the BIR.

RECOMMENDATION

Provide that the filing of a non-fraudulent return with the USVI by a person claiming to be a *bona fide* USVI resident is treated as the filing of a return with the IRS so that the filing starts the statute of limitations under Internal Revenue Code (IRC) § 6501.[9] This change should apply to tax years after 1986. However, it should only be effective with respect to assessments made 90 or more days after it is enacted to allow the IRS time to wrap up any ongoing examinations. As a correlative matter, require the USVI to automatically provide copies of returns filed with its BIR to the IRS within a reasonable period of time.

PRESENT LAW

How USVI residents lost and partially regained a SOL

USVI tax benefits presented a potential for abuse

Bona fide residents of the United States Virgin Islands (USVI) are required to file returns with and pay tax to the USVI Bureau of Internal Revenue (BIR) rather than the IRS.[10] Their tax liability, which is determined under a "mirror code" system, is usually the same as it would be if the were residents of the U.S., except that the USVI Economic Development Commission (EDC) may grant certain *bona fide* residents of the USVI a period of reduced taxation on eligible income.[11] The EDC's economic development program is designed to attract jobs to the USVI.[12] According to the IRS, beneficiaries of the program had claimed over $373 million in credits as of November 2007.[13]

By 2003, however, government officials became aware of tax shelter marketing material claiming that a person could obtain USVI EDC benefits, even if the person was not actually a USVI resident, or his or her income was not otherwise eligible for the benefits.[14] According to press accounts, these revelations were followed in 2004 by the public prosecution for tax evasion of a Massachusetts resident who claimed EDC benefits.[15]

9 Some have argued that this is already the case. *See* Robert Katcher, *et al.*, *Signed, Sealed, Delivered – U.S.V.I. Returns and Section 6501*, 2009 TNT 161-8 (Aug. 24, 2009) (arguing that the filing with the BIR starts the U.S. SOL because the Form 1040 instructions direct permanent USVI residents to file with the IRS by sending their returns to the BIR).

10 IRC § 932(c)(2).

11 *See* IRC § 934(b).

12 For a discussion of the importance of this program to the economy of the USVI, see PricewaterhouseCoopers LLP, *PWC Warns of Jobs Act Effect on Virgin Islands*, 2005 TNT 140-21 (July 21, 2005).

13 Letter from Kathy K. Petronchak, Commissioner SB/SE, to Charles E. Grassley, Ranking Member, Committee on Finance, United States Senate (Nov. 9, 2007), *reprinted as*, Kathy K. Petronchak, *USVI Proposal Would Significantly Affect Examinations, IRS Says*, 2007 TNT 222-45, n.1 (Nov. 16, 2007) (hereinafter "Petronchak Letter").

14 *See, e.g.*, Ryan J. Donmoyer, *Hedge Funds Flee Tax Haven in Virgin Islands, Hounded by IRS*, Bloomberg (Jan. 25, 2007), *available at* http://www.bloomberg.com/apps/news?pid=20601100&sid=avwOz7YrGJLU&refer=germany.

15 *Id.*

Reaction to abuse of USVI tax benefits

In June 2004, the IRS announced its intention to challenge taxpayers who claimed EDC benefits based on some "highly questionable" positions.[16] In October 2004, Congress enacted The American Jobs Creation Act of 2004 (Jobs Act), which generally makes it more difficult for certain taxpayers to establish *bona fide* USVI residence and narrows the types of income that can qualify for reduced rates.[17] The Jobs Act also requires taxpayers to file an information return with the IRS when they first become or cease to be residents of a U.S. possession.[18] In addition, the IRS is reported to have initiated a systematic audit program, sometimes examining returns with respect to which the normal three-year SOL under IRC § 6501(a) would have expired if they had been residents of other parts of the U.S., even in cases where the taxpayer did not claim EDC benefits.[19]

IRS essentially eliminated the SOL for USVI residents

Although the Jobs Act had already eliminated the SOL applicable to undisclosed "listed" transactions (*i.e.*, tax shelters),[20] the IRS went further by essentially eliminating it for USVI residents who did not participate in listed transactions. Many taxpayers and practitioners previously believed, based on the analysis contained in Field Service Advice 199906031 (Feb. 12, 1999), that the filing of a return by a *bona fide* resident of the USVI with the BIR started the SOL applicable to the IRS with respect to the return. The IRS subsequently reversed course, issuing Chief Counsel Advice Memorandum 200624002 (June 19, 2006). This memo concluded that such filings with the BIR did not start the SOL for U.S. federal income tax purposes unless all income (and its source) was reflected on the return and the taxpayer fully paid his tax liability to the USVI.[21]

Because a taxpayer may be subject to an audit to determine whether he or she reported all income on the return, the 2006 memo effectively eliminated the SOL for USVI residents. As a result, even taxpayers who filed returns and paid tax in the USVI, believing they had filed correctly, could be subject to an IRS audit assessment long after the normal three-year SOL would have expired if they resided anywhere else in the United States.

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16 *See* Notice 2004-45, 2004-2 C.B. 33. This notice is somewhat controversial. *See* Joseph M. Erwin, *Notice 2004-45: IRS Scare Tactics And Tax Enforcement in the U.S. Virgin Islands*, 104 Tax Notes 177 (July 12, 2004) (stating the notice "contains misleading statements and questionable legal conclusions advanced by the IRS in a peremptory manner, rather than through a studied and deliberative regulatory process in which comment and discussion by all government and private-sector stakeholders was considered.").

17 Pub. L. No. 108-357, 118 Stat. 1418 § 908 (codified, in relevant part, at IRC § 937).

18 *See* IRC § 937(c); Form 8898, *Statement for Individuals Who Begin or End Bona fide Residence in a U.S. Possession* (Jan. 2007). The IRS revised the original March, 2007 version of Form 8898 to eliminate certain questions after receiving the comment that the original version unnecessarily invaded taxpayer privacy by asking, among other things, for a list of memberships in social, political, cultural, religious, and professional organizations.

19 Letter from Counsel to the Government of the USVI, to the IRS, *Notice 2007-19 and Notice 2007-31*, 6 (June 5, 2007).

20 *See* Pub. L. No. 108-357, 118 Stat. 1418 § 814 (codified at IRC § 6501(c)(10) and applicable to taxable years with respect to which the period for assessing a deficiency did not expire before October 22, 2004). *See also* Rev. Proc. 2005-26, 2005-1 C.B. 965 (describing procedures for disclosing listed transactions so as to start the SOL).

21 The IRS did not alert the public to this significant departure from its prior analysis for over a year. The 2006 memo was issued February 16, 2005, but not released to the public until June 16, 2006. For a general discussion of the problems presented by "secret law," see National Taxpayer Advocate 2006 Annual Report to Congress 10-31 (Most Serious Problem: *Transparency of the IRS*).

The IRS restored the SOL for those with gross income of less than $75,000

On February 21, 2007, the IRS issued Notice 2007-19, which provided that filing a return with the BIR started the SOL (retroactively) if the taxpayer was a "covered person" – an individual claiming to be a *bona fide* resident of the USVI with gross income of less than $75,000 (subject to confirmation via IRS audit).[22] For tax years ending on or after December 31, 2006, a non-covered person – an individual claiming to be a *bona fide* resident of the USVI with gross income of $75,000 or more – would be required to file a *pro forma* return with the IRS along with a "Bona fide Residence-Based Return Position" (BFRBRP) statement, which would start the SOL.[23] For tax years ending before December 31, 2006, non-covered persons could elect to file returns with the IRS for prior years in order to start the SOL (prospectively) with respect to those years.[24] These procedures were short lived, however.

The IRS restored the SOL for tax years ending on or after December 31, 2006

On March 30, 2007, the IRS issued Notice 2007-31, which provided that for tax years ending on or after December 31, 2006, the U.S. federal SOL would commence upon the filing of an income tax return with the USVI (without regard to the person's income), as long as a Working Arrangement on the routine exchange of information under the Tax Implementation Agreement between the U.S. and the USVI remains in force.[25] On April 9, 2008, the IRS and Treasury Department issued final regulations formally adopting this rule, effectively leaving non-covered persons with no SOL for years ending before December 31, 2006.[26] The regulations also make a taxpayer's SOL for future years contingent on something he or she has no control over – the IRS's satisfaction with the Working Arrangement under the USVI Tax Implementation Agreement.

REASONS FOR CHANGE

Neither residency nor gross income is a traditional basis for extending a SOL.

For most U.S. citizens, the filing of a federal income tax return starts a three-year SOL within which the IRS may assess a deficiency.[27] An exception to the general principle that actions must be brought within a reasonable period of time has traditionally applied when

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22 Notice 2007-19, 2007-1 C.B. 689. On September 19, 2006, Representative Rangel, Chairman of the House Committee on Ways and Means, sent a letter to Nina E. Olson, National Taxpayer Advocate, expressing concerns that residents of the USVI have no statute of limitation protections. On January 24, 2007, he sent a letter to Henry Paulson, Secretary of the Treasury, expressing similar concerns.

23 Similar information is now required on Form 8898, *Statement for Individuals Who Begin or End Residence in a U.S. Possession*.

24 The IRS initially estimated that an average person would spend five hours in connection with a BFPRP and that approximately 8,500 persons would take the time to do so. *See* Notice 2007-19, § 4, 2007-1 C.B. 689. This reporting burden was eliminated with Notice 2007-31. On March 28, 2007, Chairman Rangel and Senators Rockefeller, Hatch and Crapo, members of the Senate Committee on Finance, sent a letter to Secretary Paulson expressing their dissatisfaction with Notice 2007-19.

25 *See* Notice 2007-31, 2007-1 C.B. 971.

26 *See* T.D. 9391, 73 F.R. 19,350, 19,355-56, 61-65 (Apr. 9, 2008); Treas. Reg. §§ 1.932-1(c)(2)(ii), -1(i)(5)(iii) (Example 5).

27 IRC § 6501(a).

persons flee from justice.[28] In the context of federal income taxes, exceptions to the SOL on assessments already apply when taxpayers intentionally evade detection (*e.g.*, via fraud), significantly understate income, or do not provide the IRS with information (or a return) that the IRS could use to timely detect a deficiency.[29] By contrast, U.S. citizens who believe they are USVI residents may have no SOL (because they have not started it) even if they have not done any of these things and have timely filed nonfraudulent returns with the BIR as required by law.

Fixed SOLs allow taxpayers to establish reasonable document retention policies.

Taxpayers who have filed non-fraudulent returns cannot reasonably be expected to defend tax positions long after memories of witnesses have faded or evidence is lost.[30] Since most taxpayers do not intentionally evade tax and believe they have provided the IRS with all required information, they assume the filing of a return begins the SOL. As a result, some taxpayers reasonably assume they can begin to dispose of tax-related documents after the normal three-year SOL is scheduled to expire.

Fixed SOLs allow the IRS to use its audit resources more efficiently.

One argument sometimes advanced for lengthening or eliminating the SOL is that it will reduce the likelihood that taxpayers will take questionable tax positions. This argument is based on the theory that deterrence is a function of the liability likely to result from an audit multiplied by the likelihood of detection.[31] The conclusion that a longer SOL will increase deterrence rests, in part, on the assumption that the IRS is more likely to detect deficiencies if it has more time. This assumption is not necessarily correct.

Since the IRS does not have sufficient resources to audit most returns, extending the SOL will dilute audit coverage by expanding the potential universe of returns and periods that the IRS needs to spend its limited resources to audit. The IRS will be less efficient in

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28 *See, e.g.*, *Adams v. Woods*, 6 U.S. (2 Cranch) 336, 337 (1805) (quoting the 32d § of the Act of Congress of April 30th, 1790, vol. 1, p 113, 114, which provided a statute of limitations for both criminal and civil actions, except with respect to "persons fleeing from justice.").

29 *See, e.g.*, IRC § 6501(c) (withdrawing the benefit of a SOL when a taxpayer fails to file a return or files a false return with the willful intent to evade tax); IRC § 6501(e)(1) (extending the SOL to six years when a taxpayer omits gross income of more than 25 percent from the return). One proposal would create an additional exception to the SOL for assessments resulting from adjustments to State or local tax liability. Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* 103 (May 2009). For all of the reasons described below, the National Taxpayer Advocate does not support this special exception. For example, infinite document retention would become the norm; IRS examinations would become increasingly burdensome and inefficient as they apply old law to old facts; the examination rate would probably decline as the IRS is unable to complete as many examinations; and noncompliance might increase if taxpayers suspect federal and state authorities are colluding to arbitrarily circumvent the statute of limitation rules to target certain groups of taxpayers.

30 According to the Supreme Court:

> A federal cause of action brought at any distance of time would be utterly repugnant to the genius of our laws. Just determinations of fact cannot be made when, because of the passage of time, the memories of witnesses have faded or evidence is lost. *Wilson v. Garcia*, 471 U.S. 261 (Apr. 17, 1985) (superseded on other grounds).

31 *See, e.g.*, Joel Slemrod, *Why People Pay Taxes: Introduction, in* Why People Pay Taxes 1, 2 (Joel Slemrod ed., 1992) ([under a rational economic decision making model] "one would expect that noncompliance would respond to changes in both the likelihood that an act of evasion will be detected and punished, as well as the severity of the punishment. Social scientists from other disciplines have stressed the narrowness of this view and focused on the importance of peer pressure, civic responsibility and other factors.").

auditing the returns it does select because it will have to spend more time making factual and legal determinations with respect to old years, based on old records, and applying old laws.[32] As a result, the IRS will not be able to conduct as many audits. Such a shift in resource allocation will reduce, rather than increase, the likelihood that a given taxpayer will be subject to an audit for a given year.[33] Once such a reduction in audit coverage becomes known, the same theory predicts that taxpayers will take more questionable tax positions. Moreover, a clearly defined and reasonable SOL probably reduces waste and inefficiency for both the IRS and taxpayers.

Audit adjustments with respect to old years are also less likely to improve taxpayer reporting in future years than adjustments with respect to more recent years.[34] Since tax rules and a taxpayer's economic activities change over time, the educational benefit of an audit is likely to decline the longer the IRS waits to perform it after the return is filed. Moreover, a shorter SOL could increase tax compliance if it allows the IRS to use its resources more efficiently to conduct more current audits, which have a ripple effect on compliance by other taxpayers.[35]

The law should not be so vague as to allow the IRS to appear to be arbitrarily singling out a narrow class of taxpayers.

The net result of the series of IRS pronouncements described above is that the IRS has, without legislation, upset longstanding expectations by singling out for special treatment those taxpayers with gross incomes of more than $75,000 who are claiming USVI residency. For many of these taxpayers the SOL will not begin (or end) for tax years ending before December 31, 2006, even if they have properly filed nonfraudulent returns and have not claimed EDC benefits. Moreover, according to the IRS it has not been able to identify and correct the SOL reflected in IRS computer systems for 23 percent of those the IRS believes are legally entitled to one.[36]

The IRS's broad power to eliminate the benefit of a SOL may also frustrate the purpose of the tax incentives enacted to encourage investment by high income taxpayers in the USVI. Its actions inadvertently sent the message that the IRS could unilaterally decide to remove the benefit of a statute of limitations and examine high income USVI taxpayers – the very people USVI hopes to attract – decades later. More importantly, perceptions of arbitrary

32 When a private party has been injured, a statute of limitations is thought to serve four interests: (1) defendants' interest in avoiding stale claims; (2) society's interest in avoiding stale claims; (3) the plaintiff's interest in vindicating their rights; and (4) society's interest in the vindication of plaintiffs' rights. *See* Eli J. Richardson, *Eliminating the Limitations of Limitations Law*, 29 Ariz. St. L.J. 1015, 1021 (Winter 1997) (noting that society's interest in avoiding stale claims arises, in part, from a desire to relieve the government from adjudicating claims with respect to which evidence is unavailable).

33 To the extent the IRS wants to increase deterrence with respect to a given class of taxpayers or transactions, under this theory it can simply increase audit coverage of such taxpayers or transactions in the current year if it has the resources. Increasing coverage in current years does not produce the same inefficiencies as spending the same resources to audit old years.

34 One justification for the IRS's initiatives to improve audit "currency" is that identifying noncompliance early helps to improve voluntary compliance.

35 *See, e.g.*, Alan H. Plumley, Pub. 1916, *The Determinants of Individual Income Tax Compliance: Estimating The Impacts of Tax Policy, Enforcement, and IRS Responsiveness* 35-36 (Oct. 1996).

36 IRS response to TAS information request (Oct. 30, 2009) (citing SSN matching problems).

and unfair tax administration diminish the public's willingness to comply with the law, potentially reducing federal tax receipts.[37] Thus, allowing the IRS to retain such broad discretion is inconsistent with good tax administration.

IRS audits of years ending before December 31, 2006, have gone on long enough.

As of September 30, 2009, the IRS was using 49 revenue agents and 10 attorneys for USVI-related examinations and appeals.[38] These personnel were handling 371 open examinations of 231 individuals and 140 related entities, and over 90 percent of these examinations involved years prior to 2004.[39] While IRS examiners took 278 days on average to examine a non-USVI return over the FY 2005-FY 2009 period, they have been taking 508 days – 82.7 percent longer – to examine USVI returns over the same period. With more than three times as many cases open (371) as it has closed (105) since FY 2005, the IRS appears to be committing more resources to these cases.[40]

Based on the limited data available to TAS, the IRS appears to be wasting these resources. While revenue agents working these examinations generated assessments of $3,250 per hour, an average IRS revenue agent generated assessments of $3,689 per hour working on non-USVI cases during the same period.[41] Thus, by this limited measure, the IRS could be said to forego $439 ($3,689 - $3,250) in assessments for every hour its revenue agents spend on these cases.

Moreover, taxpayers have disputed 41 percent of the USVI assessments as compared to the national average of 14 percent for non-USVI cases.[42] Thus, the IRS will more frequently have to spend additional resources after it makes an assessment in these cases. These statistics support the analysis above, which suggests that increasing the SOL may reduce audit productivity along with voluntary compliance.

IRS delay in providing information about these audits to the National Taxpayer Advocate raises concerns.

For a year and a half, the National Taxpayer Advocate has been requesting specific data regarding USVI cases.[43] Only after it became evident that she would publicly discuss this

37 *See, e.g.*, Richard Lavoie, *Cultivating a Compliance Culture: An Alternative Approach for Addressing the Tax Gap*, U. of Akron Legal Studies Research Paper No. 08-05, 5-7 (Sept. 1, 2008); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

38 IRS response to TAS information request (Oct. 30, 2009).

39 *Id.*

40 *Id* (indicating the closed cases include 73 individual and 32 related entities).

41 *Id*; AIMS Closed Case Database (Nov. 2009).

42 IRS response to TAS information request (Oct. 30, 2009); AIMS Closed Case Database (Nov. 2009). For all 549 open and closed USVI cases during the FY 2005-FY 2009 period, the IRS has proposed assessments of $89,154,129 in Appeals or Tax Court, assessed $31,742,990 on closed cases, and collected $18,382,830 on closed cases, including penalties and interest. IRS response to TAS information request (Oct. 30, 2009).

43 E-mail from TAS (Apr. 15, 2008); E-mail from TAS (July 15, 2008); E-mail from TAS (Oct. 1, 2008); E-mail from TAS (Oct. 8, 2008); Meeting between TAS and SB/SE (Mar. 30, 2009); E-mail from TAS (May 28, 2009); E-mail from TAS (June 19, 2009); E-mail from TAS (July 6, 2009); E-mail from TAS (July 13, 2009).

lack of transparency did the IRS provide any USVI data to TAS.[44] The IRS's repeated failure to provide such information to TAS, an entity designed by Congress to protect taxpayer rights, is cause for concern. Without transparency or statutory limits on the IRS's exercise of discretion in conducting audits of a certain group of USVI residents for an unlimited period of time, taxpayer rights are at risk.

EXPLANATION OF RECOMMENDATION

Although the proposed change might prevent the IRS from pursuing some past noncompliance by those claiming USVI residency, every SOL allows the government to focus on more recent noncompliance at the expense of potentially overlooking old noncompliance. This proposal would simply put USVI residents who have filed nonfraudulent returns and have not invested in undisclosed listed transactions on the same footing as other U.S. citizens. Even if this proposal is enacted, the IRS could still pursue the most egregious cases of noncompliance on old returns – those involving fraud (including civil fraud), substantial understatements, or undisclosed listed transactions.[45] Moreover, no examination resources would be wasted because the legislation would give the IRS another 90 days to complete ongoing examinations. The provision requiring the USVI to automatically provide the IRS with returns filed with the BIR undercuts the argument that an unlimited SOL might be needed if some future USVI administration is unwilling to provide returns to the IRS in a timely manner.

[44] On October 30, 2009, after a number of additional communications, the IRS sent TAS an unexplained spreadsheet labeled "USVI A-CIS data as of 9/30/09." IRS response to TAS information request (Oct. 30, 2009).

[45] *See* IRC § 6501(c)(1); IRC § 6501(c)(10); Rev. Proc. 2005-26, 2005-1 C.B. 965. In addition, according to the IRS, injunctions against those who were initially promoting abuse of the USVI EDC program are unnecessary "in light of the abatement of current promotion activity and the 2004 enactment of stricter residence and source requirements under section 937." *See* Petronchak Letter.

LR #11 Increase the Threshold for the Election to Claim the Foreign Tax Credit Without Filing Form 1116 for Individuals and Index It for Inflation

PROBLEM

Taxpayers can generally take either a credit or a deduction for foreign taxes paid or accrued on income (including foreign taxes paid in lieu of a tax on income).[1] The foreign tax credit (FTC) is a highly sophisticated and complex mechanism, containing detailed and complicated limitations that are separately applied to various "income baskets."[2] These provisions are difficult to comprehend, and some individual taxpayers may not have the resources to fully comply with them.[3]

Individual taxpayers who claim the FTC generally must compute applicable limitations by completing Form 1116, *Foreign Tax Credit*.[4] However, an individual taxpayer may elect to claim the FTC for any tax year without applying the limitations or filing Form 1116 if his or her creditable foreign taxes for the year relate exclusively to qualified passive income and are not more than $300 ($600 if filing a joint return) and if certain other criteria are met.[5]

Inflation has eroded the value of the $300/$600 threshold, which has not been adjusted since 1997.[6] Had it been indexed for inflation, the election threshold would have increased to more than $404.00 (more than $808.00 for jointly filed returns) in 2009.[7]

EXAMPLE

A retired couple invested $50,000 of their retirement savings into a U.S. mutual fund that invests in foreign stocks and securities. In tax year (TY) 2002 through TY 2006, the couple received payee statements on Form 1099-DIV reporting foreign income and creditable foreign taxes withheld, and elected to claim the FTC on their Form 1040 without computing the FTC limitation and filing a separate Form 1116. While the mutual fund's annual income from the investment in terms of foreign currency remained unchanged, the dollar exchange rate toward the foreign currency decreased at a rate of 15 percent per annum

1 Internal Revenue Code (IRC) §§ 901 and 903. *See also* IRS Pub. 514, *Foreign Tax Credit for Individuals* (2008).

2 *See generally* IRC § 904. Publication 514, *Foreign Tax Credit for Individuals*, is 44 pages long and contains cross-references to two other publications comprising about 145 more pages.

3 *See* Most Serious Problem: *U.S. Taxpayers Located or Conducting Business Abroad Face Compliance Challenges, supra. See also* American Bar Association (ABA), *Report of the Task Force on International Tax Reform*, 59 Tax Lawyer 649, 717 (2006) (stating that the cost of taxpayer compliance with the international rules is proportionately much higher than for domestic rules).

4 The total estimated time for taxpayers to complete and file this form is about five hours. *See* Instructions to IRS Form 1116, *Foreign Tax Credit* (2008).

5 IRC § 904(k)(2); Treas. Reg. § 1.904(j)-1.

6 This provision was added by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997).

7 U.S. Bureau of Labor Statistics, Inflation Calculator, http://data.bls.gov/cgi-bin/cpicalc.pl (last visited Dec. 22, 2009).

from TY 2004 through TY 2006. As a result, in TY 2007 the dollar amount of the couple's qualified passive income and creditable foreign taxes increased. Creditable foreign taxes exceeded the $600 threshold by approximately $90. The couple had to compute the FTC limitation and spent about five hours completing Form 1116. However, being unfamiliar with the limitation, the taxpayers overstated the amount of FTC, which led the IRS to examine their return and assess additional tax, penalty, and interest. In TY 2008, the couple received $5,300 in qualified passive income and exceeded the election threshold by approximately $105. Therefore, the taxpayers hired a preparer to complete and file Form 1116 with their tax return, which cost them an additional $200.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 904(k)(2)(B) to increase the amount of creditable foreign taxes on qualified passive income threshold to $500 ($1000 if filing a joint return) and index this amount for inflation in $50 increments.

PRESENT LAW

An individual taxpayer may elect an exemption from the FTC limitation (and claim the FTC for any tax year without using Form 1116) if his or her creditable foreign taxes on qualified passive income for the year are not more than $300 ($600 if filing a joint return) and the following criteria are met:

- All of the individual's foreign source gross income for the taxable year is qualified passive income, such as interest and dividends;[8] and
- All foreign income and creditable foreign taxes paid or accrued for the year are shown on a payee statement furnished to the individual, such as Forms 1099-INT, *Interest Income*, or 1099-DIV, *Dividends and Distributions*.[9]

REASONS FOR CHANGE

The FTC contains detailed and complicated limitation and "income basket" provisions,[10] which for individual taxpayers are difficult to understand and comply with in full.[11] The exemption from the FTC limitation is intended to relieve taxpayers with small amounts of foreign tax and corresponding tax credit from the reporting burden of completing the complex Form 1116.[12] However, inflation has eroded the value of the $300/$600 threshold,

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8 IRC § 904(k)(2)(A).

9 IRC §§ 904(k)(3)(A)(ii), 904(k)(3)(B), and 904(k)(3)(C).

10 *See generally* IRC § 904.

11 *See* Most Serious Problem: *U.S. Taxpayers Located or Conducting Business Abroad Face Compliance Challenges, supra. See also* ABA, *Report of the Task Force on International Tax Reform*, 59 Tax Lawyer 649, 717 (2006) (stating that the cost of taxpayer compliance with the international rules is proportionately much higher than for domestic rules).

12 Publication 514, *Foreign Tax Credit for Individuals*, is 44 pages long and contains cross-references to two other publications comprising about 145 more pages.

which has not been adjusted since 1997.[13] In addition, more taxpayers are being exposed to the FTC limitation and have to claim FTC on Form 1116 because of falling dollar exchange rates and increased investments in mutual funds holding foreign investments.[14]

EXPLANATION OF RECOMMENDATION

This legislative change would enable individual taxpayers to claim the FTC for any tax year without the burden of computing the FTC limitation and filing Form 1116 when they receive *de minimis* qualified passive income. By increasing the amount of creditable foreign taxes on qualified passive income threshold from $300 to $500 for individual taxpayers, and from $600 to $1,000 for joint filers, this legislative recommendation would reduce burden for 152,404 taxpayers (or over five percent of all Form 1116 filers) based on TY 2008 data.[15]

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13 This provision was added by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997).

14 *See* Systemic Advocacy Management System Issue No. 16051 (Sept. 16, 2009).

15 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File, Form 1040 and Form 1116 tables (Tax Year 2008 (for returns filed through Sept. 2009)).