

**Written Statement of Nina E. Olson
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Before the

**Subcommittee on Financial Services and General Government
Committee on Appropriations
U.S. House of Representatives**

On

Tax Fairness: Policy and Enforcement

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Mr. Chairman, Ranking Member Regula, and Members of the Subcommittee:

Thank you for inviting me to testify today about tax fairness in policy and enforcement.¹ Before I discuss specific issues of fairness in tax administration, I would like to make three threshold observations about the components of a balanced tax system.

First, I think we can all agree that good tax administration requires the IRS to collect the correct amount of tax from each taxpayer while it respects the rights of each taxpayer. In order for the IRS to treat taxpayers fairly, even when it takes a compliance or enforcement action against them, the IRS must be properly funded. In the National Taxpayer Advocate's 2006 Annual Report to Congress, I made a recommendation that squarely addresses IRS funding – namely, to change the budget rules by which IRS funding decisions are made to provide funding at whatever level will maximize tax compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.²

Second, in our focus on closing the net tax gap, estimated to be about \$290 billion for 2001, we must not forget that taxpayers paid almost 84 percent of the tax dollars known to be due and owing. Of the \$2.24 trillion collected annually by the IRS, only two percent is attributable to enforcement activity. Taxpayer service surely plays an important role in collecting the other 98 percent of revenue. With the recent focus on closing the upper end of the tax gap, we must be very careful not to take currently compliant taxpayers for granted and fail to provide them the services they need to comply. Once we lose these taxpayers' confidence and trust by degrading IRS level of service, it will be very hard to gain it back.

My third observation relates to the importance of research in addressing the tax gap. Without a clear understanding of the causes of noncompliance, we will be shooting in the dark. We need to know whether noncompliance is inadvertent (due to tax law or procedural complexity) or facilitated by preparers or promoters, or whether it is asocial (evasion) or social (in response to a perceived unfairness in the application of the laws). Each type of noncompliance requires a different approach to bring the taxpayer into compliance. Thus, Congress should fund a robust IRS research program. A starting point would be to fund the National Research Program on an ongoing basis, with taxpayer interviews conducted by a neutral party after completion of the audit and

¹ 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. The statute establishing the position directs the National Taxpayer Advocate to present an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Accordingly, 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.

² National Taxpayer Advocate 2006 Annual Report to Congress 442 – 457.

designed to understand the causes of the identified noncompliance. Such knowledge lays the groundwork for a sound and strategic approach to minimizing the tax gap without harming well-meaning taxpayers in the process.

I. Overview of the Problem of IRS Underfunding

The Internal Revenue Service is effectively the Accounts Receivable Department of the United States Government. On a budget of about \$10.6 billion,³ the IRS currently collects about \$2.24 trillion a year.⁴ That translates to an average return-on-investment (ROI) of about 210:1.⁵

Rather than recognizing the IRS's unique role as the revenue generator for the federal government, however, the congressional budget rules treat spending for the IRS exactly the same way they treat spending for all other federal agencies.

The current budget procedures work essentially as follows: Early each year, a spending ceiling is established for a category of programs that in recent years included the Department of Transportation, the Department of the Treasury (of which the IRS is a part), the Department of Housing and Urban Development, the Judiciary, the District of Columbia, and independent federal agencies.⁶ The House and Senate Appropriations subcommittees with jurisdiction over this grouping of federal programs must apportion the total number of dollars it receives among them. If more funding was provided for transportation programs, for example, less funding was available for the IRS. Thus, the IRS competes dollar-for-dollar against many other federal programs for resources.

These procedures make little sense. The IRS collects about 96 percent of all federal revenue.⁷ The more revenue the IRS collects, the more revenue Congress may spend on other programs or may use to cut taxes or reduce the deficit. The less revenue the IRS collects, the less revenue Congress has available for other purposes.

³ Department of the Treasury, *FY 2007 Budget in Brief* at 59.

⁴ Government Accountability Office, GAO-07-136, *Financial Audit: IRS's Fiscal Years 2006 and 2005 Financial Statements* at 95 (Nov. 2006). The IRS actually collected \$2.51 trillion on a gross basis in FY 2006, but issued \$277 billion in tax refunds.

⁵ When collecting tax from the vast majority of taxpayers who file returns and pay all or substantially all of the tax they owe voluntarily, the cost the IRS incurs per taxpayer is very low. As the IRS attempts to collect tax from noncompliant taxpayers through broader outreach efforts or through examination and collection actions, the cost per taxpayer rises substantially. Therefore, the *marginal* return on investment (ROI) the IRS achieves as it attempts to collect unpaid taxes is likely to be considerably lower than the *average* ROI of 210:1 that the IRS achieves on taxes paid voluntarily. But if the IRS were given more resources, most data indicate that the IRS could generate a substantially positive marginal ROI.

⁶ In the current Congress, the Appropriations subcommittees have been restructured, and the IRS will be funded through the Appropriations Subcommittee on Financial Services and General Government.

⁷ Government Accountability Office, GAO-07-136, *Financial Audit: IRS's Fiscal Years 2006 and 2005 Financial Statements* 68 (Nov. 2006).

If the federal government were a private company, its management clearly would fund the Accounts Receivable Department at a level that it believed would maximize the company's bottom line.

Since the IRS is not a private company, maximizing the bottom line is not – in and of itself – an appropriate goal. But the public sector analogue should be to maximize tax compliance, especially voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden. If the IRS were given more resources, studies show the IRS could collect substantially more revenue.

Former IRS Commissioner Charles Rossotti has written:

When I talked to business friends about my job at the IRS, they were always surprised when I said that the most intractable part of the job, by far, was dealing with the IRS budget. The reaction was usually “Why should that be a problem? If you need a little money to bring in a lot of money, why wouldn't you be able to get it?”⁸

Yet obtaining a little extra money to bring in a lot of extra money remains an intractable challenge for the IRS. Over the past few years, Congress has focused increasing attention on the “tax gap”⁹ – the difference between taxes owed and taxes paid, even while it holds the IRS accountable for improving taxpayer service.¹⁰ As part of this discussion, it should be recognized that the IRS currently suffers from a “resources gap,” and the IRS's lack of resources is a significant impediment to its ability to improve

⁸ Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 278 (2005). On pages 278-286, Mr. Rossotti presents an interesting personal perspective on the budget process and the politics behind the chronic underfunding of the IRS.

⁹The recent IRS National Research Program study estimates the 2001 “gross tax gap” – the difference between the amount of tax imposed by law and the amount of tax paid voluntarily and timely – at \$345 billion. It estimates the “net tax gap” – the difference between the amount of tax imposed by law and the amount of tax paid after taking into account late payments and enforced collection – at \$290 billion.

¹⁰See Pub. L. No. 109-115, § 205, 119 Stat. 2396 (2005), which provided:

None of the funds appropriated or otherwise made available in this or any other Act or source to the Internal Revenue Service may be used to reduce taxpayer services as proposed in fiscal year 2006 until the Treasury Inspector General for Tax Administration completes a study detailing the impact of such proposed reductions on taxpayer compliance and taxpayer services, and the Internal Revenue Service's plans for providing adequate alternative services, and submits such study and plans to the Committees on Appropriations of the House of Representatives and the Senate for approval. . . . Provided further, That the Internal Revenue Service shall consult with stakeholder organizations, including but not limited to, the National Taxpayer Advocate, the Internal Revenue Service Oversight Board, the Treasury Inspector General for Tax Administration, and Internal Revenue Service employees with respect to any proposed or planned efforts by the Internal Revenue Service to terminate or reduce significantly any taxpayer service activity.

taxpayer service, help close the tax gap, and thereby reduce the federal budget deficit.¹¹

II. The Consequences of Underfunding the IRS

The failure to fund the IRS at appropriate levels leads to two sets of consequences. First, the IRS lacks the resources to collect a significant amount of unpaid tax, resulting in a larger tax gap and a larger budget deficit. Second, the lack of resources often leads the IRS to take steps that are, in my judgment, unwise and unfair from the standpoint of tax compliance and taxpayer rights. For example, in a tight budget environment, the IRS demonstrates an increased tendency to look for “efficient” approaches to tax administration (*i.e.*, efficient from the IRS perspective) and a resistance to analyzing problems from the taxpayer perspective. I provide examples of this tendency to superficial efficiency below.

III. Insufficient IRS Funding Leads to a Failure to Collect Unpaid Taxes

In his final report to the IRS Oversight Board in 2002, former Commissioner Rossotti presented a discussion titled “Winning the Battle but Losing the War” that detailed the consequences of the lack of adequate funding for the IRS. He identified 11 specific areas in which the IRS lacked resources to do its job, including taxpayer service, collection of known tax debts, identification and collection of tax from nonfilers, identification and collection of tax from underreported income, and noncompliance in the tax-exempt sector.

Commissioner Rossotti provided estimates of the revenue cost in each of the 11 areas based on IRS research data. In the aggregate, the data indicated that the IRS lacked the resources to handle cases worth about \$29.9 billion each year. It placed the additional funding the agency would have needed to handle those cases at about \$2.2 billion.¹²

Significantly, this estimate reflects only the potential *direct* revenue gains. Economists have estimated that the indirect effects of an examination on voluntary compliance provide further revenue gains. While the indirect revenue effects cannot be precisely

¹¹ The chairman and ranking member of the Senate Budget Committee supported additional funding for the IRS in the FY 2007 budget resolution. Senator Judd Gregg acknowledged that the existing budget procedures have the effect of shortchanging the IRS. He said: “We’ve got to talk to the [Congressional Budget Office] about scoring on [additional funding provided to IRS]. Clearly there’s a return on that money.” Dustin Stamper, *Everson Pledges to Narrow Growing Tax Gap*, 110 Tax Notes 807 (Feb. 20, 2006). Similarly, Senator Kent Conrad stated: “Rather than a tax increase, I think the first place we ought to look . . . is the tax gap. If we could collect this money, we’d virtually eliminate the deficit.” Emily Dagostino, *Senate Budget Resolution Would Increase IRS Enforcement Funding*, 110 Tax Notes 1129 (Mar. 13, 2006).

¹² Commissioner Charles O. Rossotti, *Report to the IRS Oversight Board: Assessment of the IRS and the Tax System* 16 (Sept. 2002).

quantified, two of the more prominent studies in the area suggest the indirect revenue gains are between six and 12 times the amount of the proposed adjustment.¹³

I want to emphasize that the existing modeling in this area is not especially accurate, and estimates of both the direct and indirect effects of IRS programs vary considerably. The IRS needs to develop better modeling to produce more accurate return-on-investment estimates. But I also want to emphasize that almost all studies show that, within reasonable limits, each additional dollar appropriated to the IRS should generate substantially more than an additional dollar in additional federal revenue assuming the funding is wisely spent.

IV. Insufficient Measures and Funding Result in an Unbalanced and Inadequate IRS Compliance Program

The IRS can do more – much more – to improve tax compliance. Yet the lack of appropriate and reliable measures of investment return for taxpayer service leads the IRS to chronically underfund taxpayer service activities. And the pressure to show activity and generate numbers in the enforcement arena leads the IRS to centralize and automate much of its compliance and enforcement activity, and virtually walk away from a meaningful face-to-face presence in communities throughout the United States.

For example, despite a finding by a leading IRS researcher that the direct and indirect benefits of IRS's preparing tax returns for low income taxpayers pays for itself many times over,¹⁴ the IRS has reduced by about half the number of tax returns it helps low income taxpayers prepare in its walk-in sites.¹⁵ Despite the challenges individuals who start small businesses face in learning for the first time about the legal requirements they face as employers (including the payroll responsibilities of income and employment tax withholding, paying over tax to the IRS, reporting to the IRS, and reporting to the employee), the IRS has substantially reduced its field outreach operation.¹⁶ Despite the number of taxpayers in certain states with taxable income from farming activities, the

¹³ 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); Jeffrey A. Dubin, Michael J. Graetz & Louis L. Wilde, *The Effect of Audit Rates on the Federal Individual Income Tax, 1977-1986*, 43 Nat. Tax J. 395, 396, 405 (1990).

¹⁴ See Alan H. Plumley, Pub. 1916, *The Determinants of Individual Income Tax Compliance: Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness* 41 (Oct. 1996).

¹⁵ IRS Wage & Investment Operating Division, *Business Performance Review, Wage and Investment Operating Division, FY 2006*; IRS Wage & Investment Operating Division, *Business Performance Review, Wage and Investment Operating Division, FY 2005*; IRS Wage & Investment Operating Division, *Business Performance Review, Wage and Investment Operating Division, FY 2004*; IRS Wage & Investment Operating Division, *Business Performance Review, Wage and Investment Operating Division, FY 2003*.

¹⁶ IRS Small Business/Self Employed Operating Division, Response to Taxpayer Advocate Information Request (Sept. 5, 2006).

IRS has apparently declared questions about farm income and expenses “out of scope” for IRS walk-in sites in those areas.¹⁷

On the enforcement side, the IRS is currently conducting face-to-face audits of only about one out of every 435 tax returns.¹⁸ It does not have the resources to pursue a significant percentage of its accounts receivable. And the private debt collection initiative, a controversial program that is projected to raise only about \$1.4 billion over the next 10 years,¹⁹ results from the IRS’s lack of resources to pursue these cases itself.

V. Insufficient Funding Leads to Inadequate Face-to-Face Audit Coverage

During fiscal year (FY) 2005, the IRS examined 1,215,308 individual income tax returns, with 84 percent of those examinations conducted by correspondence.²⁰ Correspondence examinations accounted for 88 percent of the FY 2005 examinations of individuals with incomes under \$100,000 and 67 percent of those with incomes of \$100,000 or more.²¹ While face-to-face examinations rose by 25 percent from FY 2002 through FY 2005, correspondence examinations increased by 170 percent over the same period.²²

¹⁷ This concern was raised by a taxpayer during a 2006 Town Hall meeting with the National Taxpayer Advocate in Fargo, North Dakota.

¹⁸ Internal Revenue Service, *Fiscal Year 2006 Enforcement and Service Results* (Nov. 20, 2006).

¹⁹ See IRS News Release IR-2006-42, *IRS Selects Three Firms to Take Part In Delinquent Tax Collection Effort* (March 9, 2006).

²⁰ Treasury Inspector General for Tax Administration, Ref. No. 2006-30-055, *Trends in Compliance Activities through Fiscal Year 2005 8* (Mar. 27, 2006).

²¹ Treasury Inspector General for Tax Administration, Ref. No. 2006-30-055, *Trends in Compliance Activities through Fiscal Year 2005 8* (Mar.27, 2006).

²² Treasury Inspector General for Tax Administration, Ref. No. 2006-30-105, *While Examinations of High-Income Taxpayers Have Increased, the Impact on Compliance May Be Limited 2* (Jul. 25, 2006).

TABLE 1. FACE-TO-FACE AUDIT RATES²³

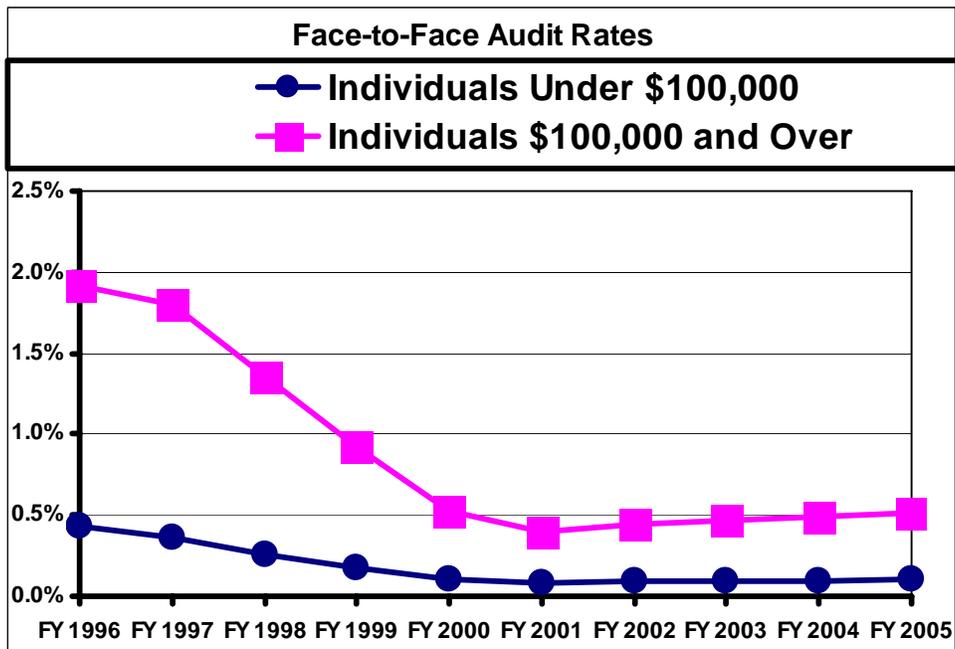
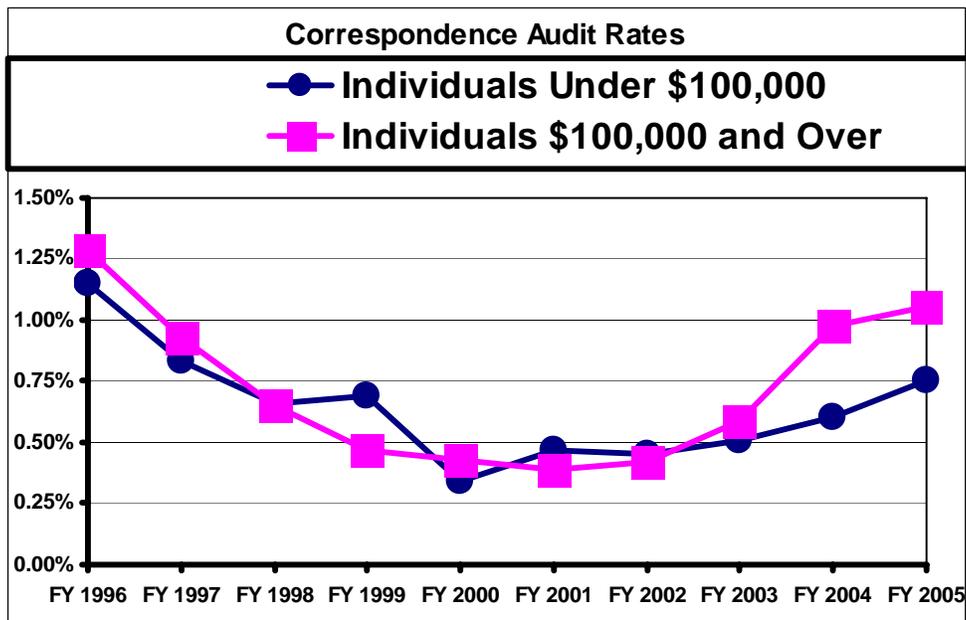


TABLE 2. CORRESPONDENCE AUDIT RATES²⁴



²³ Treasury Inspector General for Tax Administration, Ref. No. 2006-30-055, Trends in Compliance Activities, IRS Data Book Spreadsheet (Mar. 2006).

²⁴ Treasury Inspector General for Tax Administration, Ref. No. 2006-30-055, *Trends in Compliance Activities*, IRS Data Book Spreadsheet (Mar. 2006). The significant drop in correspondence audits between 1996 and 1997 may be due to Congress authorizing the IRS to use Math Error Authority for specific dependency, EITC, and child tax credit issues. Once the IRS received summary assessment authority, it didn't have to use deficiency procedures to assess tax so the results are excluded from correspondence audit rates. For a more detailed discussion of the IRS's math and clerical error authority, see National Taxpayer Advocate 2002 Annual Report to Congress 25-31 and 185-197.

In correspondence examinations, the IRS generally sends an initial contact letter informing the taxpayer that his or her return is under examination, then a 30-day letter accompanied by a report detailing any tax adjustment attributable to examined issues, and finally a Statutory Notice of Deficiency if the taxpayer does not agree to, or otherwise resolve, the proposed adjustment.²⁵ Each phase of the process has timeframes established by internal policy. If the taxpayer does not respond within a prescribed time for action, the case moves to the next phase through an automated batch process.²⁶

VI. Identifying Appropriate Inventory for Correspondence Examinations

The IRS utilizes internal database information to identify audit issues such as the Earned Income Tax Credit (EITC). The exam functions may select a return for correspondence audit if all the questioned items are susceptible to direct verification from records that the taxpayer could easily provide by mail, and a review of the return clearly indicates the taxpayer can effectively communicate with the IRS in writing.²⁷

Correspondence examinations rely heavily on information reporting. While correspondence examiners may request certain documents to identify unreported income, the revenue agents and tax compliance officers who conduct field and office examinations, respectively, use more sophisticated indirect methods. Unlike correspondence examiners, revenue agents are trained to use a “dynamic” examination strategy and change the focus of the examination in response to new information. This approach allows agents to find unreported income that the IRS could not locate in a correspondence examination of limited scope.²⁸ There are indications that the IRS is using correspondence examinations to accomplish work that is better reserved for interviews or field audits. As depicted in the following chart, since fiscal year 2000, high income taxpayers filing individual income tax returns are increasingly examined by correspondence.

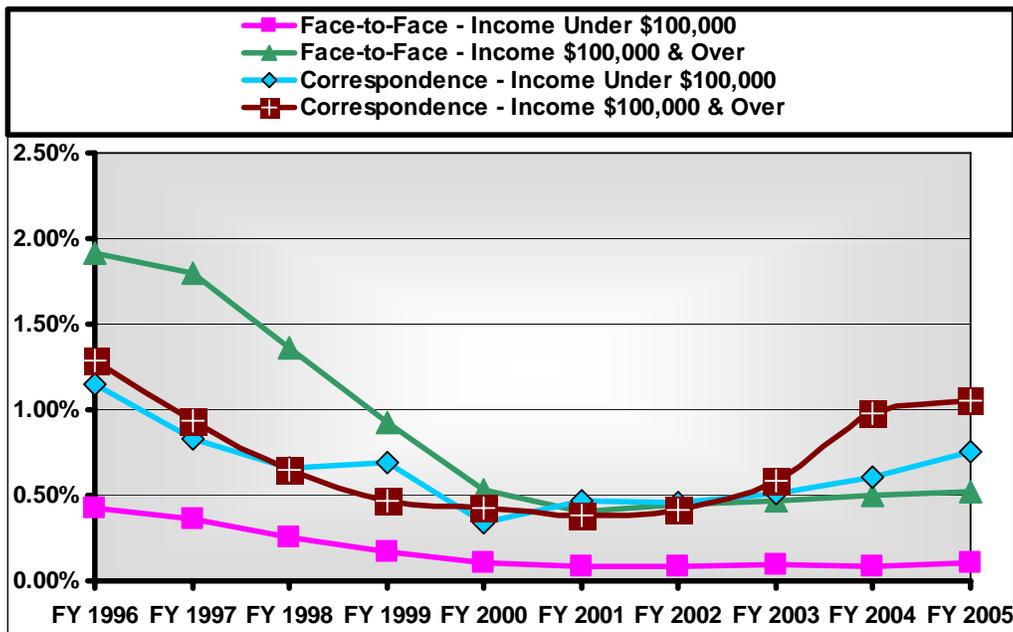
²⁵ IRC § 6212. If the IRS proposes changes to a tax liability and the taxpayer does not respond or cannot reach an agreement with the IRS, the IRS issues a Statutory Notice of Deficiency. The notice of deficiency allows the taxpayer 90 days to petition the United States Tax Court and outlines the procedures to follow. If the taxpayer does not petition the Tax Court, the IRS assesses the tax and gives notice and demand to the taxpayer for the amount due.

²⁶ IRS Wage and Investment Division, *Correspondence Examination Automation Support, Concept of Operations* 6 (Jul. 16, 2004).

²⁷ IRM 4.1.5.9.1(4) (Oct. 1, 2001).

²⁸ *The Tax Gap: Hearing Before the Subcomm. on Federal Financial Management, Government Information, and International Security, Senate Comm. On Homeland Security and Governmental Affairs*, 109th Cong., 2nd Sess (Oct.26, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).

TABLE 3. PERCENTAGE OF FORMS 1040 EXAMINED FACE-TO-FACE OR THROUGH CORRESPONDENCE²⁹



Correspondence examinations have expanded to include strategies for dealing with nonfilers, projects involving return preparers, and high income taxpayers. However, the complexity of a case should dictate the audit method. Conducting a correspondence examination that fails to identify adjustments attributable to a complex issue only serves to reinforce the noncompliance, not deter it.

A 2006 report by the Treasury Inspector General for Tax Administration (TIGTA) found the IRS either abated or did not collect 86 percent of the audit assessments on high income taxpayers, almost two years after the assessments.³⁰ In addition, of the \$2.1 billion assessed on high income taxpayers through correspondence examination in FY 2004, \$1.4 billion (66 percent) was attributable to taxpayers who did not respond to the examiner.³¹

The increase in correspondence examinations of taxpayers with Schedule C businesses rose to about 30 percent of all high income taxpayer Schedule C examinations from FY 2002 through FY 2004, and 54 percent of all high income taxpayer Schedule C

²⁹ Treasury Inspector General for Tax Administration, Ref. No. 2006-30-055, *Trends in Compliance Activities* 33 (Mar. 2006).

³⁰ Treasury Inspector General for Tax Administration, Ref. No. 2006-30-105, *While Examinations of High-Income Taxpayers Have Increased, the Impact on Compliance May Be Limited* 2 (Jul. 25, 2006).

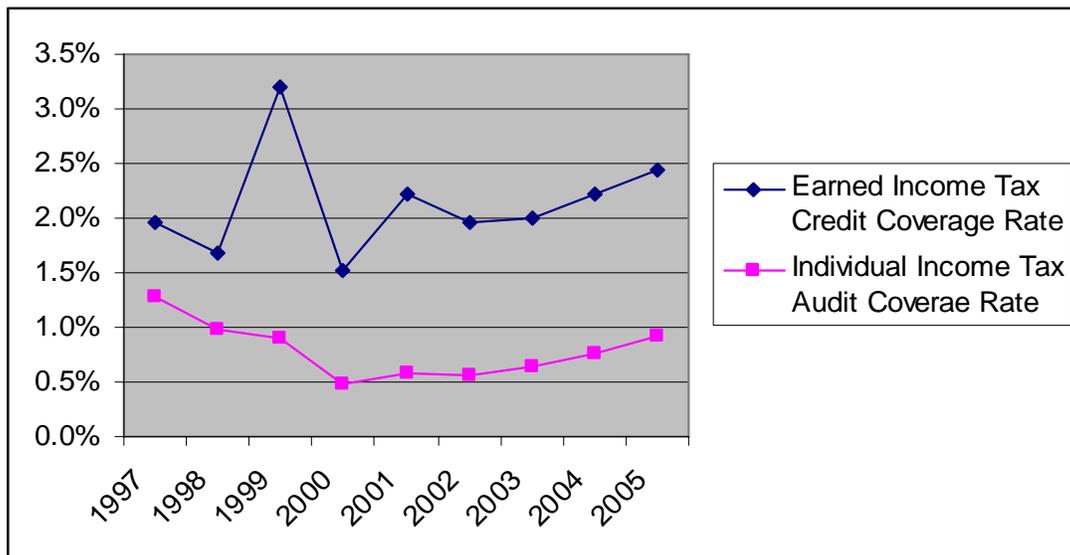
³¹ For a related discussion of non-responders, see National Taxpayer Advocate 2006 Annual Report to Congress, *Most Serious Problem, Taxpayer No Response Rates*, 355 – 375..

examinations in fiscal year 2005.³² Given the potential for unreported income in Schedule C business activities and the lack of third-party information reporting, it would appear that the IRS should conduct most of these examinations face-to-face. Recent reports on the makeup of the tax gap support this notion, indicating that well over half (\$109 billion) of the individual underreporting gap came from understated net business income — underreported receipts and overstated expenses.³³

VII. Insufficient IRS Funding Limits Personal Contact in Earned Income Tax Credit Audits and Can Lead to Incorrect Audit Results

While the IRS is currently auditing only one out of 64 high income returns, it is auditing one out of 41 EITC returns.³⁴ In my view, the level of EITC examinations is reasonable. On the other hand, as compared to the low audit rate of high income and other taxpayers, there is clearly disparate audit presence in the low income EITC taxpayer population. This effect is even more obvious when comparing EITC audit coverage to individual taxpayer coverage in general, where the EITC audit coverage rate was 2.4 percent in FY 2005, but the overall individual income tax audit rate was 0.9 percent.

TABLE 4. INDIVIDUAL INCOME AND EITC RETURN COVERAGE RATES (1997-2005)



³² Treasury Inspector General for Tax Administration, Ref. No. 2006-30-105, *While Examinations of High-Income Taxpayers Have Increased, the Impact on Compliance May Be Limited 2* (Jul. 25, 2006).

³³ IRS, *Business Income and the Tax Gap*, at <http://www.irs.gov/newsroom/article/0,,id=158618,00.html> (Jun. 2006).

³⁴ High income returns are defined as those for which the total positive income is \$100,000 or more, where total positive income is defined, in general, as the sum of all positive amounts shown for the various sources of income reported on the individual income tax return and, thus, excludes net losses. IRS Data Book 2005, Table 10. Earned Income Tax Audits are from the Audit Information Management System (AIMS) Closed Case Database.

CHART 1. INDIVIDUAL INCOME AND EITC RETURN COVERAGE RATES (1997-2005)³⁵

Fiscal Year	1997	1998	1999	2000	2001	2002	2003	2004	2005
Individual Income Tax Audits	1,519,243	1,192,780	1,100,273	617,765	731,756	743,881	849,296	1,007,874	1,215,308
Individual Income Tax Audit Coverage Rate	1.3%	1.0%	0.9%	0.5%	0.6%	0.6%	0.7%	0.8%	0.9%
Earned Income Tax Credit Audits	365,646	324,243	607,308	272,020	413,896	377,758	421,409	479,342	535,676
Earned Income Tax Credit Coverage Rate	2.0%	1.7%	3.2%	1.5%	2.2%	2.0%	2.0%	2.2%	2.4%

In 2004, the Taxpayer Advocate Service conducted a study of audit reconsideration cases where taxpayers claimed the EITC.³⁶ The findings suggest that the manner in which the IRS communicates with taxpayers may significantly affect the outcome of the audit process. TAS found that the likelihood of a taxpayer receiving additional EITC in audit reconsideration increased with the number of phone calls made by TAS employees. Overall, of taxpayers who went through the audit reconsideration process and received no phone calls, only 38 percent were awarded additional EITC. This percentage increased to 67 percent for taxpayers who received three or more calls.³⁷ Considering that more than 40 million adults, or approximately 21 percent of the adult population of the United States, have less than a high school education, the lack of telephone or face-to-face individual contact can negatively impact those taxpayers.³⁸

³⁵ Individual Income Tax Audits and Coverage Rates from IRS Data Books FY 1997 – FY 2005. Earned Income Tax Audits FY 1997 – FY 2003 from IRS Summary of Compliance Activity. Earned Income Tax Audits FY 2004 and 2005 from Audit Information System Closed Case Database. EITC Coverage Rate computed by dividing EITC audits by EITC returns filed from prior processing year (IRTF).

³⁶ National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, at i.

³⁷ *Id.* The National Taxpayer Advocate's Earned Income Tax Credit (EITC) Audit Reconsideration Study included a random sample of more than 900 EITC audit reconsideration cases closed between July 1, 2002, and January 31, 2003. Ultimately, 679 cases (340 IRS Examination and 339 TAS) were analyzed in detail. The study found 70 percent of the EITC audit reconsideration cases came to TAS for assistance because the taxpayer had not heard from IRS concerning his or her original audit or audit reconsideration request. For the 339 TAS cases, employees made 293 follow-up contact phone calls with the taxpayers and sent 436 follow-up letters. In contrast, of the 340 IRS Examination cases, tax examiners made only six follow-up contact phone calls to taxpayers and sent only 173 follow-up letters during the initial audit process. The likelihood of a taxpayer receiving additional EITC increased with the number of phone calls made by the TAS employees. Overall, of taxpayers who went through the audit reconsideration process and received no phone calls, only 38 percent were awarded EITC. This percentage increased to 67 percent for taxpayers who received three or more calls.

³⁸ Beth Lasater and Barbara Elliott, RTI International Center for Research in Education, *Profiles of the Adult Education Target Population*, Information from the 2000 Census 1-9 (Revised Dec. 2005). That is, they have not completed a high school diploma or equivalent adults who have completed four or fewer

The IRS has made some significant improvements to its ability to answer taxpayer calls. In January 2006, the Wage & Investment (W&I) Operating Division instituted Intelligent Call Management on its toll-free phones to improve the quality of correspondence examinations. This service provides more immediate assistance to taxpayers by providing a better level of service on unassigned cases and reduces the need for the taxpayer to call several times to seek assistance. Additional programming now allows extension routed calls to roll over to the next available examiner if the assigned examiner is not available. As a result of these improvements, the number of calls answered by a live assistor rose from 14.9 percent in FY 2005 to 39.8 percent in FY 2006.³⁹

This increased level of service is a significant move in the right direction. However, the IRS's ability to sustain or enhance service depends on staffing. Telephone assistors who serve a dual role as correspondence examiners may be assigned cases that reduce telephone communication with taxpayers as well as the overall level of service. With FY 2007 funding levels for taxpayer service held to FY 2006 levels, the IRS is moving employees from processing correspondence to answering phones. Thus, when taxpayers send in responses to IRS inquiries, these letters are often "unassociated" with their cases. Taxpayers who need their refunds are harmed by these delays. In some instances, IRS may issue a Notice of Deficiency without reviewing the taxpayer's correspondence.

Moreover, taxpayers and their representatives continue to cite problems with inconsistencies in the acceptance of documentation for correspondence examination issues. These problems are especially burdensome for low income taxpayers subject to EITC examinations and can lead to incorrect results and IRS reworking the case as an audit reconsideration when the taxpayer objects to collection of the tax.

In 2004, the IRS tested the use of an EITC certification form offering three options for certifying child residency, a significant cause of EITC disallowance. The study marked the first time that the IRS accepted affidavits from third parties with record or personal knowledge of the child's residency.⁴⁰ Form 8836, Qualifying Children Residency Statement, including the affidavit, guides the taxpayer through the process of proving the EITC child residency test and eliminates the need for multiple contacts by correspondence. The test results showed that affidavits had the highest acceptance rate and provided a reliable way to substantiate EITC eligibility, with significantly less

years of secondary schooling constitute 11.3 percent of the target population, or 2.4 percent of the total adult population.

³⁹ IRS Wage and Investment Operating Division research request response (Nov. 22, 2006).

⁴⁰ See IRS, *IRS Earned Income Tax Credit (EITC) Initiative: Final Report to Congress, October 2005* 17 (Oct. 2005).

burden to the taxpayer.⁴¹ The IRS is resisting the National Taxpayer Advocate's request that it utilize Form 8836 in all EITC examinations, on the ground that the form requires further testing.⁴² In our view, the IRS's failure to use this form in all EITC examinations burdens taxpayers and wastes IRS resources by causing unnecessary calls or correspondence, incorrect audit results, and rework in the form of audit reconsiderations.

VIII. Insufficient Funding Leads to Outsourcing Tax Collection

In his final report to the IRS Oversight Board, former Commissioner Rossotti reported the IRS was receiving sufficient resources to work only 40 percent of some 4.5 million accounts receivable cases each year. IRS research estimated that with an additional \$296.4 million, the agency could collect \$9.47 billion.⁴³ That translates to a return on investment of 32:1. Among collection cases handled solely through phone calls, the IRS has estimated an ROI of about 13:1.⁴⁴

Because Congress has not provided IRS with sufficient funding to work these accounts, the Administration requested the authority to outsource the collection of certain tax debts to private collection agencies. Congress granted the requested authority in 2004,⁴⁵ and the IRS began to send cases to private debt collectors in September 2006.

Under the terms of the program, the IRS is paying out commissions of up to 25 percent of each dollar collected to the private collection agencies. The IRS is also bearing significant additional costs to create, maintain, and oversee the program.⁴⁶

Internal IRS estimates show that the IRS, if given the funding, could generate a substantially higher ROI than private contractors with the potential to receive commissions of nearly 25 percent can produce. Assuming a roughly 20 cent commission per dollar collected by PCAs, the best the PCAs can do is a return of 4:1, disregarding IRS investment or overhead costs. The significant administrative costs the IRS is incurring to run the program, including the opportunity costs of pulling experienced IRS personnel off higher dollar work to assist with this initiative, reduce the

⁴¹ *Id.* at 33. The overall acceptance rate of documents was 64 percent. Affidavits had the highest acceptance rate of 82 percent, followed by letters with an acceptance rate of 55 percent, and records with an acceptance rate of 48 percent.

⁴² See National Taxpayer Advocate 2006 Annual Report to Congress 305.

⁴³ Commissioner Charles O. Rossotti, *Report to the IRS Oversight Board: Assessment of the IRS and the Tax System* 16 (Sept. 2002).

⁴⁴ Government Accountability Office, GAO-06-1000T, *Tax Compliance: Opportunities Exist to Reduce the Tax Gap Using a Variety of Approaches*, at 17 (July 26, 2006).

⁴⁵ Pub. L. No. 108-357, § 881(a)(1) (enacting IRC § 6306).

⁴⁶ For a detailed discussion of the private debt collection program, see National Taxpayer Advocate 2006 Annual Report to Congress at 34-61 (Most Serious Problem: *True Costs and Benefits of Private Debt Collection*).

ROI further. Despite supporting the use of private debt collectors because of IRS resource limitations, IRS Commissioner Mark Everson has repeatedly acknowledged that IRS employees could collect unpaid taxes more cheaply and efficiently.⁴⁷

The result of underfunding the IRS in this area is that the government is not maximizing its revenue collection and the risk of taxpayer rights violations has been heightened due to the use as collectors of non-governmental employees who will receive only limited taxpayer-rights training. Collection practices that involve the “psychological pause” (“the next person who speaks loses”) or instructions to “close the sale” seem closer to boiler room techniques than efforts to bring taxpayers into compliance. At the very least, such approaches are inconsistent with the values built into IRS customer service initiatives since the Internal Revenue Service Restructuring and Reform Act of 1998.

IX. Insufficient IRS Funding Can Lead to Collection Practices that Harm Taxpayers , Particularly Low Income Taxpayers, and Increase Accounts Receivable.

A. IRS Collection Practices Do Not Promote Early Intervention in Collection Cases

In the 2006 Annual Report to Congress, we analyzed IRS collection practices and noted that the lack of early, meaningful interventions by the IRS on delinquent tax accounts contributes to long-term financial problems for many taxpayers and cost the government billions of dollars in lost revenue.⁴⁸ IRS methods for establishing the priority of collection cases have traditionally placed primary emphasis on the aggregate dollar amounts of delinquencies.⁴⁹ As a result, many collection accounts do not receive adequate attention because the taxpayer does not owe “enough” delinquent taxes, at least not yet. The IRS usually cites a lack of available collection resources as a barrier to providing personal attention to many of these cases.⁵⁰

This IRS collection strategy harms taxpayers, particularly low income taxpayers. Specifically, because low income taxpayers generally incur relatively small tax debts and the IRS considers them low priority cases, these accounts carry a high probability of being “surveyed,” *i.e.*, systemically reported as not collectible. Since penalty and interest continue to accrue on these unresolved accounts, by the time they grow to the

⁴⁷ See, e.g., Dustin Stamber, *Everson Admits Private Debt Collection Costs More, Defends Return Disclosure Regs*, 111 Tax Notes 11 (Apr. 3, 2006).

⁴⁸ National Taxpayer Advocate 2006 Annual Report to Congress, *Most Serious Problem: Early Intervention in IRS Collection Cases*, 62 – 82.

⁴⁹ IRS, Small Business/Self-Employed Operating Division, *Risk Based Collection* (Mar. 2006), available at http://sbse.web.irs.gov/ACS/Risk_Based/Risk_Based_Collection.htm.

⁵⁰ Treasury Inspector General for Tax Administration, Ref. No. 2006-30-055, *Trends in Compliance Activities Through Fiscal Year 2005* (Mar. 2006).

level that triggers IRS attention, the amounts are so large that the low income taxpayer cannot pay the debt in full or over time.

B. IRS Collection Practices Do Not Realistically Determine the Reasonable Collection Potential of Cases Involving Low Income Taxpayers

When low income taxpayers proactively attempt to resolve their delinquency problems, IRS collection practices serve as barriers to mutually beneficial solutions. For example, the IRS's current national standards for allowable living expenses (ALEs), used to calculate the reasonable collection potential for purposes of offers in compromise and installment agreements, discriminate against low income taxpayers.

The IRS's current ALE "national standards," which primarily represent allowances for food and clothing, group taxpayers into eight income stratifications.⁵¹ As defined by the ALE, *a family of four living at the lowest defined income level is only entitled to \$11 more per month for food than a family of three – or \$132 per year!* The lowest three income stratifications – with their attendant "allowable" expenses – are actually below the poverty income level as defined by the U.S. Department of Health and Human Services.⁵² Thus, by basing "national standards" on actual expenditure data instead of realistic cost of living allowances, the IRS forces low income taxpayers to live *below* the poverty threshold with respect to their basic living expenses.⁵³ For the federal government to expect a family of four to feed a child on \$132 a year is an affront to basic human dignity.

The IRS's failure to develop reasonable allowable expense standards that recognize the need for taxpayers to retain sufficient net income to rise above the poverty level, as measured by federal poverty guidelines (or some reasonable percentage above them), harms taxpayers by requiring them to pay unrealistic amounts, increases the IRS's accounts receivable by failing to provide for account resolution, and alienates taxpayers who may be trying to become compliant.

⁵¹ IRS, *National Standards for Allowable Living Expenses*, at <http://www.irs.gov/businesses/small/article/0,,id=104627,00.html>.

⁵² United States Department of Health and Human Services, *Poverty Guidelines Research and Measurement* at <http://aspe.hhs.gov/poverty>.

⁵³ To deviate from the national standard ALEs, the taxpayer must provide documentation that his or her expenses are greater than the sum of *all* the categories covered by the national standards. This requirement is virtually impossible for low income taxpayers to meet, who are often "unbanked" and conduct transactions in cash. See IRM 5.15.1.8(3) (Rev. 05-01-2004).

X. IRS Emphasis on Automated Levies Harms Elderly and Disabled Social Security Recipients

The Taxpayer Relief Act of 1997 (TRA 97) authorized the IRS to issue continuous levies for up to 15 percent of federal payments due to taxpayers who have an unpaid federal tax liability.⁵⁴ Under the Federal Payment Levy Program (FPLP), an automated system matches IRS records against those of the government's Financial Management Service (FMS) to locate federal payment recipients who have delinquent income tax debts.⁵⁵ Once a match occurs, the IRS attempts to notify the recipient of the potential levy by sending a letter with information about the liability and the taxpayer's appeal rights. As an additional precaution for taxpayers who receive benefits paid by the Social Security Administration (SSA), the IRS sends a second notice before transmitting the levy to the FMS. When the FMS generates a levy payment, it sends a notice to the taxpayer's address of record on file with the appropriate federal agency.

From FY 2002 through the first quarter of FY 2006, 84 percent of all FPLP levies involved SSA payments to the elderly and disabled.⁵⁶ Although the law limits FPLP levies to only 15 percent of each Social Security payment, the remainder may not be enough to avoid a financial hardship, considering that:

- Social Security provides at least half of the total income for 65 percent of beneficiaries aged 65 or over, and is the only source of income for more than 20 percent of this population;⁵⁷ and
- As of August 2006, Social Security recipients received an average monthly benefit of \$923.30. An FPLP levy would reduce the amount to \$784.80 per month.⁵⁸

Between FY 2005 and FY 2006, FPLP case receipts in the Taxpayer Advocate Service increased by 143 percent (from 1,707 case receipts in FY 2005 to 4,147 case receipts in FY 2006). Of the 3,527 FPLP cases closed by TAS in FY 2006, 73 percent received full or partial relief from the levy.⁵⁹ TAS FPLP cases often involve not only the TAS

⁵⁴ IRC § 6331(h)(2)(A). Payments subject to the Federal Payment Levy Program include any federal payments other than those for which eligibility is based on the income or assets of the recipients.

⁵⁵ The Financial Management Service (FMS) is the Department of Treasury agency that processes payments for various federal agencies.

⁵⁶ IRS, W&I Operating Division spreadsheets titled "FPLP Monthly counts CUM" (May 5, 2006) and "FPLP Monthly counts FY 2006" (February 28, 2007). [Total number of SSA levies from FY 2002 through FY 2006 divided by total number of FPLP levies from FY 2002 through FY 2006 = 84 percent.]

⁵⁷ Social Security Administration, *Fast Facts & Figures About Social Security*, 2005 (Sept. 2005).

⁵⁸ Social Security Administration, Office of Policy, Research, Evaluation and Statistics, *Monthly Statistical Snapshot*, Table 2, Social Security Benefits (Oct. 2006). [$\$923.30 \times .15 = \138.50 and $\$923.30 - 138.50 = \784.80 .]

⁵⁹ Taxpayer Advocate Management Information System (TAMIS).

case advocate but also several IRS, Social Security Administration, and FMS employees. Frequently, at least four federal employees must undo what an effective screen could prevent occurring. This situation is not only harmful and burdensome to taxpayers but it is also an astonishing waste of valuable resources.

All of these statistics demonstrate how imperative it is that the IRS develops an effective screen to eliminate the need for low income elderly or disabled individuals to contact the IRS and seek relief from a levy after the fact. Yet despite two IRS task forces, a GAO audit, and multiple National Taxpayer Advocate Annual Reports to Congress (with specific recommendations) over the past five years, the IRS has been unable to devise a feasible method of screening out low income taxpayers from this automated process.⁶⁰

The IRS has finally agreed, in response to the 2006 Annual Report to Congress, to conduct the necessary research to develop an appropriate screen. While this research has yet to commence, elderly and disabled Social Security recipients are today having their benefits reduced under the FPLP. Congress needs to let the IRS know that this research and the development of an effective screening mechanism is of the utmost importance for protecting the rights of this vulnerable population.

XI. Insufficient Funding Leads to Neglect of Important Taxpayer Service Programs

The IRS has long acknowledged that taxpayer service plays a significant role in promoting tax compliance. In fact, its current strategic plan is based on the principle: “Service + Enforcement = Compliance.”⁶¹ Yet the following examples illustrate the neglect of important services that likely is resulting in a higher tax gap.

A. Tax Return Preparation

The IRS historically has prepared tax returns for low income taxpayers at its walk-in sites (called “Taxpayer Assistance Centers,” or “TACs”). Low income taxpayers generally qualify for the earned income tax credit (EITC), which is a refundable credit

⁶⁰ See National Taxpayer Advocate 2001 Annual Report to Congress 202 - 209; National Taxpayer Advocate 2003 Annual Report to Congress 206 – 212; National Taxpayer Advocate 2004 Annual Report to Congress 246 – 263; National Taxpayer Advocate 2005 Annual Report to Congress 123 - 135. See also, National Taxpayer Advocate 2006 Annual Report to Congress 114 – 117.

⁶¹ In the preface to the National Taxpayer Advocate 2006 Annual Report to Congress, I argue that compliance should be viewed as a third category or IRS emphasis rather than as the sum of service and enforcement. There are many compliance activities the IRS undertakes, such as document matching, that catch errors taxpayers make either inadvertently or negligently. In my view, these activities should be classified as “compliance” activities, and the “enforcement” label should be reserved for cases of willful violation of the laws. I argue that nomenclature matters in this area because if the IRS treats willful and inadvertent compliance the same way, IRS personnel will treat innocent taxpayers harshly and taxpayers will feel that the IRS has dealt with them unfairly, perhaps alienating them from the tax system and reducing their future compliance.

that caps out at \$4,536 in 2006. Studies show that the average overclaim rate for EITC benefits is between 27 percent and 32 percent.⁶² IRS personnel who prepare tax returns are trained to ask questions that minimize the likelihood of EITC overclaims and thus can save the government hundreds of dollars per return. Yet to free up resources for other program initiatives, the IRS has substantially reduced return preparation at its TACs. The number of tax returns it prepared dropped from 665,868 in FY 2003 to a projected 305,000 in FY 2006.

IRS data for tax years 2002 through 2004 suggest that EITC returns prepared by IRS TACs may be significantly more compliant than self-prepared and commercially prepared returns. Discriminant Function (DIF) scores⁶³ for self-prepared returns were between 21 and 26 percent higher than returns prepared at the TACs. The DIF scores for returns prepared by commercial preparers were between 25 and 31 percent higher than returns prepared at the TACs.⁶⁴

These findings are corroborated by examination results for EITC returns for these tax years. As compared with TAC-prepared returns, average audit assessments among EITC returns for tax years 2002 - 2004 ranged from about \$640 to \$1,300 higher for self-prepared returns and from about \$820 to \$1,300 higher for commercially prepared returns.⁶⁵ Similarly, a study conducted in 1996 that examined the relationship between IRS return preparation and compliance over a ten-year period showed that an increase in the number of returns prepared by the IRS correlates with improvements in compliance among filers of individual returns.⁶⁶

B. *Portal for Free Electronic Filing of Tax Returns*

Few policy decisions make less sense to me than the IRS's failure to provide taxpayers with the ability to file a return electronically and directly with the IRS *for free*. The IRS is far behind in meeting its congressional mandate to achieve electronic filing of 80 percent of all returns by FY 2007.⁶⁷ For the 2006 filing season, about 42.4 million individual tax returns, or about 32.5 percent, were prepared using computer software yet were printed out on paper and mailed to the IRS.⁶⁸

⁶² Internal Revenue Service, Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns 3 (Feb. 28, 2002).

⁶³ The DIF score is an estimate of the likelihood of noncompliance on a return. A higher score indicates a higher likelihood of noncompliance.

⁶⁴ IRS Compliance Data Warehouse, Individual Returns Transaction File data for tax years 2002-2004.

⁶⁵ IRS Compliance Data Warehouse, Audit Inventory Management System data for tax years 2002-2004.

⁶⁶ See Alan H. Plumley, Pub. 1916, *The Determinants of Individual Income Tax Compliance: Estimating The Impacts of Tax Policy, Enforcement, and IRS Responsiveness* 41 (Oct. 1996).

⁶⁷ In 2006, through August 26 of that year, about 72 million individual income tax returns out of the approximately 130 million individual returns filed were filed electronically (about 55%). Tax Year 2005 Taxpayer Usage Study (August 26, 2006).

⁶⁸ *Id.*

Taxpayers in focus groups and town hall meetings consistently say that the cost of electronically filing and privacy concerns about data going through third parties are significant barriers to them e-filing their returns. Given the benefits that could be realized by reallocating the significant IRS savings from increased e-filing – increased phone coverage, increased responsiveness to taxpayer correspondence, early intervention in collection accounts (including outbound calling) – it makes economic sense as well as common sense to mandate the IRS to undertake the research and development of a portal for directly receiving electronically-filed returns.

C. *Meeting Taxpayers' Service Needs and Preferences*

In September 2005, the IRS formed the Taxpayer Assistance Blueprint (TAB) team, with employees from several IRS functions, including the Taxpayer Advocate Service (TAS), in response to a congressional directive to develop a five-year plan for taxpayer service.⁶⁹ The TAB delivered an initial report to Congress in April 2006⁷⁰ and plans to release its final report in early 2007. The critical part of the upcoming report is the five-year plan for how the IRS should provide taxpayer service.⁷¹

In developing a five-year plan for taxpayer service and weighing various policy and budget considerations, the IRS must decide what obligation it has to provide information and services to taxpayers to meet their needs. There are a number of sources available to meet taxpayer needs, including the IRS, volunteer organizations, and paid practitioners. When deciding how to meet taxpayer needs in the future, the IRS must be sure it is not shifting this responsibility from itself to volunteers and paid practitioners. While volunteer groups and practitioners play an important role in the tax community, where the IRS is the best source for providing information and services to meet taxpayer needs, it should not shift that responsibility to outside groups over which it has little or no control.

⁶⁹ H. Rep. No. 109-307, at 209 (2005). The Senate Committee Report provides further detail on the content of the five-year plan, directing the IRS to:

. . . undertake a comprehensive review of its current portfolio of taxpayer services and develop a 5-year plan that outlines the services it should provide to improve services for taxpayers. This plan should detail how it [IRS] plans to meet the service needs on a geographic basis (by State and major metropolitan area), including any proposals to realign existing resources to improve taxpayer access to services, and address how the plan will improve taxpayer service based on reliable data on taxpayer service needs. As part of this review, the Committee strongly urges the IRS to use innovative approaches to taxpayer services, such as virtual technology and mobile units. The IRS also should expand efforts to partner with State and local governments and private entities to improve taxpayer services.

S. Rep. No. 109-109, at 133-34 (2005).

⁷⁰ IRS, *Taxpayer Assistance Blueprint: Phase I* (April 16, 2006).

⁷¹ For an analysis of taxpayer survey data about taxpayer needs and preferences, see National Taxpayer Advocate 2006 Annual Report to Congress, vol. 2, *Study of Taxpayers Needs, Preferences, and Willingness to Use IRS Services* 1 – 16.

Taxpayer preferences are linked to their ability to use a certain method (or channel) of service delivery. Factors such as age, income, literacy, language skills, and disability also influence preferences.⁷² When analyzing taxpayer preferences, the IRS must keep in mind the needs of certain taxpaying populations such as the elderly, low income, low literacy, limited English proficiency, and disabled. While the general taxpayer population may have certain preferences for obtaining needed services, these preferences may not hold true for all taxpayers. The IRS owes an obligation to provide services in a manner that all taxpayers can access them, including those taxpayers whose needs differ from the general population.

D. Reasonable Accommodations for Taxpayers with Disabilities

Persons with disabilities are the largest protected class in the United States. This group is diverse in age, race, and economic standing.

- There are 51.2 million Americans, 18 percent of the population, who have some level of disability.
- There are 32.5 million Americans, or 12 percent of the population, who have a severe disability.
- 10.7 million Americans age six and older need daily assistance with one or more activities of life, such as taking a bath or using the telephone.
- 1.8 million Americans 15 and older report being unable to see.
- There are 2.6 million Americans, 15 or older, who report some difficulty having their speech understood by others.
- There are 14.3 million Americans with limitations on their cognitive function or an emotional or mental illness.⁷³

The median income for Americans who have a non-severe disability is \$22,000, compared to \$25,000 for those who have no disability.⁷⁴ Twenty-six percent of Americans with a severe disability fall below the poverty line, compared with 11 percent of those with a non-severe disability and six percent with no disability.⁷⁵ Thirty-three percent of Americans between the ages of 25 and 64 who have a non-severe disability, and 22 percent of those with severe disabilities have graduated from college, compared to the 43 percent who do not have disabilities.⁷⁶ Thirty-six percent of Americans between the ages of 15 and 64 with a severe disability have a computer and 29 percent use the Internet at home, compared with 61 percent of Americans who do not have a

⁷² See National Taxpayer Advocate 2006 Annual Report to Congress: Most Serious Problem, *Reasonable Accommodations For Taxpayers With Disabilities*, 376 - 395; see also Most Serious Problem, *Limited English Proficient Taxpayers: Language And Cultural Barriers to Tax Compliance*, 333 - 354.

⁷³ U.S Census Bureau, *Question and Answer Center*, at http://www.census.gov/Press-Release/www/releases/archives/facts_for_features_special_editions/006841.html (last visited Sept. 11, 2006).

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Id.*

disability and have a computer and 51 percent who use the Internet at home.⁷⁷ Finally, 2.6 million veterans receive compensation for service related disabilities.⁷⁸ Clearly, persons with disabilities constitute a large and diverse segment of the U.S. population.

In the 2006 Annual Report to Congress, I identified three major barriers encountered by disabled taxpayers:

- communication barriers, which limit or deter taxpayers' ability to receive IRS assistance or communicate effectively in audits or collection matters;
- insufficient education and outreach to the disabled community, particularly with respect to disabled persons who are self-employed or running a small business; and
- the complexity of tax deductions and credits designed to act as incentives for employment of disabled persons, which leads to underutilization of these provisions.

The IRS's inability to adequately serve this taxpayer population does not arise from a lack of caring. In fact, the IRS's Stakeholder Partnership, Education, and Communication (SPEC) function has many innovative products and projects to assist these taxpayers. The IRS has the ability and the will to do much more than it is currently doing, but it needs to establish a strategic plan that reaches across all IRS functions to ensure access at each stage of a disabled person's interaction with the tax system. And Congress should adequately fund implementation of that plan.

E. Assistance to Persons with Limited English Proficiency

In the 2006 Annual Report to Congress, I commend the IRS for many of its efforts but also highlight several challenges facing tax administrators as they attempt to assist taxpayers with limited English proficiency (LEP).⁷⁹ I would like to discuss one particular aspect here, as I believe that it has the greatest likelihood of harming LEP taxpayers. When corresponding with taxpayers, the IRS does not offer written language assistance to a large number of LEP taxpayers, and does not translate into other languages vital documents that significantly impact taxpayers' rights.

Executive Order 13166 requires all federal agencies to develop and implement a system by which LEP individuals can meaningfully access services without unduly burdening the fundamental mission of the agency.⁸⁰ Per the Executive Order, the Department of Justice issued guidance and provided a framework for federal agencies to carry out this mission, including determining what documents should be considered

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ See National Taxpayer Advocate 2006 Annual Report to Congress, Most Serious Problem: *Limited English Proficient (LEP) Taxpayers: Language and Cultural Barriers to Tax Compliance* 333 – 354.

⁸⁰ Exec. Order No. 13166, 65 Fed. Reg. 50121 (Aug. 11, 2000).

for translation.⁸¹ Using this guidance, the IRS has designated 108 documents as “vital.”⁸² The IRS defines vital documents as either “required by law or critical to the receipt of a federal benefit or service.”⁸³

The IRS plans to translate these vital documents only into Spanish, its sole designated “regularly encountered” language. This policy, which precludes the translation of vital documents into any language but Spanish, leaves millions of LEP taxpayers struggling to understand their tax obligations and navigate the tax controversy process. For example, the IRS offers no written language assistance or translated notices to approximately 1.3 million people who speak Chinese and identify themselves as speaking English less than “very well.”⁸⁴ The IRS recognizes the Asian population as the second fastest growing LEP population segment in the U.S., yet does not include any Asian languages in its translation policy.⁸⁵

The IRS has translated a limited number of documents into other languages, mostly for education and outreach purposes.⁸⁶ Individuals who speak languages other than English or Spanish must look outside the IRS for help in translating forms, notices, and letters, many which directly impact taxpayer rights. Expecting LEP taxpayers to find their own translators to interpret forms, notices, and publications places a burden upon these taxpayers. Further, not being aware of the complexity or importance of IRS forms and notices, these LEP taxpayers may seek help from others, such as their school-age children, who only have limited English skills or who cannot comprehend and translate complex IRS issues.

The IRS has translated over 240 documents into Spanish.⁸⁷ While this figure includes 87 of the 108 “vital” documents, the IRS has yet to translate several “vital” documents that are essential to the examination or collection process and the protection of taxpayer rights.⁸⁸

⁸¹ Department of Justice Guidance to Federal Financial Assistance Recipients Regarding Title VI Prohibition Against National Origin Discrimination Affecting Limited English Proficient Persons, 67 Fed. Reg. 117 (Jun. 18, 2002).

⁸² IRS, *Multilingual Initiative Customer Base Report FY 2006 70* (Feb. 2006). Form 2688, which is listed as a vital document for translation, is now obsolete and superseded by Form 4868.

⁸³ IRS, *Multilingual Initiative Customer Base Report FY 2006 70* (Feb. 2006).

⁸⁴ U.S. Census Bureau, *2005 American Community Survey*, Table B16001, Language Spoken at Home by Ability to Speak English for the Population 5 Years and Older.

⁸⁵ IRS, *Multilingual Initiative Customer Base Report FY 2006 19* (Feb. 2006).

⁸⁶ IRS, *Multilingual Initiative Customer Base Report FY 2006 70* (Feb. 2006).

⁸⁷ IRS, *Multilingual Initiative Customer Base Report FY 2006 60* (Feb. 2006).

⁸⁸ *Id.* The IRS designated these documents as vital, but has not yet translated these documents. In lieu of translating Notice CP-90, the IRS added a statement informing the taxpayer where (telephone number) he or she can obtain assistance in Spanish.

TABLE 5. SAMPLE OF VITAL DOCUMENTS NOT CURRENTLY TRANSLATED INTO SPANISH⁸⁹

Document Title	Product Type	Product Number	Legislative Requirement
Notice of Deficiency ⁹⁰	Letter	531(DO) 531(SC)	IRC 6212/6155/6303
CP 2000 – AUR Notice of Proposed Tax Changes ⁹¹	Notice	CP 2000	IRC 6212
Notice of Intent to Levy and Notice of Your Right to a Hearing ⁹²	Notice	CP-90	IRC 6331/6320
LT 11 Notice of Intent to Levy ⁹³	Notice	LT 11	IRC 6330/6331

As noted earlier, the IRS defines “vital documents” as those that are “required by law or critical to the receipt of a federal benefit or service.”⁹⁴ Following this definition without consideration for IRS-specific rights may lead the IRS to omit documents for translation that impact taxpayer rights or provide taxpayer protections. It is clear from the list above that the IRS has adopted a narrow definition of the term “federal benefit or service” – perhaps driven by resource concerns. Notwithstanding resource levels,

⁸⁹ IRS, *Multilingual Initiative Customer Base Report FY 2006 71-77* (Feb. 2006).

⁹⁰ The Statutory Notice of Deficiency is required by IRC § 6212 when the IRS determines there is a deficiency, which is generally the excess of the amount the IRS contends is the correct tax over the amount the taxpayer showed on the return. Meeting prescribed timeframes is important because per IRC § 6213 the taxpayer has 90 days from the date of the letter to file a petition in Tax Court challenging the proposed tax deficiency (or 150 days if addressed to a person who resides outside the United States). Failing to meet these statutory guidelines would require the taxpayer to first pay the tax and file a claim for a refund before litigating the issue.

⁹¹ CP 2000 is a notice that informs the taxpayer of a proposed change to tax liability because of income that is not identifiable or apparently not fully reported on the return. It may also include credits and deductions that appear overstated. If the taxpayer’s response does not resolve the issue, there is no response, or the notice is undeliverable, a Statutory Notice under IRC § 6212 will be issued. The taxpayer would then fall under the prescribed timeframes for IRC § 6213.

⁹² This notice informs taxpayer that IRS intends to issue a levy against any federal payments due the taxpayer, such as SSA benefits or OPM retirement benefits, because the taxpayer still has a balance due on his or her tax account. If the taxpayer does not agree with the proposed action, the taxpayer has the right to file a Collection Due Process (CDP) hearing request. The request for a CDP hearing must be filed within 30 days of the notice for full CDP rights.

⁹³ This notice, as required under IRC §§ 6330 and 6331, informs a taxpayer that the IRS intends to levy on his or her property or rights to property 30 days after the date of the letter unless the taxpayer pays, makes arrangements to pay or files for a CDP hearing, if available. Examples of property include bank accounts, wages, commissions, business assets, cars and other income and assets.

⁹⁴ IRS, *Multilingual Initiative Customer Base Report FY 2006 70* (Feb. 2006).

fundamental statutory taxpayer rights, such as the right to be heard in Tax Court or have a Collection Due Process (CDP) hearing, are indeed “fundamental benefits or services.” In our view, the IRS’s current translation policy does not comply with Executive Order 13166.

F. *Small Business Outreach*

IRS data show that self-employed taxpayers account for the largest chunk of the tax gap and indicate that the tax compliance rate for self-employed sole proprietors runs at about 43 percent.⁹⁵ Much of the underreporting is deliberate, but some is not. For example, many small businesses are started by individuals who lack detailed knowledge of the tax laws and do not have the resources to hire tax attorneys or accountants. When they hire a few workers, they often do not realize that they are assuming tax reporting, tax withholding, and tax payment obligations, and they often do not understand enough about the details of complying with the requirements to do so with reasonable effort.

After the IRS Restructuring and Reform Act of 1998, the IRS developed a function known as Taxpayer Education and Communications, or “TEC.” TEC was the IRS’s outreach arm to small businesses to try to educate them about the complexity of their tax obligations. For 2002, TEC was named the Small Business Administration’s agency of the year for what the SBA called its outstanding progress in creating an effective education and compliance assistance program for small business and self-employed taxpayers.⁹⁶ Yet in the name of achieving “efficiencies,” TEC was “realigned” in February 2005 through a merger with other outreach functions and redesignated as “Stakeholder Liaison.” Prior to the realignment, TEC had 536 employees. After the realignment, Stakeholder Liaison staffing included 219 employees.⁹⁷ In my view, the reduction in TEC staffing will reduce tax compliance and place a greater burden on IRS enforcement personnel.

I cite these examples to make two points. First, although I disagree with certain decisions the IRS has made, the failure to provide the IRS with adequate resources to collect taxes has forced the IRS to cut corners in places where corners should not have to be cut. Second, I cite the examples of tax return preparation and TEC to underscore the important role taxpayer service plays in promoting tax compliance. Additional funding for the IRS should be provided in a balanced manner. The revenue derived from direct enforcement actions may be easier to measure, but the effects of taxpayer service may be equally significant and perhaps more significant.

⁹⁵ See IRS News Release, *IRS Updates Tax Gap Estimates*, IR-2006-28 (Feb. 14, 2006) (accompanying charts).

⁹⁶ See *Closing the Tax Gap and the Impact on Small Business*, Hearing Before the House Comm. on Small Business, 109th Cong. (Apr. 27, 2005) (testimony of John Satagaj, President and General Counsel, Small Business Legislative Council).

⁹⁷ IRS Small Business/Self Employed Division response to Taxpayer Advocate Service Information Request (Sept. 5, 2006).

XII. Insufficient Funding For Programs that Assist Taxpayers Will Negatively Impact Taxpayer Compliance

A. Low Income Taxpayer Clinics

In 1998 Congress authorized funding for the Low Income Taxpayer Clinic grant program to provide access to representation for low income taxpayers, so that achieving a correct outcome in an IRS dispute did not hinge on the taxpayer's ability to pay for representation. IRC § 7526 provides for matching grants of up to \$100,000 per year for qualifying organizations that represent low income taxpayers involved in controversies with the IRS and for organizations that provide tax education and outreach to taxpayers who speak English as second language (ESL taxpayers) or who have limited English proficiency (LEP). IRC § 7526 requires clinics to provide services for free or for no more than a nominal fee.

In the 2006 grant cycle, the LITC Program funded at least one clinic in every state, the District of Columbia, and Puerto Rico. For the 2007 grant cycle, TAS received 192 grant applications, including 52 first-time applicants – many in areas where taxpayers are underserved – and for the first time in the history of the LITC program, TAS received an application from Guam. TAS awarded 2007 grants to at least one clinic in the District of Columbia, Puerto Rico, Guam, and every state except Colorado. We plan to issue a 2007 supplemental grant application that will focus solely on Colorado, so we have coverage in each state.

In addition to educating ESL and LEP taxpayers about their rights and responsibilities under the U.S. tax system, LITCs provide much-needed representation to taxpayers in all types of tax controversies, including audits, levies, liens, installment agreements, offers in compromise, and nonfilers re-entering the system. For example, LITCs represent low income taxpayers before the United States Tax Court. LITCs also have stepped in to help low income taxpayers in the following situations:

- Representation of taxpayers in EITC audits, including Somali low income taxpayers whose returns were prepared by incompetent, unscrupulous or criminal preparers;

- TAS referrals for representation of claimants in the “Pigford” class action with respect to general tax issues faced by claimants;⁹⁸ and
- Representation of low income taxpayers who are victims of identity theft.

The Taxpayer Advocate Service has established the following goals for the Low Income Taxpayer Clinic program:

- Ensure each state (plus the District of Columbia and Puerto Rico) continues to be served by at least one clinic;
- Expand coverage in states that do not have both controversy representation and ESL education and outreach; and
- Ensure grant recipients demonstrate they are serving geographic areas that have sizable populations eligible for and requiring LITC services.

Additional funding for the LITC grant program is good for taxpayers and good for the government. LITCs help taxpayers re-enter the tax system or remain in compliance. I encourage Congress to support this program by providing for further expansion of the clinics. By statute, every dollar Congress invests in this program must be matched by another dollar raised by the LITC for LITC services. This is surely an excellent investment.

B. Taxpayer Advocate Service

The Taxpayer Advocate Service was created by Congress to help taxpayers solve their problems with the IRS and make legislative and administrative recommendations to mitigate such problems.⁹⁹ The two main functions in TAS are “case advocacy” and “systemic advocacy.” Approximately 90 percent of TAS’s operating funds in FY 2006 were spent on case advocacy. By statute, TAS is required to maintain at least one office in each state, and TAS maintains multiple offices in the largest states and in co-location with each IRS campus. Since FY 2001, TAS’s first full year of existence, the results of TAS’s case advocacy quality measure have improved from 71.6 percent (+/- 1.01%) in FY 2001 to 89.7 percent (+/- .73%) in FY 2006.¹⁰⁰ At the same time, we have managed to reduce cycle time (median cycle time on TAS cases was 45 days in

⁹⁸ “Pigford cases” are known by many names: USDA Black Farmers Settlement Claims, USDA Settlement, Black or African-American Farmer Settlement, Pigford v. Veneman or Glickman, Farmer Debt Forgiveness, or Pigford cases. As background, these cases arose as a result of a nationwide class action suit in which the plaintiffs, many of whom were African-American farmers, alleged race-based discrimination on the part of the United States Department of Agriculture (USDA). The plaintiffs prevailed, and many were awarded \$50,000 and debt-relief, if applicable. The USDA also made a \$12,500 tax payment on behalf of each plaintiff, which was sent directly to the IRS. The tax problems of these claimant/taxpayers are rooted in the tax consequences of debt relief, the \$50,000 cash award to the plaintiff, and the \$12,500 estimated tax payment on behalf of the plaintiff to the IRS, as well as how these items were reported to the IRS.

⁹⁹ IRC § 7803(c)(2)(A)(i)-(iv).

¹⁰⁰ TAS Quality Review Database. TAS quality is scored as a weighted percentage of the number of standards correct over the number of standards applicable in the aggregate.

FY 2006), and satisfy the taxpayers whom we serve (on a scale of 0-5, taxpayers reported an average satisfaction level of 4.34 in FY 2006). In 70 percent of the cases TAS closed in FY 2006, we were able to obtain relief for the taxpayer.

I am particularly pleased that TAS has managed to maintain its high levels of TAS case quality and timeliness in the face of a 43 percent increase in TAS cases over the past two years (from 168,856 in FY 2004 to 242,173 in FY 2006) and a reduction in TAS staffing of seven percent.¹⁰¹ The increase in cases combined with the reduction in staffing means that the average workload of each TAS case advocate has increased by about 50 percent.

Because cases generally come to TAS only when taxpayers have encountered problems trying to resolve their problems directly with other IRS functions, it is essential to sound tax administration that these taxpayers be properly treated on the second attempt. While we have managed to handle our increasing inventory to date, I am concerned that our effectiveness in meeting the needs of the taxpaying public will decline if the gap between the number of cases we receive and the staffing we have available to work those cases widens much further.

XIII. A Proposal to Revise the Congressional Budget Rules to Improve IRS Funding Decisions

In light of the IRS's unique role as the government's revenue generator, and to increase voluntary compliance by maintaining the appropriate balance between service and enforcement activities, we believe IRS funding decisions should stand on their own and not be subject to the general spending caps. Thus, we make the following recommendations:

- Congress should consider revising its budget rules in a manner that allows the budget and appropriations committees to make a judgment about the answer to the question: "What level of funding will maximize tax compliance, particularly voluntary compliance, with our nation's tax laws, with due regard for protecting taxpayer rights and minimizing taxpayer burden?" and then set the IRS funding level accordingly, without regard to spending caps.
- In allocating IRS resources, Congress should keep in mind that tax compliance is a function of both high quality taxpayer service and effective tax-law enforcement, and it is essential that the IRS continue to maintain a balanced approach to improving tax compliance.

¹⁰¹ Due to differences in the time of measurement and methodology, annual case receipts reported in the GAO report differ slightly from official TAS case totals. However, the totals differ by less than one percent; and both sets of numbers show a 43 percent increase in TAS cases over the past two years.

- Congress should provide increases in IRS personnel funding at a steady but gradual pace, perhaps two percent to three percent a year above inflation. We do not think the IRS can ramp up its staffing more quickly without encountering significant transitional difficulties. However, Congress should consider providing more rapid funding increases for technology and research improvements, as the transitional challenges of absorbing additional resources are probably less significant in these areas and the potential exists to generate substantial productivity gains.
- To assist Congress in performing its oversight responsibilities and determining the appropriate IRS funding level in future years, Congress should require the IRS to provide annual or semiannual reports detailing IRS's progress in handling all significant categories of work, including the known workload, the percentage of the known workload the IRS is able to handle and the percentage of the known workload the IRS is not able to handle, the additional resources the IRS would require to perform the additional work, and the likely return-on-investment of performing that work.¹⁰²

¹⁰² Much of this information was published in former Commissioner Rossotti's final report to the IRS Oversight Board. Commissioner Charles O. Rossotti, *Report to the IRS Oversight Board: Assessment of the IRS and the Tax System* 16 (Sept. 2002). However, we have not seen updated statistics published in this format since that time.