

**WRITTEN STATEMENT OF**

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**HEARING ON**

**“IRS: IS IT READY?”**

**BEFORE THE**

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Chairman Connolly, Ranking Member Hice, and distinguished Members of the Subcommittee:

Thank you for inviting me to testify at today's hearing.<sup>1</sup> As I wrote in the National Taxpayer Advocate's Annual Report to Congress, 2021 was the most challenging year taxpayers and tax professionals have ever experienced, and last year's challenges and processing backlog continue to cause delays this filing season.<sup>2</sup>

In this statement, I will highlight the main challenges taxpayers faced last year; suggest steps the IRS can take now to reduce its processing backlog, minimize the backlog's impact on the 2022 filing season, and otherwise meet taxpayers' needs; make recommendations for medium-term and longer-term solutions; and address challenges my own organization, the Taxpayer Advocate Service (TAS), has been facing in assisting taxpayers.

Before I discuss taxpayer problems, I want to take a moment to credit the IRS for doing a lot right under difficult circumstances. Although taxpayer service challenges existed prior to 2020, the unprecedented return processing and correspondence backlogs we have seen over the past two years did not exist before the pandemic. The pandemic forced the IRS to temporarily shut down its processing facilities for the health and safety of employees. That, in turn, caused the IRS to fall behind on its inventories. The resulting problems snowballed over the last two years into unprecedented delays and challenges, and the IRS is still struggling to catch up. Also due to the pandemic, Congress directed the IRS to administer several financial relief programs that required the IRS to divert resources from its core tax administration work, straining its resources even more.

Among other things, last year the IRS issued 478 million stimulus payments (referred to as Economic Impact Payments or EIPs) totaling \$812 billion and sent Advance Child Tax Credit (AdvCTC) payments to over 36 million families totaling over \$93 billion. It also implemented a retroactive change in law enacted during the 2021 filing season that excluded up to \$10,200 in 2020 unemployment compensation benefits from gross income – in most cases without requiring affected taxpayers who had already filed returns to file amended returns. The IRS's leadership and workforce deserve credit for their accomplishments – and I am particularly grateful to TAS employees for all they have done to assist taxpayers under these difficult circumstances.

## **I. Biggest Taxpayer Challenges**

The biggest problems taxpayers encountered last year – and are continuing to encounter this year – were return processing delays, correspondence processing delays, difficulty reaching the IRS by telephone, and the inability to obtain information from the IRS's Where's My Refund? and Where's My Amended Return? tools.

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<sup>1</sup> The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

<sup>2</sup> National Taxpayer Advocate 2021 Annual Report to Congress 1 (Preface: *Introductory Remarks by the National Taxpayer Advocate*).

**A. Taxpayers have been experiencing significant delays in receiving their tax refunds because of unprecedented IRS backlogs in the processing of original and amended tax returns.**

During 2021, the IRS received approximately 169 million individual income tax returns. About 90 percent were e-filed, and most of them were processed without delay.<sup>3</sup> Nevertheless, tens of millions of taxpayers were subject to delays in the processing of their returns, and many of the delays have been substantial and ongoing.

At the close of the 2021 filing season (which was May 17, 2021, due to the postponed deadline), the IRS was holding 35.3 million tax returns for manual review. This backlog consisted of roughly half unprocessed paper returns and half tax returns suspended during processing, leading to refund delays for many of these taxpayers.<sup>4</sup> For original returns that were e-filed in 2021, the IRS has worked through the backlog. But the story is very different for paper returns.

In releasing my Annual Report to Congress, I said that paper is the IRS's kryptonite and that the IRS is still buried in it. There is no doubt that paper processing remains the agency's biggest challenge, and that will continue throughout 2022. As of late December 2021, the IRS still had backlogs of six million unprocessed original individual returns (Form 1040 series) and 2.3 million unprocessed amended individual returns (Forms 1040-X) – with some return submissions dating back at least to April and many taxpayers still waiting for their refunds one year later. In addition, more than two million employer's quarterly tax returns (Forms 941 and 941-X) remained unprocessed.<sup>5</sup>

As of April 8, 2022, the IRS had in its inventory about 20.9 million tax returns and about 5.3 million pieces of taxpayer correspondence/Accounts Management cases (excluding amended tax returns) that require manual processing, as shown in Figure 1.

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<sup>3</sup> IRS, Filing Season Statistics for Week Ending December 3, 2021, <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-3-2021>.

<sup>4</sup> National Taxpayer Advocate 2021 Annual Report to Congress 95-108 (Most Serious Problem: *Filing Season Delays: Millions of Taxpayers Experienced Difficulties and Challenges in the 2021 Filing Season*).

<sup>5</sup> National Taxpayer Advocate 2021 Annual Report to Congress 1-11 (Prologue: *Preface: Introductory Remarks by the National Taxpayer Advocate*).

**Figure 1, Status of Inventory Requiring Manual Processing (as of April 8, 2022)<sup>6</sup>**

	Individual	Business	Not Specified	Total
<b>Paper Returns Awaiting Processing</b>				
Received in Calendar Year 2021	2,100,000	834,000	-	2,900,000
Received in Calendar Year 2022	3,400,000	4,400,000	1,400,000	9,200,000
<b>Total Paper Returns Awaiting Processing</b>	<b>5,500,000</b>	<b>5,200,000</b>	<b>1,400,000</b>	<b>12,100,000</b>
<b>Paper and Electronic Returns – Processing Suspended</b>	3,700,000	1,400,000	-	5,200,000
<b>Amended Returns Inventory</b>	<b>2,500,000</b>	<b>1,100,000</b>	-	<b>3,600,000</b>
<b>Total Unprocessed Returns</b>	<b>11,700,000</b>	<b>7,700,000</b>	<b>1,400,000</b>	<b>20,900,000</b>
<b>Correspondence/Accounts Management Cases (excluding amended returns)</b>	<b>2,300,000</b>	<b>1,000,000</b>	<b>2,000,000</b>	<b>5,300,000</b>
<b>Total Inventory Requiring Manual Processing</b>	<b>14,000,000</b>	<b>8,700,000</b>	<b>3,400,000</b>	<b>26,200,000</b>

As of April 11, 2022, the IRS website reports that it has “processed all error free refund returns received prior to April 2021” and continues “to work the returns that need to be manually reviewed due to errors.”<sup>7</sup> By implication, that means returns filed as far back as April of last year are still awaiting processing. That is now one year ago and counting, and if IRS systems detect any discrepancies and issue a math error notice with respect to a return, the taxpayer likely will end up waiting more than a year to receive any refund due.

Of all individual returns processed last year, 77 percent resulted in refunds, and during the current filing season through April 1, 2022, about 71 percent of individual returns resulted in refunds.<sup>8</sup> Therefore, processing delays translate directly into refund delays. Refund delays can create financial hardships for many taxpayers, particularly those who are low-income. For tax year 2021, Earned Income Tax Credit benefits are worth up to \$6,728; Child Tax Credit benefits are worth up to \$3,600 per qualifying child aged five and under and \$3,000 per qualifying child aged six to 17; and the Recovery Rebate Credits (RRCs) were potentially worth several thousand dollars for families who did not receive some or all of their third EIP. Millions of taxpayers rely on the benefits from these programs to pay their basic living expenses, and when refunds are substantially delayed, the financial impact can range from mild inconvenience to severe financial hardship.

While taxpayers who e-filed their returns generally fared better than taxpayers who filed on paper, millions of e-filed returns were suspended during processing due to discrepancies between amounts claimed on the returns and amounts reflected in the IRS’s records. The most common discrepancy involved RRC claims filed by taxpayers who did not receive some or all of their EIPs the prior year. The IRS had to manually review these returns. Of the nearly 14 million math error notices issued in 2021, more than 11 million math error notices were due to

<sup>6</sup> Email from Wage and Investment Division (Apr. 18, 2022); IRS, Status of Unopened Mail and Backlog Inventory (Apr. 15, 2022).

<sup>7</sup> IRS Operations During COVID-19: Mission-critical functions continue, <https://www.irs.gov/newsroom/irs-operations-during-covid-19-mission-critical-functions-continue> (showing information updated on Apr. 11, 2022).

<sup>8</sup> IRS, Filing Season Statistics for week ending April 1, 2022, 2022 Filing Season Statistics Cumulative Statistics Comparing April 2, 2021, and April 1, 2022.

RRC discrepancies with the IRS's records.<sup>9</sup> As of early April 2022, the IRS has issued about 9.4 million math error notices for RRC, the Child Tax Credit, or other inconsistencies.<sup>10</sup> When a taxpayer disagreed with a math error notice and submitted a response, the resulting correspondence added to the IRS's mounting paper submission pile that awaited processing and generated more delayed responses. I anticipate the IRS will issue millions more math error notices for the 2021 tax returns not yet filed. I am concerned that the number of returns unprocessed or suspended that require manual processing will be high again throughout 2022. The IRS needs to process the current inventory backlog faster than incoming returns, which are continuing to increase the total inventory awaiting processing. It needs to decrease and quickly resolve the total inventory weekly numbers.

As part of the American Rescue Plan Act (ARPA) enacted in March 2021, Congress authorized two advance tax credit payments that may result in additional discrepancies between amounts claimed on tax returns and in IRS records.<sup>11</sup> The first was a third round of EIPs that may be claimed as RRCs by taxpayers who did not receive them or did not receive the full amounts for which they are eligible. The second was monthly payments of the AdvCTC for the second half of 2021. Taxpayers will have to claim and/or reconcile both credits on a 2021 individual tax return. Though the IRS has attempted to minimize discrepancies by including the information in online taxpayer accounts and sending notices to taxpayers who received EIPs and AdvCTC payments showing how much they received, a small number of the notices were inaccurate and millions of discrepancies – and subsequent math error notices – remain likely.

**B. Taxpayers have been experiencing additional delays in receiving their tax refunds because of IRS delays in processing taxpayer correspondence.**

The IRS sent tens of millions of notices to taxpayers during 2021. These included nearly 14 million math error notices overall, Automated Underreporter notices (where an amount reported on a tax return did not match the corresponding amount reported to the IRS on a Form 1099 or other third-party information return), notices requesting a taxpayer authenticate his or her identity (where IRS security filters flagged a return as potentially filed by an identity thief), correspondence examination notices, and collection notices. In many cases, taxpayer responses were required, and if the IRS did not process a response, its automated processes could take adverse action or not release the refund claimed on the tax return. The IRS received 6.2 million taxpayer responses to proposed adjustments and took an average of 199 days to process them – up from 74 days in fiscal year (FY) 2019, the most recent pre-pandemic year.<sup>12</sup>

**C. Taxpayers had more difficulty reaching the IRS by telephone in 2021 than in any prior year.**

The combination of processing delays and questions about new legislation and programs such as the AdvCTC caused call volumes to almost triple from the prior year to a record 282 million telephone calls. Customer service representatives (CSRs) only answered about 32 million, or 11 percent, of those calls. As a result, most callers could not obtain answers to their tax law

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<sup>9</sup> IRS, 2021 IRS Math Error Report (cycle 50).

<sup>10</sup> IRS, 2022 IRS Math Error Report (cycle 14).

<sup>11</sup> ARPA, Pub. L. No. 117-2, 135 Stat. 144-45 (2021).

<sup>12</sup> National Taxpayer Advocate 2021 Annual Report to Congress 12-19 (Prologue: *Taxpayer Rights and Service Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights and Service*).

questions, get help with account problems, or speak with a CSR about a compliance notice. Among the one in nine callers who was able to reach a CSR, the IRS reported that hold times averaged 23 minutes.<sup>13</sup> However, the IRS data on hold times excludes taxpayers who waited on hold for extended periods and hung up before a CSR answered their calls. Tax professionals and taxpayers have reported that hold times were often much longer than 23 minutes, and frustration and dissatisfaction were high throughout 2021 with the low level of telephone service. During the current filing season, through April 9, 2022, CSRs answered about ten percent of the 63 million calls received on all telephone lines.<sup>14</sup>

**D. Taxpayers found that the IRS’s Where’s My Refund? and Where’s My Amended Return? tools often could not answer those questions.**

Taxpayers attempted to check the status of their refunds on IRS.gov more than 632 million times in 2021 and more than 309 million times this year through April 8, 2022, but Where’s My Refund? does not provide information on unprocessed returns, and it does not explain any status delays, the reasons for delays, where returns stand in the processing pipeline, or what actions taxpayers need to take, if any.<sup>15</sup> In addition, the refund information is only available for a limited amount of time.<sup>16</sup> Where’s My Amended Return? received more than 13 million hits in 2021 and almost eight million hits this fiscal year through April 2, 2022, but it suffers from similar limitations.<sup>17</sup> For taxpayers who experienced significant refund delays, these tools often did not answer the questions they were designed to address and added to overall frustration.

**II. Short-Term Recommendations**

The IRS’s leadership recognizes that processing delays are the most serious problem facing taxpayers and has been developing plans to work through its backlog. However, the IRS must process returns more quickly, protect taxpayer rights, treat taxpayers more fairly, and provide transparency. TAS recommends the following:

- ***Continue to prioritize the processing of original and amended paper tax returns through an “all-hands-on-deck” surge strategy.*** The IRS reassigned employees from other areas to its Accounts Management function and provided them with additional training to process tax returns. This first surge team has begun processing returns and correspondence. This reallocation of employees is intended to continue until the agency fully works through its backlog, as it struggles with its antiquated information technology (IT) systems for return processing and the overwhelming volume of paper returns and correspondence. The IRS is also increasing staffing in its Submission Processing function (second surge team) as a significant volume of the unprocessed

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<sup>13</sup> National Taxpayer Advocate 2021 Annual Report to Congress 1-11 (Prologue: *Preface: Introductory Remarks by the National Taxpayer Advocate*).

<sup>14</sup> IRS, Joint Operations Center, Enterprise Snapshot Report (Apr. 9, 2021).

<sup>15</sup> IRS, CY 2022 Individual Return Filing and Services, Cumulative Statistics for Week Ending April 8, 2022; See Government Accountability Office, GAO-22-104938, *Tax Filing: 2021 Performance Underscores Need for IRS to Address Persistent Challenges* 31-38 (Apr. 2022).

<sup>16</sup> For example, for individual income tax returns filed before July 1, the refund information is available through the second or third week of December; for those individual income tax returns filed on or after July 1, the refund information is available throughout the following year until a tax return is filed for a more current tax year. See IRS, About “Where’s My Refund,” <https://www.irs.gov/refunds/about-wheres-my-refund>.

<sup>17</sup> Email from Wage and Investment Division (Apr. 15, 2022).

returns work resides there, including all paper Forms 1040. Additionally, paper Forms 1040-X are sent through Submission Processing for initial screening, and many are worked through manual adjustments by Submission Processing employees.

- ***Explore options to increase compensation for processing employees, minimize hiring lags, and utilize outside consultants to assist if necessary.*** Submission Processing employees are generally hired at or around the GS-3 level. The current base pay for GS-3 employees is \$24,749. If the IRS is having difficulty finding enough suitable job applicants, it should utilize all available pay flexibilities, including incentive and retention bonuses, hazard pay, and other options, to retain key processing employees and attract qualified job applicants who can quickly be onboarded and trained.
- ***Provide penalty relief for 2020 and 2021 tax returns.*** The penalties for failure-to-file (FTF), failure-to-pay (FTP), and failure-to-deposit (FTD) must be abated if a taxpayer can show that the failure to comply was “due to reasonable cause and not due to willful neglect.”<sup>18</sup> Where the taxpayer does not make this showing, the IRS can abate these penalties under its “first-time abatement” (FTA) procedures, which require that the taxpayer is otherwise compliant and has not utilized an FTA penalty waiver within the preceding three years.<sup>19</sup> To reduce administrative burdens on taxpayers and the IRS, free up resources, and provide equitable treatment of similarly situated taxpayers, we recommend the IRS provide administrative penalty relief for years impacted by the COVID-19 pandemic challenges systemically for all taxpayers, thereby reserving their FTA for future years. In addition, when the IRS provides taxpayers FTA waivers, we recommend the IRS send correspondence informing taxpayers that they have automatically received the FTA penalty waiver but can ask the IRS to consider a request for “reasonable cause” relief so they can preserve the availability of an FTA waiver for future tax years.
- ***Continue the suspension of all automated collection notices until the IRS gets current in processing original and amended tax returns and taxpayer correspondence.*** Premature lien and levy notices have been issued to taxpayers in circumstances where tax returns or correspondence that show the taxpayers do not have liabilities have not yet been processed. That should not happen. In February, the IRS announced it was suspending the issuance of several collection notices to reduce confusion and frustration for taxpayers still waiting for the IRS to process their returns or correspondence. I commend the IRS for taking this step, and I encourage the IRS to reassign employees who ordinarily process responses to these notices to assist with return processing and the related correspondence.
- ***Add a dedicated team to accelerate the processing of claims for tentative refunds and employer’s quarterly federal tax returns.*** Taxpayers have experienced long processing delays resulting in delayed payment of refunds. Individuals, estates, and trusts may file Form 1045, Application for Tentative Refund, and corporations may file Form 1139, Corporation Application for Tentative Refund, to carry back net operating losses and certain other tax benefits to prior years, as authorized by the Coronavirus Aid, Relief,

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<sup>18</sup> See IRC §§ 6651(a)(1) (FTF), 6651(a)(2) & (a)(3) (FTP), and 6656 (FTD).

<sup>19</sup> See Internal Revenue Manual (IRM) 20.1.1.3.3.2.1, *First Time Abate (FTA)* (Oct. 19, 2020).

and Economic Security Act.<sup>20</sup> Some taxpayers need these refunds to meet payroll or otherwise maintain operations. In addition, the IRS should accelerate the processing of Forms 941, Employer's Quarterly Federal Tax Return, and Forms 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund. Many Forms 941-X have been filed to claim the Employee Retention Credit, and a Form 941-X cannot be processed until the original Form 941 has been processed.

- ***Include a weekly “dashboard” on IRS.gov to provide the public with current and specific information about delays.*** Although the IRS has created a webpage, [IRS Operations During COVID-19: Mission-critical functions continue](#), it only provides certain high-level information rather than detailed information on processing backlogs.<sup>21</sup> For amended individual returns, for example, it says only that “[t]he current timeframe can be more than 20 weeks.” For correspondence backlogs, it says only that processing mail “is taking longer than usual,” and “[t]he exact timeframe varies depending on the type of issue.” It does not provide information on recent telephone delays, even though doing so would give taxpayers a better sense of whether they should devote the time to calling.

On November 9, 2021, I issued Taxpayer Advocate Directive (TAD) 2021-2, in which I recommended that the IRS post a filing season dashboard, updated at least weekly, that lists each category of work and the date through which the IRS has completed processing (e.g., the IRS has processed all original tax returns through Date X and all amended tax returns through Date Y).<sup>22</sup> The dashboard should include this information for original paper tax returns, amended paper tax returns, and math error and other categories of taxpayer correspondence. To apprise taxpayers of their chances of reaching an IRS employee by telephone, the IRS should also post data for each key telephone line showing the percentage of calls that reached an IRS employee the previous week. On December 8, 2021, the IRS responded that it is committed to continuing to work with TAS to improve internal and external reporting and is working with TAS to develop a plan to provide weekly data and to post meaningful updates on IRS.gov.<sup>23</sup> Unfortunately, to date, the IRS has not posted the filing season information we envisioned or requested to provide taxpayers and practitioners much-needed transparency on the filing season challenges.

None of these steps, standing alone, will immediately solve the processing backlog. But taken together, they should accelerate processing, reduce current filing season challenges, ensure taxpayers are treated fairly, and inform taxpayers and tax professionals of the status of work at the IRS.

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<sup>20</sup> CARES Act, Pub. L. No. 116-136, §§ 2303-2305, 134 Stat. 281, 352-357 (2020).

<sup>21</sup> IRS Operations During COVID-19: Mission-critical functions continue, <https://www.irs.gov/newsroom/irs-operations-during-covid-19-mission-critical-functions-continue>.

<sup>22</sup> National Taxpayer Advocate, Taxpayer Advocate Directive 2021-2, Backlog of Unprocessed Amended Returns (Nov. 29, 2021), <https://www.irs.gov/pub/irs-utl/tad-2021-2.pdf>.

<sup>23</sup> Memorandum from IRS Deputy Commissioner for Services and Enforcement, Taxpayer Advocate Directive (TAD) 2021-2 (Dec. 8, 2021), <https://www.irs.gov/pub/irs-utl/tad-2021-2-memo-from-dcse.pdf>.

### **III. Medium-Term and Longer-Term Administrative Recommendations**

#### **A. Improve online taxpayer accounts and allow taxpayers to communicate with the IRS routinely by secure email.**

Online taxpayer accounts are plagued by limited functionality. For example, taxpayers generally cannot use their online accounts to view images of their past tax returns, most IRS notices, or proposed assessments; file documents; or update their addresses. Taxpayers should have the ability to make corrections or adjustments to their returns through their online accounts. Similarly, the IRS generally does not communicate with taxpayers by email. Limitations on communicating with the IRS electronically frustrate taxpayers who have been conducting comparable transactions with financial institutions for more than two decades. This increases the number of telephone calls and pieces of correspondence the IRS sends and receives, and it leads to more paper processing delays. I recommend that the IRS prioritize the development of online accounts along the lines of what financial institutions offer. Additionally, the IRS needs to provide taxpayers options, including in-person verification, to authenticate their identity to establish an online account and provide the highest level of security and protection of taxpayer data.

#### **B. Utilize scanning technology.**

The IRS could reduce its backlog of paper tax returns by using scanning technology to machine-read paper returns and prevent future delays for subsequent filing seasons. Currently, there are two leading types of scanning technology: (i) 2-D barcoding and (ii) optical character recognition (OCR). On March 29, 2022, I issued TAD 2022-1 directing the IRS to work with the tax return software industry to develop a plan for the companies to voluntarily place 2-D barcodes on paper returns prepared with their software products for the 2023 filing season. The TAD also directed the IRS to implement OCR or similar technology to expedite the processing of handwritten tax returns and returns with barcodes that cannot be read for the 2023 filing season if possible or, if not, for the following filing season.<sup>24</sup> As I am not an IT expert, I am not a proponent of a specific technology to use. However, my recommendation is that the IRS quickly implement scanning technology with the goal of it being available for the next filing season to minimize processing time for paper returns and correspondence.

When a customer buys a product at a grocery store or a pharmacy, the product is typically marked with a barcode that can be scanned at the checkout line. Similarly, when a taxpayer prepares a paper tax return using tax return software, the software companies generally can place a 2-D barcode on the return that encodes the return data in a machine-readable form. The IRS could then scan the barcode – like the supermarket or pharmacy does – and convert the data into a digital form that would allow the IRS to process the return like an e-filed return. Software companies have been placing 2-D barcodes on returns for some state tax agencies for more than two decades. The main advantages of 2-D barcoding are that it provides nearly 100 percent accuracy and

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<sup>24</sup> National Taxpayer Advocate, Taxpayer Advocate Directive 2022-1: Implement Scanning Technology to Machine Read Paper Tax Return and Address the Paper Return Backlog (Mar. 29, 2022), <https://www.irs.gov/pub/irs-utl/tad-2022-1-memo-from-nta.pdf>; Erin M. Collins, Getting Rid of the Kryptonite; The IRS Should Quickly Implement Scanning Technology to Process Paper Tax Returns, NATIONAL TAXPAYER ADVOCATE BLOG (Mar. 30, 2022), <https://www.taxpayeradvocate.irs.gov/news/nta-blog-getting-rid-of-the-kryptonite-the-irs-should-quickly-implement-scanning-technology-to-process-paper-tax-returns/>.

eliminates the need for an IRS employee to manually transcribe each digit on the return. The disadvantage is that it does not help with paper tax returns prepared by hand or otherwise prepared without using tax software. Based on TAS's analysis, 50 to 60 percent of the individual income tax returns submitted on paper and processed over the last two years were prepared with tax return software and would not need to be transcribed if 2-D barcodes were added.<sup>25</sup>

OCR, an alternative type of scanning technology, has the opposite advantage and disadvantage. The advantage is that it can be used to machine-read all returns, including returns prepared by hand. The main disadvantage is that it is not 100 percent accurate; for example, a "1" and a "7" may look similar, so OCR may read the digit incorrectly. However, OCR technology should still be more accurate than manual data transcription because an employee not only may have the same difficulty distinguishing between the "1" and the "7" but also may hit the wrong key by mistake from time to time. Last year, IRS employees made transcription errors on 22 percent of paper returns.<sup>26</sup>

Some states use both 2-D barcoding for software-prepared returns and OCR for other returns. The IRS recently conducted a pilot and is exploring broader use of scanning technology. In my view, this should be a top technology priority. Implementation of scanning technology by the 2023 filing season would ensure that the current paper return processing backlog is resolved within a year and would achieve significant paper return processing efficiencies in the future. For those reasons, in TAD 2022-1, I directed the IRS to take immediate steps to implement scanning technology for Forms 1040, Forms 1040-X, and business returns filed on paper. We expect the IRS response to the TAD by May 13, 2022.

### **C. Reduce barriers to e-filing.**

The IRS deserves considerable credit for raising the e-file rate for individual returns to about 90 percent in the 2021 filing season. But that still left about 17 million individual income tax returns coming in on paper.<sup>27</sup> During the current filing season, as of April 1, 2022, 96.3 percent of individual returns have been e-filed.<sup>28</sup> However, historically, early filers e-file and paper filers file later in the filing season and on extension. Last year at the same time, a slightly smaller 94.7 percent of returns were e-filed, but by December 3, 2021, the e-file rate decreased to 90 percent due to the subsequent paper filings.<sup>29</sup>

Scanning technology, as discussed above, would provide a solution. However, it is worth noting that some taxpayers who want to e-file their returns are not able to do so for any of several reasons: some lower-volume tax forms are not "supported" by the IRS's e-file system; the IRS rejected millions of e-filed returns last year because they broke one or more "business rules;" and some taxpayers cannot e-file when they need to include an attachment or when they override a field prepopulated by software. The IRS should take a hard look at the barriers that prevent taxpayers who wish to e-file from doing so. If it can find ways to eliminate those barriers, it will reduce its paper return inventory.

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<sup>25</sup> IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File for tax years 2019 and 2020.

<sup>26</sup> IRS response to TAS information request (Sept. 16, 2021) (data through August 2021).

<sup>27</sup> IRS, Filing Season Statistics for Week Ending December 3, 2021, <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-3-2021>.

<sup>28</sup> IRS, Filing Season Statistics for Week Ending April 1, 2022, <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-april-1-2022>.

<sup>29</sup> IRS, Filing Season Statistics for Week Ending December 3, 2021, <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-3-2021>.

**D. Automate the creation and review of amended tax returns.**

All Forms 1040-X, Amended U.S. Individual Income Tax Return, are reviewed by IRS employees and treated as if submitted on paper even if they are e-filed. That is highly inefficient. The IRS should prioritize an IT upgrade to allow taxpayers to log into their online accounts, select to file an amended return, and have all return data from the taxpayer's originally filed return prepopulate. The taxpayer could then enter the changes – often just one or two – and the amended return could be e-filed and processed electronically. The IRS should be able to pass the return through its business rules via automation. Those returns that pass would be approved quickly without employee review. Others would be routed for further review. If the IRS could implement an upgrade along these lines, it would substantially accelerate the processing of amended tax returns. Over the longer term, the IRS should expand the online account features to allow taxpayers to adjust their tax returns in lieu of filing amended returns.

**E. Deploy “customer callback” technology on all telephone lines, so taxpayers and tax professionals don’t have to wait on hold and can receive a return call when the next customer service representative is available.**

The IRS has begun to deploy customer callback technology on some of its telephone lines. It should continue to expand this technology to all lines. I need to caution, however, that customer callback may not be a cure-all for IRS telephone operations. If the IRS workforce only has the capacity to answer 32 million telephone calls, as it did last year, customer callback still would not have enabled the IRS to handle the 250 million calls that went unanswered.<sup>30</sup> However, many taxpayers and tax professionals call the IRS multiple times before they get through, and if effectively used, customer callback technology could substantially reduce the need for repeat calls, thereby reducing call volumes and assisting taxpayers more effectively. I recommend that Congress provide funding specifically allocated to expand the use of customer callback technology. Moreover, the IRS should establish a goal of answering 85 percent of calls on all IRS lines by appropriately staffing its phone lines based upon average number of yearly calls, and Congress should fully fund this goal.

**F. Disaster relief postponements should enable taxpayers to electronically file their return, which would reduce paper filings.**

Typically, the IRS stops accepting electronic filings before the end of November until the beginning of the next filing season to change over and update its systems from one filing season to the next. This creates a two-month gap preventing taxpayers from filing electronically. A disaster that occurs in the fall postponing the filing or extended filing date typically lands within this gap period. Hurricane Ida is one example. The severity of the disaster and proximity of tax deadlines are primary factors in determining the level of tax relief provided. A postponement period will be at least 60 days from the event date listed in the Federal Emergency Management Agency declaration.<sup>31</sup> I would recommend that the IRS take into consideration the impact on return filing during this gap period when providing much-needed relief at the time of a disaster.

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<sup>30</sup> National Taxpayer Advocate 2021 Annual Report to Congress 66-80 (Most Serious Problem: *Telephone and In-Person Service: Taxpayers Face Significant Challenges Reaching IRS Representatives Due to Longstanding Deficiencies and Pandemic Complications*).

<sup>31</sup> Treas. Reg. § 301-7508A-1(g).

The IRS should provide a postponement date that enables taxpayers to file their returns electronically at least until the IRS has automated its paper processing.

#### **IV. Legislative Recommendations**

The recommendations I have proposed above are ones the IRS can implement on its own. To improve the taxpayer experience, I will highlight three legislative changes that I encourage the Congress to consider.

##### **A. Provide the IRS with additional sustained, multiyear funding at sufficient levels to meet taxpayers' needs.**

The pandemic and the resulting processing and refund delays have shined a spotlight on the IRS's taxpayer service challenges, but they existed before the pandemic. Since FY 2010, the IRS's workforce has shrunk by 17 percent, while its workload – as measured by the number of individual return filings – has increased by 19 percent. The increasing imbalance between more work and reduced resources has had predictable effects. In FY 2019 – the most recent year before the pandemic – IRS employees answered only 29 percent of taxpayer telephone calls, and they were not able to process 58 percent of taxpayer responses to proposed tax adjustments within the agency's own standard processing times. IT systems are antiquated and are largely held together by belts and suspenders, currently unable to offer taxpayers features like effective and robust online accounts.

The IRS receives its annual appropriation in four accounts: (i) Taxpayer Services; (ii) Enforcement; (iii) Operations Support; and (iv) Business Systems Modernization. With limited exceptions, the IRS cannot move funds among its accounts.

To meet basic taxpayer service needs, the IRS requires additional funding in its Taxpayer Services account to improve return processing, correspondence processing, and telephone service. My own organization, TAS, is provided with a minimum funding level in the Taxpayer Services account and requires additional funding to address the increase in our cases, including the spike in congressionally referred cases that we have been receiving, as discussed below. Relatedly, funds from the Operations Support account, which includes IT funding, are allocated partly to support Taxpayer Services operations and partly to support Enforcement operations. To ensure that Taxpayer Services programs receive the funding they need, I encourage Congress to require that a specified amount of Operations Support funding be dedicated to Taxpayer Services initiatives. This would include, for example, additional funding to improve telephone service.

##### **B. Refrain from making changes to the Internal Revenue Code just before, and particularly during, the filing season.**

Last-minute tax law changes create administrability challenges for the IRS and tax software companies and confusion for taxpayers and tax return preparers. When a law is changed, the IRS must reprogram its processing systems to accommodate the change, sometimes leading to delays in the start of the filing season, and tax software companies must update their software so taxpayers and tax return preparers get the right results. In 2007, the National Taxpayer

Advocate's Annual Report to Congress designated the impact of late-year tax law changes as the #1 most serious problem facing taxpayers.<sup>32</sup>

This problem is compounded when the law is changed *during* the filing season. ARPA, enacted in March 2021, provided taxpayers' the ability to exclude up to \$10,200 in 2020 unemployment compensation benefits from gross income.<sup>33</sup> By that time, almost half of all individual taxpayers had filed their 2020 tax returns, including millions who included the full amount of their unemployment compensation benefits in gross income. To its credit, the IRS refigured its IT programming to retroactively give most taxpayers the benefit of the exclusion without requiring them to file amended returns. But there were several adverse consequences: (i) the IRS was forced to divert its limited IT resources to develop and implement this fix; (ii) confused taxpayers made millions of calls to the IRS, and some filed amended returns before the fix was announced; and (iii) the fix could not be applied in all cases, generating further confusion for taxpayers and tax return preparers regarding which taxpayers had to file amended returns.

I recognize that Congress must balance competing priorities, and there are occasions where providing retroactive taxpayer relief may trump considerations of administrability. But changes in law enacted after the IRS has programmed its systems for the filing season create significant challenges for the IRS, software companies, taxpayers, and tax return preparers. I urge Congress to keep these administrability concerns in mind and refrain from making retroactive tax law changes except in extraordinary circumstances.

### **C. Vastly simplify the Internal Revenue Code.**

I list this recommendation last only because it is the least likely to be implemented quickly. Over the long run, simplifying the tax law is the most important step Congress can take to reduce taxpayer compliance burdens. In prior reports, we have discussed the benefits of tax law simplification at length, and we have designated the complexity of the tax code as the most serious problem facing taxpayers.<sup>34</sup> In our 2016 Annual Report to Congress, we said the current tax code:

- Makes compliance difficult, requiring taxpayers to devote excessive time to preparing and filing their returns;
- Requires the significant majority of taxpayers to bear monetary costs to comply, as most taxpayers utilize tax return preparers, and many other taxpayers purchase tax return preparation software;
- Rewards taxpayers who can afford expensive tax advice and discriminates against taxpayers who cannot;

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<sup>32</sup> National Taxpayer Advocate 2007 Annual Report to Congress 3-12 (Most Serious Problem: *The Impact of Late-Year Tax-Law Changes o Taxpayers*).

<sup>33</sup> ARPA, Pub. L. No. 117-2, 135 Stat. 40 (2021).

<sup>34</sup> See National Taxpayer Advocate 2016 Annual Report to Congress 305-324 (Legislative Recommendation: *Tax Reform: Simplify the Internal Revenue Code Now*); National Taxpayer Advocate 2012 Annual Report to Congress 3-23 (Most Serious Problem: *The Complexity of the Tax Code*); National Taxpayer Advocate 2010 Annual Report to Congress 3-14 (Most Serious Problem: *The Time for Tax Reform Is Now*); National Taxpayer Advocate 2010 Annual Report to Congress 365-372 (Legislative Recommendation: *Enact Tax Reform Now*); National Taxpayer Advocate 2005 Annual Report to Congress 375-380 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*).

- Undermines trust and confidence in the tax system, as many taxpayers do not understand how their taxes are computed or even what rate of tax they pay;
- Leads to lower levels of tax compliance, as taxpayers make high rates of both inadvertent and deliberate errors, and the complexity of tax returns limits the IRS's ability to detect noncompliance through audits or other means; and
- Requires a large federal agency to administer the tax system, as the IRS each year must, among other things, publish forms and publications, create computer code for thousands of tax provisions, enforce the law, and respond to more than 100 million telephone calls, ten million letters, and several million visits from taxpayers (although in-person visits were lower over the last two years due to the pandemic).

We continue to believe that simplifying tax law should be prioritized because it would enhance public confidence in the fairness of the tax system and reduce taxpayer compliance burdens.

## V. TAS Case Processing

Congress created TAS to serve as a “safety net” for taxpayers, but over the past few years, the combination of more cases, fewer experienced case advocates, and an inability to close cases due to limited IRS resources has caused the TAS safety net to fray. That has increased case cycle times, made it harder for taxpayers to reach TAS, and reduced service levels for taxpayers and congressional offices that refer cases to us. From FY 2017 to FY 2021, TAS's case receipts rose from 167,000 to 264,000 – a 58 percent increase – while our appropriated funding on an inflation-adjusted basis declined by about six percent. Recently, Congress increased our appropriated funding by \$10 million, which is a start to rebuilding the number of our case and intake advocates to assist taxpayers with IRS challenges.<sup>35</sup> Increasing TAS's resources directly benefits taxpayers and taxpayer service and protects taxpayers' rights.

When taxpayers cannot get their problems resolved directly with the IRS, they often contact their congressional offices for assistance. The number of cases TAS received from congressional offices demonstrates the magnitude of the challenges taxpayers experienced in 2021. In the three years preceding the pandemic, TAS received between 10,000 and 11,000 congressional referrals annually. Last year, we received more than 66,000 congressional referrals – more than *six times* as many cases as in pre-pandemic years.

Although our employees are resilient and want to help every taxpayer in need of assistance, we had to make some difficult decisions during the past year to address our workload challenges. In November 2021, we reinstated our prior policy against accepting cases where the sole issue was a delay in the processing of an original or amended tax return. Since then, numerous members of Congress have contacted us to express concern about this policy. We recognized the hardship and frustration taxpayers are facing, and in January 2022, we communicated to your local offices that we will again accept processing cases in certain circumstances. TAS worked with the IRS to obtain dedicated resources to enable us to do this. TAS is utilizing the IRS's surge team to assist in processing TAS cases while we work through the backlog.

Nevertheless, I think it would be helpful to explain TAS's role in assisting taxpayers and the tradeoffs that accepting these processing cases involves. Congress created TAS as part of the

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<sup>35</sup> Consolidated Appropriations Act, Pub. L. No. 117-103, Div. E, tit. 1, 136 Stat. 49, 245 (2022).

IRS Restructuring and Reform Act of 1998 to serve as an “advocate” for taxpayers in resolving problems with the IRS. By law, “taxpayer advocate offices operate independently of any other Internal Revenue Service office,”<sup>36</sup> and the National Taxpayer Advocate and her delegates are authorized to issue “Taxpayer Assistance Orders” to assist taxpayers by requiring the IRS to take certain actions or refrain from taking certain actions, unless an order is modified or rescinded by the Commissioner or the Deputy Commissioner.<sup>37</sup>

As advocates operating independently of the IRS, TAS is not authorized to resolve taxpayer problems on its own. We “advocate.” We do not implement. We do not have the authority to accept or process tax returns, to resolve audits, or to make final determinations regarding whether collection actions are warranted. Rather, our function is to serve as an ombuds when a taxpayer is suffering or about to suffer a significant hardship or when a taxpayer’s case has fallen through the bureaucratic cracks. Our case advocates generally resolve cases by sending an “Operations Assistance Request” (OAR) to the IRS operating division with control over the issue to request that it take specified actions, and we include documentation to support the request. In pre-pandemic years, TAS had sufficient staff to accept substantially all cases that met our case acceptance criteria, and the IRS had sufficient staff to process our OARs in a relatively timely manner.

The pandemic has presented unique challenges for TAS that are derivative of the challenges facing the IRS. For example, processing delays of a year or more mean that millions of taxpayers are experiencing economic or systemic hardships and ordinarily may qualify for TAS’s services. But TAS does not currently have the staffing to accept more cases, and the IRS is so buried in backlogged returns that it cannot give priority to the returns of taxpayers who come to TAS without slowing down the processing of all other returns.

That is the tradeoff we face when asked to expedite the processing of original or amended tax returns. In general, the IRS is processing returns on a first-in, first-out basis. When tax returns come in, they are “batched” by the date of receipt. If TAS accepts a case involving an amended tax return and asks the processing center to locate it or expedite its processing, the processing center manager generally must instruct employees to stop transcribing returns to look through all the returns in the “batch” where the target return is thought to be located. There may be thousands of returns in the batch. This is akin to asking an IRS employee to find a needle in a haystack. As a result, a request to expedite the processing of one return will delay the processing of many other returns, as IRS employees must stop transcribing returns by date of receipt to locate the return at issue.

This is obviously not an ideal situation, but it typifies the current challenges. While TAS may be able to help in limited circumstances, our ability to assist taxpayers is limited by our staffing and the IRS’s speed in responding to us. Although TAS has expanded our case acceptance criteria, there is no getting around the reality that millions of taxpayers will continue to experience refund delays, and some will experience economic hardships, until the IRS works through its processing backlog.

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<sup>36</sup> IRC § 7803(c)(4)(A)(iii).

<sup>37</sup> IRC § 7811.

## **VI. Conclusion**

The 2021 filing season presented unprecedented challenges for taxpayers and the IRS alike. Most of those challenges remain. Some arguably have grown worse. There are millions of tax returns and pieces of correspondence that the IRS received last year but has not processed. It therefore started the 2022 filing season in a deep hole. While there is no magic bullet, there are short-term steps the IRS can take to accelerate the processing of returns and treat taxpayers fairly, and with Congress's support, there are steps the agency can and should take over the medium and longer term to improve its operations overall.

The longer-term solution should involve strengthening both employee and IT resources. And once the IRS digs out of its current backlog hole, it will require an investment in its infrastructure, touching everything from basic taxpayer service and filing season processing to tax law enforcement that is effective but fair to taxpayers who are experiencing economic hardships. The IRS needs to rebuild and modernize its foundation to enable it to make good on its stated mission to “[p]rovide America’s taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.”<sup>38</sup> In this statement, I have outlined my priority recommendations to help the IRS do a better job of accomplishing its mission by improving the taxpayer experience and ensuring the protection of taxpayer rights.

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<sup>38</sup> See IRM 1.1.1.2, IRS Mission (July 29, 2019).