



YOUR VOICE AT THE IRS



THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

Response Due:
January 27, 2012

January 12, 2012

MEMORANDUM FOR STEVEN T. MILLER, DEPUTY COMMISSIONER
SERVICES AND ENFORCEMENT
BETH TUCKER, DEPUTY COMMISSIONER
OPERATIONS SUPPORT
WILLIAM J. WILKINS, CHIEF COUNSEL

FROM: Nina E. Olson *s/ Nina E. Olson*
National Taxpayer Advocate

SUBJECT: Taxpayer Advocate Directive 2012-3 (*Review IRS
Priorities in the Examination Process to Protect Taxpayer
Rights, Improve Taxpayer Service, and Further
Compliance*).

TAXPAYER ADVOCATE DIRECTIVE

I am issuing this Taxpayer Advocate Directive (TAD) to direct that within **30 business days** the Deputy Commissioner, Services and Enforcement, the Deputy Commissioner, Operations Support, and Chief Counsel take the actions described in the numbered sections below. Within **10 business days** please also provide me with a written response to this TAD discussing the action(s) you plan to take and whether you plan to appeal.¹

1. Convene a high-level cross-functional team, including the National Taxpayer Advocate, to review the Service's priorities in the examination process, particularly with respect to correspondence examination, to determine how we can better protect taxpayer rights, improve taxpayer service, and further compliance. This review should address the issues

¹ See IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

raised by the National Taxpayer Advocate 2011 Annual Report to Congress Volume II Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights* (the “Exam Report,” attached) including the recommendations to:

- a. Reverse the erosion of the taxpayer’s right to avoid right to avoid unnecessary and repetitive examinations of the same return that has occurred as the IRS has increased its use of automated processes in lieu of examinations;²
- b. Update obsolete Treas. Reg. § 301.7605-1, *Time and Place of Examination*, which still reference the now-extinct district structure and does not mention correspondence audit or discuss when a transfer would be appropriate;
- c. Ensure that taxpayers who are subject to examinations have direct contact information for the assigned examiner, and that this same examiner will work the case to resolution; and
- d. Expand the use of “Virtual Service Delivery” methods and other technologies that will allow better communication with and service to taxpayers who are under audit or similar automated adjustment process.

I. Authority

Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a TAD to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) “when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment or provide an essential service to taxpayers.”³

In the 2008 Annual Report to Congress, the National Taxpayer Advocate raised concerns about whether centralized audit results reflect a correct determination of tax or a taxpayer’s inability to navigate the system.⁴ Perhaps because the centralized examination procedures do not foster communication with taxpayers, more than 25 percent of the EITC taxpayers surveyed for a TAS Research study were not even aware the IRS had audited their returns.⁵ As described in the

² See IRC § 7605(b); Policy Statement 4-3 (Dec. 21, 1984), *reprinted at* IRM 1.2.13.1.1 (Aug. 31, 2007); 26 C.F.R. § 601.105(j)(statement of procedural rules).

³ Internal Revenue Manual (IRM) 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

⁴ National Taxpayer Advocate 2008 Annual Report to Congress 227-242.

⁵ National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 103.

Exam Report, the IRS has not adequately addressed the National Taxpayer Advocate's concerns. Therefore, the procedural requirements for issuing this TAD are satisfied.⁶

II. Overview

As described in the Exam Report and Revenue Protection Intro, the IRS increasingly relies on unexplained data mismatches to make automated adjustments to a person's liability and to deny or delay refunds. Mismatches between returns and third party data can result even if the return is accurate. Third-party data are not always accurate and some mismatches will remain unexplained as a result of communication difficulties. As summarized in the Revenue Protection Introduction, IRS correspondence does not always reach the taxpayer. When it does it is often confusing. When a taxpayer calls for clarification the IRS does not always answer the phone, and if the taxpayer reaches an IRS employee, the employee is often unable to resolve the inquiry.

Increasing reliance on automation can produce similar communication problems in connection with correspondence examinations. For example, the IRS conducts most (60 percent) EITC audits by correspondence before issuing refunds and paying the credit.⁷ Almost 70 percent of these taxpayers do not respond to the audit inquiry letters from the IRS,⁸ which then denies the EITC. A 2004 TAS Research study found that in these "no response" cases that qualified for an audit reconsideration, 43 percent obtained additional EITC and on average received 94 percent of the EITC amount claimed on their original returns.⁹ Thus, in the IRS's adjustment will be inaccurate in many cases and taxpayers will be harmed.

In addition, by defining most automated procedures as "not an examination," without explaining what they are and what taxpayer rights apply, the IRS abridges longstanding taxpayer rights. For example, the right to avoid unnecessary and repetitive examinations of the same return does not apply. Similarly, when the IRS uses streamlined assessment procedures to make "math error" adjustments, the taxpayer is required to respond more quickly or risk losing the right to appeal the adjustment to the Tax Court.

In fiscal year (FY) 2010, the IRS made over 15 million contacts that taxpayers might regard as examinations, but treated only about ten percent (1.6 million) as

⁶ IRM 13.2.1.6.1 (July 16, 2009).

⁷ TIGTA, Ref. No.2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Payments Each Year* 29 (Feb. 7, 2011).

⁸ IRS AIMS FY 2010 (Oct. 2011) (ranging from 63 to 73 percent).

⁹ See National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, i (*EITC Reconsideration Study*).

“real” examinations – and it conducted about 78 percent of these by correspondence in a highly-automated campus setting.¹⁰ The IRS is likely to expand its reliance on automation as it receives, and attempts to process and use, more third-party data. For example, credit card issuers will soon be required to report the charges they process for businesses.

Moreover, low income taxpayers are often subject to these automated adjustments. Pursuant to new Accounts Management Taxpayer Assurance Program (AMTAP) and math error procedures, the IRS plans to check more returns from low income taxpayers where the amounts at issue are “below tolerance” (*i.e.*, not considered significant enough to warrant a “real” examination) – precisely the taxpayers who are most likely to have difficulty communicating with the IRS.

Attachments

1. National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*; and
2. National Taxpayer Advocate 2011 Annual Report to Congress, *Introduction to Revenue Protection Issues: As the IRS Steps up Enforcement Using Automation, There Is an Increased Risk that It Will Assume Incorrectly that Taxpayers are Cheating, Confuse Them About Their Rights, and Sidestep Longstanding Taxpayer Protections*.

cc: Douglas Shulman, Commissioner of Internal Revenue
Judy Wall, Special Counsel to the National Taxpayer Advocate

¹⁰ IRS Pub. 55B, Data Book, *Table 9a, Examination Coverage* (2010) (reflecting 1,581,394 examinations of individuals in FY 2010, including 1,238,632 by correspondence from an IRS campus and 342,762 in the field or from a field office).