

**STATEMENT OF**

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**HEARING ON**

**THE TAX FILING SEASON**

**BEFORE THE**

**SUBCOMMITTEE ON OVERSIGHT**

**COMMITTEE ON WAYS AND MEANS**

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Chairman Lewis, Ranking Member Kelly, and Members of the Subcommittee:

Thank you for inviting me to testify at today's hearing on the IRS filing season.<sup>1</sup>

Before I discuss the subject of this hearing, I would like to take this occasion to thank this subcommittee and the full Committee on Ways and Means for your support of the Office of the Taxpayer Advocate, its employees, and me personally over almost two decades. As you know, last week I announced I will retire from the position of National Taxpayer Advocate on July 31, 2019, after 18 years on the job. But my work with this subcommittee actually began in 1997, more than two decades ago, when I testified before you during the hearings that led to the enactment of the IRS Restructuring and Reform Act of 1998. At that time, I had no idea I would serve as the National Taxpayer Advocate, and I certainly had no expectation that I would testify before Congress more than sixty times. I have learned so much from working with the subcommittee and its staff, and I am deeply grateful for the continued interest in and support you have shown for our legislative and administrative recommendations designed to strengthen taxpayer rights and improve tax administration. I must add that it is important my successor have the same passion and independent perspective that I brought to the job. The taxpayers of the United States deserve no less.

Moving to the subject of today's hearing: Delivering a successful filing season is the IRS's most significant responsibility, and this year, the task has been made more difficult by two developments. First, most provisions of the Tax Cuts and Jobs Act (TCJA) took effect for Tax Year 2018, and those provisions are being reported on tax returns for the first time. Second, the recent government shutdown occurred during the five-week period before the start of the filing season, so some important tasks were not accomplished, such as the processing of correspondence and critical employee training. As a result, the IRS started out behind, and it has had to work hard to try to catch up.

When analyzing the filing season, I think it is important to look at it through the eyes of two sets of taxpayers: (i) taxpayers who can file their returns on their own or with the help of a preparer and whose returns are processed without issue and (ii) taxpayers who require assistance from the IRS or whose returns are frozen and refunds delayed due to suspected fraud, identity theft, or other issues. In most years, the IRS does a remarkably good job of processing clean returns, but it struggles to assist taxpayers who have questions or run into problems.

Because the 2019 filing season began just over one month ago, it is too soon to provide a comprehensive assessment. Trends that are apparent today may reverse. Thus, I

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

caution against drawing conclusions about this unique filing season before it is over. In this statement, I will present some preliminary data that, for the most part, reflects the IRS's performance through four weeks of the filing season, and I will identify certain issues to keep an eye on in the coming weeks.

Specifically, I will address the following issues relating to the filing season:

- 1. Big Picture View:** To date, the number of tax returns received and processed, the percentage of returns filed electronically, the percentage of taxpayers electing to receive their refunds via direct deposit, and the percentage of taxpayers receiving refunds is comparable to prior years.
- 2. Telephone Service:** To date, the IRS has reported a "Level of Service" (LOS) of 57 percent on its Accounts Management telephone lines and assistors have answered only 18 percent of taxpayer calls – both substantially below last year's levels. During the first week after the shutdown, the Installment Agreement/Balance Due line experienced an LOS of 6.7 percent – meaning 93.3 percent of the calls from taxpayers trying to make payment arrangements were not answered.<sup>2</sup>
- 3. Correspondence:** The IRS is facing significantly larger correspondence backlogs than at this point last year. Because Accounts Management employees are shifted between answering the phones and processing correspondence, the IRS cannot improve in one area without neglecting the other.
- 4. Tax Law Questions:** Since 2014, the IRS has generally been answering tax-law questions only during filing season. This year, because of the significant tax-law changes made by the TCJA, the IRS indicated it would answer questions about the new law year-round. TAS testers calling the toll-free lines with sample questions have received inconsistent service and inaccurate information.
- 5. Fraud Detection Filters:** Overly broad fraud detection filters cause refund delays for hundreds of thousands of taxpayers. Last year, the false positive rate for the IRS's general refund fraud filters was 81 percent and caused a 287 percent increase in TAS cases involving this issue. The IRS has attempted to make changes to improve the selection and processing of these returns, but this issue warrants close monitoring as the filing season progresses.
- 6. Form 1040:** After the enactment of the TCJA, the IRS redesigned the iconic Form 1040, breaking it up into a main form and six separate schedules, and eliminated the Form 1040A and the Form 1040-EZ. For taxpayers with simple returns, the shorter form should provide simplification. But for the majority of taxpayers who will have to complete additional schedules, the new form is likely to create more complexity. Some taxpayers who previously completed only the

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<sup>2</sup> IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (week ending Feb. 2, 2019).

Form 1040 will now have to complete one form and up to six schedules to report the same information.

7. **Free File:** The IRS's Free File program is failing to meet its objectives and address taxpayer needs. Although 70 percent of taxpayers are eligible to use Free File software to prepare their returns at no cost, fewer than two percent of taxpayers are doing so. Moreover, taxpayers who use Free File software are widely dissatisfied with it. Among taxpayers who used Free File software in 2017, fewer than half used it again in 2018.
8. **Impact of TCJA SSN Requirement on the Amish and Certain Other Religious Groups:** Under the TCJA, a taxpayer must provide a qualifying child's Social Security Number (SSN) to claim the full Child Tax Credit. Some religious groups, most notably the Amish, do not obtain SSNs for religious reasons. There are Constitutional and equity questions about whether otherwise qualifying individuals may be denied a tax credit where satisfying a substantiation requirement violates their religious beliefs. The IRS has not decided whether to allow the credit in these circumstances this year.

In addition, I will address the following issues that are not directly related to the filing season but I believe warrant your attention:

1. **TAS's Need to Resume Hiring Attorney-Advisors:** Attorney-advisors play a critical role in enabling TAS to perform its statutory mission to advocate for taxpayers. Beginning shortly after the enactment of the IRS Restructuring and Reform Act of 1998 and continuing until 2015, TAS was permitted to hire attorney-advisors. Since that time, the IRS has prohibited TAS from backfilling attorney positions due to a Departmental policy. Unless TAS is permitted to backfill attorney positions again quickly, our ability to advocate for taxpayers both individually and systemically and the National Taxpayer Advocate's ability to produce high-quality reports to Congress will be seriously jeopardized.
2. **Excepted Activities During a Government Shutdown:** The IRS's interpretation of the Anti-Deficiency Act, which prevents government agencies from incurring obligations in the absence of appropriations, effectively suspends statutory taxpayer protections during government shutdowns.
3. **IT Modernization:** The IRS's information technology (IT) challenges are well known. Among other things: (i) the IRS systems that hold the official records of taxpayer accounts – the Individual Master File and the Business Master File -- are the oldest major IT systems still in use in the federal government and (ii) taxpayer information is stored in over 60 separate case management systems that generally do not communicate with each other. The IRS desperately needs more funding – which should be coupled with appropriate oversight – to replace its antiquated systems and to develop a single enterprise-wide case management system.

4. **Public Access to Certain Legal Advice:** Under a 2007 court settlement, the IRS Office of Chief Counsel is required to disclose written legal advice it provides to IRS program managers. However, the Office of Chief Counsel has disclosed very few such memos in recent years, and it has taken the remarkable position that it is not required to disclose advice transmitted by email.
  
5. **Economic Hardship Determinations:** The IRS is required by law to halt certain collection actions, like levies, if a taxpayer is determined to be experiencing an economic hardship. The IRS could, but does not, take proactive steps to identify taxpayers at risk of economic hardship before taking collection actions in the first place. As a result, many taxpayers enter into installment agreements they cannot afford, and others are harmed because they are not aware they may ask the IRS to halt collection action on account of economic hardship. The TAS Research function has developed an automated algorithm that can identify such taxpayers with a high degree of accuracy.

**I. BIG PICTURE VIEW: Aggregate Data Indicate the 2019 Filing Season Has Been Comparable to the 2018 Filing Season During the Initial Four-Week Period**

Despite the government shutdown, the IRS began accepting and processing tax returns as planned on Monday, January 28. Figure 1 shows key filing measures through Feb. 22 (after 4 weeks of the filing season) as compared with the same date last year:

**Figure 1: Filing Season Statistics Comparing Weeks Ending February 23, 2018 and February 22, 2019**

		2018	2019	% Change
<b>Individual Income Tax Returns</b>	Total Returns Received	51,740,000	49,923,000	-3.5
	Total Returns Processed	49,992,000	47,700,000	-4.6
<b>E-Filing Receipts</b>	Total	49,192,000	47,866,000	-2.7
	Tax Professionals	23,438,000	21,869,000	-6.7
	Self-Prepared	25,754,000	25,997,000	0.9
<b>Web Usage</b>	Visits to IRS.gov	213,117,000	232,545,000	9.1
<b>Total Refunds</b>	Number	40,504,000	38,566,000	-4.8
	Amount	\$125.671 billion	\$121.203 billion	-3.6
	Average Refund	\$3,103	\$3,143	1.3
<b>Direct Deposit Refunds</b>	Number	37,731,000	36,329,000	-3.7
	Amount	\$120.689 billion	\$117.189 billion	-2.9
	Average Refund	\$3,199	\$3,226	0.8

As the chart shows, the IRS has processed more than 47 million returns. Of the total returns received, about 96 percent have been filed electronically. Of taxpayers receiving refunds, about 94 percent have elected to receive their refunds through direct deposit. This data is comparable to last year's at the same point.

Of all returns processed, 81 percent have received refunds – the same percentage as at this point last year. Of those receiving refunds, the average refund amount has increased by about one percent, rising from \$3,103 last year to \$3,143.

Over the last few weeks, there has been considerable public discussion about tax refunds in light of the TCJA. I offer two thoughts:

1. **Are Bigger Refunds Better?** There is a reasonable debate about whether it is better for taxpayers to have less tax withheld throughout the year and receive smaller refunds (or owe a balance) as opposed to having more tax withheld throughout the year and receiving larger refunds. Many economists argue against big refunds, saying that taxpayers are better off getting to keep more of what they earn throughout the year and not “giving the government an interest-free loan.” Others argue that a large segment of taxpayers consciously uses the government as a savings vehicle and prefers to receive a large check once a year. In my opinion, there is no single “correct” answer. Taxpayers will have different preferences.
2. **The Central Role of Forms W-4.** Employees are directed to complete and submit to their employer IRS Form W-4, *Employee's Withholding Allowance Certificate*, as the basis for determining how much tax will be withheld from each paycheck. During 2018, taxpayers experienced considerable difficulty figuring out how to use Form W-4 to adjust their withholdings. The IRS can take steps to simplify the use of Form W-4 and allow taxpayers to make their own decisions regarding whether to pay tax ratably or to elect some degree of overwithholding to ensure they will receive a large refund when they file their returns.<sup>3</sup>

## **Recommendations**

To address confusion and taxpayer preferences regarding refunds, I recommend the IRS take the following action:

- Improve Form W-4 so that taxpayers can better understand how it works and can select to have either (i) approximately the “correct” amount of tax withheld to satisfy their tax liabilities or (ii) additional tax withheld so they may receive a tax refund when they file their returns.

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<sup>3</sup> I support the IRS's decision to wait until after the 2019 filing season before modifying the Form W-4. It will be in a better position to design the form after it sees how the current form has worked to date.

To address the risks to personal data that arise when taxpayers provide their employers with a Form W-4 that includes details about their marital status, number of children, or other sources of income, I recommend the IRS:

- Study the procedures used in countries such as New Zealand and the United Kingdom that do not require employees to share these items of personal information, which impact withholding rates, with employers. Generally, these countries allow taxpayers to determine their withholding rates by using an easy-to-access online questionnaire and then require them to provide only the result of the questionnaire, expressed in terms of a withholding code, to their employers. This approach increases taxpayer privacy and data security.<sup>4</sup>

## **II. TELEPHONE SERVICE: The IRS Has Reported a “Level of Service” of 57 Percent on Its Accounts Management Telephone Lines and Assistors Have Answered 18 Percent of Taxpayer Calls.**

In most years over the past decade, the IRS has received more than 100 million telephone calls.<sup>5</sup> That’s a staggering number, and not surprisingly, discussions about the quality of taxpayer service often focus largely on how the IRS handles its phone calls. Both for the filing season to date and for the one-week period ending Feb. 23, 2019, the IRS is performing substantially below last year’s levels.

Before I present the data, there are several background points worth noting.

First, the government shutdown set the IRS back considerably going into the filing season. The IRS typically uses the weeks preceding the filing season to complete the hiring and onboarding of seasonal employees and to work through backlogs of correspondence. The shutdown prevented the IRS from undertaking these activities, and at the same time, new work piled up. By January 24, 2019, the final day of the shutdown, the IRS had over 5 million pieces of unprocessed mail, 80,000 responses to fiscal year (FY) 2018 Earned Income Tax Credit (EITC) audits that had not been addressed, and 87,000 amended returns waiting to be processed.

Second, the way the IRS maintains and presents filing season data is complex and confusing. At a basic level, the IRS reports a benchmark “Level of Service” (LOS),

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<sup>4</sup> National Taxpayer Advocate 2018 Annual Report to Congress 404-414 (Legislative Recommendation: *Tax Withholding: Improve the Processes and Tools for Determining the Proper Amount of Withholding and Reporting of Tax Liabilities*). This Legislative Recommendation is based on an in-depth study undertaken by TAS. National Taxpayer Advocate 2018 Annual Report to Congress vol. 2, 1-38 (Research Study: *A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems as a Mechanism for Simplifying and Improving U.S. Tax Administration*).

<sup>5</sup> IRS JOC, *Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total* (final week of each fiscal year (FY) for FY 2009 through FY 2018) (showing telephone call volumes exceeding 100 million in every year through FY 2016).



which many observers believe reflects the percentage of its calls that IRS telephone assistors answer.

That is not the case. The benchmark measure is a very narrow one and does not reflect the taxpayer experience in two respects. First, the benchmark measure only reflects calls that are directed to the IRS's "Account Management" (AM) telephone lines. During the 2019 filing season through February 23, the IRS received 15.0 million calls overall.<sup>6</sup> Of those, 12.4 million (83 percent) came in on or were routed to the AM lines and 2.6 million (17 percent) came in on or were routed to other telephone lines, such as the compliance lines.<sup>7</sup> The benchmark measure does not tell us anything about how these 2.6 million calls were handled.

Second, callers to the AM lines are greeted by a phone tree, and based on their responses, callers are directed either to an employee for live assistance or to an automated system. Depending on which buttons a caller pushes, the IRS decides whether to direct the caller to its automated offerings. In other words, automation is not a deliberate caller-selected option.

Notably, the IRS's LOS computation is based primarily on calls routed to telephone assistors. Through February 23, only 32 percent of taxpayer calls to the AM lines (about 4.0 million) were routed to assistors and included in the LOS computation, while 68 percent of taxpayer calls (about 8.4 million) were routed to automation or reflected taxpayer hang-ups (typically because taxpayers do not want to work through the phone tree or wait on hold).<sup>8</sup> As a result, while the IRS is reporting a benchmark LOS on its AM lines of 57 percent, *IRS employees answered only 18 percent of the calls received on the AM lines and 19 percent of calls received on all lines.*<sup>9</sup>

Figure 2 shows IRS telephone performance for all telephone lines ("Enterprise"), for the AM telephone lines, and for several other key lines:

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<sup>6</sup> IRS JOC, *Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total* (week ending Feb. 23, 2019).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

**Figure 2: Filing Season Statistics for Select Telephone Lines, 2018 (Through Feb. 24, 2018) and 2019 (Through Feb. 23, 2019)<sup>10</sup>**

Telephone Line	Year	Dialed Attempts	Assistor Calls Answered	Average Speed of Answer	Level of Service	% of All Calls Answered by Assistors
Enterprise	2018	16,882,990	5,368,521	10 min	71%	32%
	2019	14,997,006	2,910,385	17 min	48%	19%
Accounts Management	2018	13,720,367	3,892,283	6 min	78%	28%
	2019	12,445,935	2,295,589	12 min	57%	18%
Automated Collection System	2018	570,527	307,615	20 min	63%	54%
	2019	545,375	182,862	40 min	44%	34%
Installment Agreement/ Balance Due	2018	877,218	461,504	31 min	53%	53%
	2019	873,761	129,364	60 min	15%	15%
Taxpayer Assistance Center Appointments	2018	754,565	507,757	5 min	81%	67%
	2019	586,913	277,453	8 min	59%	47%
Taxpayer Advocate Service	2018	58,039	29,284	1 min	77%	50%
	2019	87,815	26,896	10 min	46%	31%

As this chart shows, the benchmark LOS on the AM lines has dropped from 78 percent last year to 57 percent this year for the comparable period, and hold times for taxpayers whose calls were answered have doubled from six minutes last year to 12 minutes this year. For all IRS telephone lines, the Level of Service has dropped from 71 percent to 48 percent and hold times have increased from 10 minutes to 17 minutes. And notably, the percentage of calls actually answered by assistors on the AM lines dropped from 28 percent last year to 18 percent this year.

Several points are worth noting about the select lines listed in Figures 1 and 2:

- A taxpayer typically calls the Automated Collection System (ACS) line when the IRS is taking a collection action and the taxpayer is seeking to speak with an IRS employee to address the liability. The LOS has declined from 63 percent with a 20-minute hold time last year to 44 percent and a 40-minute hold time this year.
- A taxpayer typically calls the Installment Agreement/Balance Due line when he or she is trying to resolve a delinquent tax liability. The 15 percent LOS and 60-minute wait time on this line to date is among the lowest of all IRS phone lines. During the first week of the filing season, this line had a 6.7 percent

<sup>10</sup> *Id.*

LOS – one of the lowest I recall seeing on a major IRS telephone line. The wait-time for that week was 81 minutes.<sup>11</sup>

- A taxpayer typically calls the Taxpayer Assistance Center (TAC) Appointments line when he or she wishes to visit a TAC to speak with an IRS employee in person. Under the IRS’s “appointments only” policy, taxpayers generally are not assisted if they walk into a TAC without having made an appointment, so it is essential that a taxpayer first speak with a telephone assistor. To date, IRS telephone assistors are answering fewer than half the calls directed to this line.
- A taxpayer typically calls the Taxpayer Advocate Service (TAS) line when he or she is experiencing a hardship and is seeking TAS assistance. The TAS toll-free line is not answered by TAS employees. Rather, it is answered initially by telephone assistors in the IRS call centers. Taxpayers seeking TAS assistance usually believe they have not been adequately assisted by other parts of the IRS. Frustration is compounded when they cannot get through by phone to try to open a case with TAS, as has been true two-thirds of the time this filing season.

Because the IRS was not able to answer the phones during the government shutdown, we have also looked at telephone responsiveness for the most recent week available. Figure 3 shows the results:

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<sup>11</sup> IRS, JOC, *Snapshot Reports: Product Line Detail* (week ending Feb. 2, 2019).

**Figure 3: Filing Season Statistics for Select Telephone Lines, One-Week Periods Ending Feb. 24, 2018 and Feb. 23, 2019**

Telephone Line	Year	Dialed Attempts	Assistor Calls Answered	Average Speed of Answer	Level of Service	% of All Calls Answered by Assistors
Enterprise	2018	3,988,817	904,134	8	60%	23%
	2019	5,192,337	783,988	16	43%	15%
Accounts Management	2018	3,565,082	733,392	5	63%	21%
	2019	4,735,874	655,887	13	45%	14%
Automated Collection System	2018	83,272	40,253	21	58%	48%
	2019	105,038	35,334	41	45%	34%
Installment Agreement/ Balance Due	2018	111,389	45,546	34	41%	41%
	2019	170,007	26,674	46	16%	16%
Taxpayer Assistance Center Appointments	2018	145,245	91,001	2	76%	63%
	2019	152,177	82,287	4	68%	54%
Taxpayer Advocate Service	2018	22,417	10,084	2	62%	45%
	2019	49,024	11,701	18	33%	24%

It should be noted that this week includes President’s Day and is among the highest volume call periods for the IRS. However, a comparison between this week in 2019 and this week in 2018 shows that the IRS continued to perform substantially below last year’s level. For the one-week period, the benchmark LOS on the AM lines dropped from 63 percent last year to 45 percent this year, and hold times for taxpayers whose calls were answered increased from 5 minutes last year to 13 minutes this year. For all IRS telephone lines, the LOS dropped from 60 percent to 43 percent and hold times have doubled from 8 minutes to 16 minutes. And notably, the percentage of calls actually answered by assistors on the AM lines dropped from 21 percent last year to 14 percent this year.

To a large extent, the decline in the IRS’s telephone service has almost surely been budget-driven. We estimate the IRS’s inflation-adjusted budget is more than 20 percent lower today than it was in FY 2010, and the IRS workforce overall is down by about 23 percent.<sup>12</sup> While it’s possible to compensate somewhat for reduced resources by

<sup>12</sup> The IRS appropriated budget has declined by almost 8 percent from \$12.1 billion in FY 2010 to \$11.2 billion in FY 2019. See Pub. L. No. 111-117, Consolidated Appropriations Act, 2010, Division C, 123 Stat. 3034, 3159 (2009); Pub. L. No. 116-6, Consolidated Appropriations Act, 2019, Division D, 133 Stat. 13 (2019). At the same time, the Consumer Price Index has risen by 16 percent from January 2010 to January 2019. Bureau of Labor Statistics, CPI Inflation Calculator, <https://data.bls.gov/cgi-bin/cpicalc.pl>. The combination results in an inflation-adjusted reduction of more than 20 percent. At the same time the number of IRS employees declined from 94,346 at the end of FY 2010 to 72,803 at the end of FY 2017.

achieving greater efficiencies, the IRS needs telephone assistors to answer taxpayer calls, and fewer assistors mean fewer calls answered. I have recommended that Congress provide the IRS with additional funding for taxpayer services in the past, and I continue to do so.

In addition, I have made two administrative recommendations that should help improve the taxpayer experience. First, I have recommended that the IRS offer taxpayers a “customer callback” option, so that taxpayers can elect to receive a call from the next available assistor rather than wait on hold. The IRS has considered offering this option, but it has not done so to date because of budget constraints. We understand the IRS is planning to implement it in the near future. (Notwithstanding this technology, the IRS will still need more assistors to make these callbacks.)

Second, we have recommended the IRS adopt “First Contact Resolution” as a performance measure. Measures such as the LOS are helpful indicators, but as we have discussed in prior reports to Congress, many private businesses consider “First Contact Resolution” their most important measure and objective because it means the customer’s problem has been solved and repeat calls and rework will not be necessary.

### **Recommendations**

To improve telephone responsiveness, I recommend that the IRS take the following actions:

- Fully implement “customer callback” functionality as quickly as possible.
- Adopt “First Contact Resolution” as a performance measure.

### **III. CORRESPONDENCE: Backlogs Are Larger This Year, Forcing the IRS to Decide Whether to Prioritize Telephone Service or Correspondence**

IRS Accounts Management employees answer calls on the toll-free lines and open and process taxpayer correspondence. The IRS shifts employees between the two functions based on current needs. However, it has no good option when phone volumes and correspondence inventories are simultaneously high.

Figure 4 shows a comparison of ending correspondence inventories and overage cases for the periods ending Feb. 24, 2018, and Feb. 23, 2019.

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See IRS Data Book for fiscal years 2010 and 2017 (table 30). The IRS Data Book for FY 2018 has not yet been published.

**Figure 4: Individual Master File and Business Master File Correspondence, 2018 and 2019<sup>13</sup>**

	FY 2018	FY 2019	% Increase
<b>Ending Inventory</b>	154,705	389,796	152%
<b>Overage Inventory</b>	47,162	204,203	333%
<b>% of Inventory Overage</b>	30%	52%	73%

With correspondence inventories up 152 percent and overage inventories up 333 percent as compared with this time last year, the IRS cannot shift employees to improve telephone responsiveness without falling further behind in addressing taxpayer correspondence.

In addition, one measure I am watching very closely is the number of returns in the Error Resolution/Rejects (ERS) function. A return ends up in ERS if there is something wrong or missing on the return that is not related to refund fraud. Examples include a missing schedule or a missing checkbox. In general, an IRS employee must review the return and communicate with the taxpayer. If ERS returns get backed up, the IRS receives more calls on its phone lines and more correspondence, and TAS winds up with additional cases. Some returns are sent to the Examination function, but if Exam falls behind in screening the returns, the returns can sit in limbo for a while, again leading to more phone calls, correspondence, and TAS cases. Through February 28, the percentage of returns that have fallen out to ERS stood at 4.78 percent – up from 3.66 percent last year at that time.<sup>14</sup> That represents an increase of 31 percent, or roughly 600,000 returns.

#### **IV. TAX LAW QUESTIONS: Test Calls Continue to Show Uneven Service**

The first right in the Taxpayer Bill of Rights is “The Right to Be Informed.”<sup>15</sup> In 2014, over my objections, the IRS decided it would answer tax law questions only during the filing season. Given the large number of taxpayers who obtain extensions and file their returns later in the year, I have previously expressed concern about the impact of that decision on the ability of taxpayers to understand the law and file accurate returns. My concern was even greater this year, as taxpayers sought to understand the significant changes to the law implemented through the TCJA.

Beginning in the spring of 2018 and continuing through February 2019, TAS testers have periodically made calls to the IRS’s toll-free telephone lines to pose tax-law

<sup>13</sup> IRS FY 2019 Correspondence Report, *Enterprise: BMF and IMF Correspondence, 4000X, 1000X* (week ending Feb. 23, 2019).

<sup>14</sup> IRS, Submission Processing Filing Season Statistics, Executive Reports, 2019 IMF ERS Fallout Percentages (as of Feb. 28, 2019).

<sup>15</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

questions and assess the responses. The results of the first two rounds of calls were detailed in my recent reports to Congress.<sup>16</sup>

The IRS indicated it would answer questions about changes to the tax law under the TCJA year-round. However, test calls in the spring and fall of 2018 revealed that in most circumstances, callers were transferred to a recorded message that said questions could not be answered until January 2, 2019, were told the employee had not received training in the TCJA, or were informed their questions were “out of scope” and could not be answered.<sup>17</sup>

In preparation for this testimony, TAS testers again called the IRS’s toll-free lines in late February 2019 to pose the same questions.<sup>18</sup> Nearly one-third ended with a recording stating the volume of calls prevented the IRS from answering the call at that time.<sup>19</sup> Calls that were answered continued to receive inaccurate answers. For example, one set of calls asked about claiming a dependency exemption for tax year 2018 for a child who resides outside the United States. The TCJA suspended dependency exemptions from tax years 2018 through 2025.<sup>20</sup> Yet an assistor told a TAS caller that she could claim the child for purposes of the dependency exemption on her 2018 tax return. Other calls on this topic revealed similar confusion, with all callers being led through a series of questions to determine whether they were eligible to claim the dependency exemption. No callers on this topic were informed that the dependency exemption has been suspended.

Receiving incorrect information or no information undermines the *right to be informed* and erodes trust and confidence in the IRS and the tax system. Taxpayers should be able to call the IRS at any time and expect to reach a knowledgeable representative who can provide accurate answers to their questions.

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<sup>16</sup> See National Taxpayer Advocate 2018 Annual Report to Congress 17-33 (Most Serious Problem: *The IRS’s Failure to Answer the Right Tax Law Questions at the Right Time Harms Taxpayers, Erodes Taxpayer Rights, and Undermines Confidence in the IRS*); National Taxpayer Advocate Fiscal Year 2019 Objectives Report 36-40.

<sup>17</sup> For a further discussion of TAS’s first rounds of test calls, see National Taxpayer Advocate 2018 Annual Report to Congress 17-33 (Most Serious Problem: *The IRS’s Failure to Answer the Right Tax Law Questions at the Right Time Harms Taxpayers, Erodes Taxpayer Rights, and Undermines Confidence in the IRS*); National Taxpayer Advocate Fiscal Year 2019 Objectives Report 36-40. See also IRM 21.1.1.3.1, *Out of Scope and Limited Service* (Oct. 1, 2018); IRM Exhibit 21.1.1-1, *Out-of-Scope Topics and Forms* (Oct. 1, 2017).

<sup>18</sup> TAS employees called the main IRS 1040 phone line in February 2019. Callers were assigned specific questions about various topics, some impacted by the TCJA, some topics that are considered year-round tax-law topics, and some that are answered only during filing season. The calls were limited in number and do not represent a statistically valid sample. We relate our findings here solely as qualitative and anecdotal evidence of the taxpayer’s experience.

<sup>19</sup> TAS made 19 test calls in February 2019. Six calls, or just under 32 percent, were disconnected due to high call volume. Two additional calls were unable to get through the phone tree to make a selection and were disconnected.

<sup>20</sup> IRC § 151(d)(5)(A).

## **Recommendations**

To assist taxpayers in obtaining tax-law answers, I recommend the IRS take the following actions:

- Answer in-scope tax-law questions year-round.
- Provide all assistors with more complete training in changes under the TCJA, offer year-round assistance with questions related to the TCJA for a period of at least two years, and evaluate taxpayer demand prior to declaring any TCJA topics out-of-scope.

### **V. FRAUD DETECTION FILTERS: High False Positive Rates Burden Taxpayers and Create Extra Work for the IRS**

The IRS has two programs that are designed to detect and prevent refund fraud: (i) the Taxpayer Protection Program (TPP), which seeks to detect returns reflecting identity theft (IDT), and (ii) the Pre-Refund Wage Verification Program (WVP), which seeks to detect non-identity theft forms of refund fraud.<sup>21</sup>

The TPP and WVP use a series of filters designed to prevent the payment of improper refunds. If the filters are not well calibrated, however, legitimate taxpayers may be significantly inconvenienced and some experience economic hardship. These taxpayers often must submit documentation to substantiate their claims, and they often experience significant delays in receiving their refunds.

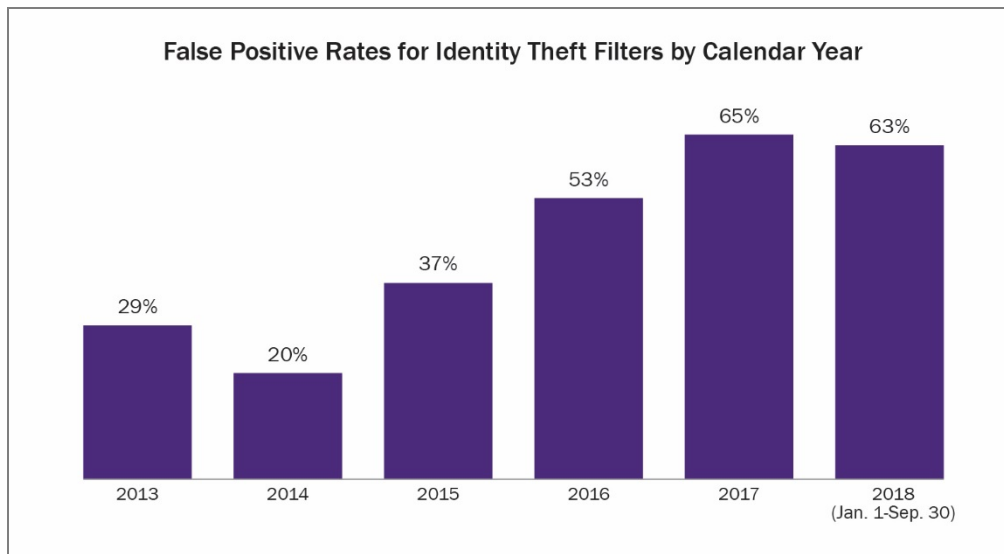
In recent years, the false positive rates of both programs have generally been rising, as shown on Figures 5 and 6:

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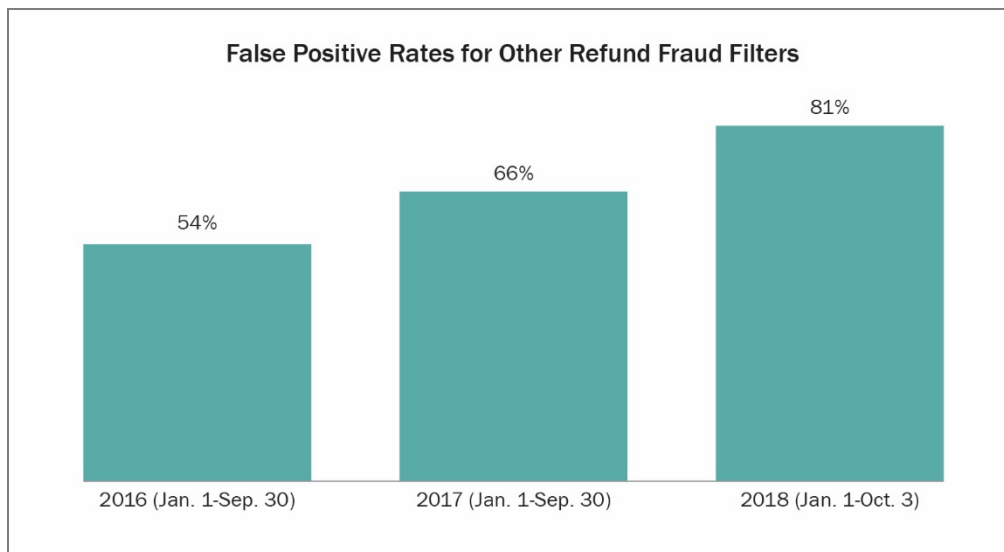
<sup>21</sup> See IRM 25.25.6.1.1, *Background* (Apr. 11, 2018); IRM 25.25.6.1(1) and (3), *Program Scope and Objectives* (Apr. 11, 2018); and IRM 25.25.3.1(1), *Program Scope and Objectives* (May 10, 2018). For purposes of this discussion, we have used “TPP” and “IDT refund fraud program” interchangeably, and the terms “pre-refund wage verification program” and “non-IDT refund program” interchangeably.



**Figure 5: False Positive Rates for Identity Theft Filters by Calendar Year<sup>22</sup>**



**Figure 6: False Positive Rates for Other Refund Fraud Filters<sup>23</sup>**



As shown, the false positive rate for the non-identity theft refund fraud filters last year hit a staggering 81 percent – meaning that more than four out of every five returns stopped by the filters turned out to be legitimate.

<sup>22</sup> IRS Wage & Investment Division, Business Performance Reviews, May 15, 2015, at 9 (showing rates for 2013 and 2014); May 11, 2017, at 9 (showing rates for 2015 and 2016); and Aug. 9, 2018 (showing rates for 2017 and for 2018 through June 27, 2018).

<sup>23</sup> IRS, IDT and IVO Performance Report, 19, 32 (Oct. 10, 2018) (showing rate for 2018); IRS response to TAS information request (Oct. 19, 2017) (providing rates for 2016 and 2017).

The IRS uses two systems to select returns into either of these programs.<sup>24</sup> When a return is sent to the TPP, the IRS will ask the taxpayer to authenticate his or her identity either over the phone, online, or by visiting a TAC. A return that is sent to WVP will be verified with third-party information provided by the taxpayer's employer(s) and payer(s).<sup>25</sup> In my recent annual report, we published a chart that shows the steps a tax return goes through during processing.<sup>26</sup>

As noted above, during the 2018 filing season, the IRS's refund fraud programs were plagued with high false positive rates and long processing times. Between January 1 and October 3, 2018, the false positive rate (FPR) for non-IDT refund fraud filters was 81 percent, while the FPR for IDT refund fraud filters was 63 percent.<sup>27</sup> From January 1 through June 30, 2018, the returns selected into the IDT refund fraud program took 40 days, on average, to be processed, and the non-IDT refund fraud returns took 38 days to be processed. These high false positive rates and long processing times contributed to a 287 percent increase in TAS Pre-Refund Wage Verification cases between January 1 and September 30, 2018 when compared to the same period in 2017. The non-IDT refund fraud program's poor performance during the 2018 filing season can largely be attributed to late filing of third-party information, a failure to consult historical data that would have provided insight into the veracity of the information on the return, and a reliance on manual processes for releasing legitimate refunds.<sup>28</sup>

To improve the effectiveness of its non-IDT refund fraud program for the 2019 filing season, the IRS has made several changes, including the following:

- It is systemically checking for the posting of third-party information daily instead of weekly.<sup>29</sup>
- When the return is being selected due to a mismatch between the information on the return and the third-party information, the IRS will conduct an analysis, and if

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<sup>24</sup> The IRS relies primarily on two systems to detect and prevent fraud: the Dependent Database (DDb) to detect IDT, and the Return Review Program (RRP) to detect IDT *and* non-IDT. See National Taxpayer Advocate 2018 Annual Report to Congress 81 (Most Serious Problem: *False Positive Rates: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers*).

<sup>25</sup> Beginning in Filing Season 2017, employers and other payers were required to submit third-party reporting information (Forms W-2 and Forms 1099-MISC) on or before January 31, thus providing the IRS more time to match the wage and tax information reported on the taxpayer's return against information submitted by third parties. IRC § 6071(c). See also IRS response to TAS information request (Aug. 3, 2018).

<sup>26</sup> See National Taxpayer Advocate 2018 Annual Report to Congress 11 (Chart: *Tax Return Processing Roadmap*).

<sup>27</sup> A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. See IDT and IVO Performance Report, 19, 32 (Oct. 10, 2018). National Taxpayer Advocate 2018 Annual Report to Congress 79.

<sup>28</sup> For FY 2018, the IRS received 42 percent of expected employer/employee documentation on or by February 5, representing 43 percent of employee information documents. National Taxpayer Advocate 2018 Annual Report to Congress 86.

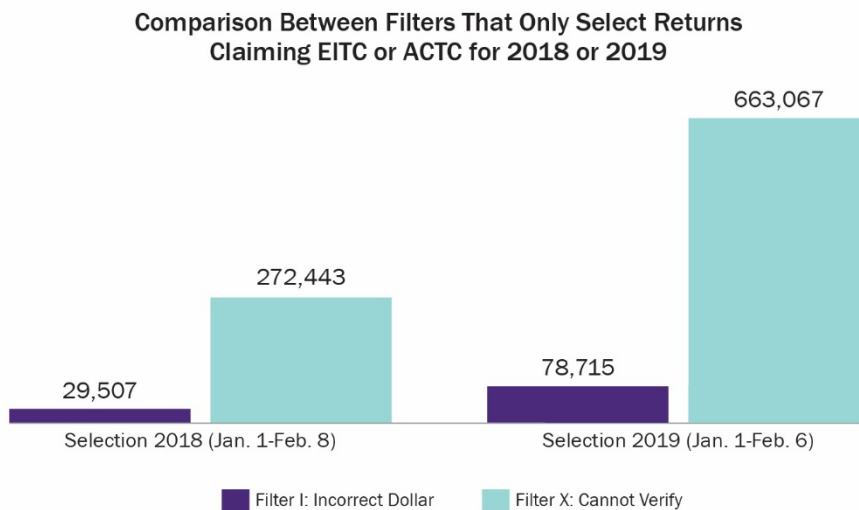
<sup>29</sup> The daily checks will take place through the end of filing season, when the system will revert to weekly checks.

the third-party information would have no impact on the amount of the refund, the refund will be released immediately.

- When a return carries with it both an IDT and non-IDT refund fraud concern, IRS systems will have the capability to systemically verify income and withholding information while simultaneously working to authenticate the taxpayer’s identity, thereby compressing the processing time.

Although it is too early to determine the impact of these changes, the data available thus far shows some noteworthy differences between the non-IDT refund fraud program for this filing season compared with last filing season. As shown in Figure 7, the two filters that select returns where the EITC or Additional Child Tax Credit (ACTC) has been claimed have more than doubled their selections when compared to last year.<sup>30</sup>

**Figure 7: Comparison Between Filters That Only Select Returns Claiming EITC or ACTC for 2018 or 2019<sup>31</sup>**

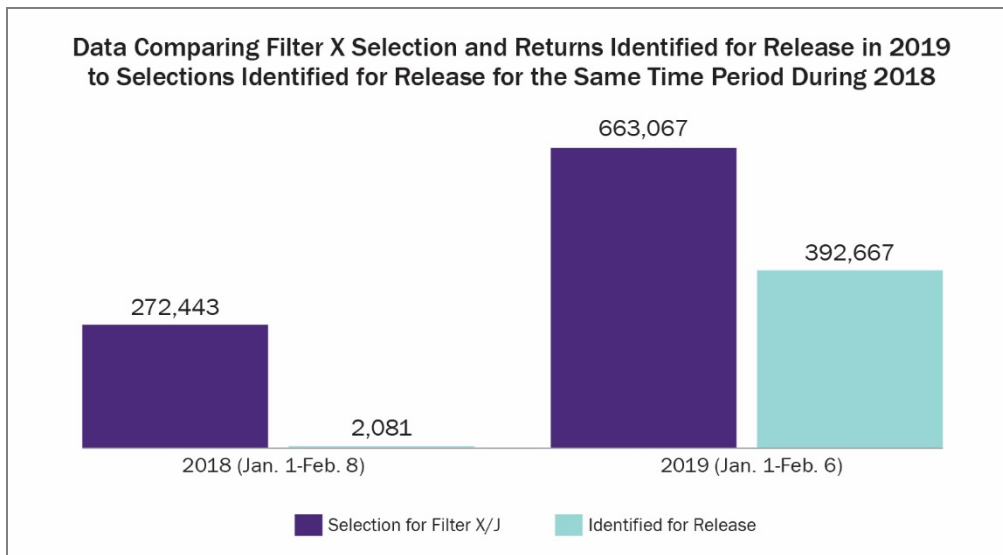


One possible explanation for this increase is the adoption of systemic selection features for Filter X, which allows the IRS to increase its workload projections. Systemic verification and reprocessing features, new in 2019, should reduce processing and release times for those returns initially identified as questionable. Thus, while Filter X has selected about 663,067 returns, more than half of those returns have already been identified for release. Comparing these results with the same filter selections and release rates for the same period during 2018, Figure 8 indicates the IRS is doing a better job at systemically identifying more returns for release earlier in the process.

<sup>30</sup> Filter X selects returns where EITC or ACTC is claimed on the return, and there is no third-party information available to verify the income or withholding on the return. Filter I selects returns where EITC or ACTC have been claimed, and there is a discrepancy of income between the return and the W-2 information.

<sup>31</sup> IDT and IVO Performance Report (Feb. 13, 2019); IDT and IVO Performance Report (Feb. 14, 2018).

**Figure 8: Data Comparing Filter X Selections and Returns Identified for Release in 2019 to Selections Identified for Release for the Same Time Period During 2018<sup>32</sup>**



More W-2s were submitted to the IRS earlier in the filing season this year compared with last year. The IRS received 219 million W-2s through February 4 this filing season, compared with 101 million for the same period last filing season – an increase of about 117 percent.<sup>33</sup> The early submissions of W-2s allowed the non-IDT refund fraud program to perform pre-work on selected returns, so the IRS could begin issuing certain refunds after February 15.<sup>34</sup>

Thus, initial indicators seem to show changes made to the non-IDT refund fraud program have resulted in a more effective fraud detection system that creates less burden for taxpayers. However, as the filing season rolls on and more data becomes available, I will continue to evaluate the impact of these changes.

<sup>32</sup> IDT and IVO Performance Report (Feb. 13, 2019); IDT and IVO Performance Report (Feb. 14, 2018). Filter J has been redesignated as Filter X.

<sup>33</sup> IRS IDT and IVO Modeling Analysis - MAIN Performance Report, slide 10 (Feb. 6, 2019).

<sup>34</sup> IRC § 6402(m). See Pub. L. No. 114-113, Division Q, Title IV, § 201, 129 Stat. 2242, 3076 (2015), which added subsection (m) to prevent the IRS from issuing certain refunds before February 15<sup>th</sup> each year. The increase in timely received Form W-2 data, in conjunction with two other changes, likely resulted in more returns being released earlier in the process this year compared to last year. One change is the newly adopted systemic release feature which allows returns to be released back into normal processing systemically rather than waiting for an IRS employee to manually release the refund. The other is the availability of third-party documentation daily rather than weekly.

## **Recommendations**

To reduce the burden on taxpayers caused by high false positive rates, I recommend Congress take the following action:

- Require the IRS to establish a maximum acceptable FPR goal within industry accepted standards and an actionable timeline to achieve that goal.
- Direct the IRS to adopt a systemic selection and release feature for all its refund fraud filters, as such a feature is only included in Filter X at this time.

### **VI. FORM 1040: The Newly Designed Form 1040 Provides Simplification for Some Taxpayers But Creates More Complexity for Others**

After the enactment of the TCJA, the IRS redesigned the iconic Form 1040. The intent was to reduce the Form 1040 to roughly the size of a postcard. To do that, the 79 numbered lines on the 2017 version of Form 1040 were broken out into a main form and six separate schedules. Form 1040A and Form 1040-EZ were eliminated. For taxpayers with simple returns, the shorter form should provide simplification. But for the majority of taxpayers who will have to complete additional schedules, the new form is likely to create more complexity. Some taxpayers who previously completed only the Form 1040 will now have to complete the same lines spread over one form and up to six schedules.

TAS estimates that approximately 47 million taxpayers (32 percent) will be able to meet their filing requirements by using the main form alone.<sup>35</sup> As shown in Figure 9, the remaining 68 percent of taxpayers – nearly 102 million – will have to complete at least one additional schedule, with 38 percent having to complete two or more.<sup>36</sup>

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<sup>35</sup> TAS research estimates that 68 percent of taxpayers will need to file one or more schedules of the 2018 Form 1040 based on tax year (TY) 2017 tax return filing data. IRS Compliance Data Warehouse (CDW), Individual Returns Transactions File, TY 2017. For example, using the new Form 1040, a taxpayer with unemployment compensation, student loan interest deduction, and child and dependent care expenses will now have to file Schedules 1 and 3, whereas with the 2017 1040, they only needed to file the main form, which was two pages.

<sup>36</sup> *Id.*

**Figure 9: Breakdown of Taxpayers Required to File Tax Year 2018 Form 1040 Schedules Based on Tax Year 2017 Filing Data (in millions)<sup>37</sup>**

<b>Number of Schedules Required to Be Filed</b>	<b>Volume</b>	<b>Percent</b>
Zero	47.3	31.8%
One	46.3	31.1%
Two	30.8	20.7%
Three	17.2	11.6%
Four	5.4	3.6%
Five	1.7	1.1%
Six	-	0.0%
<b>Total</b>	<b>148.7</b>	<b>100.0%</b>

I am concerned the new Form 1040 will cause additional complexity and hassle for many taxpayers and preparers. While most taxpayers who self-prepare their returns will use software, some like to make entries directly onto the Form 1040. Now, they will have to work through multiple forms and schedules and carry totals from the schedules to the main Form 1040, increasing the risk of transcription errors.

Preparers will also be affected. Most returns continue to be prepared by professionals. Many professional preparers are accustomed to printing out hard copies for review before filing, and it will be more cumbersome for them to print and review multiple schedules and may result in higher fees charged to taxpayers. Preparers also are required to provide taxpayers with a copy of the completed return, which now will require printing additional pages.

In my view, taxpayers should be given the choice of whether to file the traditional Form 1040 or the simplified version. Particularly since the Form 1040A and the Form 1040-EZ have been eliminated, the IRS can publish both forms.

### **Recommendation**

To maximize simplicity for taxpayers and preparers in completing and filing tax returns, I recommend the IRS take the following action for next year:

- Make both the traditional Form 1040 and the new simplified Form 1040 available and allow taxpayers to decide which version to use.

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<sup>37</sup> *Id.*

## VII. FREE FILE: The Free File Program Is Failing to Achieve Its Objectives and Should be Substantially Improved or Eliminated

The IRS Restructuring and Reform Act of 1998 directed the IRS to set a goal of increasing the e-file rate to at least 80 percent by 2007.<sup>38</sup> In 2002, the IRS entered into an agreement with a consortium of tax software companies under which the companies would provide free tax return software to a certain percentage of U.S. taxpayers, and in exchange, the IRS would not compete with these companies by providing its own software to taxpayers. The agreement has been renewed at regular intervals, and for at least the past decade, the agreement has provided that the consortium would make free tax return software available for *70 percent* of taxpayers (as measured by adjusted gross income).

In 2018, individual taxpayers filed more than 154 million tax returns.<sup>39</sup> Yet fewer than 2.5 million of those returns, or *1.6 percent*, were filed using a Free File product.<sup>40</sup> Thus, about 68 percent of all taxpayers were eligible to use a Free File product but did not do so – frequently paying to purchase the same or comparable software instead.

In addition, data on repeat usage suggest Free File users are widely dissatisfied with the program. Among taxpayers who used Free File software in 2017, the *majority* (51 percent) did not use Free File software again in 2018.<sup>41</sup>

Why do so few taxpayers use Free File, instead often opting to pay for the same or comparable software? In my 2018 Annual Report to Congress, I expressed concern that the IRS devotes minimal resources to oversee and test this program, to understand why so few eligible taxpayers are using it, and to consider how the service offerings could be improved.<sup>42</sup> I identified the following specific shortcomings:

- The lack of a marketing budget for the Free File program. The IRS does not promote or advertise Free File, outside of placing it on its website.
- The absence of an effective evaluation process to understand the experience of taxpayers who use the program and whether the terms of the IRS Free File agreement are being met.
- Age restrictions that sharply curtail the number of Free File options available to older taxpayers. Only three of the current 12 Free File providers offer services to taxpayers of all ages, and five have age limitations that start before the age of 60.

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<sup>38</sup> Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (1998).

<sup>39</sup> IRS, *2018 Filing Season Statistics* (week ending Nov. 23, 2018), <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-november-23-2018>.

<sup>40</sup> IRS, Compliance Data Warehouse, Electronic Administration Research & Analysis System.

<sup>41</sup> *Id.*

<sup>42</sup> National Taxpayer Advocate 2018 Annual Report to Congress 66-78 (Most Serious Problem: *Free File: The IRS's Free File Offerings Are Underutilized, and the IRS Has Failed to Set Standards for Improvement*).

- The absence of any Free File options for English as a Second Language (ESL) taxpayers during filing season 2018.<sup>43</sup>

Testing by TAS found that several software providers have limitations in their navigational features and ability to help taxpayers correctly complete their returns, resulting in poor service quality. In addition, cross-marketing and advertising of other services on Free File software platforms can confuse and frustrate taxpayers, probably contributing to the low repeat-usage rate. Because Free File software programs are accessed through IRS.gov, taxpayers may be under the false impression that the IRS endorses the Free File products available there, and thus a poor experience with Free File may reflect poorly on the IRS

### **Recommendations**

To address the deficiencies in the Free File program, I recommend that Congress direct the IRS to:

- Develop actionable goals for the Free File program before entering into a new agreement that, among other things, aim to substantially increase taxpayer usage and increase the percentage of taxpayers who continue to use the program from year to year.
- Create measures evaluating taxpayer satisfaction with the Free File program and test each return preparation software's ability to complete various forms, schedules, and deductions.
- Provide Free File Fillable Forms and software options for ESL taxpayers.
- Prepare an advertising and outreach plan to make taxpayers, particularly in underserved communities, aware of the Free File program.

If the Free File program cannot be substantially improved, I recommend that it be terminated and that the IRS improve the capabilities offered to taxpayers through Free Fillable Forms.

### **VIII. IMPACT OF TCJA SSN REQUIREMENT TO CLAIM CHILD TAX CREDIT: Certain Religious Groups May Be Forced to Choose Between Observing the Tenets of Their Religion and Foregoing Thousands of Dollars in Tax Credits or Compromising Their Religious Beliefs**

Some recognized religious groups, most notably the Amish, object to participating in Social Security and obtaining Social Security Numbers (SSNs) on religious grounds. To

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<sup>43</sup> *Id.*



address these objections, Congress enacted IRC §§ 1402(g) and 3127.<sup>44</sup> To qualify for an exemption, an applicant must be a member of a recognized religious sect that conscientiously opposes receiving benefits from certain private or public insurance programs.<sup>45</sup>

The TCJA amended IRC § 24 to require a taxpayer who is claiming a credit for a qualifying child to provide the child's SSN on the return.<sup>46</sup> Prior to this amendment, IRC § 24 only required that a taxpayer identification number (TIN) be provided, and the IRS developed a procedure that allowed an Amish taxpayer to claim the Child Tax Credit (CTC) without placing an identifying number on the dependent line of the return.<sup>47</sup> The stated purpose for the TCJA amendment was to prevent taxpayers who are not eligible to obtain a work-eligible SSN from fraudulently claiming the CTC or the American Opportunity Tax Credit.<sup>48</sup>

In 2018, I raised the issue of the CTC SSN requirement imposed by TCJA to IRS senior leadership and requested implementation of a similar administrative workaround for

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<sup>44</sup> Self-employed individuals may apply for exemption under IRC § 1402(g). Employers and their employees who are both members of the same religious sect may apply for exemption from paying employment taxes under IRC § 3127. An individual of certain recognized religious sects who objects to participating in Social Security programs must file Form 4029, *Application for Exemption from Social Security and Medicare Taxes and Waiver of Benefits*, which will provide an exemption for payment of employment taxes if the exemption is approved by the Social Security Administration (SSA) and the IRS. To identify individuals who have an approved Form 4029 on file, SSA has associated a taxpayer identification number (TIN) with the individual. SSA wanted to associate the individual's approved Form 4029 with an SSN, but the Amish object to SSNs on the basis that it provides a temptation to participate in and receive benefits. Thus, the TIN compromise was reached. Letter from Old Order Amish Steering Committee (Dec. 3, 1997). In IRM 3.13.5.76, *Special Requests for IRSNs* (Mar. 2, 2015), the IRS provided guidance to its employees on how to assist taxpayers who have a religious exemption in obtaining a TIN.

<sup>45</sup> Specifically, the established tenets of the recognized religious sect must be conscientiously opposed to receiving benefits from any private or public insurance that either makes payment in the event of death, disability, old-age, or retirement, or makes payment for the cost of, or provides services for, medical care, including the benefits of any insurance system established by the Social Security Act. IRC §§ 1402(g)(1) and 3127(a)(1)-(2) (Oct. 1, 2018).

<sup>46</sup> IRC § 24(h)(7).

<sup>47</sup> See IRM 21.6.3.4.1.3, *Child and Dependent Care Credit* (Oct. 1, 2018). For taxpayers indicating a religious (e.g., Amish/Mennonite) or conscience-based objection to obtaining a TIN, refer to IRM 21.6.1.6.1, *Determining the Exemption Deduction*.

<sup>48</sup> H.R. Rep. No. 115-409, at 141-42 (2017). Individuals must list their SSN on a tax return, and individuals who must file a return but do not have an SSN must apply for an Individual Taxpayer Identification number (ITIN) from the IRS. Individuals who are eligible to obtain an SSN are not eligible to receive an ITIN. Individuals receiving an ITIN are not eligible to work in the United States or receive Social Security benefits. To obtain the CTC in 2018, the taxpayer must list on the return as the child's identifying number an SSN that is valid for employment in the United States. See H.R. Rep. No. 115-466, at 230-233 (2017). The requirement to have a work-eligible SSN to claim the CTC is similar to the requirement to have a work-eligible SSN to obtain the EITC, which was added to the Internal Revenue Code under the Personal Responsibility and Work Opportunity Reconciliation Act, Pub. L. No. 115-97, 110 Stat. 2105 (1996). The House Report states that the requirement to provide an SSN to claim the EITC was to ensure that only individuals who were authorized to work in the United States should be able to claim the credit. H.R. Rep. NO. 104-651, at 1457.

those with religious objections to an SSN. At the end of 2018, I was advised the IRS had created a process that would allow Amish taxpayers to claim the CTC.<sup>49</sup>

Notwithstanding this agreement, on February 6, 2019, the IRS issued guidance instructing the *suspension* of amended returns where the taxpayer:

- is claiming the CTC, Additional Child Tax Credit (ACTC), or the Credit for Other Dependent (ODC);
- does not provide an SSN(s) for the dependent(s); and
- identifies as Amish, Mennonite, has a Form 4029/4029 exemption or has a religious or conscience-based objection.<sup>50</sup>

I was also advised by the IRS's Wage & Investment Division (W&I) that the IRS would be suspending both amended and original returns that meet the above criteria and would not correspond with the taxpayer during this time. TAS's preliminary research shows that about 29,000 taxpayers could find themselves in this compromising position.<sup>51</sup> Under TCJA, the maximum CTC for 2018 is \$2,000 per child. Without an SSN, the taxpayer can only receive a \$500 per child credit, a significant reduction of 75 percent.<sup>52</sup>

Religious groups have been exempted from such legal obligations by the courts and Congress to avoid conflicts between complying with a mandate and observing the tenets of their religion.<sup>53</sup> Such exceptions were established in the U.S. Supreme Court's holdings in *Wisconsin v. Yoder* and *Sherbert v. Verner*,<sup>54</sup> and by Congress'

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<sup>49</sup> Email from Deputy Chief Counsel to Nina E. Olson, National Taxpayer Advocate (Dec. 18, 2018). The IRS plans to largely continue its practice of allowing taxpayers with a religious exemption who have an approved Form 4029 on file, and did not provide an SSN for their dependents, to claim the CTC. Taxpayers who object to providing the dependent's SSN for religious reasons will receive a slightly modified Letter 3050C to confirm the taxpayer's U.S. citizenship. IRM 21.6.1.6.1(8), *Determining the Exemption Deduction* (Oct. 1, 2018) requires the IRS to issue letter 3050C requesting specific documentation "in paragraph 1" of that letter. That letter contains paragraphs the sender must select. In the case of an Amish return where the children do not have SSNs, IRS uses that letter to request that the taxpayer submit the child's birth certificate or green card, hospital medical records documenting the birth of the child or other public record documenting the birth of the child, and school records, childcare records, a letter from a government benefits provider, cancelled child support checks, or medical records or statement from a health care provider verifying the child's address.

<sup>50</sup> SERP Alert 19A0070 (Feb. 6, 2019).

<sup>51</sup> This number includes returns where either the primary or secondary taxpayer has an approved Form 4029 on file, and one or more of their dependents has no SSN.

<sup>52</sup> IRC § 24 (h)(2), (4), and (7).

<sup>53</sup> See § 1402(g); 20 C.F.R. § 404.1039 (Dec. 10, 1993). See *State of Wisconsin v. Yoder*, 406 U.S. 205 (1972); *Sherbert v. Verner*, 374 U.S. 398 (1963); and IRC §1402(g).

<sup>54</sup> In *Wisconsin v. Yoder*, 406 U.S. 205 (1972), the U.S. Supreme Court held that Wisconsin's compulsory school-attendance law was unconstitutional when applied to the Amish, because it imposed a substantial burden on the practice of religion and was not necessary to serve a compelling government interest. In *Sherbert v. Verner*, 374 U.S. 398 (1963), an employee was fired for her refusal to work on Saturdays and was denied unemployment compensation when other employers wouldn't hire her because of her refusal.

enactment of IRC § 1402(g). In 1982, however, the Supreme Court held in *United States v. Lee* that although “compulsory participation in the social security system interferes with [Amish employers’] free exercise rights,”<sup>55</sup> “[t]he tax system could not function if denominations were allowed to challenge the tax system because tax payments were spent in a manner that violates their religious belief.”<sup>56</sup> In 1988, Congress responded to the ruling in *Lee* by enacting IRC § 3127, applying the exemption for self-employed individuals to employees and employers, both of whom belonged to the same religious group.

In 1990, in *Employment Division, Department of Human Resources of Oregon v. Smith*, the Supreme Court rejected the *Sherbert* balancing test as inapplicable to “an across-the-board criminal prohibition on a particular form of conduct.”<sup>57</sup> Three years after this decision, Congress passed the Religious Freedom Restoration Act of 1993 (RFRA),<sup>58</sup> which provides:

- (a) In General. Government shall not substantially burden a person’s exercise of religion even if the burden results from a rule of general applicability, except as provided in subsection (b).
- (b) Exception. Government may substantially burden a person’s exercise of religion only if it demonstrates that application of the burden to the person--
  - (1) is in furtherance of a compelling governmental interest; and
  - (2) is the least restrictive means of furthering that compelling governmental interest.<sup>59</sup>

The Supreme Court has noted that the least-restrictive-means standard is “exceptionally demanding.”<sup>60</sup>

In *Burwell v. Hobby Lobby Stores, Inc.*, the Court adopted a three-step analysis to determine how the RFRA applies.

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In concluding the denial of unemployment compensation was unconstitutional, the Supreme Court held that where government action substantially burdened a religious practice, the government must demonstrate both a compelling governmental interest and that the law in question was narrowly tailored (the *Sherbert* balancing test). *Sherbert*, 374 U.S. at 406-09.

<sup>55</sup> *United States v. Lee*, 455 U.S. 252, 257 (1982). Lee, a member of the Old Order Amish, employed other members of his sect. He did not withhold and pay over Social Security taxes on the basis of his religious beliefs. The Court held that “[b]ecause the broad public interest in maintaining a sound tax system is of such a high order, religious belief in conflict with the payment of taxes affords no basis for resisting the tax.” *Id.* at 260.

<sup>56</sup> *Id.* at 260 (citations omitted).

<sup>57</sup> 494 U.S. 872, 884 (1990). Respondents were fired by a private drug rehabilitation organization and denied unemployment compensation because they had ingested peyote as part of a religious ceremony of their Native American Church.

<sup>58</sup> Religious Freedom Restoration Act of 1993 (RFRA), Pub. L. No. 103-141, 107 Stat. 1488 (1993), codified at 42 U.S.C. § 2000bb *et seq.*

<sup>59</sup> 42 U.S.C. § 2000bb-1(a) & (b).

<sup>60</sup> *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682, 728 (citation omitted) (2014).

- Step 1: The Court determined whether the complainant was covered under the RFRA.
- Step 2: The Court determined whether the government action or mandate “substantially burdens” the “exercise of religion” as defined under the Act.
- Step 3: The Court decided whether the government action or mandate is *both* (1) in furtherance of a compelling governmental interest *and* (2) is the least restrictive means of furthering that compelling governmental interest.

In distinguishing *Lee* from its holding in *Burwell*, the Court noted that if *Lee* were decided under RFRA,

[the] fundamental point would be that there is simply no less restrictive alternative to the categorical requirement to pay taxes. Because of the enormous variety of government expenditures funded by tax dollars, allowing taxpayers to withhold a portion of their tax obligations on religious grounds would lead to chaos.”<sup>61</sup>

In the case of the Child Tax Credit under IRC § 24, we can also distinguish *Lee* from the situation at hand. We aren’t talking here about *withholding* tax payments. IRC §§ 1402(g) and 3127 have dealt with that issue statutorily: the Amish are exempted from Social security taxation and benefits upon application for a waiver. What we are talking about here is that a person is being *denied, on the basis of his or her religious beliefs*, the benefit of a universally available component of the Internal Revenue Code -- a provision that was designed to determine a person’s ability to pay tax. The U.S. tax system, unlike many other systems worldwide, makes the household – the family unit – the taxable unit. It takes into account the size of the family unit, including children, in determining the taxable unit’s taxable income (prior to Tax Year (TY) 2018 it did so via dependency exemptions) or in determining the amount of tax the unit pays (for TY 2018 through 2025, via the CTC). The effect of the “SSN only” requirement for the CTC, as applied to the Amish and similar religious groups, is to blot out the existence of their children, even though those children still exist and impact the taxable unit’s ability to pay tax. In essence, we are requiring the Amish to *pay more tax than others under the national tax regime, solely because of their religious beliefs. In effect, this requirement is a tax on religious beliefs.*

The SSN requirement was added to the CTC to address the risk that persons residing and working unlawfully in the United States but still required to file and pay taxes would benefit from a refundable credit like the CTC. That clearly is a compelling governmental interest, so it meets the first part of the *Burwell* Step 3 test.

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<sup>61</sup> *Id.* at 734.

I believe, however, that the SSN requirement fails the second part of the Step 3 test under RFRA; namely, that it must be *the* least restrictive means (not a *less* restrictive means).

The Form 4029 application process used for decades by the IRS clearly addresses the concerns that led Congress to enact an SSN requirement. Applicants must come forward to SSA and the IRS and express their religious opposition to paying and receiving Social Security benefits and obtaining an SSN.

Thus, with respect to persons with deeply held religious opposition to participating in the Social Security system, the TCJA SSN requirement does nothing to address the purported reason for the requirement – to prevent persons unlawfully in the US from receiving the benefit of the full Child Tax Credit – and instead impermissibly burdens the free exercise of religion, under the RFRA and very likely under the First Amendment.

### **Recommendations**

To address this problem over the long term, I recommend that Congress take the following action:

- Amend IRC § 24(h)(7) to provide that no credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the SSN of such child on the return of tax for the taxable year, *except that no SSN shall be required in the case of a taxpayer who has met the requirements under IRC § 1402(g), and is therefore a member of a recognized religious group, and who so indicates this on the return.*

To address this problem for the 2019 filing season, I recommend the IRS take the following action:

- Reinstated its prior practice of allowing a return to be processed without a dependent's SSN when a Form 4029 is on file once a taxpayer has responded to the Letter 3050C, which requests proof of the taxpayer's United States citizenship.

## **IX. NON-FILING SEASON ISSUES**

While recognizing that the focus of today's hearing is on the filing season, I would like to call the subcommittee's attention to the following additional issues.

### **a. The National Taxpayer Advocate Desperately Needs the Authority to Resume Hiring Attorney-Advisors**

I have a short list of priority items to accomplish before I retire to ensure the next National Taxpayer Advocate has the tools and infrastructure to do the job. The

authority to continue to hire attorney-advisors – which was permitted until 2015 and then barred – is the #1 item on my list. Very simply, my office could not function as Congress intends without attorneys.

Some background: When Congress reorganized the IRS in 1998, it recognized that the National Taxpayer Advocate requires independent legal advice. The conference report stated that the “conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate.”<sup>62</sup>

The National Taxpayer Advocate requires independent attorney-advisors because she often takes positions, both in working taxpayer cases and in systemic advocacy, that are directly contrary to the position of the IRS and the Office of Chief Counsel (OCC). Once attorneys in the OCC have adopted a legal position interpreting a law or regulations for purposes of IRS operations, procedures, or litigation, it would be unrealistic to expect those same attorneys could effectively help the National Taxpayer Advocate develop a legal position that challenges their own interpretation. It would also create an untenable conflict of interest. Thus, TAS attorney-advisors are indispensable in enabling the National Taxpayer Advocate to develop an independent perspective and advocate as the law intends.

Among other things, TAS attorney-advisors help TAS case advocates develop legal positions in complex taxpayer cases; write the section of the National Taxpayer Advocate’s Annual Report to Congress that identifies and analyzes the ten tax issues that were most frequently litigated in the U.S. Tax Court and other federal courts over the preceding year; and write the section of the National Taxpayer Advocate’s annual report to Congress that proposes legislative changes to mitigate taxpayer problems, including the Purple Book. All this work requires considerable legal expertise and could not be performed at anywhere near the same level by non-attorneys.

Since 2004, with the approval of the Commissioner of Internal Revenue, TAS has employed attorney-advisors to provide independent legal advice and analysis to the National Taxpayer Advocate. For more than a decade, TAS had no difficulty backfilling attorney positions. In 2015, the IRS for the first time denied a routine TAS hiring request. It cited Treasury Department General Counsel Directive No. 2, which states: “Except for positions in the Inspectors General offices or within the Office of the Comptroller of the Currency, attorney positions shall not be established outside of the Legal Division” unless the General Counsel or Deputy General Counsel(s) provides a waiver. We were told that General Counsel Directive No. 2 had long been on the books, but it was only recently being enforced.

In November 2016, the National Taxpayer Advocate submitted a memorandum to the Acting General Counsel requesting permission to continue to hire attorney-advisors. The memorandum noted that the Office of the Taxpayer Advocate, from an independence standpoint, plays a role somewhat akin to an inspector general – *i.e.*, the

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<sup>62</sup> H.R. Rep. No. 105-599, at 215 (1998) (Conf. Rep.). See *also* 144 Cong. Rec. S. 4460 (May 7, 1998) (statement of Sen. Grassley).

office exists within the agency but is required by statute to operate independently in key respects. On the basis of independence, the memorandum asked the Acting General Counsel to modify General Counsel Directive No. 2 to add a carve-out for the Office of the Taxpayer Advocate to the clause that contains the carve-out for the Inspectors General offices. Alternatively, the National Taxpayer Advocate requested that a “waiver” be granted, as provided in the directive. To date, TAS has not received a response.

In the fall of 2018, TAS submitted a new hiring request, and it was again blocked by the IRS. The National Taxpayer Advocate asked the Commissioner if he would support a renewed request for a waiver from General Counsel Directive No. 2 to allow TAS to continue to hire attorney-advisors. The Commissioner declined to support the National Taxpayer Advocate’s request at that time.

The inability of the National Taxpayer Advocate to hire attorney-advisors extends to announcing higher graded positions for attorneys currently working in TAS. Therefore, TAS is not only barred from hiring new attorneys, but existing attorneys cannot be promoted to higher graded positions, either.

The TAS attorney-advisor group has dwindled from 15 attorneys in 2015 to nine attorneys today. If the National Taxpayer Advocate is not permitted to hire attorney-advisors in the near future, TAS’s ability to advocate for taxpayers both individually and systemically and the National Taxpayer Advocate’s ability to produce high-quality reports to Congress will be seriously jeopardized.

This problem can be fixed administratively. However, in light of the difficulty TAS has encountered in obtaining administrative relief and in light of the significance of the issue, we are recommending Congress codify the directive in the RRA 98 conference report.

### **Recommendation**

- Amend IRC § 7803(c)(2)(D) to expressly authorize the National Taxpayer Advocate to hire legal counsel that reports directly to her.<sup>63</sup>

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<sup>63</sup> For more detail, see National Taxpayer Advocate 2019 Purple Book 70-71 (Legislative Recommendation #41: *Clarify That the National Taxpayer Advocate May Hire Legal Counsel to Enable Her to Advocate Effectively for Taxpayers*).

## **b. The IRS’s Definition of “Excepted” Activities During a Government Shutdown is Questionable and Fails to Protect Taxpayers**

Article I of the Constitution provides that “No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law.”<sup>64</sup> The Anti-Deficiency Act (ADA) implements this provision.<sup>65</sup> Specifically, 31 U.S.C. § 1341(a)(1)(B) forbids any officer or employee of the United States government or of the District of Columbia government to “involve either government in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.”

A statutory exception to this rule is provided in 31 U.S.C. § 1342, which permits such government activity “for emergencies involving the safety of human life or the protection of property.”<sup>66</sup> In addition, as the Attorney General has observed, some activities are authorized by “necessary implication:” statutory authority to incur obligations in advance of appropriations may be implied as well as express.<sup>67</sup>

The IRS, through “Lapse in Appropriations Contingency Plans,” describes the actions and activities that will be permitted for the first five business days following a lapse in appropriations. There is one plan for lapses that occur outside the filing season and another plan for lapses that occur during the filing season.<sup>68</sup> The plans are adjusted as needed in the event a lapse, or shutdown, lasts for more than five days.

Congress has enacted important taxpayer protections that are not, by their terms, suspended or made inoperative by government shutdowns. For example:

- IRC § 6343(a)(1)(D) requires the IRS to release a levy that creates an economic hardship for a taxpayer;
- IRC § 7811(b)(1) authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order (TAO) “to release property of the taxpayer levied upon” where the taxpayer is experiencing significant hardship; and

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<sup>64</sup> U.S. CONST. Art. I, § 9, cl. 7.

<sup>65</sup> Pub. L. No. 97-258, 96 Stat. 923 (1982).

<sup>66</sup> Because this exception has been interpreted as applicable to activities necessary to protect the property of the federal government, but not to protect the property of U.S. taxpayers, I have recommended that Congress clarify that this exception includes taxpayer property as well as government property. See National Taxpayer Advocate 2019 Purple Book #47, *Authorize the Office of the Taxpayer Advocate to Assist Certain Taxpayers During a Lapse in Appropriations*; National Taxpayer Advocate 2011 Annual Report to Congress 552 (Legislative Recommendation: *Clarify that the Emergency Exception to the Anti-Deficiency Act Includes IRS Activities that Protect Taxpayer Life and Property*).

<sup>67</sup> See *Authority for the Continuance of Government Functions During a Temporary Lapse in Appropriations*, 43 Op. Attorney Gen. 293, 296-301 (1981), describing necessarily implied activities as those that permit an agency to accomplish activities that are “authorized by law” within the meaning of 31 U.S.C. § 1341(a)(1)(B).

<sup>68</sup> See *IRS FY2019 Lapsed Appropriations Contingency Plan (Tax Year 2018 Non-Filing Season - December 8-31, 2018)* (Nov. 29, 2018); *IRS FY2019 Lapsed Appropriations Contingency Plan (Tax Year 2018 Filing Season)* (Jan. 15, 2019), [https://home.treasury.gov/system/files/266/IRS-Lapse-in-Appropriations-Contingency-Plan\\_Filing-Season\\_2019-01-15.pdf](https://home.treasury.gov/system/files/266/IRS-Lapse-in-Appropriations-Contingency-Plan_Filing-Season_2019-01-15.pdf).



- IRC § 6343(a)(1)(C) generally requires the IRS to release a levy if the taxpayer has entered into an installment agreement (IA) to satisfy the liability.

Under the IRS's most recent shutdown contingency plans (for the non-filing season and the filing season):

- Automated lien and levy activity was authorized;
- No IRS employees were authorized to release liens or levies;<sup>69</sup>
- No TAS employees were authorized to assist taxpayers in demonstrating they were entitled to levy release under IRC § 6343(a)(1)(D); and
- No TAS employees, including the National Taxpayer Advocate, were authorized to issue TAOs.

Under the filing season shutdown contingency plan, IRS and TAS employees were authorized to enter into IAs, but as noted, IRS employees were not authorized to release levies as required by IRC § 6343(a)(1)(C).

The harm to taxpayers is not merely theoretical. When the IRS issues a levy to a bank, for example, the bank must freeze the taxpayer's account for 21 days, and then if the levy has not been released, the bank must turn the funds over to the IRS. If the IRS issues a levy within the 21 days preceding a government shutdown, the date on which the bank must turn over the funds may occur during the shutdown, yet the IRS takes the position that it may not release the levy even if the taxpayer is able to show economic hardship. Similarly, the IRS programs certain enforcement actions in advance, so they may automatically kick in during the period of a shutdown.

Based on partial data, our TAS Research function has computed that at least 550,000 enforcement actions were taken in the 30 days preceding the shutdown, and about 200,000 additional enforcement actions were taken from December 22 through December 31 (while the shutdown was ongoing). Most were attributable to either the Federal Payment Levy Program or the Systemic State Income Tax Levy Program.<sup>70</sup>

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<sup>69</sup> See IRS SERP Alert #19A0017, *Release of Levy and Release of Lien* (Jan. 23, 2019) ("While there is a lapse in funding during the partial shutdown we are not authorized to take this action. We may do so once we are fully opened, so please call us back at that time. Please apologize to the taxpayer and explain we are not authorized to release the levy or lien due to the partial government shutdown. Explain that they may call us back after we are fully reopened.").

<sup>70</sup> IRS Compliance Data Warehouse, Individual Master File Transactions Process Through 2018.

## **Recommendations**

To ensure taxpayer protections are provided during future government shutdowns, I recommend that Congress take the following action:

- Clarify that the emergency exception to the Anti-Deficiency Act for the protection of property includes taxpayer property as well as government property.

Alternatively, I recommend Congress clarify the following:

- The National Taxpayer Advocate may incur obligations in advance of appropriations for purposes of assisting taxpayers experiencing an economic hardship within the meaning of IRC § 6343(a)(1)(D) due to an IRS action or inaction.
- The IRS may incur obligations in advance of appropriations for purposes of complying with any TAO issued pursuant to IRC § 7811.

### **c. Antiquated IT Systems Limit the IRS's Ability to Assist Taxpayers and Collect Revenue**

The IRS's core information technology (IT) systems are among the oldest in the Federal government, limiting the agency's capabilities in significant ways. Partly due to historic poor planning and execution and partly due to lack of funding, the IRS has been unable to replace these antiquated systems. Every year, instead, the agency layers more and more applications and smaller systems onto its core systems.

On April 17, 2018, the filing deadline for filing 2017 federal income tax returns, an IRS systems crash prevented taxpayers from submitting their tax returns and payments. The damage from the crash was limited because the IRS gave taxpayers an extra day to file and pay. However, the crash had the effect of creating significant confusion and anxiety among taxpayers and their preparers, and it served as an important wake-up call and a warning of future problems if the IRS is unable to replace its legacy systems soon.

Moreover, focusing on the risks of a catastrophic crash obscures a less dramatic but far more significant problem: The IRS's antiquated technology limits its ability to do its job every day in ways large and small.

**Example: Online Taxpayer Accounts.** The IRS is trying to develop online taxpayer accounts that are analogous to the online accounts made available by financial institutions. Notably, a bank or brokerage account customer is typically able to access complete information – account statements going back multiple years, Forms 1099, recent transactions, the ability to pay bills electronically, the ability to order replacement checks, the ability to trade stocks, and the like. The IRS is currently limited in its ability

to create such extensive functionality because it relies on at least 60 separate case management systems that generally do not communicate with each other. Even IRS employees cannot easily obtain a 360-degree view of a taxpayer's record. Until the IRS has a 360-degree database and can develop and implement a single enterprise-wide case management system, the functionality of any online account the IRS is able to offer is likely to be limited.

**Example: Customer Callback Technology.** As discussed above, the IRS is often overwhelmed with more telephone calls than it can answer, leading many taxpayers to hang up or requiring them to wait on hold for extended periods of time. Most telephone call centers maintained by large businesses and Federal agencies, including the Social Security Administration and the Department of Veterans Affairs, offer a "customer callback" feature. That is, in lieu of waiting on hold for long periods of time, callers may elect to receive a call back when the next customer service representative is available. Despite the large volume of calls it receives, the IRS still does not have this technology.<sup>71</sup>

In the President's FY 2015 and FY 2016 budgets, the IRS proposed adding customer callback and estimated it would cost about \$3.3 million to acquire the technology.<sup>72</sup> In November 2015, however, Commissioner Koskinen said that although the customer callback technology itself would cost only about \$3.5 million, the IRS had determined its phone system would need to be upgraded to be able to run the customer callback technology – and the upgrade would cost about \$45 million.<sup>73</sup> We understand the IRS has finally decided to absorb the cost of implementing a customer callback feature. This is a very positive development for taxpayers and practitioners. However, the time, effort, and cost it has required to implement this feature illustrate the challenges the IRS consistently faces as it tries to modernize its capabilities based on antiquated technology platforms.

Because the IRS has not received sufficient funding to replace its core antiquated systems, it has had no choice but to layer new application after new application onto its old systems. In effect, the IRS has erected a 50-story office building on top of a creaky, 60-year-old foundation, and it is adding a few more floors every year. This cannot continue indefinitely. Because of systems limitations, taxpayers are harmed, practitioners are inconvenienced, and the IRS is hampered in delivering on its mission to provide U.S. taxpayers top quality service and apply the tax law with integrity and fairness to all.

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<sup>71</sup> *Id.* at 31-32.

<sup>72</sup> See IRS, Congressional Justification for Appropriations accompanying the President's FY 2015 Budget at IRS-20 (2014); IRS, Congressional Justification for Appropriations accompanying the President's FY 2016 Budget at IRS-22 (2015).

<sup>73</sup> See Lisa Rein, *IRS Customer Service Will Get Even Worse This Tax Filing Season, Tax Chief Warns*, Washington Post.com, Nov. 3, 2015.

## **Recommendation**

To improve the IRS's ability to administer the tax system, I recommend that Congress take the following action:

- Provide the IRS with additional dedicated, multi-year funding to replace its core legacy IT systems pursuant to a plan that sets forth specific goals and metrics and is evaluated annually by an independent third party.

### **d. The IRS Office of Chief Counsel Uses Email to Avoid Disclosing Legal Advice, Even Though Taxpayers Need Guidance More Than Ever**

The IRS Office of Chief Counsel (OCC) provides written advice to headquarters employees called Program Manager Technical Advice (PMTA). PMTA generally must be disclosed to the public pursuant to the Freedom of Information Act (FOIA) (5 U.S.C. § 552) and a settlement with Tax Analysts.<sup>74</sup> However, I am concerned that the OCC does not disclose the advice if it is transmitted as an email, rather than as a memo.<sup>75</sup>

The OCC's narrow view of the disclosure requirements is a problem for taxpayers. The *right to be informed* is the first right listed in the Taxpayer Bill of Rights for good reason.<sup>76</sup> If taxpayers do not know the rules and why the IRS has adopted them, they cannot determine if they should exercise their other rights (e.g., the *right to challenge the IRS's position and be heard* or the *right to appeal an IRS decision in an independent forum*). Information about how the OCC interprets the law also helps taxpayers avoid taking positions that would incur penalties or ensnare them in audits or litigation. In other words, it promotes voluntary tax compliance, which brings in tax revenue and saves resources that might otherwise be wasted on audits and litigation.

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<sup>74</sup> *Tax Analysts v. IRS*, Stipulation of Decision, CA No. 1:96-2285-CKK (July 23, 2007).

<sup>75</sup> For a more detailed discussion, see National Taxpayer Advocate 2018 Annual Report to Congress 34-51 (Most Serious Problem: *Counsel Is Keeping More of Its Analysis Secret, Just When Taxpayers Need Guidance More than Ever*). See also Kristen A. Parillo and Andrew Velarde, *Taxpayer Advocate: IRS Using Email to Avoid Advice Disclosure*, 162 TAX NOTES 734 (Feb. 18, 2019).

<sup>76</sup> See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights) and IRC § 7803(a)(3). For prior discussions of transparency, see, e.g., National Taxpayer Advocate 2019 Objectives Report to Congress 43-50 (Area of Focus: *The Offshore Voluntary Disclosure (OVD) Programs Still Lack Focus Transparency, Violating the Right to Be Informed*); National Taxpayer Advocate 2011 Annual Report to Congress 380-403 (Most Serious Problem: *The IRS's Failure to Consistently Vet and Disclose its Procedures Harms Taxpayers, Deprives It of Valuable Comments, and Violates the Law*); National Taxpayer Advocate 2010 Annual Report to Congress 71-84 (Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review*); National Taxpayer Advocate 2007 Annual Report to Congress 124-139 (Most Serious Problem: *Transparency of the Office of Professional Responsibility*); National Taxpayer Advocate 2008 Objectives Report to Congress xxi-xxvii (Area of Emphasis: *Update on Transparency of the IRS*); National Taxpayer Advocate 2006 Annual Report to Congress 10-30 (Most Serious Problem: *Transparency of the IRS*).

Taxpayers need prompt guidance now more than ever, due to the TCJA, which was enacted on December 22, 2017.<sup>77</sup> Although the OCC issued (and published) 68 PMTAs following tax legislation enacted in 1998—more than double the number for 1997, this figure declined in 2018, following the enactment of the TCJA.<sup>78</sup>

As of February 19, 2019, the OCC had released only 12 of the PMTAs that it had issued in 2018 (down from 15 in 2017), and only one of those addressed TCJA issues (*i.e.*, PMTA 2018-16). Consistent with the notion that OCC’s disclosure of PMTA is optional, the OCC said it released PMTA 2018-16 at the “request” of the LB&I Commissioner, rather than because it was required to do so under the FOIA or the settlement.<sup>79</sup>

In addition to uncovering that the OCC believes it can avoid the disclosure of PMTAs that are copied into emails, TAS also learned that the OCC has not issued written guidance to its attorneys describing what must be disclosed as PMTA and has no systems to ensure all PMTAs are timely identified, processed as PMTAs, and disclosed.

### **Recommendations**

To ensure the public has access to the legal reasoning of the IRS Office of Chief Counsel, I recommend that the IRS take the following actions:

- Develop clear written guidance that defines when advice constitutes PMTA that must be disclosed.
- Require disclosure of any advice that is, in substance, PMTA. For example, the OCC’s guidance should not permit attorneys to withhold advice because of its form or mode of transmission (*e.g.*, email), because of the title of the recipient, or because a business unit does not want the advice to be disclosed.
- Establish a written process to monitor whether advice that should be disclosed as PMTA is being identified and disclosed to the public in a timely manner. For example, consider aiming to disclose PMTAs no later than when the IRS issues guidance (*e.g.*, FAQs, Publications, News Releases, IRMs, etc.) that reveals the agency’s position.

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<sup>77</sup> Pub. L. No. 115-97, 131 Stat. 2054 (2017).

<sup>78</sup> TAS analysis of PMTAs posted on IRS.gov. The number of a PMTA reflects the date it was released, rather than the date it was issued. For example, ten PMTAs have numbers beginning with “2017-,” suggesting that they were *released* in 2017, but 15 were *issued* in 2017. Nine of the PMTA issued in 2017 have numbers beginning with “2018-,” suggesting they were not released until 2018. Some PMTAs that were issued in 2018 may not have been released as of the last date we checked (February 19, 2019).

<sup>79</sup> OCC response to TAS information request (Sept. 11, 2018) Q12: “Does the Tax Analysts settlement require the OCC to release the memo underlying the IRS’s position in section 965 FAQ 14?” A12: “The Office of Chief Counsel published this memorandum at the request of the Division Commissioner, LBI.”).

- Incorporate the new PMTA guidance and monitoring procedures into the Chief Counsel Directives Manual, distribute it at PMTA training classes, and release it to the public.

#### **e. The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process**

Congress has repeatedly directed the IRS to protect taxpayers who experience economic hardship or who cannot pay their basic living expenses.<sup>80</sup> Nevertheless, the IRS does not *proactively* identify such taxpayers throughout the collection process.<sup>81</sup> Instead, the IRS routinely undertakes collection treatments that do not require any financial analysis, including entering taxpayers into streamlined installment agreements (IAs).<sup>82</sup> Because taxpayers at risk of economic hardship are not identified at the onset of the collection process, there is no indicator to alert IRS employees that a taxpayer may be unable to pay and to consider collection alternatives. Over the past six years, about nearly 4.3 million IAs have been arranged for cases assigned to the IRS's Automated Collection System (ACS) and about 84 percent of those IAs were streamlined – that is, entered into with no financial analysis.<sup>83</sup>

Economic hardship occurs when an individual is unable to pay reasonable basic living expenses.<sup>84</sup> The IRS has internal data about taxpayers that it could use to be proactive in identifying taxpayers at risk of economic hardship. The IRS does not compare internal data about a taxpayer's income to his or her calculated Allowable Living Expenses (ALE), in beginning collection actions or agreeing to streamlined IAs with

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<sup>80</sup> For a more detailed discussion, see National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*). See also National Taxpayer Advocate 2019 Purple Book 50-51 (*Direct the IRS to Study the Feasibility of Using an Automated Formula to Identify Taxpayers at Risk of Economic Hardship*).

<sup>81</sup> The IRS has internal data available to provide an initial indicator of whether a taxpayer may be at risk of economic hardship, but uses this information in very limited circumstances, such as the Low Income Indicator (LII) used to determine whether taxpayers entering into an IA are eligible for a reduced waived user fee. The LII is placed on the IRS's Individual Master File system and is determined by reviewing the taxpayer's income and exemptions on the taxpayer's most recent tax return and comparing them with the poverty level charts created by the Department of Health and Human Services (HHS). IRM 5.14.1.2, *Installment Agreements and Taxpayer Rights* (July 16, 2018); see also IRS response to TAS information request (Sept. 14, 2018) (on file with TAS).

<sup>82</sup> IRC § 6159; IRM 5.14.1.1.1, *Streamlined Installment Agreements* (Dec. 23, 2015). In theory, a streamlined IA may help taxpayers by avoiding the burden of providing financial information. However, by avoiding the financial analysis this tool instead harms taxpayers who would otherwise not be able to afford an IA and would be better off with a different collection alternative.

<sup>83</sup> There are instances where IAs may be arranged by other Collection units than ACS. In FY 2018, streamlined IAs made up about 72 percent of total IAs. IRS, Collection Activity Report NO-5000-6 (Oct. 1, 2018).

<sup>84</sup> See IRC § 6343; Treas. Reg. § 301.6343-1; and IRM 5.8.11.2.1, *Economic Hardship* (Aug. 5, 2015).

taxpayers.<sup>85</sup> As a result, many anxious or intimidated taxpayers agree to tax payments they cannot afford, worsening their financial hardship. TAS's research shows that an algorithm using internal data about a taxpayer's income and assets, and comparing that information to ALEs, can be a reliable way to predict taxpayers at risk of economic hardship.<sup>86</sup>

*In FY 2018, 40 percent of taxpayers who entered into a streamlined IA within ACS had incomes at or below their ALEs.*<sup>87</sup> These taxpayers could have been eligible for collection alternatives, such as offers in compromise or CNC-Hardship ("currently not collectible - hardship") status, if they had known to call the IRS to explain their financial circumstances.

TAS research shows the default rate for streamlined IAs of taxpayers whose income was at or below their ALEs within ACS in FY 2018 was about 39 percent. To emphasize the point—about four out of ten taxpayers with income below their ALEs were unable to meet the terms of their payment agreement, while the rest continued making payments while, even by the IRS's own standards, they could not pay for their basic living expenses.<sup>88</sup>

The TAS Research function has developed an automated algorithm that I believe can identify taxpayers with incomes below their ALEs.<sup>89</sup> The IRS could apply this formula by automation to the accounts of all taxpayers who owe back taxes, and then place a marker on the accounts of taxpayers whom the screen identifies as having incomes below their ALEs – that is, taxpayers at risk of economic hardship. While this marker would not automatically close a case as CNC-Hardship, it could be used to create a warning for telephone assistors responding to taxpayers calls and for taxpayers entering into IAs online. The IRS could also use this algorithm to screen out these taxpayers from automated collection treatments such as the Federal Payment Levy Program, selection for referral to Private Collection Agencies (PCAs), or passport certification

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<sup>85</sup> IRC § 7122(d)(2)(A) requires that the IRS "develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses." These are known as the allowable living expense (ALE) standards.

<sup>86</sup> See National Taxpayer Advocate 2018 Annual Report to Congress, vol. 2, 39-52 (Research Study: *A Study of the IRS's Use of the Allowable Living Expense Standards*).

<sup>87</sup> Due to the lapse in appropriations, the IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process. See also National Taxpayer Advocate 2018 Annual Report to Congress 255-265 (Most Serious Problem: *IRS's Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS*).

<sup>88</sup> TAS Research analysis of the IMF and Individual Returns Transaction File on IAs established in FY 2018. This figure assumes taxpayers have one IRS-allowed vehicle ownership and operating expenses, and only a second one if the taxpayer filed jointly with his or her spouse. If we assume the taxpayers did not have vehicle ownership expenses, the default rate would be about 32 percent.

<sup>89</sup> The IRS has expressed concern regarding the ALE determination methodology and how to address income when no income tax return is found. However, the results of TAS's research highlight the need for the IRS to study the feasibility of using internal data further and in which situations the algorithm could be beneficial. In some instances where no income tax return is found, the IRS should consider other data about taxpayers such as third-party reporting information.

unless and until the IRS has made a direct personal contact with the taxpayer to verify the information.

### **Recommendations**

To protect taxpayers from IRS collection actions that cause or exacerbate economic hardship, I recommend that Congress direct the IRS to take the following actions:

- Develop and utilize an algorithm to compare a taxpayer's financial information to ALEs during case scoring and as a template made available to Revenue Officers and telephone assistants responding to taxpayer inquiries.
- Apply this algorithm before sending any cases to PCAs, and exclude any case involving a taxpayer at risk of economic hardship from potentially collectible inventory.
- Route cases identified as at risk of economic hardship to a specific group within ACS and send those taxpayers a specific written notification to educate them on collection alternatives and additional assistance available, including TAS and Low Income Taxpayer Clinics (LITCs).
- Create a new help line dedicated to responding to taxpayers at risk of economic hardship and helping them determine the most appropriate collection alternative, including OICs.
- Partner with TAS and LITCs to develop issue-focused training for IRS employees who interact with taxpayers at risk of economic hardship.