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National Taxpayer Advocate Delivers Annual Report to Congress; Focuses on IRS's Future Plans for Taxpayer Service

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WASHINGTON — National Taxpayer Advocate Nina E. Olson today released her [2015 annual report to Congress](#), expressing concern that the IRS may be on the verge of dramatically scaling back telephone and face-to-face service it has provided for decades to assist the nation's 150 million individual taxpayers and 11 million business entities in complying with their tax obligations. The report reiterates a recommendation the Advocate made in June that the IRS release its "*Future State*" plan documents, provide additional detail about their anticipated impact on taxpayer service operations, and solicit comments from the public. The report also recommends that Congress conduct oversight hearings on the plan.

The Future State Plan. Since 2014, the IRS has invested substantial resources to develop a *Future State* plan, which has involved significant participation by virtually all IRS business units and the engagement of management consultants, at a cost of several million dollars. To date, the IRS has chosen not to make the plan public.

The Advocate's report says there are many positive components to the plan, including the stated goal of creating online taxpayer accounts through which taxpayers will be able to obtain information and interact with the IRS. The report also acknowledges that cuts to the IRS budget – about 19 percent in inflation-adjusted terms since fiscal year (FY) 2010 – have forced the IRS to explore cheaper service options.

Reduced Service Levels. The Advocate expresses particular concern about IRS intentions regarding what is *not* stated in the plan. "Implicit in the plan – and explicit in internal discussion – is an intention on the part of the IRS to substantially reduce telephone and face-to-face interaction with taxpayers," the report says. "The key unanswered question is by how much. . . It is incumbent upon the IRS to be much more specific about how much personal taxpayer assistance it expects to provide in its 'future state.'"

The report says the IRS appears to presume taxpayer interactions with the IRS through online accounts will address a high percentage of taxpayer needs, enabling it to curtail existing taxpayer services without significantly impacting taxpayers. The *Future State* plan also calls for expanding the role of tax return preparers and tax software companies in providing taxpayer assistance – an approach that likely would increase compliance costs for millions of taxpayers who now obtain that assistance from the IRS for free.

The IRS *Future State* plan could transform the role the agency has long played in helping taxpayers comply with their tax obligations, the report says. The IRS historically has maintained a robust customer service telephone operation that, in every year since FY 2008, has received more than 100 million taxpayer telephone calls, as well as a network of nearly 400 walk-in sites that, in every year for over a decade, has provided face-to-face assistance to more than five million taxpayers.

Online accounts are likely to reduce taxpayer demand for telephone and face-to-face interaction to some degree but are unlikely to be useful in addressing complex account-specific matters, the report says. “This is true for several reasons, including that millions of taxpayers do not have Internet access, millions of taxpayers with Internet access do not feel comfortable trying to resolve important financial matters over the Internet, and many taxpayer problems are not ‘cookie cutter,’ thus requiring a degree of back-and-forth discussion that is better suited for conversation.” Last year, more than 9 million taxpayers either received post-filing IRS notices proposing to adjust their tax or experienced refund delays, all matters that are account-specific.

Technology improvements often do not reduce demand for personal service to the extent expected, the report says. For example, the IRS over the past decade has increased the individual tax return e-filing rate from 54 percent to 85 percent, enhanced the *Where’s My Refund?* tool, and added substantial content to IRS.gov, yet the number of taxpayer calls to its customer service lines has *increased* by 59 percent. Similarly, the report cites a recent Federal Reserve survey in which 72 percent of mobile banking customers reported they had visited a branch and spoken with a teller an average of two times within the preceding month. The report says customers often use online service as a supplement to, rather than a substitute for, personal service, particularly for complex matters.

In recent years, the IRS has already begun to reduce taxpayer services, including by declaring all but simple tax-law questions “out of scope” for the IRS to answer during the filing season; declaring it will not answer *any* tax-law questions after the filing season (including questions from millions of taxpayers with proper extensions of time to file); eliminating preparation of tax returns in its walk-in sites; and eliminating an online program that allowed taxpayers to submit questions electronically.

Need for Transparency. “We believe it is critical that the IRS share its plans in detail with Congress and outside stakeholders and then engage in a dialogue about the extent to which it intends to curtail or eliminate various categories of telephone service and face-to-face service, whether it will provide sufficient support for taxpayers – and how – as it transitions to its future state, and whether it has an adequate ‘Plan B’ if taxpayer demand for telephone and face-to-face service remains higher than the IRS anticipates,” the report says.

In releasing the report, Olson emphasized that Congress has repeatedly shown support for high-quality taxpayer service. In the IRS Restructuring and Reform Act of 1998, Congress directed the IRS to “review and restate its mission to place a greater emphasis on serving the public and meeting taxpayers’ needs.” Added Olson: “The fact that Congress just last month provided the IRS with an additional \$290 million in funding for taxpayer assistance

and codified the provisions of the Taxpayer Bill of Rights, including *The Right to Quality Service*, demonstrates that Members of Congress continue to believe taxpayer service should be strengthened, not reduced,” Olson said.

“Pay to Play” Tax System. Olson characterized the combination of reductions in personal service and the IRS’s plans to direct taxpayers with questions to preparers and other third parties (along with the expansion of user fees, discussed below) as creating a “pay to play” tax system, where only taxpayers who can afford to pay for tax advice will receive personal service, while others will be left struggling for themselves.

Data Security Concerns. Olson also warned about the consequences of giving tax return preparers more access to taxpayer accounts. “When you give that access to unregulated preparers or to other third parties, I have significant concerns. We already see the problems in this population of preparers relating to the Earned Income Tax Credit (EITC), where certain unregulated, untrained preparers prey on vulnerable taxpayers. Why would we want to give these preparers even more access to taxpayer information? And yet, if we don’t provide these preparers access to taxpayer accounts, it is very likely the tens of millions of taxpayers who use these preparers won’t be able to or won’t want to utilize their own online accounts, thereby carving a big hole in the IRS’s online strategy. Thus, through a single-minded emphasis on online accounts, the IRS creates a situation where it will face enormous pressure to open up taxpayer account access to unregulated return preparers.”

Need for More Details and Public Discussion. Because the contemplated reductions in service are significant yet undefined, Olson called on the IRS in her FY 2016 Objectives Report to Congress to release its plans and solicit taxpayer comments. The new report again recommends that the IRS immediately publish its plan and seek public comments. “U.S. taxpayers pay the bills for our government. U.S. taxpayers deserve a say in how the tax collection agency will treat them,” the report says.

The report also recommends that Congress hold hearings on the future state of IRS operations so it can obtain more specific information about the IRS’s plans and have an opportunity to weigh in.

Said Olson: “This has been a difficult report to write because while the intent to reduce telephone and face-to-face service has been a central assumption in the *Future State* planning process, little about service reductions has been committed to writing. Therefore, it is impossible to describe the scope of contemplated reductions with specificity. If there is good news here, it is that the IRS has not formally committed itself to the service reductions we understand to be contemplated. I am hopeful the IRS will make the plan public, present its perspective on tradeoffs, seek public comments, and ultimately make a commitment to continue to maintain existing telephone and face-to-face services for the millions of U.S. taxpayers who rely on them.”

National Taxpayer Advocate to Hold Public Hearings on Taxpayer Service Needs.

“For the IRS to do its job well, it must start from the perspective of what government is about – namely, it is of the people, by the people, and for the people,” Olson wrote. “The government is funded by taxes paid by the people. Therefore, the future state vision of the

IRS needs to be designed around the needs of the people.” To assist the IRS in developing a plan that is responsive to the needs of U.S. taxpayers, Olson announced plans to conduct public hearings around the country in the coming months to which she plans to invite groups that represent the interests of individual taxpayers (including elderly, low income, disabled, and limited English proficiency taxpayers), sole proprietors, and other small businesses as well as Circular 230 practitioners and unenrolled tax return preparers to describe what they need from the IRS to help them comply with the tax laws.

OTHER KEY ISSUES ADDRESSED

Federal law requires the Annual Report to Congress to identify at least 20 of the “most serious problems” encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems. Overall, this year’s report identifies 24 problems, makes dozens of recommendations for administrative change, makes 15 recommendations for legislative change, and analyzes the 10 tax issues most frequently litigated in the federal courts.

The “most serious problems” discussed in the report are grouped into four sections: (1) IRS Future State Vision: Implications for Today and Tomorrow; (2) Problems that Undermine Taxpayer Rights and Impose Taxpayer Burden; (3) Problems that Waste IRS Resources and Impose Taxpayer Burden; and (4) Problems that Contribute to Earned Income Tax Credit Noncompliance and Recommendations for Improvement. The report says that as the IRS has struggled with reduced funding, it has sometimes made short-sighted decisions that have had the effect of creating rework for itself as well as increasing taxpayer burden.

Among the problems addressed are the following:

IRS User Fee Decisions May Impose Heavy Taxpayer Burden. Like other federal agencies, the IRS is required to consider charging for services that convey “special benefits.” In the past, the IRS tried to avoid imposing fees that would impair its mission, particularly in the years before it was authorized to retain fee revenue. Between FY 2010 and FY 2015, however, when the IRS’s appropriation was reduced by about 10 percent (nominally), its user fee revenue rose by 34 percent. The report suggests that cuts to the agency’s budget have prompted it to consider fees that will impede its mission to help taxpayers voluntarily comply and pay their taxes.

As an example, the IRS collects revenue when delinquent taxpayers agree to pay their liabilities voluntarily, even if they can only pay in installments over time rather than in a single lump-sum. Under an installment agreement, tax is collected without draining IRS enforcement resources. Yet the IRS charges taxpayers a user fee for entering into installment agreements and is actively considering increasing the fee. The report says such fees exacerbate the “pay to play” aspects of the IRS *Future State* (discussed above) and expresses concern that increasing user fees may have the effect of deterring taxpayers from using IRS services that promote compliance, thereby reducing voluntary compliance and potentially costing the government more in tax than it would earn in user fees.

In a Dec. 4 memorandum to the Commissioner, the Advocate conveyed concerns about specific user fees that are under consideration; the memorandum is published in the report but has been substantially redacted at the request of the IRS. The report recommends the IRS estimate the effect of proposed fee increases on demand for services, make its analysis public before adopting the increases, and refrain from charging fees that will have a significant negative impact on its service-oriented mission, voluntary compliance, or taxpayer rights.

Form 1023-EZ Process Allows Unqualified Entities to Obtain Tax-Exempt Status.

Since July 2014, the IRS has addressed backlogs in its inventory of applications for tax-exempt status by allowing certain organizations to use Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3)*. Form 1023-EZ adopts a “checkbox approach” that requires applicants merely to attest, rather than demonstrate, that they qualify for exempt status. In particular, Form 1023-EZ does not solicit any narrative regarding an organization’s planned activities, any organizing documents (such as articles of incorporation or bylaws), any financial data, or any explanatory material. The IRS approves about 95 percent of applications submitted on Form 1023-EZ. However, the IRS’s own data show it approves only about 77 percent of applications when it requests documentation.

Similarly, TAS conducted a research study, published in Volume 2 of the report, that examined a representative sample of organizations in 20 states that make articles of incorporation viewable online and whose Form 1023-EZ application had been approved by the IRS. It found, among other things, that 37 percent do not meet the organizational test for qualification as a Section 501(c)(3) organization. In other words, these organizations received favorable determination letters from the IRS even though they are not eligible for exempt status under the law. The report recommends that the IRS revise Form 1023-EZ to require applicants to submit their organizing documents, a description of actual or planned activities, and past or projected financial information, and that the IRS review this information before deciding whether to approve exemption applications.

IRS Anti-Fraud Filters Delay Refunds for Hundreds of Thousands of Legitimate Taxpayers, with One Major Program Having a False Positive Rate of 36 Percent.

The IRS operates several programs that filter tax returns to ferret out improper refund claims, including returns showing bogus wage or withholding amounts and returns suspicious for identity theft. While these are critical programs, the filters have high “false positive” rates, causing substantial refund delays for hundreds of thousands of legitimate taxpayers. For example, the false positive rate was about 36 percent during FY 2015 in the Taxpayer Protection Program (TPP), which freezes returns the IRS suspects may reflect identity theft. The IRS sends notices to taxpayers whose returns have been flagged by TPP filters and instructs the taxpayers to authenticate their identities online or by phone. Yet for three consecutive weeks during the filing season, the IRS answered fewer than 10 percent of taxpayer calls on that telephone line, making it extraordinarily difficult for affected taxpayers to get their returns unfrozen and receive their refunds. For other anti-fraud programs, the IRS currently does not track the false positive rate. The report recommends that the IRS begin tracking the false positive rate of all screening programs, monitor and adjust filters

and rules quickly if they are not effectively zeroing in on fraud, and establish maximum false positive rates for each process and filter.

Other issues analyzed in the “most serious problems” section of the report include the adequacy of taxpayer service for taxpayers living abroad, the whistleblower program, the IRS’s administration of the Patient Protection and Affordable Care Act, victim assistance in tax-related identity theft cases, and several issues relating to EITC compliance, including the need for better taxpayer education and assistance in the pre-filing environment, more effective use of audits, and greater emphasis on the role tax return preparers can play to promote compliance.

New TAS Research Studies. Volume 2 of the report contains four new research studies, including a study examining whether organizations that obtained Section 501(c)(3) status on the basis of Form 1023-EZ applications meet the requirements for exempt status and a study designed to gain a better understanding of the needs of underserved Hispanic taxpayers. The report also contains two studies that look at IRS enforcement programs.

One study examined the impact of audits on the subsequent compliance of self-employed individuals. The results of the study “provide robust evidence that audits have important long-term revenue implications,” the report says. However, the study found a significant disparity in results when it attempted to differentiate the subsequent behavioral responses of (seemingly) compliant taxpayers and (seemingly) noncompliant taxpayers. It found that (seemingly) non-compliant taxpayers who were audited increased their reporting compliance of taxable income by about 120 percent three years later, while (seemingly) compliant taxpayers who were audited subsequently reported *less* income.

A second study examined the IRS’s “collectability curve.” The IRS generally assigns delinquencies to Taxpayer Delinquent Account (TDA) status within four to five months after it assesses a liability and sends the taxpayer a series of notices. However, the volume of TDAs may delay collection actions from occurring for some time. The study found that the IRS is most successful at collecting liabilities soon after TDA assignment. While dollars continue to be collected throughout the life of the 10-year statutory collection period, the payment rate slows considerably. These findings are similar to the results reported by private collection agencies, but run counter to some IRS procedures that prioritize collecting larger accounts, even though many “smaller accounts” become “larger accounts” simply because the IRS delays collection, allowing penalties and interest to continue to accrue and ultimately making them more difficult to resolve.

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Please visit <http://www.taxpayeradvocate.irs.gov/2015AnnualReport> for more information.

Related Items:

- [Complete Report: 2015 Annual Report to Congress](#)

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About the Taxpayer Advocate Service

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