

**Hearing with the National Taxpayer Advocate**

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**HEARING**

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

FIRST SESSION

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**Hearing with the National Taxpayer Advocate**

U.S. House of Representatives,  
Subcommittee on Oversight,  
Committee on Ways and Means,  
Washington, D.C

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**WITNESS**

**Nina Olson**  
National Taxpayer Advocate

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# WAYS AND MEANS

CHAIRMAN KEVIN BRADY

## **Chairman Buchanan Announces Hearing with the National Taxpayer Advocate**

House Ways and Means Oversight Subcommittee Chairman Vern Buchanan (R-FL) announced today that the Subcommittee will hold a hearing entitled “IRS Reform: Lessons Learned from the National Taxpayer Advocate.” The hearing will provide input on reforms that can be made to the agency based on the experience of the Taxpayer Advocate Service, an independent office which helps taxpayers resolve problems with the IRS. **The hearing will take place on Friday, May 19, 2017 in 1100 Longworth House Office Building, beginning at 9:00 AM.**

In view of the limited time to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

### **DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:**

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select “Hearings.” Select the hearing for which you would like to make a submission, and click on the link entitled, “Click here to provide a submission for the record.” Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Friday, June 2, 2017**. For questions, or if you encounter technical problems, please call (202) 225-3625.

### **FORMATTING REQUIREMENTS:**

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written

comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

**Note:** All Committee advisories and news releases are available at <http://www.waysandmeans.house.gov/>

IRS REFORM: LESSONS LEARNED FROM THE NATIONAL TAXPAYER  
ADVOCATE

Friday, May 19, 2017  
House of Representatives,  
Subcommittee on Oversight,  
Committee on Ways and Means,  
Washington, D.C.

The Subcommittee met, pursuant to call, at 8:59 a.m., in Room 1100, Longworth House Office Building, Hon. Vern Buchanan [chairman of the subcommittee] presiding.

Chairman Buchanan. The Subcommittee will come to order.

Welcome to the Ways and Means Oversight Subcommittee hearing on IRS Reforms: Lessons Learned from the National Taxpayer Advocate.

It has been nearly 20 years since Congress seriously considered reforms to the IRS. I am hopeful that as we embark on a renewed effort to improve the agency that we can work hand-in-hand with Members on both sides of the aisle. Working together, I am confident that we can find common ground and make progress.

I think it is important to emphasize that our efforts to reform the IRS should not be seen as a punishment or a criticism of the average agency employee; instead, they are a recognition that the IRS's mission is very important. Every government entity, just like private companies, can benefit from a thorough review and some thoughtful, long-term planning and action. And that is what we are here for today.

I have a business background. I started my own business many years ago, and my experience tells me that we always need to look for ways to improve. Continuous improvement has been part of my philosophy over a lot of years. We always find a way to get better and more efficient.

When evaluating any entity- government or business- I always ask myself the reason for improving, but the big goal is to have continuous improvement, I think, as your organization has done so over the years.

The task before us today is to ask the tough questions and look for solutions. This work is important because taxpayers need to be able to trust the entity administering the Tax Code. Ninety-eight percent of our tax revenues come to the IRS voluntarily. Only 2 percent is collected through the IRS enforcement action.

Trust is a key component of voluntary compliance. The Taxpayer Bill of Rights contains the right to quality service, and I think that is one of our biggest focuses as second on the list. An IRS publication describes the right as the right to receive prompt, courteous, and

professional assistance in taxpayer dealings with the IRS. As we consider reforms to the IRS, we should keep this right, as well as well as the other nine in mind.

I look forward to working with the Ranking Member, Mr. Lewis, and other Members of the Committee, to make the IRS a 21st century agency.

I want to thank our witness, Ms. Olson, for being here today. She has been a champion for taxpayers for many years, and her insight on this topic will be valuable. I look forward to her testimony.

I now yield to the distinguished Ranking Member, Mr. Lewis, for the purposes of an opening statement.

Mr. Lewis. Good morning, Mr. Chairman. Thank you very much for holding this hearing with the National Taxpayer Advocate.

And I want to thank Ms. Olson for being here and for her many years of service.

I would also like to thank our Members for being here. I know for some of us, this is a little early.

Chairman Buchanan. I agree.

Mr. Lewis. But we are here.

Mr. Chairman, we must approach the important matter of reforming and improving the Internal Revenue Service with a great deal of care. We must remain focused on doing what is right, and what is just for the interests of every American taxpayer. If we stay on a bipartisan path together, we help the IRS become a model of success for constituent services.

The IRS is a large and complex organization that has suffered from a lack of resources for many years. Congress cut the agency's budget by almost \$1 billion since 2010. These cuts hurt and harm taxpayer services and tax compliance.

And the IRS needs technology, infrastructure, and employees to provide secure, quality customer service. For these reasons, responsible reform must include strong, robust funding. As we study the IRS structure and service, we must also consider how much the world has changed since Congress last acted on this matter.

Over the last 20 years, smartphones and internet access created opportunities for some and barriers for others. Both taxpayers and those who serve them struggle with increased identity theft, fraud, and scams. Unfortunately, certain programs, like private debt collection, which have been tried and repeatedly failed, just lead to more confusion.



Mr. Chairman, I believe that we agree on the importance of an agency that would provide taxpayers with greater access to customer service online, over the phone, and in person. I believe we can help build a tax administration system that will take advantage of new technology, while enhancing the security of taxpayer data.

I believe that we must do better, and that if we work together, we can do better. I look forward to hearing from the National Taxpayer Advocate today, and learning more from her experience with taxpayers and the agency.

And again, thank you, Mr. Chairman, for holding this hearing today. And thank you for your service. I yield back.

Chairman Buchanan. Thank you, Mr. Lewis. And I look forward to working with you on the IRS reforms.

Without objections, other Members' opening statements will be made part of the record.

Today's witness panel includes one expert, Nina Olson, the National Taxpayer Advocate for Taxpayer Advocate Services at the IRS. And I did mention to her earlier, I met with a group of CPAs from Florida, and your organization was well thought of.

And also last week, preparers that are here in Washington, I asked them about your organization, and they gave you high marks. I don't want you to get a big head, but the point is, we do believe in continuous improvement.

Ms. Olson, we appreciate you being here today. The subcommittee will receive your written statement, which will be made part of the formal hearing record. You now have five minutes to deliver your oral remarks. You may begin when you are ready. Thank you.

#### **STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE**

Ms. Olson. Chairman Buchanan, Ranking Member Lewis, and Members of the Subcommittee, thank you for inviting me to testify today regarding the operations of the Internal Revenue Service, and to offer some suggestions to improve the responsiveness of the agency to U.S. taxpayers.

It has been nearly two decades since Congress last reviewed and updated the laws governing IRS operations. A lot has changed during that time, and tax administration would benefit from a fresh review of those laws.

In my written statement, I make the following points: First, reforms to IRS operations will be most successful if Congress consults widely on its proposals, engages IRS employees and external stakeholders, and provides the IRS with adequate funding to succeed.

Second, sound tax administration should be predicated on foundational principles, and the most important principle is respect for taxpayer rights. Not only is respecting the rights of the taxpayers who pay our Nation's bills the right thing to do, but there is significant empirical data that suggests building trust with taxpayers, which requires respecting their rights, enhances voluntary compliance as well.

In 2015, Congress codified the provisions of the Taxpayer Bill of Rights, or TBOR, as part of a provision requiring that the Commissioner ensure IRS employees receive training and act in accord with those rights. The challenge now is to ensure that TBOR is not merely aspirational, but is incorporated into the very ethos of the IRS, and explicitly into its business practices.

I believe a clear statement that taxpayers actually have the 10 fundamental TBOR rights would provide a stronger foundation for effective tax administration. And, therefore, I recommend that Congress enact the Taxpayer Bill of Rights as a freestanding provision in the Internal Revenue Code.

Third, to become an effective 21st century tax administration, the IRS must place greater emphasis on taxpayer service. In my view, there is no conflict whatsoever between providing high-quality taxpayer service and taking actions to ensure tax compliance, particularly on the part of persons actively seeking to evade tax. It should not be an either/or proposition.

But to create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented.

Of the IRS's current appropriated budget of \$11.2 billion, 43 percent is allocated to enforcement, while only 4 percent -- I repeat, only 4 percent -- is allocated to taxpayer outreach and education activities.

According to IRS data, the agency dedicates only 98 employees to conduct outreach and education to the roughly 62 million small business and self-employed taxpayers, and only 376 employees to conduct outreach and education to the 125 million wage and investment taxpayers. Meanwhile, the IRS has over 3,000 revenue officers who collect field collection activity, and over 8,800 revenue agents who conduct field audits.

In RRA 98, Congress directed the IRS to restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs. In response, the IRS adopted the following mission statement: "Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."

In 2009, with no public discussion or notice to Congress or to myself, the IRS quietly changed its mission statement to read, "and enforce the tax law with integrity and fairness to all." This shift in tone and emphasis from "applying" to "enforcing" the law suggests

IRS leadership disagreed with the congressional directive and decided to place greater emphasis on enforcement in the mission statement.

Accordingly, I recommend that Congress require the IRS to revise its mission statement to reemphasize a noncoercive approach to tax administration and explicitly affirm the role of taxpayer rights as a guiding principle for tax administration.

Fourth, Congress has passed three important taxpayer rights bills, including RRA 98. And in my testimony, I highlight provisions that IRS has -- that Congress has enacted, that the IRS has either not implemented, defined away through writ guidance, or only done a partial job.

Fifth, RRA 98 joint oversight hearings would give Congress better insight into the IRS strategic and operational plans, promote dialogue between Congress, IRS, and interested stakeholders, and help ensure the tax writing and appropriations committees coordinate their expectations and approaches toward the IRS operations.

Thank you for this opportunity, and I look forward to answering any questions.

**STATEMENT OF**

**NINA E. OLSON**

**NATIONAL TAXPAYER ADVOCATE**

**HEARING ON**

**IRS REFORM:**

**PERSPECTIVES FROM THE NATIONAL TAXPAYER ADVOCATE**

**BEFORE THE**

**SUBCOMMITTEE ON OVERSIGHT**

**COMMITTEE ON WAYS AND MEANS**

**U.S. HOUSE OF REPRESENTATIVES**

**MAY 19, 2017**

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

Thank you for inviting me to testify today regarding the operations of the Internal Revenue Service and to offer some suggestions to improve the responsiveness of the agency to U.S. taxpayers.<sup>1</sup>

In a summary of its blueprint, *A Better Way*, the House Republicans' Tax Reform Task Force describes "A Service First IRS," noting that "[a] simpler, fairer tax code will require a simpler, fairer IRS with one mission: Put the taxpayers first."<sup>2</sup>

I am delighted this subcommittee is planning to take a hard look at IRS priorities and operations. Between 1988 and 1998, Congress passed three significant pieces of legislation to improve tax administration and strengthen taxpayer rights.<sup>3</sup> It has now been nearly two decades since the final of those bills was enacted, and tax administration has changed in many ways. Perhaps the most significant changes are the increasing use of automation by the IRS and the increasing use of the Internet and other digital services by taxpayers. During this time, we have also had a chance to assess the impact of the changes made by the landmark IRS Restructuring and Reform Act of 1998 (RRA 98). Most have stood the test of time well, but some require tweaking.

In my testimony today, I will make the following points:

1. Reforms to IRS operations will be most successful if Congress consults widely on its proposals, engages IRS employees, and provides the IRS with adequate funding.
2. Sound tax administration should be predicated on foundational principles, and the most important principle is respect for taxpayer rights.

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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.

<sup>2</sup> House Republicans' Tax Reform Task Force, *A Better Way for Tax Reform*, <http://abetterway.speaker.gov/assets/pdf/ABetterWay-Tax-Snapshot.pdf>.

<sup>3</sup> See Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the "Omnibus Taxpayer Bill of Rights," also known as TBOR 1); Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685, 726 (1998) (Title III is known as "Taxpayer Bill of Rights III" or TBOR 3).

3. To become an effective 21<sup>st</sup> century tax administration, the IRS must place greater emphasis on taxpayer service.
4. The IRS has not implemented, has narrowly interpreted, or has not effectively implemented many taxpayer protections enacted by Congress.
5. RRA 98-style “joint oversight hearings” would give Congress better insight into the IRS’s strategic and operational plans, promote dialogue among Congress, the IRS and interested stakeholders, and help ensure the tax-writing and appropriations committees coordinate their expectations and approaches toward IRS operations.
6. Lastly, I summarize key provisions in the Blueprint and offer some suggestions for the subcommittee to consider as it converts the Blueprint’s concepts into more detailed proposals.

**I. General Observations: Reforms to IRS Operations Will Be Most Successful if Congress Consults Widely on Its Proposals, Engages IRS Employees, and Provides the IRS with Adequate Funding.**

The Blueprint, by its nature, is a general document. It is not clear yet what specific changes its authors contemplate or how far-reaching the changes may be. As one who participated in the crafting of RRA 98 as an outside practitioner and who witnessed much of its implementation after I became the National Taxpayer Advocate, I offer three threshold observations:

- **Significant Changes Should Be Thoroughly Vetted**. The IRS is a large and complex agency, and as such, well-intentioned proposals can often have unintended consequences. Therefore, it is important to vet significant changes thoroughly before implementing them. Leading up to RRA 98, for example, Congress created an independent commission to review the then-existing practices of the IRS and recommend ways to modernize the agency’s efficiency and productivity while improving taxpayer services.<sup>4</sup> The commission, led by then-Senator Bob Kerrey and then-Congressman Rob Portman, was bicameral and bipartisan, and it employed significant professional staff. The commission spent a full year studying IRS operations and developing its recommendations. Among other things, the commission interviewed more than 500 individuals, worked closely with the Treasury Department and the IRS to gain a comprehensive understanding of IRS operations, and held 12 days of public hearings.

After the commission completed its work in June 1997, the House Ways and

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<sup>4</sup> Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>.

Means and Senate Finance committees held numerous hearings of their own before eventually passing the legislation. I am not advocating for an undertaking of that magnitude. But I do think it's important that the tax-writing committees take the time to talk with Treasury and IRS officials and outside stakeholders and to study IRS operations carefully before enacting legislation that would make major changes to the agency. Such consultations will maximize the chances for success while minimizing the risks of unintended consequences.

- **Employee Morale Affects Performance**. The performance of the IRS as an agency is dependent on the performance of its workforce. The agency's roughly 83,000 employees do everything from interacting personally with taxpayers, to writing tax forms and instructions, to programing computer code.<sup>5</sup> It is therefore essential that they be engaged and fully committed to their jobs. Because of several well publicized incidents over the last few years, the IRS has been a widely criticized agency, and many IRS employees feel besieged. Morale is low. I am concerned that a congressional review of IRS operations with an eye toward reforming parts of the agency may be interpreted as further disparagement.

In fact, it should not be interpreted in that way. Congress has an essential and constructive role to play in reviewing and updating the laws that enable effective tax administration. That can be good for employees as well as taxpayers. Based on conversations with Chairman Buchanan and the majority and minority staffs, I believe the subcommittee plans to work in a bipartisan manner to improve tax administration. I encourage Members to speak with sensitivity and avoid furthering the perception of many IRS employees that IRS reforms would be a "punishment" of sorts.

- **High Quality Taxpayer Service Cannot Be Achieved Without Adequate Funding**. Each year, the IRS receives more than 100 million telephone calls, roughly five million taxpayer visits in its Taxpayer Assistance Centers (TACs), and some ten million pieces of correspondence from taxpayers responding to proposed tax adjustment notices.<sup>6</sup> To fulfill the "Service First" objective, the IRS requires sufficient funding to hire and train enough employees to respond to each of these contacts and to modernize its technology systems so that employees

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<sup>5</sup> IRS, *2016 Data Book* at 68 (Table 31). This count includes total full-time, part-time, and seasonal personnel employed by the IRS during FY 2016. The number of full-time-equivalent positions used to conduct IRS operations was approximately 78,000 during FY 2016 and 76,000 as of the end of FY 2016. *Id.* at 67 (Table 30).

<sup>6</sup> IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot, IRS Enterprise Total* (final week of each fiscal year for FY 2008 through FY 2016) (showing telephone call volumes exceeding 100 million in every year); IRS Wage & Investment Division, Business Performance Review 7 (1<sup>st</sup> Quarter – FY 2017, Feb. 9, 2017) (showing 5.6 million visits in FY 2015 and 4.5 million visits in FY 2016); IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2007 through FY 2016) (showing annual taxpayer correspondence volumes regarding potential adjustments has ranged from a low of 7.3 million letters to a high of 11.8 million letters and has averaged around ten million per year).



have access to complete and accurate information when they are communicating with taxpayers. Since fiscal year (FY) 2010, we estimate the IRS's annual appropriation has been cut by nearly 20 percent on an inflation-adjusted basis.<sup>7</sup> At the same time, the agency has faced an increasing volume of tax returns, the requirement to implement the Patient Protection and Affordable Care Act,<sup>8</sup> and a surge in stolen identity refund fraud. High quality taxpayer service cannot be provided on the cheap. If we want the IRS to provide better service, we have to recognize it will require the resources to do so.

For purposes of today's hearing, I will keep my observations and recommendations very general. Since I became the National Taxpayer Advocate in 2001, I have made more than 100 legislative recommendations in my annual reports to Congress, many of which have been introduced in bills sponsored by Members of Congress. Some have been designed to fill gaps in RRA 98 or to update taxpayer protections. I would be happy to discuss some of the specific proposals I believe would improve tax administration in response to your questions today or with the committee's staff in the coming months.

## **II. Sound Tax Administration Should Be Predicated on Foundational Principles – and the Most Important Principle Is Respect for Taxpayer Rights.**

I believe it is important to build organizations based on foundational goals and principles. In the case of a tax collection agency, the overriding foundational goal is to maximize voluntary tax compliance. Voluntary compliance is far preferable to enforced compliance because audits are expensive on a per-return basis and often don't even uncover much of the noncompliance on a tax return.

In working toward the foundational goal of maximizing voluntary tax compliance, I believe the most important foundational principle is respect for taxpayer rights. Taxpayer rights deserve priority emphasis for two reasons. First, it is simply the right thing to do. I think of the requirement to pay taxes as a "social contract" of sorts between the government and its taxpayers. Taxpayers agree to pay a percentage of their annual incomes to the government for the common good, and in exchange, the government agrees to make the process as fair and burden-free as possible.

Second, there is empirical data that suggests building trust with taxpayers – which requires respecting their rights – enhances voluntary compliance. In 2012, my office

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<sup>7</sup> IRS funding is down in dollar terms by 7.5 percent since FY 2010. In FY 2010, the agency's appropriated budget stood at \$12.1 billion. For FY 2016, its budget was \$11.2 billion. Based on the Consumer Price Index measure of inflation, costs have risen by 12 percent over the same period. Bureau of Labor Statistics, *Consumer Price Index – Urban (CPI-U)* (reflecting inflation from March 2010 through March 2017). Thus, the inflation-adjusted reduction is nearly 20 percent. There are multiple measures of inflation, so the use of a different measure may produce slightly different results.

<sup>8</sup> Pub. L. No. 111-148, 124 Stat. 119 (2010).

conducted a significant research study to try to tease out factors that influence tax compliance (or non-compliance). The study focused on sole proprietors, because IRS “tax gap” studies have shown sole proprietors are responsible for the largest single portion of unreported income. This was the first study that has attempted to link an individual’s responses to survey questions to the IRS’s estimates of the individual’s tax compliance on filed tax returns. The study found that trust played an important role in tax compliance. More specifically, a taxpayer’s self-reported level of trust in government, the tax laws, and the IRS correlated with the taxpayer’s level of tax compliance.<sup>9</sup> The study suggests that gaining the trust of U.S. taxpayers is not only good government, but it makes for effective tax collection as well.

In 2014, the IRS took a significant step toward acknowledging the value of taxpayer rights. It adopted the Taxpayer Bill of Rights (TBOR) – something I had been recommending since 2007.<sup>10</sup> These rights include (1) the right to be informed; (2) the right to quality service; (3) the right to pay no more than the correct amount of tax; (4) the right to challenge the IRS’s position and be heard; (5) the right to appeal an IRS decision in an independent forum; (6) the right to finality; (7) the right to privacy; (8) the right to confidentiality; (9) the right to retain representation; and (10) the right to a fair and just tax system.<sup>11</sup>

In 2015, Congress codified these ten rights as part of a provision requiring that the Commissioner ensure IRS employees receive training and act in accord with them.<sup>12</sup> These were very important developments. The challenge now is to ensure the TBOR is not merely aspirational but is incorporated into the very ethos of the IRS – and explicitly into its business practices.

In our Annual Report to Congress, we now publish a Taxpayer Rights Assessment based on performance measures that I believe help show how well the IRS is complying with the TBOR.<sup>13</sup> These measures are organized under each of the ten TBOR rights. In many cases, the performance measures I identify currently exist, and where they do, we have included data. In other cases, we identify measures we believe the IRS can and should start to track. The intent of this assessment is to give the IRS as well as

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<sup>9</sup> National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 1-70 (Research Study: *Factors Influencing Voluntary Compliance by S Small Businesses: Preliminary Survey Results*).

<sup>10</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payments*); see also National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

<sup>11</sup> See IRS, *Taxpayer Bill of Rights*, <https://www.irs.gov/taxpayer-bill-of-rights>.

<sup>12</sup> See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, § 401(a), 129 Stat. 2242, 3117 (2015) (codified at IRC § 7803(a)(3)).

<sup>13</sup> See National Taxpayer Advocate 2016 Annual Report to Congress 42-47 (Taxpayer Rights Assessment: *IRS Performance Measures and Data Relating to Taxpayer Rights*), [https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16\\_Volume1\\_TaxpayerRightsAssessment.pdf](https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16_Volume1_TaxpayerRightsAssessment.pdf).

Congress and the tax community more information regarding the IRS's performance. Some of the measures can be refined, but ultimately, I believe it would be helpful to incorporate some of these measures into IRS executive and senior manager performance plans so that IRS managers are evaluated, in part, on their efforts to uphold taxpayer rights.

One important point to note is that U.S. taxpayers already have a significant number of statutory protections as a result of legislation enacted by Congress. Initially, I viewed the TBOR primarily as a vehicle for making those rights clearer. As I have watched the rollout of the TBOR and have had an opportunity to reflect on its impact and its role in sound tax administration, however, I have come to believe that the tax system would benefit from placing greater emphasis on the ten TBOR rights and using them as a foundational document for tax administration.

In that regard, a significant limitation of the statutory provision reciting the ten TBOR provisions is that it does not use the term "Taxpayer Bill of Rights" and it does not explicitly state that taxpayers have any of these rights. By its terms, the provision requires only that the Commissioner "ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights."<sup>14</sup> This leaves the practical impact of the provision murky. If a taxpayer were to assert that the IRS had violated one of the TBOR rights, it is open to question whether a court would find the rights are legally cognizable.

I was not a party to the conversations that gave rise to this provision. My guess is the IRS expressed concern that if the law provided that taxpayers possess these rights, it is not clear how courts would interpret them and it could make it harder for the IRS to win cases. If that was an expressed concern, I find it unpersuasive. Courts are regularly called upon to interpret general provisions, and they do so by balancing competing interests. For example, there are many provisions that are phrased in general terms in the Bill of Rights in the U.S. Constitution. Yet the courts have shown they are quite capable of defining the parameters of those rights. The courts have held, for example, that the First Amendment right to free speech does not extend to falsely shouting "fire" in a crowded movie theater, or to spreading knowingly false and defamatory information about another individual, or to publishing obscene material.<sup>15</sup>

As with the Bill of Rights, some of the TBOR provisions are more general than others. For example, the courts would initially have to decide how to interpret the "Right to Quality Service" and what a violation of that right would mean. But that does not mean courts are incapable of doing so. A court might rule that the fact a taxpayer had to call

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<sup>14</sup> IRC § 7803(a)(3).

<sup>15</sup> See, e.g., *Schenck v. United States*, 249 U.S. 47, 52 (1919) ("The most stringent protection of free speech would not protect a man in falsely shouting fire in a theatre"); *Garrison v. Louisiana*, 378 U.S. 64, 75 (1964) ("[T]he knowingly false statement and the false statement made with reckless disregard of the truth do not enjoy constitutional protection"); *Roth v. United States*, 354 U.S. 476 (1957) (concluding that obscene material is not protected by the First Amendment).

the IRS several times and wait for an extended period on hold would not affect the outcome of a case, yet it would consider the “Right to Quality Service” as relevant if a taxpayer can demonstrate that he called and spoke to an IRS employee and the employee put notes in the file promising to take actions that the IRS never ended up taking. As with any new law, there would be an initial period of some uncertainty as courts begin to interpret it. And if the IRS loses a few cases because it has violated the TBOR, the agency would realize immediately that it has to modify its procedures to ensure the violations do not continue.<sup>16</sup> In other words, it would promote accountability. Ultimately, I believe a clear statement that taxpayers have the ten fundamental TBOR rights would provide a stronger foundation for effective tax administration, and I am confident the courts would interpret those rights in a manner that is fair and reasonable. To assist them, the tax-writing committees could provide guidance in the accompanying committee reports.

Accordingly, I recommend that Congress:

- Enact the Taxpayer Bill of Rights as a freestanding provision in the Internal Revenue Code.
- In addition, or in lieu of the above recommendation if Congress decides not to go that far, direct the IRS to incorporate the foundational role of the TBOR into its mission statement and structure its programs around the core principle of respect for taxpayer rights.

### **III. To Become an Effective 21<sup>st</sup> Century Tax Administration, the IRS Must Place Greater Emphasis on Taxpayer Service.**

As noted above, one of the rights included in the Taxpayer Bill of Rights is “The Right to Quality Service.”<sup>17</sup> This right warrants additional discussion because it is central to taxpayers’ experiences in dealing with the IRS.

I note at the outset that I believe IRS compliance activities, including audits and other authorized compliance measures, are central to effective tax administration. In my view, there is no conflict whatsoever between providing high quality taxpayer service and taking steps to ensure tax compliance, particularly on the part of persons actively

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<sup>16</sup> It is also worth noting that the percentage of disputed cases that ends up in the U.S. Tax Court is low. In FY 2016, fewer than two percent of individual taxpayers who received a statutory notice of deficiency or a Collection Due Process notice filed a petition in the Tax Court. IRS, Compliance Data Warehouse, *IRS Notice Delivery System*.

<sup>17</sup> The IRS describes the “Right to Quality Service” as follows: “Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to have a way to file complaints about inadequate service.” For additional detail, see <https://taxpayeradvocate.irs.gov/taxpayer-rights/right-2>.

seeking to evade tax. It is not an “either/or” proposition. Although beyond the scope of my testimony today, I have made many recommendations in the past to improve IRS compliance programs.<sup>18</sup>

Last year, the Taxpayer Advocate Service (TAS) and I personally embarked on an extraordinary endeavor to actively engage with the taxpayers we serve. As announced in my 2015 Annual Report to Congress, in which we analyzed the IRS’s “Future State” vision, I traveled the country and held 12 Public Forums on Taxpayer Needs and Preferences.<sup>19</sup> Together with Members of Congress, including Congressmen Roskam, Serrano, Meadows, Renacci, Becerra, and Doggett and Senators Grassley and Cardin, I heard directly from taxpayers and their representatives about the challenges they face in complying with the tax laws and dealing with the IRS.<sup>20</sup> TAS also held “Future State” focus groups of tax return preparers and practitioners at the IRS Tax Forums.<sup>21</sup> And we engaged every TAS office in meetings about the “Future State” because TAS typically assists between 200,000 and 250,000 taxpayers a year in resolving their problems with the IRS, so our employees see first-hand the challenges taxpayers face.<sup>22</sup>

We also conducted a nationwide survey of U.S. taxpayers to hear directly what they need in the way of taxpayer service.<sup>23</sup> Finally, my immediate staff identified significant research on topics that have relevance for tax administration, including approaches to voluntary compliance, worldwide taxpayer service, alternative dispute resolution, taxpayer rights, fraud detection, online accounts, and the impact of geographic

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<sup>18</sup> See, e.g., National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, at 63-90 (*An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).

<sup>19</sup> See National Taxpayer Advocate 2015 Annual Report to Congress xv. National Taxpayer Advocate Public Forums were held in the following locations: Washington, DC (Feb. 23, 2016); Glen Ellyn, IL (Mar. 9, 2016 with Congressman Roskam); Bronx, NY (Mar. 18, 2016 with Congressman Serrano); Hendersonville, NC (Apr. 4, 2016 with Congressman Meadows); Harrisburg, PA (Apr. 8, 2016); Red Oak, IA (May 5, 2016 with Senator Grassley); Baltimore, MD (May 13, 2016 with Senator Cardin); Washington, DC (May 17, 2016); Parma, OH (Aug. 16, 2016 with Congressman Renacci); Portland, OR (Aug. 18, 2016); Los Angeles, CA (Aug. 22, 2016 with Congressman Becerra); and San Antonio, TX (Aug. 30, 2016 with Congressman Doggett).

<sup>20</sup> For information about and full transcripts from the National Taxpayer Advocate Public Forums, see <https://taxpayeradvocate.irs.gov/public-forums>.

<sup>21</sup> TAS Communications and Liaison, *2016 IRS Nationwide Tax Forums TAS Focus Group Report: Preparers’ Thoughts About IRS’s Proposed Future State* (Oct. 2016), [https://taxpayeradvocate.irs.gov/Media/Default/Documents/ResearchStudies/2016\\_TaxForum\\_FutureState\\_FocusGroup\\_Report.pdf](https://taxpayeradvocate.irs.gov/Media/Default/Documents/ResearchStudies/2016_TaxForum_FutureState_FocusGroup_Report.pdf).

<sup>22</sup> For the results of the discussions with TAS employees, see <https://taxpayeradvocate.irs.gov/public-forums>.

<sup>23</sup> See National Taxpayer Advocate 2016 Annual Report to Congress, vol. 2, at 1-30 (Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

presence and focus. We expanded our searches beyond the tax literature to psychology, behavioral economics, organizational theory, network theory, marketing, and other disciplines. These literature reviews are published in volume 3 of the National Taxpayer Advocate's 2016 Annual Report to Congress.

Last year's "learning tour" culminated in a Special Focus section of my most recent Annual Report to Congress, in which I set forth my observations and recommendations to help the IRS become a taxpayer-centric 21<sup>st</sup> century tax administration.<sup>24</sup> I am submitting the Special Focus section as Exhibit A to this statement. It identified the following areas of tax administration that require particular attention to meet the needs of U.S. taxpayers:

- *IRS Budget and Oversight:* To fairly, effectively, and efficiently administer the tax system, the IRS must receive increased funding, but such funding should be tied to additional congressional oversight of IRS strategic and operational plans.
- *IRS Culture:* To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented.
- *IRS Mission Statement:* To ensure the IRS recruits, hires, and trains employees with the appropriate skill sets, the IRS must revise its mission statement to explicitly acknowledge the IRS's dual mission of collecting revenue and disbursing benefits, as well as the foundational role of the Taxpayer Bill of Rights.
- *Understanding Taxpayer Needs and Preferences:* To ensure that the IRS designs its Current and Future State initiatives based on actual taxpayer needs and preferences, the IRS must actively and directly engage with the taxpayer populations it serves as well as undertake a robust research agenda that furthers an understanding of taxpayer compliance.
- *Grossly Outdated Technology and Infrastructure:* To enable the IRS to meet the major technology improvements required for a 21<sup>st</sup> century tax administration, even as it fulfills current operational technology demands, the IRS must articulate a clear strategy that will reassure Congress and taxpayers the funding will be well-spent.
- *Office of the Taxpayer Advocate:* To protect taxpayer rights and ensure a fair and just tax system, Congress should take steps to strengthen the Taxpayer Advocate Service.

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<sup>24</sup> National Taxpayer Advocate 2016 Annual Report to Congress 1-41 (Special Focus: *IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21 Century Tax Administration*), [https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16\\_Volume1\\_SpecialFocus.pdf](https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16_Volume1_SpecialFocus.pdf).

One important takeaway that emerged from the Public Forms is the strong preference expressed by many taxpayers and practitioners for the opportunity to speak with an IRS employee directly and for the opportunity to meet with an IRS employee face-to-face for certain kinds of interactions.

Yet these preferences run directly counter to the IRS's continuing efforts to automate more and more of its activities and to make personal interaction less accessible. Part of this trend is attributable to funding limitations in recent years, but much of it began before the funding reductions. In addition, the IRS's priorities make it appear that contrary to taking a "Service First" approach toward tax administration, it often appears to follow an "Enforcement First" approach.

To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented. Of the IRS's current appropriated budget of \$11.2 billion, 43 percent is allocated to enforcement, while only four percent is allocated to taxpayer outreach and education activities.<sup>25</sup> In 2014, the IRS ceased all tax return preparation in its Taxpayer Assistance Centers, sharply curtailed the scope of tax-law questions it would answer during the filing season on its telephone lines and in its TACs, and stopped answering any tax-law questions at all after April 15.

The TACs, which were previously known as "walk-in sites," moved to an "appointment-only" system this year. I previously recommended the IRS offer appointments by request as an option. However, the IRS's new policy against accepting walk-in taxpayers has led to considerable taxpayer frustration and a failure to meet taxpayer needs. Many – if not most – taxpayers have no way of knowing the IRS is no longer accepting walk-ins, so some taxpayers travel considerable distances only to be sent home. The IRS cites customer satisfaction surveys to suggest taxpayers are pleased with the appointment-only approach. But these surveys are misleading because they are only administered to taxpayers who have been served. They do not reflect the opinions of taxpayers who are turned away. The IRS has reduced the number of TACs from 401 to 376 since 2011.<sup>26</sup> In addition, 22 TACs have no staff, while 95 have only

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<sup>25</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015); U.S. Department of the Treasury, *Internal Revenue Service FY 2017 Budget-in-Brief 1*, <https://www.irs.gov/pub/newsroom/IRS%20FY%202017%20BIB.pdf> (showing that the Taxpayer Services appropriation (showing that only about \$630 million of the Taxpayer Services account is allocated to "Pre-filing Taxpayer Assistance and Education"). The IRS includes about \$173 million in Taxpayer Advocate Case Processing, which generally does not constitute pre-filing taxpayer assistance or education, in that \$630 million total. After backing out Taxpayer Advocate Case Processing, the Pre-filing Taxpayer Assistance and Education budget is about \$457 million out of total IRS appropriations of about \$11.235 billion, or four percent. Thirty-three percent of the IRS budget is allocated to the Operations Support account, which is used to support program activities, and three percent is allocated for Business Systems Modernization.

<sup>26</sup> In 2011, the IRS operated 401 TACs. IRS response to TAS information request (Dec. 23, 2014). As of December 31, 2016, the IRS operated 376 TACs, a reduction of six percent. IRS response to TAS fact check (Dec. 20, 2016).

one employee,<sup>27</sup> and the IRS is considering closing a significant number of additional TACs through FY 2018.

Twelve states have no Appeals Officers stationed within their boundaries,<sup>28</sup> and 14 states have no IRS liaisons to Small Business and Self-Employed taxpayers.<sup>29</sup> In fact, according to IRS data, the agency dedicates only 98 employees to conduct outreach and education to the roughly 62 million Small Business and Self-Employed taxpayers (*i.e.*, taxpayers who are self-employed or own small businesses), and only 376 employees to conduct outreach and education to the nearly 125 million Wage and Investment taxpayers (*i.e.*, taxpayers who are classified as “employees”). Meanwhile, the IRS has over 3,000 revenue officers (who conduct field collection activities) and over 8,800 revenue agents (who conduct field audit activities).<sup>30</sup>

Figure 1: Locations with Specified Employees in the Last Pay Period of the Fiscal Year

Number of Locations, Employees, or Visitors	2011	2012	2013	2014	2015	2016
IRS Offices (Cities)	541	523	510	499	479	470
Appeals Officers (AOs)	1,129	1,058	958	881	795	739
Revenue Officers (ROs)	4,402	4,035	3,703	3,441	3,191	3,072
Revenue Agents (RAs)	11,959	11,258	10,502	9,776	9,090	8,871
Stakeholder Liaison Outreach Employees	137	123	119	110	105	98
Stakeholder Partnerships, Education and Communication Outreach Employees	522	475	444	405	386	365
Taxpayer Assistance Centers (TACs)	401	401	398	382	378	376
TAC Service Reps	1,639	1,515	1,484	1,520	1,423	1,267

Despite this imbalance, the IRS budget request for FY 2017 sought an increase of 7.2 percent in enforcement funding, as compared with an increase of just 3.1 percent in taxpayer services funding.<sup>31</sup> This proposal to increase enforcement funding by more than twice the rate of taxpayer services funding was made against a backdrop in which

<sup>27</sup> IRS response to TAS fact check (Dec. 20, 2016).

<sup>28</sup> The 12 states that lack a permanent Appeals Officer are Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont, and Wyoming. There is also no Appeals Office in the territory of Puerto Rico. IRS Office of Appeals response to TAS information request (June 6, 2016).

<sup>29</sup> The 14 states are Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, Wisconsin, and Wyoming. There is also no liaison in the District of Columbia. IRS response to TAS fact check (Dec. 15, 2016); IRS Human Resources Reporting Center, *Report of Small Business/Self-Employed (SB/SE) Job Series 0526, Stakeholder Liaison Field Employees as of the week ending October 1, 2016* (Dec. 1, 2016).

<sup>30</sup> IRS response to TAS fact check (Dec. 16, 2016).

<sup>31</sup> IRS FY 2017 Budget-in-Brief, at 1, <https://www.irs.gov/pub/newsroom/IRS%20FY%202017%20BIB.pdf>.



the agency has been unable to meet basic taxpayer needs. Among calls routed to its telephone assistors, the IRS was able to answer only 38 percent in FY 2015 and 53 percent in FY 2016, and taxpayers who managed to get through to the IRS were kept on hold for an average of 30 minutes and 18 minutes, respectively, in those years.<sup>32</sup>

During the recently concluded 2017 filing season, although the IRS achieved a much higher level of service (LOS) on general assistor calls, it was only able to answer 40 percent of about 2.7 million calls received on its Installment Agreement/Balance Due line.<sup>33</sup> That is down 47 percent from the same period last year. The hold time for taxpayers who actually got through on the line was up even more significantly – from 11 minutes last year to 47 minutes this year.<sup>34</sup> *To be clear: The 2.7 million calls to this line during the filing season generally came from taxpayers who owe money to the IRS and are trying to make payment arrangements – precisely the sorts of calls most private businesses are eager to receive and pick up quickly. Yet the IRS did not answer 60 percent of these calls, and it made the other 40 percent of callers wait 47 minutes to get through.*

There is no doubt that funding constraints have contributed to reduced service levels, but the IRS in a variety of ways signals to its employees – and taxpayers – that it disproportionately values enforcement. For example, the IRS every year posts annual “Enforcement and Service Results” on its website.<sup>35</sup> This generally consists of about seven pages of enforcement data (including audit rates for individuals and business entities, enforcement dollars assessed, enforcement dollars collected, liens filed, levies issued, and criminal indictments and convictions), with a single page of taxpayer service data tacked on at the end. There is a lot of truth to the well-known adage, “you get what you measure.” The fact that the word “Enforcement” comes first and is much more heavily emphasized makes a statement to the public – and to the IRS’s own employees – about agency priorities.

Congress has previously expressed concern about the IRS’s focus on enforcement at the expense of service. In RRA 98, Congress directed the IRS to “restate its mission to place a greater emphasis on serving the public and meeting taxpayers’ needs.”<sup>36</sup> In response, the IRS adopted the following mission statement: “Provide America’s taxpayers top quality service by helping them understand and meet their tax

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<sup>32</sup> IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016) (showing both FY 2015 and FY 2016 toll-free telephone performance statistics).

<sup>33</sup> See IRS, Joint Operations Center, *Snapshot Reports: Product Line Detail: Installment Agreement/Balance Due* (week ending April 22, 2017).

<sup>34</sup> *Id.*

<sup>35</sup> IRS, *Fiscal Year 2016 Enforcement and Service Results*, [https://www.irs.gov/PUP/newsroom/fy\\_2016\\_enforcement\\_and\\_service\\_results.pdf](https://www.irs.gov/PUP/newsroom/fy_2016_enforcement_and_service_results.pdf).

<sup>36</sup> IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685, 690 (1998).

responsibilities and *by applying the tax law* with integrity and fairness to all.”<sup>37</sup> (Emphasis added.) In 2009 – with no public discussion or notice to Congress – the IRS quietly changed its mission statement to read: “Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and *enforce the tax law* with integrity and fairness to all.”<sup>38</sup> (Emphasis added.) This shift in tone and emphasis – from *applying* the law to *enforcing* the law – suggests the IRS leadership disagreed with the Congressional directive and decided to place greater emphasis on “enforcement” in its mission statement.<sup>39</sup>

As I stated above, it should be emphasized that service and enforcement should not be treated as an “either/or” proposition. The IRS, like any tax administrator, should have one overriding goal – to increase tax compliance, and particularly voluntary tax compliance. That means, for example, that part of every compliance touch should involve talking with the taxpayer and making sure the taxpayer understands what he or she did wrong so he or she is less likely to do it again. Indeed, if the IRS engages with taxpayers in this way, it might even learn where it is wrong itself. Regardless, there is substantial research and documentary evidence that show a service-oriented approach toward tax administration is effective and efficient, and maximizes *long-term* voluntary compliance. Moreover, the TBOR provides U.S. taxpayers with, among other things, the right to *challenge the IRS’s position and be heard*.<sup>40</sup> The last part of that right is critical. It is not enough simply for taxpayers to be able to object; the IRS must *listen*. This right is fundamental to procedural due process.

All this is not to say that IRS employees don’t care about taxpayer service, nor am I saying the IRS is “just” focused on enforcement. But I do believe that IRS employees and the taxpaying public often see things quite differently. Often, the IRS doesn’t clearly see how it is presenting itself to the public. For example, as part of the process of developing the IRS’s “Future State” vision, each of the four IRS Business Operating Divisions (or BODs) began by developing its own Concept of Operations (CONOPS)

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<sup>37</sup> IRM 1.1.1.1 (Mar. 1, 2006).

<sup>38</sup> IRM 1.1.1.2 (June 2, 2015).

<sup>39</sup> I have also recommended a second change to the IRS mission statement. The IRS as structured today is not just a revenue collection agency. It is also a benefits administrator. Congress has given the IRS responsibility for disbursing funds through refundable tax credits like the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit, through non-refundable benefits like the child tax credit and child and dependent care credit, through a host of other permanent provisions in the tax code, and through one-time or limited-time tax benefits like Economic Stimulus Payments and the First-Time Homebuyer Credit. Although many of these benefits are disbursed to different types of taxpayers (both individual and business), there is a lot of attention focused on those paid out to low income taxpayers. I discuss the issue of improper payments later in this statement, but I note here that for the IRS to fulfill its role of benefits administrator properly, it needs to recognize it is dealing with different taxpayer populations, and doing so requires different skill sets and different employee training. Because the mission statement drives strategic plans and organizational goals, I have recommended that the IRS mission statement be modified to recognize the IRS’s dual roles as revenue collector and benefits administrator.

<sup>40</sup> IRC § 7803(a)(3).

and an accompanying “taxpayer vignette” to illustrate how its vision of the “Future State” will work. Notably, each BOD’s vignette shows the IRS contacting a taxpayer to conduct an audit or otherwise challenge a taxpayer’s return, and in every case, the vignette shows the taxpayer ultimately conceding the IRS is correct and consenting to the IRS’s proposed adjustment. At best, these vignettes reveal a lack of sensitivity as to how external stakeholders (such as taxpayers) will perceive them. At worst, they suggest to the taxpaying public that the IRS believes it is always right and the taxpayer is always wrong.<sup>41</sup>

Accordingly, I recommend that the IRS:

- Revise its mission statement to re-emphasize a non-coercive approach to tax administration and explicitly affirm the role of the Taxpayer Bill of Rights as the guiding principle for tax administration.

#### **IV. The IRS Has Not Implemented, Has Narrowly Interpreted, or Has Not Effectively Implemented Many Taxpayer Protections Enacted by Congress.**

As noted above, Congress passed several laws between 1988 and 1998 establishing taxpayer protections. TAS has analyzed actions the IRS took in response to these directives, particularly those enacted as part of RRA 98.<sup>42</sup> TAS found that the IRS did not implement, narrowly interpreted, or did not effectively implement many of them, as summarized in the following list of select provisions.

In some cases, the IRS may have made a reasonable policy call in deciding not to implement a directive or to interpret it as it did. But particularly if Congress decides to implement far-reaching IRS reforms, it is important to understand how the IRS has implemented similar legislation in the past. Although there is significant overlap among the categories, the IRS’s progress can be categorized, as follows:

##### *Directives Not Implemented*

- *Provide taxpayers with reasonable advanced notice of contact with third parties and periodic reports.* RRA 98 § 3417 (codified at IRC § 7602(c)) generally requires the IRS to provide “reasonable notice in advance to the taxpayer” before contacting a third party with respect to the determination or collection of a tax

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<sup>41</sup> “I find it funny that in both scenarios, there’s more taxes. I think that reflects the idea that this model is about the IRS finding new ways to use technology for their benefit, and not for taxpayer purposes.” Statement of Audience Member, National Taxpayer Advocate Public Forum 39 (Aug. 18, 2016), [https://taxpayeradvocate.irs.gov/Media/Default/Documents/PublicForums/PortlandOR\\_Transcript\\_081816.pdf](https://taxpayeradvocate.irs.gov/Media/Default/Documents/PublicForums/PortlandOR_Transcript_081816.pdf). “I’m a CPA, and I’ve been practicing for 35 years... [T]he examples here – both end up resolving in more tax being owed – is like, ‘We were right, you were wrong, pay us the money.’” *Id.* at 55-56.

<sup>42</sup> RRA 98, Pub. L. No. 105-206, 112 Stat. 685 (1998). In this section, I also discuss one item from the Tax Reform Act of 1976, Pub. L. No. 94-455, § 1206(b), 90 Stat. 1520, 1703 (1976).

liability. It also requires the IRS to “periodically provide to a taxpayer a record of persons [third parties] contacted.” According to the preamble of a regulation promulgated under IRC § 7602(c), contrary to the statutory directive, the IRS will not “periodically” provide the taxpayer a list of its third party contacts.<sup>43</sup> In addition, the IRS believes it satisfies the reasonable notice requirement by including boilerplate language in a widely-distributed publication, Publication 1, *Your Rights as a Taxpayer*, which it uses as an all-purpose stuffer.<sup>44</sup> Publication 1 says, “we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information...”<sup>45</sup> The IRS does not use a tailored notice that is designed to be effective in obtaining information that would obviate the need to contact third parties. If the notice were designed to be effective, it would inform the taxpayer of the specific information the IRS would seek from third parties in his or her case if not provided by the taxpayer first.

- *Provide Congress with complexity reports.* RRA 98 § 4022(a) requires the IRS Commissioner to report to Congress each year on the sources of complexity in tax administration and on ways to reduce it. The IRS produced two complexity reports, which highlighted issues that Congress ultimately addressed.<sup>46</sup> However, the IRS has not issued a complexity report since 2002.<sup>47</sup>

#### *Directives Narrowly Interpreted*

- *Have employees obtain supervisory approval of penalties.* RRA 98 § 3306(a) (codified at IRC § 6751(b)) generally requires that no accuracy-related penalty can be assessed “unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor...” except for penalties “automatically calculated through electronic means.” The IRS believes the exception for “automatically calculated” penalties is so broad that it covers the negligence penalty when applied by a computer, even though a negligence determination requires more than a mere calculation.<sup>48</sup> In cases where

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<sup>43</sup> T.D. 9028, 67 Fed. Reg. 77,419, 77,420 (Dec. 18, 2002) (stating the Treasury Department has “determined that the issuance of periodic reports may result in harm to third parties and, accordingly, has determined that periodic reports should not be issued.”).

<sup>44</sup> See National Taxpayer Advocate 2015 Annual Report to Congress 123 (Most Serious Problem: *IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers’ Businesses and Reputations*).

<sup>45</sup> IRS Pub. 1, at 2 (Dec. 2014).

<sup>46</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 102 (Most Serious Problem: *The IRS Does Not Report on Tax Complexity as Required by Law*). For the two complexity reports, see IRS Pub. 4105, *Report from the Commissioner of the Internal Revenue Service on Tax Law Complexity* (June 5, 2000 and Sept. 20, 2002).

<sup>47</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 102.

<sup>48</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 275-286 (Most Serious Problem: *The Accuracy-Related Penalty in the Automated Underreporter Units*); National Taxpayer Advocate 2014

supervisory approval is required, the IRS has argued that the approval can be obtained long after an employee first proposes the assessment, potentially even after the taxpayer petitions the Tax Court to review the penalty.<sup>49</sup>

- *Have employees obtain supervisory approval of Notice of Federal Tax Lien (NFTL) filings.* RRA 98 § 3421 requires the IRS to adopt procedures requiring that an employee's determination to file an NFTL be approved by a supervisor "where appropriate," and under which appropriate disciplinary action would be taken when approval is not obtained. The IRS has rarely deemed it "appropriate" to require such approval because it has made virtually no adjustments to its procedures along these lines.<sup>50</sup> Instead, the IRS has required employees to obtain managerial approval if they determine *not* to file an NFTL (or defer filing it) in many circumstances.<sup>51</sup> Further, the IRS never established appropriate disciplinary actions for employees who fail to secure a supervisor's approval to file an NFTL when such approval is required (*i.e.*, Revenue Officers below the level of GS-9).<sup>52</sup>
- *Assign one IRS employee to handle a taxpayer's matter until it is closed.* RRA 98 § 3705(b) requires the IRS "to the extent practicable and if advantageous to the taxpayer" to assign one IRS employee to handle a taxpayer's matter until it is resolved. However, the Correspondence Examination program, through which about three-quarters of individual taxpayer audits are conducted,<sup>53</sup> has no way to determine when a taxpayer should have one employee assigned to

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Annual Report to Congress 404-10 (Legislative Recommendation: *Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy Related Penalty Attributable to Negligence under IRC § 6662(b)(1)*). See also Service Center Advice 200211040 (Jan. 30, 2002) (explaining how attorneys at the IRS Office of Chief Counsel reached this conclusion).

<sup>49</sup> See *Graev v. Comm'r*, 147 T.C. No. 16 (2016). The Second Circuit has recently rejected the IRS's narrow view. See *Chai v. Comm'r*, 851 F.3d 190 (2d Cir. 2017) (holding IRC § 6751(b)(1) requires written approval of an IRS employee's initial penalty determination before the IRS issues a notice of deficiency (or files an answer) asserting penalties). In light of the holding in *Chai*, the government filed a motion to vacate the decision in *Graev*, which the Tax Court granted.

<sup>50</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 225, 226 (Most Serious Problem: *The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*); National Taxpayer Advocate 2014 Annual Report to Congress 396, 400 (Legislative Recommendation: *Require Managerial Approval Prior to Filing a Notice of Federal Tax Lien in Certain Situations*).

<sup>51</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 396, 400.

<sup>52</sup> *Id.*

<sup>53</sup> In FY 2016, the IRS conducted 1,034,955 individual audits. Of that total, 791,233 were conducted by correspondence (76 percent) and 243,722 were field audits (24 percent). IRS, *Fiscal Year 2016 Enforcement and Service Results*,

[https://www.irs.gov/PUP/newsroom/fy\\_2016\\_enforcement\\_and\\_service\\_results.pdf](https://www.irs.gov/PUP/newsroom/fy_2016_enforcement_and_service_results.pdf).

handle the exam.<sup>54</sup> For example, it does not ask taxpayers if they would like one employee to handle their cases. Rather, IRS systems automatically route a taxpayer's call to the next available examiner — who may not be the one currently working on the case.<sup>55</sup> This approach is highly inefficient, resulting in multiple callbacks and downstream re-work, and it undermines employee accountability for IRS audits.

- *Allow taxpayers to speak to a live person who can help.* RRA 98 § 3705(d) requires the IRS to make a live person available on helplines in “appropriate circumstances,” and for that person to direct the taxpayer to an employee who can help.<sup>56</sup> The IRS has repeatedly declined to answer TAS’s inquiries about whether it considers the phone lines for local offices (*i.e.*, the lines required by RRA 98 § 3709 to be listed in the phone book)<sup>57</sup> to be “helplines” for the purpose of this requirement.<sup>58</sup> A live person does not answer these lines, and callers cannot leave a message.<sup>59</sup>

#### *Directives Not Effectively Implemented*

- *Explain the reasons for disallowing taxpayers’ refund claims.* RRA 98 § 3505(a) (currently codified at IRC § 6402(l)) requires the IRS to “provide taxpayers with an explanation” of the reason for disallowing their refund claims. TAS pulled a sample of 100 Letters 105C, *Statutory Notice of Claim Disallowance*, and determined that 92 of them did not provide an adequate explanation.<sup>60</sup>

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<sup>54</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 134, (Most Serious Problem: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*).

<sup>55</sup> Government Accountability Office (GAO), GAO-14-479, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 9 (June 2014), <http://www.gao.gov/assets/670/663840.pdf>.

<sup>56</sup> RRA 98 § 3705(d) requires the IRS to “provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours. The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer.” Pub. L. No. 105-206, § 3705(d), 112 Stat. 685, 777 (1998).

<sup>57</sup> RRA 98 § 3709 requires that the IRS “provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area.” Pub. L. No. 105-206, § 3709, 112 Stat. 685, 779 (1998).

<sup>58</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 123 (Most Serious Problem: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*). See also National Taxpayer Advocate 2008 Annual Report to Congress 114 (Most Serious Problem: *Navigating the IRS*).

<sup>59</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 123 (Most Serious Problem: *Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*).

<sup>60</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 172, 177 (Most Serious Problem: *Refund Disallowance Notices Do Not Provide Adequate Explanations*).

- *Explain alleged math errors on taxpayers' returns.* In 1976, when Congress enacted legislation granting the IRS's request to expand its authority to summarily assess not just math errors, but also clerical errors (e.g., inconsistent entries), it included a key taxpayer protection.<sup>61</sup> The legislation (currently codified at IRC § 6213(b)(1)) requires that each math error notice "set forth the error alleged and an explanation thereof." Legislative history provided examples of the type of explanations it expected the IRS to provide, such as: "You entered six dependents on line x but listed a total of seven dependents on line y. We are using six. If there is one more, please provide corrected information."<sup>62</sup>

Although four decades have passed since Congress required the IRS to provide an explanation, the IRS's math error notices are still not as clear as the examples Congress provided. A typical math error notice might say:

We refigured your tax on page 2 of your tax return using the tax table, tax rate schedules, or capital gains tax computations. Because of an error on another part of your tax return we were unable to compute your tax on Form 8615, *Tax for Certain Children Who Have Investment Income*.<sup>63</sup>

Without a clear explanation of the alleged error, it is difficult for taxpayers to determine what, specifically, the IRS is proposing to change on their returns and whether they should accept the adjustment or request a correction.

- *Include employee contact information on manually generated correspondence.* RRA 98 § 3705(a) requires the IRS to include an employee's name, telephone number, and unique employee identifying number in any "manually generated correspondence." However, employees frequently send letters that do not include their contact information, even when they have worked the case or customized the letter for the specific taxpayer.<sup>64</sup> When the correspondence does

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<sup>61</sup> Pub. L. No. 94-455, § 1206(b), 90 Stat. 1520, 1703 (1976).

<sup>62</sup> See H.R. Rep. No. 94-658, at 291 (1976). See also Joint Committee on Taxation, JCS-33-76, at 371-374, *Assessments in Case of Mathematical or Clerical Errors (sec. 1206 of the Act and sec. 6213 of the Code)* (Dec. 29, 1976).

<sup>63</sup> IRM Exhibit 3.12.3-2 (Jan. 1, 2017) (TPNC 220). See also National Taxpayer Advocate 2014 Annual Report to Congress 163, 167 (Most Serious Problem: *The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*). For additional concerns about the IRS's proposal to expand its math error authority, see National Taxpayer Advocate 2015 Annual Report to Congress 329 (Legislative Recommendation: *Authorize the IRS to Summarily Assess Math and "Correctable" Errors Only in Appropriate Circumstances*).

<sup>64</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 145 (Most Serious Problem: *The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*). See also National Taxpayer Advocate 2014 Annual Report to Congress (Legislative Recommendation: *Codify § 3705(a)(1) of RRA 98, Define "Manually Generated," and Require Contact Information on Certain Notices in All Cases*).

include a name, it is often so generic as to be meaningless (e.g., Tax Examiner), or is the name of the director of a unit who would not be knowledgeable about the specific case.<sup>65</sup> Similarly, the phone number often included on the correspondence is the IRS's main toll-free number, rather than the direct number of the employee working the case.<sup>66</sup> The failure to include the contact information of the person responsible for working the case undermines accountability and de-humanizes tax administration.

- *Include Local Taxpayer Advocate (LTA) contact information on statutory notices of deficiency.* RRA 98 § 1102(b) (codified at IRC § 6212(a)) requires that statutory notices of deficiency include notice of “the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of *the appropriate office.*” (Emphasis added.) The conference report to RRA 98 also contemplated the IRS would “publish the taxpayer’s right to contact the local Taxpayer Advocate on the statutory notice of deficiency.”<sup>67</sup> However, the IRS buries this information in a stuffer notice that lists contact information for all LTA offices, rather than just the appropriate one.<sup>68</sup> According to focus group participants, stuffers usually end up in the trash if they are even taken out of the envelope.<sup>69</sup> The IRS spends about \$47,000 to print these stuffers each year.<sup>70</sup> Thus, listing the “appropriate office” on the face of the letter would save printing costs and, more importantly, help taxpayers contact TAS for assistance in avoiding unnecessary litigation.
- *Use a balancing test in Collection Due Process (CDP) hearings to ensure collection is no more intrusive than necessary.* When a taxpayer appeals an IRS collection action by timely requesting a CDP hearing, RRA 98 § 3401 (codified in part at IRC § 6330(c)(3)) requires the IRS’s Appeals function to consider “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection

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<sup>65</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 145 (Most Serious Problem: *The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*).

<sup>66</sup> *Id.*

<sup>67</sup> H.R. Rep. No. 105-599, at 215 (1998) (Conf. Rep.).

<sup>68</sup> See IRS Notice 1214, *Helpful Contacts for Your “Notice of Deficiency”* (March 2017). See also National Taxpayer Advocate 2014 Annual Report to Congress 237 (Most Serious Problem: *Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice*); National Taxpayer Advocate 2014 Annual Report to Congress (Legislative Recommendation: *Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population*).

<sup>69</sup> TAS, 2011 IRS Nationwide Tax Forums TAS Focus Group Report: Publication 1 – Taxpayer Rights, 26-27 (2011).

<sup>70</sup> TAS estimate (Oct. 14, 2016) (based on 3.5 million copies at a cost of \$0.0134 each).



action be *no more intrusive than necessary*.”<sup>71</sup> If properly applied, this balancing test should give taxpayers confidence that the hearing is fair. A TAS review of applicable CDP procedures and case law revealed that the IRS Office of Appeals lacks detailed and specific procedures for how employees should balance these considerations, is not properly considering the legitimate concerns of taxpayers regarding the intrusiveness of the proposed collection action, and is often using *pro forma* statements (without elaboration or proper analysis) that the balancing test has been performed.<sup>72</sup> Thus, Appeals gives taxpayers the impression that it is simply “rubber stamping” prior determinations made by collection employees or automated systems.<sup>73</sup>

- *IRS front-line technical experts should advise Congress about the administrability of pending tax legislation.* RRA 98 § 4021 states the tax-writing committees in Congress should hear from “front-line technical experts” at the IRS with respect to the “administrability” of pending amendments to the tax code. When legislation is crafted with smooth tax administration in mind, and is informed by discussions with the front-line employees who may have to explain it to taxpayers, it is likely to be simpler, less burdensome, more taxpayer-focused, and easier to administer. When asked by TAS, however, the IRS could not identify any front-line technical expert(s) who had ever been consulted about the administrability of pending amendments.<sup>74</sup>
- *Reorganize the IRS so that units serve particular groups of taxpayers.* RRA 98 § 1001(a) directed the IRS to establish “organizational units serving particular groups of taxpayers with similar needs.” While the IRS’s units are named after groups of taxpayers (e.g., the Small Business/Self-Employed Division), the IRS is largely organized around IRS-centric processes and functions.<sup>75</sup> As a result, no unit at the IRS can be held accountable for a particular taxpayer segment’s overall satisfaction with the IRS or voluntary tax compliance.

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<sup>71</sup> See also H.R. Rep. No. 105-599, at 263 (1998) (Conf. Rep.); S. Rep. No. 105-174, at 68 (1998) (stating that “a proposed collection action should not be approved solely because the IRS shows that it has followed appropriate procedures.”).

<sup>72</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 185, 188 (Most Serious Problem: *The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*).

<sup>73</sup> See, e.g., *Budish v. Comm’r*, T.C. Memo. 2014-239; *Eichler v. Comm’r*, 143 T.C. 30 (2014); *Isley v. Comm’r*, 141 T.C. 349 (2013); *Crosswhite v. Comm’r*, T.C. Memo. 2014-179; *Lofgren Trucking Service, Inc. v. United States*, 508 F. Supp. 2d 734 (D. Minn. 2007).

<sup>74</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 108 (Most Serious Problem: *The IRS Has No Process to Ensure Front-Line Technical Experts Discuss Legislation with the Tax Writing Committees, as Requested by Congress*).

<sup>75</sup> See, e.g., National Taxpayer Advocate 2016 Annual Report to Congress (Most Serious Problem: *The IRS’s Functional Structure Is Better at Implementing Procedures than Understanding and Serving Specific Customer Segments, as Contemplated by RRA 98*); National Taxpayer Advocate 2014 Annual Report to Congress 31 (Most Serious Problem: *The Lack of a Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*).

- *Restate the IRS mission to emphasize service.* RRA 98 § 1002 directed the IRS to “restate its mission to place a greater emphasis on serving the public and meeting taxpayers’ needs.” In 2009, as pointed out above, the IRS added the word “enforce” to its mission, even though enforcement had not even been part of its mission statement before RRA 98.<sup>76</sup>
- *Make appeals officers regularly available in each state.* RRA 98 § 3465(b) requires the IRS Commissioner to “ensure that an appeals officer is regularly available within each State.” However, appeals officers are not regularly available in at least 12 states, and the IRS has been making it more difficult for taxpayers to obtain face-to-face conferences with them.<sup>77</sup>

**V. RRA 98-Style “Joint Oversight Hearings” Would Give Congress Better Insight into the IRS’s Strategic and Operational Plans, Promote Dialogue Among Congress, the IRS and Interested Stakeholders, and Help Ensure the Tax-Writing and Appropriations Committees Coordinate Their Expectations and Approaches Toward IRS Operations.**

Congress has a significant role to play in ensuring that the IRS has adequate resources to do its job and that it allocates those resources wisely. Appropriate oversight and greater transparency increase taxpayer trust in the tax agency and the tax system. As part of the reorganization mandated by Congress in RRA 98, Congress held joint annual hearings, over five years, to review the IRS strategic plan.<sup>78</sup> The hearing participants included three members (two from the majority and one from the minority) from each of the congressional committees with jurisdiction over the IRS – Senate Finance, Appropriations, and Governmental Affairs, and House Ways and Means, Appropriations, and Governmental Reform and Oversight. The hearings were to cover the following topics:

1. IRS progress in meeting its objectives under its strategic and business plans;
2. IRS progress in improving taxpayer service and compliance;

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<sup>76</sup> See National Taxpayer Advocate 2016 Annual Report to Congress 15 (Special Focus: *IRS Mission*).

<sup>77</sup> See National Taxpayer Advocate 2014 Annual Report to Congress 46 (Most Serious Problem: *The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*); National Taxpayer Advocate 2014 Annual Report to Congress 311 (Legislative Recommendation: *Require that Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico*). See also IRM 8.6.1 (Oct. 1, 2016) (noting that a material change adopted with this IRM revision is “to reflect that most conferences in Appeals are conducted by telephone and to make that the default method.”).

<sup>78</sup> Pub. L. No. 105-206, § 4001 (enacting IRC § 8021(f)) and § 4002 (amending IRC § 8022), 112 Stat. 685, 783-784 (1998).

3. IRS progress on technology modernization; and
4. The annual filing season.<sup>79</sup>

I recommend that Congress reinstitute these joint oversight hearings on a permanent basis. By doing so, Congress would provide the IRS with the opportunity to articulate, with specificity, its need for additional resources and its plans for applying them. By hearing from both the IRS and outside experts – including tax professional organizations, business representatives, Low Income Taxpayer Clinics, and behavioral scientists – Congress will better understand the challenges that both the IRS and taxpayers face. It can then make informed decisions about the level and general application of resources necessary for the IRS to provide U.S. taxpayers with a 21<sup>st</sup> century tax administration that they can trust and admire.

In addition, joint oversight hearings require the staffs of the oversight committees to work together in planning the hearings and engaging in necessary follow-up actions. That was valuable during the five years after the passage of RRA 98, and it would be extremely helpful again now. I believe it is particularly important for the tax-writing and appropriations committees to work together to establish IRS priorities and ensure the agency is funded consistent with those priorities. For example, taxpayers would not be well served – and the IRS would be placed in an impossible position – if the tax-writing committees mark up legislation to require the IRS to place more emphasis on taxpayer service while the appropriations committees provide disproportionate funding for IRS enforcement activities. Deciding on agency priorities and funding them appropriately would better enable the IRS to comply with Congress's directives.

Accordingly, I recommend that Congress:

- Reinststate the joint review of the IRS strategic plans and budget provided for under IRC §§ 8021(f) and 8022.
- Require the IRS to submit a comprehensive “Future State” plan that describes in detail its vision for a 21<sup>st</sup> century IRS, including an explanation of how this vision meets the needs and preferences of different U.S. taxpayer segments as well as a description of the challenges and obstacles the IRS faces in achieving this “Future State,” including funding needs.

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<sup>79</sup> H.R. Rep. No. 105-364, at 84-85 (1997). The IRS Restructuring Commission earlier recommended that Congress create a joint committee on IRS administration, which would conduct joint hearings on similar topics. Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 11 (June 25, 1997).

## VI. General Observations Regarding House Republicans' Blueprint Proposal

The tax reform blueprint released in June 2016, *A Better Way*, includes proposals to reform the IRS in a manner that focuses first and foremost on improved customer service.<sup>80</sup>

The Blueprint identifies four categories of problems at the IRS: (1) poor customer service levels; (2) civil asset forfeiture policies that unnecessarily harm law-abiding citizens; (3) excessive improper payments in certain benefits programs, particularly the Earned Income Tax Credit (EITC); and (4) outdated IT systems. I offer some general observations about each:

- **Customer Service** – In thinking about ways to improve customer service, I encourage the subcommittee to focus not merely on improving the percentage of calls the IRS answers, but also to think about the range of services we want the tax administrator to provide. In my view, the IRS should offer both competent personal service options and a robust and secure online account system. To cite one example, I believe it is a central function of a tax administration agency to help taxpayers understand what the law requires of them. Yet the IRS today answers only “basic” tax-law questions during the filing season, and it does not answer any tax-law questions at all during the other 8½ months of the year.

To me, this is a “poster child” example of where taxpayer service is falling short. Both to reduce taxpayer burden and improve compliance, the IRS should answer most tax-law questions through all of its service-delivery channels – in its Taxpayer Assistance Centers, on its toll-free lines, and by email. It is true, as some have noted, that the IRS should not get to the point of offering “tax planning advice.” But it has a long, long way to go before it gets close to that line. Moreover, instead of centralizing its operations in a small number of campuses and closing TACs, the IRS should maintain a more robust presence in local communities. In these and other ways, the quality of customer service can be dramatically improved.

- **Civil Asset Forfeiture Policies** – I share the concern of many Members that the IRS Criminal Investigation function (CI) should generally pursue only illegal-source structuring violations and should not threaten taxpayers with the possibility of criminal prosecution as a way to get them to agree to accept excessive civil penalties. I am glad the IRS has decided it generally will no longer pursue legal-source structuring cases. However, the practice of holding out the possibility of criminal prosecution to maximize leverage in the civil context

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<sup>80</sup> House Republicans' Tax Reform Task Force, *A Better Way: Our Vision for a Confident America* (June 2016), <http://abetterway.speaker.gov>.

is not limited to structuring cases. In a wide range of Offshore Voluntary Disclosure Program cases, taxpayers felt the penalties were excessive and considered “opting out,” but were too frightened to do so because there was a risk the government could pursue criminal charges. Except in egregious cases, no taxpayer should be placed in a situation where he or she has to make decisions about how to handle an IRS audit under the threat of incarceration.

An additional concern I expressed relates to the application of the Taxpayer Bill of Rights to IRS employees working in CI. CI has taken the position that the TBOR only applies to cases it investigates under the tax code (Title 26 of the U.S. Code) and not to cases it pursues under other titles of the U.S. Code. I disagree. As discussed above, the law requires the Commissioner to “ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights.” CI employees are “IRS employees,” and there is no carve-out in the law either for CI employees or for IRS employees pursuing cases under titles of the U.S. Code other than Title 26. Moreover, it is often impossible at the beginning of a structuring or similar investigation to know whether investigators ultimately will bring charges of unreported income under Title 26. Therefore, I encourage Congress to clarify that all IRS employees must act in accord with taxpayer rights in all facets of their work, except in explicitly-stated extraordinary circumstances.

- **Improper Payments** – The EITC is a program that historically has enjoyed broad bipartisan support, yet the relatively high improper payments rate raises concerns. I offer two observations here. First, for context, my office has computed the total costs of running each of the federal government’s major social benefits programs.<sup>81</sup> For most social benefits programs, the government incurs significant up-front costs to make eligibility determinations before making payments, but having done that, the improper payments rate is low. The EITC is exactly the reverse. Because the government does not require pre-payment eligibility verification for the EITC, up-front costs are not incurred, yet for that reason, the improper payments rate is relatively high. When you look at the combination of up-front administrative costs and improper payments, it turns out the overall costs of the EITC program are in the middle of the pack of social benefits programs.

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<sup>81</sup> National Taxpayer Advocate 2016 Annual Report to Congress 325, 354-357 (Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*).

Second, there are important steps Congress can take to lower the improper payments rate. In my 2016 Annual Report to Congress, I presented a detailed proposal to reform the so-called “family status” provisions in the tax code.<sup>82</sup> I am submitting this proposal as Exhibit B to this statement. Part of my proposal is designed to reduce the EITC improper payments rate. As structured today, a certain amount of EITC is paid solely based on a worker’s wages, and the amount is then increased based on family size. In part, I recommend breaking the EITC into two separate components – a Worker Credit and a Family Credit. For reasons I detail in my report, I believe that approach would both simplify compliance burdens for taxpayers and substantially reduce the improper payments rate. I would be happy to discuss this issue in more detail today or at a future hearing focused specifically on reducing EITC improper payments.

- **Outdated Information Technology (IT) Systems** – There is no doubt that outdated technology systems substantially limit the IRS’s efficiency and make it more difficult for the agency to meet taxpayers’ needs. An adequately funded, staffed, and skilled IT function underpins all core tax administration activities, including taxpayer service, prompt refund issuance, selection and assignment of compliance work, and protection of taxpayers and the public from refund fraud and identity theft. Of particular note, the IRS currently possesses the two oldest information system databases, each nearly six decades old, in the entire federal government.<sup>83</sup>

The IRS has identified 63 separate case management systems to include in an “enterprise case management” (ECM) project. The age, number, and lack of integration across these systems cause waste and delay, and make it difficult for IRS employees, including TAS employees, to perform their jobs efficiently and provide quality service to taxpayers. This causes frustration for taxpayers and IRS employees alike.

The IRS’s current case management system structure requires employees to retrieve data from many systems manually, which requires maintaining both paper and electronic records. Employees transcribe or otherwise import information from paper and other systems into their own case management systems, and ship, mail, or fax an estimated hundreds of thousands, if not millions, of case management files and supporting documents annually within or between business functions for activities such as case work, quality review, and

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<sup>82</sup> National Taxpayer Advocate 2016 Annual Report to Congress 325-357 (Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*), [https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16\\_Volume1\\_LR\\_02\\_TaxReform.pdf](https://taxpayeradvocate.irs.gov/Media/Default/Documents/2016-ARC/ARC16_Volume1_LR_02_TaxReform.pdf).

<sup>83</sup> See GAO, GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS’s Individual Master File (IMF) and Business Master File (BMF) as the two oldest investments or systems at 56 years old each).

responses to the Office of Appeals and the Office of Chief Counsel.

To ameliorate these problems, ECM requires a significant investment of both time and money to promote productivity and efficiency gains, and to improve taxpayer service. Indeed, success of the ECM project is critical to establishing online accounts that effectively serve taxpayers and their representatives. I am encouraged by the IRS's most recent approach to ECM, including the addition of new leadership and the search for the appropriate ECM platform. However, I am frustrated that the process has been so drawn out. To improve IRS operations, IT systems are a top priority and will continue to be so for the foreseeable future.

After identifying the above-mentioned problems, the Blueprint proposes to rebuild the IRS by creating three major units focused on the following: (1) families and individuals; (2) businesses; and (3) dispute resolution through an independent "small claims court" that "will allow routine disputes to be resolved more quickly, so that small businesses no longer spend more in legal fees to resolve a dispute with the IRS than the amount of tax that was at stake."<sup>84</sup>

An independent dispute resolution mechanism is central to effective tax administration.<sup>85</sup> However, I encourage you to proceed with care. In my view, the IRS Office of Appeals was intended to provide exactly that mechanism. Unfortunately, it is falling short. There is a widespread perception that the Office of Appeals is not truly independent. Contributing to that perception, the IRS sometimes includes Appeals' leadership in policy discussions regarding enforcement policies. Moreover, when the IRS publishes its annual Enforcement and Service Results, it breaks down "Enforcement Revenue Collected" into four categories: Collection, Examination, Appeals, and Document Matching. When the IRS itself classifies revenue raised through decisions made by supposedly independent Appeals Officers as "enforcement revenue," it sends an ominous message to taxpayers about independence. For context, the IRS does not classify revenue collected through decisions of the U.S. Tax Court as "enforcement revenue."

For a dispute resolution function to work for taxpayers, it is also important that the procedures be sufficiently flexible so that unsophisticated taxpayers can use them without having to hire representatives. It is also important that taxpayers have the ability to meet with the decision-maker face-to-face. The Office of Appeals' procedures are not perceived as sufficiently user-friendly, and Appeals has been making it

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<sup>84</sup> House Republicans' Tax Reform Task Force, *A Better Way: Our Vision for a Confident America* (June 2016), <http://abetterway.speaker.gov>.

<sup>85</sup> The U.S. Tax Court does an admirable job of providing a dispute resolution forum for taxpayers – both individuals and small businesses. Moreover, the Tax Court holds its trial sessions at dozens of locations around the country. Thus, unlike when dealing with the Office of Appeals, every taxpayer receives the opportunity for a face-to-face trial in a nearby city. However, there is considerable time and expense involved when litigating cases in court, and it is critical that there be an effective administrative dispute resolution process to minimize the cases that require judicial involvement.

increasingly difficult for taxpayers to obtain face-to-face hearings – in part, as noted above, because the Office of Appeals no longer has any Appeals Officers in 12 states.

The Blueprint suggests it is important for small businesses to have access to an independent dispute resolution function. I agree entirely but also note it is important for individual taxpayers to have similar access. There is much that can be done to make this vision a reality, but I would suggest it may not be necessary to create a new function. By whatever name it is called, the independent dispute resolution function will be fulfilling the role that the Office of Appeals is designed to fulfill today. I see little benefit in creating a second dispute resolution function. In my view, it would be simplest to assess the strengths and weaknesses of the Office of Appeals and make whatever changes are deemed appropriate to strengthen its independence and improve its accessibility.

Lastly, and in general terms, I want to emphasize that I strongly support a “Service First” approach to tax administration. For the reasons I have described, I believe that approach is not only the right approach to take for taxpayers, but it is the best approach for maximizing revenue collection as well.

## **VII. Conclusion**

It has been nearly two decades since Congress last reviewed and updated the laws governing IRS operations. Much has changed during that time, and tax administration would benefit from a fresh review of those laws.

In my view, respect for taxpayer rights should serve as the foundation for effective tax administration. One important taxpayer right is “The Right to Quality Service.” That right requires meeting the needs and preferences of U.S. taxpayers in their attempts to comply with the tax laws. While the use of slogans sometimes oversimplifies complex issues, I generally share the view that the IRS should emphasize “Service First.”

At present, service levels stand at unacceptably low levels. Part of the explanation is lack of adequate funding, but there are many ways in which service levels had been declining before the agency’s funding levels were reduced. To a large degree, this has been and remains a question of agency priorities.

The “Special Focus” section in my 2016 Annual Report to Congress presents my perspective on the steps the IRS should take to become a taxpayer-centric 21<sup>st</sup> century tax administration. I have tried to summarize some of my concerns and recommendations in this statement.

I would be happy to try to answer any questions you have today, and I would be happy to work with you in the coming months as you develop a more detailed plan to improve the responsiveness of the IRS to address the needs and preferences of U.S. taxpayers.



## SPECIAL FOCUS

# IRS FUTURE STATE: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration

### INTRODUCTION

In the 2015 Annual Report to Congress (ARC), the National Taxpayer Advocate identified the IRS's plans for its "Future State" as the number one most serious problem facing taxpayers.<sup>1</sup> Among other things, she cited concerns about the IRS's lack of transparency with taxpayers and Congress about the plans; the move away from person-to-person assistance and compliance contacts in favor of impersonal electronic "self-service;" and the reliance on private third parties to provide for-fee assistance for core tax administration services previously provided by the IRS for free, thereby increasing taxpayer costs for the "privilege" of paying their taxes.

The IRS has partially addressed the National Taxpayer Advocate's concerns. For example, almost immediately after the issuance of the Annual Report to Congress, the IRS created a webpage on [irs.gov](http://irs.gov) dedicated to the "Future State" and uploaded numerous documents.<sup>2</sup> The IRS Commissioner also made clear in congressional testimony and elsewhere that the IRS did not intend to eliminate phone or in-person assistance.<sup>3</sup> Moreover, during the Nationwide Tax Forums this summer, the IRS held a presentation on the "Future State," attended by over 2,200 practitioners and preparers, and also sponsored a suggestion booth.<sup>4</sup>

These steps, however commendable, have not fully addressed the core of the National Taxpayer Advocate's concerns, namely, that the IRS has failed to adequately study and incorporate into its "Future State" plans the needs and preferences of United States taxpayers — an incredibly diverse and complex population. In a budget environment in which the IRS has seen its annual appropriation decreased by about 19 percent on an inflation-adjusted basis, it is tempting and even understandable for the IRS to try to move taxpayers

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- 1 National Taxpayer Advocate 2015 Annual Report to Congress 3-13 (Most Serious Problem: *Taxpayer Service: The IRS Has Developed a Comprehensive "Future State" Plan That Aims to Transform the Way It Interacts With Taxpayers, But Its Plan May Leave Critical Taxpayer Needs and Preferences Unmet*).
  - 2 IRS, <https://www.irs.gov/uac/newsroom/irs-future-state> (last visited Dec. 20, 2016).
  - 3 "As we improve the online experience, we understand the responsibility we have to serve the needs of all taxpayers, whatever their age, income, or location. We recognize there will always be taxpayers who do not have access to the internet, or who simply prefer not to conduct their transactions with the IRS online. The IRS remains committed to providing the services these taxpayers need. We do not intend to curtail the ability of taxpayers to deal with us by phone or in person." *Tax Return Filing Season: Hearing Before the H. Subcomm. on Oversight, Comm. on Ways and Means, 114th Cong.* (Apr. 19, 2016) (written statement of John Koskinen, Commissioner, Internal Revenue Service). See also *Can the IRS Protect Taxpayers' Personal Information? Hearing Before the H. Subcomm. on Research and Technology, Comm. on Science, Space and Technology, 114th Cong.* (Apr. 14, 2016) (statement of John Koskinen, Commissioner, Internal Revenue Service), <https://www.irs.gov/uac/written-testimony-of-commissioner-koskinen-before-the-house-science-space-and-technology-committee-on-cybersecurity-and-protecting-taxpayer-information>, and John A. Koskinen, Commissioner of Internal Revenue, Address Before the National Press Club (Mar. 24, 2016), <https://www.irs.gov/uac/March-24-2016-Commissioner-Koskinen-Speech-to-National-Press-Club>.
  - 4 10,723 practitioners and preparers attended the IRS Nationwide Tax Forums. Of those, 2,263 attended the presentation "IRS Future State Initiative" at five Tax Forums in 2016. Email from IRS Office of Online Services to TAS (Dec. 13, 2016).

to less costly methods of communication, or channels, including digital self-service options.<sup>5</sup> But as tax administrators throughout the world have learned, and as the National Taxpayer Advocate discusses in this annual report, many of these shifts are only superficially less costly.<sup>6</sup> This is so because even the best-designed digital environment cannot accommodate the sheer complexity of the tax code and the limitless variety of taxpayers' lives and circumstances. This constrained communication, coupled with automated impersonal and often harmful IRS actions, can alienate the taxpayer population and over time may undermine compliance. Even if there is no negative compliance impact (which the National Taxpayer Advocate does not believe), it is not a recipe for good government if a large portion of U.S. taxpayers are alienated from and distrustful of the one government agency they interact with at least annually throughout their adult lives.

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For these reasons, and given her statutory role as “an independent voice for the taxpayer within the IRS,”<sup>7</sup> in this Special Focus, the National Taxpayer Advocate has attempted to identify and make recommendations to address the challenges the IRS faces to become a 21st century, taxpayer-centric tax administrator. The first and most obvious is the compelling need for tax reform. In our first legislative recommendation, *Simplify the Internal Revenue Code Now*, we describe in detail the burdens the current, hideously complex Code imposes on taxpayers and the IRS alike. But suffice it to say here that a Code consisting of four million words<sup>8</sup> and requiring six billion hours of taxpayer time when meeting their filing requirements<sup>9</sup> is simply too complex to administer well. Add to that the fact that the federal government “spends” more money through the tax code each year than it spends to fund the entire federal

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- 5 In FY 2010, the agency's appropriated budget stood at \$12.1 billion. For FY 2016, its budget was \$11.2 billion, a reduction of nearly eight percent over the six-year period. Inflation over the same period is estimated at nearly 11 percent. See Office of Management and Budget, *Fiscal Year 2016 Budget of the U.S. Government, Historical Tables* (230-31), Table 10.1, <https://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/hist.pdf> (showing Gross Domestic Product (GDP) and year-to-year increases in the GDP). In addition, the IRS has had to implement the statutory requirements of the Patient Protection and Affordable Care Act and the Foreign Account Tax Compliance Act during this time, causing a further drain on its resources.
  - 6 See Most Serious Problem: *Worldwide Taxpayer Service: The IRS Has Not Adopted “Best-in-Class” Taxpayer Service Despite Facing Many of the Same Challenges as Other Tax Administrations and Literature Review: Taxpayer Service in Other Countries*, vol. 3, *infra*.
  - 7 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 48 (June 25, 1997).
  - 8 To determine the number of words in the Internal Revenue Code (IRC), TAS downloaded Title 26 of the U.S. Code (*i.e.*, the IRC) from the website of the U.S. House of Representatives, <http://uscode.house.gov>. We copied the file into Microsoft Word, and used the “word count” feature to compute the number of words. The online version of Title 26 we used was current through December 12, 2016. In Word, the document ran 10,928 single-spaced pages. The printed code contains certain information that does not have the effect of law, such as a description of amendments that have been adopted, effective dates, cross references, and captions. The word count feature also counts page numbers, the table of contents, and the like. Therefore, our count somewhat overstates the number of words that are officially considered a part of the tax code, although as a practical matter, a person seeking to determine the law will likely have to read and consider many of these additional words, including effective dates, cross references, and captions. Other attempts to determine the length of the Code may have excluded some or all of these components, but there is no clearly correct methodology to use, and we found no easy way to selectively delete information from a document of this length.
  - 9 The TAS Research function arrived at this estimate by multiplying the number of copies of each form filed for calendar year 2015 by the average amount of time the IRS estimated it took to complete the form. While the IRS's estimates are the most authoritative available, the amount of time the average taxpayer spends completing a form is difficult to measure with precision. This TAS estimate may be low because it does not take into account all forms and, as noted in the text, it does not include the amount of time taxpayers spend responding to post-filing notices, examinations, or collection actions. Conversely, the TAS estimate may be high because IRS time estimates have not necessarily kept pace fully with technology improvements that allow a wider range of processing activities to be completed via automation.

government through the appropriations process.<sup>10</sup> Clearly, the Internal Revenue Code (IRC) is due for an overhaul.

In Public Forums, Tax Forum Focus Groups, and TAS Workgroups, two other broad themes emerged. First, ours is a voluntary compliance system that rests on the cooperation of taxpayers, large and small. It requires engagement with taxpayers. For taxpayers to be engaged, the IRS needs to *talk to the taxpayer!* Here is how one TAS employee stated it: “Sometimes nothing can replace the sound and the tone of a human voice, especially in a crisis situation. IRS must present a human side to the agency to foster and keep voluntary compliance.”<sup>11</sup>

The last broad theme is the need for establishing minimum standards of and testing for competency of federal tax return preparers. The National Taxpayer Advocate has long recommended a pragmatic oversight regime designed to protect U.S. taxpayers from unscrupulous and incompetent return preparers.<sup>12</sup> She reiterates that recommendation here, and notes that without such standards and oversight, the entire tax system is at risk.

In addition to these three foundational themes, there are several other areas of tax administration requiring attention before the IRS can become a world-class 21st century tax administration. These challenges include:

- **IRS Budget and Oversight:** To fairly, effectively, and efficiently administer the tax system, the IRS must receive increased funding, but such funding should be tied to additional congressional oversight of IRS strategic and operational plans;

<sup>10</sup> In FY 2016, the Treasury Department estimated “tax expenditures” amounted to more than \$1.4 trillion. At the same time, discretionary appropriations amounted to less than \$1.2 trillion. The federal budget consists of discretionary spending for government operations that Congress sets through annual appropriations acts and mandatory spending that is established through eligibility and benefit formulas, such as Social Security and Medicare benefits, as well as interest on the federal debt. For FY 2016, appropriated funds totaled about \$1.17 trillion. See Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2016 to 2026*, Table 1-3 (Aug. 2016), <https://www.cbo.gov/sites/default/files/51118-2016-08-BudgetProjections.xlsx>. For a list and description of tax expenditures, see Office of Tax Analysis, U.S. Department of the Treasury, *Tax Expenditures* (Sept. 2016), <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2018.pdf>. The Joint Committee on Taxation also publishes estimates of tax expenditures. There are some differences in methodology between the Treasury Department’s methodology and the Joint Committee’s methodology, and the Joint Committee’s most recent estimate of tax expenditures for FY 2016 was more than \$1.3 trillion — also greater than federal appropriations but somewhat less than the Treasury Department’s estimate. See J. COMM. ON TAX’N, JCX-141R-15, *Estimates of Federal Tax Expenditures for Fiscal Years 2015-2019* (Dec. 2015), <https://www.jct.gov/publications.html?func=startdown&id=4857>.

<sup>11</sup> TAS, *Executive Briefing, Future State Discussion Analysis* 41 (Sept. 2016). Here is more wisdom from TAS employees: The Future State completely changes the expectations that the taxpaying public can have of the IRS. These taxpayers have always known they could come to an IRS walk-in office or call the IRS toll-free line in order to have their questions answered. However, this is a change in the basic “contract” between the IRS and the taxpaying public. This means that some taxpayers will be comfortable and confident in their ability to understand the tax law and meet their obligations, while other taxpayers will likely feel “left behind” in the Future State. *Id.* at 18.

And:

You can’t replace verbal communication and excel in voluntary compliance, nor customer service. *Id.* at 23.

<sup>12</sup> National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78; National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remains Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

- **IRS Culture:** To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented;
- **IRS Mission Statement:** To ensure the IRS recruits, hires, and trains employees with the appropriate skill sets, the IRS must revise its mission statement to explicitly acknowledge the IRS's dual mission of collecting revenue and disbursing benefits, as well as the foundational role of the Taxpayer Bill of Rights;
- **Understanding Taxpayer Needs and Preferences:** To ensure that the IRS designs its Current and Future State initiatives based on actual taxpayer needs and preferences, the IRS must actively and directly engage with the taxpayer populations it serves as well as undertake a robust research agenda that furthers an understanding of taxpayer compliance behavior;
- **Taxpayer Rights and the Future State:** To ensure that taxpayer rights, and the Taxpayer Bill of Rights specifically, are the foundation for tax administration the IRS should undertake a comprehensive review of key taxpayer rights provisions in the IRC and issue proposed guidance for public comment, updating these provisions to protect taxpayer rights in the digital environment envisioned by the IRS Future State;
- **Grossly Outdated Technology and Infrastructure:** To enable the IRS to meet the major technology improvements required for a 21st century tax administration, even as it fulfills current operational technology demands, the IRS must articulate a clear strategy that will reassure Congress and taxpayers the funding will be well-spent; and
- **Office of the Taxpayer Advocate:** To protect taxpayer rights and ensure a fair and just tax system, Congress should take steps to strengthen the Taxpayer Advocate Service.

The National Taxpayer Advocate has listed the need for additional IRS funding and oversight first because without adequate funding, taxpayers are being and will be harmed by the “efficiencies” the IRS imposes to deal with budget reductions. However, she links the IRS need for more funding with the need for more congressional oversight of the agency’s priorities. Congressional oversight is necessary to ensure that the IRS appropriately allocates and applies that funding, and that taxpayer needs — not just the agency’s internal needs — are met.

To achieve the appropriate level and allocation of IRS funding, in the sections that follow, the National Taxpayer Advocate identifies and discusses key elements that must be addressed, including a change in IRS culture from enforcement-focused to service first. We must embed taxpayer rights into every aspect of the agency's mission. We must understand how to improve taxpayer morale, including what factors influence taxpayer compliance behavior and what taxpayers need and prefer in order to meet their tax obligations. Similarly with tax reform — we must understand compliance behavior even as we legislate tax policy. Otherwise, we will pass laws with which taxpayers cannot comply.

In writing this Special Focus, the National Taxpayer Advocate has relied heavily on the wealth of information obtained throughout 2016 from her 12 Public Forums on Taxpayer Needs and Preferences; focus groups with practitioners and preparers about the “Future State” held at five Nationwide Tax Forums; and discussion meetings held with all employees in each office of the Taxpayer Advocate Service (TAS). All of these materials, including full transcripts of the Public Forums, are available to the public at <https://taxpayeradvocate.irs.gov/public-forums>. In addition, we include in Volume 2 of this report the interim findings of a nationwide taxpayer survey about their needs and preferences.<sup>13</sup> Thus, to an unusual extent for government, the analysis and recommendations presented here reflect the perspectives of taxpayers and their representatives, as well as the combined experience of the National Taxpayer Advocate and her employees, whose job it is to advocate for taxpayers.

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13 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

**IRS BUDGET AND OVERSIGHT: To fairly, effectively, and efficiently administer the tax system, the IRS must receive increased funding, but such funding should be tied to additional congressional oversight of IRS strategic and operational plans.**

Simply put, the IRS cannot function well in the 21st century with the budget it has today. More funding is paramount — for taxpayer service, for compliance functions, for the agency’s enforcement function (Criminal Investigation), for technology, and for its “support” operations like security and real estate.

The National Taxpayer Advocate has served in her position for over 15 years, and she has witnessed firsthand how IRS officers and employees struggle to meet the often competing demands placed on them by new legislation, congressional priorities, natural and other emergencies, the identity theft epidemic, and taxpayer needs and preferences. Each year the IRS must deliver a filing season in which it processes some 150 million individual tax returns and issues over 115 million refunds totaling over \$345 billion,<sup>14</sup> while guarding against between \$22 and \$24 billion in identity theft and refund fraud.<sup>15</sup> At the same time, it must incorporate new legislative changes — almost 5,900 since 2001, an average of more than one a day<sup>16</sup> — and major new programs like the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA). Thus, the IRS spreads thin the resources it has, and every decision to apply resources in one place means that another area goes begging. Understandably, it focuses on what it considers its major obligations — the filing season, new legislation, and the area of information technology and cybersecurity. The consequences of this “big item” focus are that smaller, important, taxpayer-facing service is reduced or eliminated, including the community presence of education and outreach, Taxpayer Assistance Centers (TACs), compliance personnel, and Appeals officers. For example:

- Despite the IRS’s increased ability to handle taxpayer calls using automation, the percentage of calls the IRS answered from taxpayers seeking to speak with a telephone assistor dropped from 87 percent to 53 percent between fiscal year (FY) 2004 and FY 2016.<sup>17</sup> Among the callers who got through, the average time spent waiting on hold increased from just over 2.5 minutes in FY 2004 to nearly 18 minutes in FY 2016.<sup>18</sup> Comparing FY 2004 with FY 2016, the number of calls the IRS received from taxpayers on its Accounts Management telephone lines increased from 71 million to 104 million, yet the number of calls answered by telephone assistors declined from 36 million to 26 million.<sup>19</sup>
- In 2014, the IRS ceased all tax preparation in the TACs and eliminated post-April 15 tax law phone and TAC assistance.
- The IRS has also reduced the number of TACs (also known as walk-in sites) from 401 to 376 (six percent) since 2011.<sup>20</sup> Additionally, 22 TACs have no staff, and 95 have only one employee.<sup>21</sup>

14 IRS Pub. 55B, IRS Data Book 2015 (Mar. 2016), Tables 2, 7 and 8. Figures are for FY 2015.

15 Treasury Inspector General for Tax Administration, Ref. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft 2* (Apr. 24, 2015).

16 For an in-depth discussion of the need for tax reform and the methodology of this calculation, see Legislative Recommendation: *Simplify the Internal Revenue Code Now*, *infra*.

17 *Compare* IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2016) with IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2004). The Accounts Management telephone lines (previously known as the Customer Account Services telephone lines) receive the significant majority of taxpayer calls. However, taxpayer calls to compliance phone lines and certain other categories of calls are excluded from this total.

18 *Id.*

19 *Id.*

20 In 2011, the IRS operated 401 TACs. IRS response to TAS information request (Dec.23, 2014). Today the IRS operates 376 TACs, a reduction of six percent. IRS response to TAS fact check (Dec. 20, 2016).

21 IRS response to TAS fact check (Dec. 20, 2016).

- Sixteen states have no Appeals or Settlement Officers present within their boundaries, and 14 states have no IRS liaisons to Small Business/Self-Employed taxpayers within their boundaries.<sup>22</sup>

Figure S.1 shows the reduction in IRS geographic presence and employees between 2011 and 2016.

**FIGURE S.1, Locations With Specified Employees in the Last Pay Period of the Fiscal Year<sup>23</sup>**

Number of Locations, Employees, or Visitors	2011	2012	2013	2014	2015	2016
IRS Offices (Cities)	541	523	510	499	479	470
Appeals Officers (AOs)	1,129	1,058	958	881	795	739
Revenue Officers (ROs)	4,402	4,035	3,703	3,441	3,191	3,072
Revenue Agents (RAs)	11,959	11,258	10,502	9,776	9,090	8,871
Stakeholder Liaison Outreach Employees	137	123	119	110	105	98
Stakeholder Partnerships, Education and Communication Outreach Employees	522	475	444	405	386	365
Taxpayer Assistance Centers (TACs)	401	401	398	382	378	376
TAC Service Reps	1,639	1,515	1,484	1,520	1,423	1,267

At the same time, taxpayer returns and forms filed increased between tax year (TY) 2011 and TY 2015. Overall, filings grew nearly four percent from 234,567,000 in TY 2011 to 243,249,000 in TY 2015.<sup>24</sup>

We discuss the effects of this reduction in our Most Serious Problems, herein, on the structure of the IRS and the lack of a geographic presence in communities.<sup>25</sup>

- 22 Appeals response to TAS information request (June 6, 2016). Puerto Rico lacks an Appeals or Settlement Officer in addition to the 16 states. IRS response to TAS fact check (Dec. 15, 2016). IRS Human Resources Reporting Center, *Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees* as of the week ending October 1, 2016 (report generated Dec. 1, 2016). The District of Columbia lacks an IRS liaison in addition to the 14 states. See Most Serious Problem: *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*, *infra*.
- 23 Figures for Appeals Officers, Revenue Officers, Revenue Agents, Stakeholder Liaison Outreach, SPEC Outreach, and Taxpayer Assistance Center (TAC) Service Representatives are from the IRS response to TAS fact check (Dec. 16, 2016). TAC customer service representative figures are from the IRS Human Resources Reporting Center, *Position Report by Employee Listing for the ending pay period for FY 2011 to 2016*, Nov. 2, 2016. The IRS response to TAS Fact Check (Dec. 16, 2016) showed the following counts for TAC customer service representative: Fiscal Year (FY) 2011 – 1,977, FY 2012 – 1,839, FY 2013 – 1,775, FY 2014 – 1,803, FY 2015 – 1,678, and FY 2016 – 1,477. TAS was unable to replicate the IRS TAC employee figures. TAC Office figures for FYs 2011–2014 from IRS response to TAS fact check (Dec. 23, 2014). TAC Office figures for FY 2015 from Wage and Investment (W&I) analyst (Dec. 13, 2106). TAC Office figures for FY 2016 from the IRS response to TAS fact check (Dec. 20, 2016).
- 24 IRS, *Databook Returns Filed Tax Year (TYs) 2011-2015* (Nov. 30, 2016). This total includes individual income tax returns, business-entity income tax returns, employment tax returns, estimated tax forms, and certain other returns and forms.
- 25 See Most Serious Problems: *IRS Structure: The IRS's Functional Structure Is Not Well-suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, and *Geographic Focus: The IRS Lacks an Adequate Local Presence in Communities, Thereby Limiting Its Ability to Meet the Needs of Specific Taxpayer Populations and Improve Voluntary Compliance*, *infra*. See also Literature Review: *Geographic Considerations for Tax Administration*, vol. 3, *infra*.

### *Downstream Costs of IRS Budget Cuts Can Outweigh Savings, Increase Taxpayer and IRS Burden, and Erode Taxpayer Trust*

Far too often, in response to budget constraints, the IRS makes penny-wise, pound-foolish decisions. For example, the recently announced revised rules about the limited availability of face-to-face Appeals conferences, and changes to settlement authority of certain Appeals' personnel, has led to criticism from key tax professional groups.<sup>26</sup> The National Taxpayer Advocate personally provided several suggestions to the Chief of Appeals and other senior Appeals officials that, if adopted, would address many of Appeals' concerns about wise use of resources while not vitiating the taxpayer's *rights to appeal an IRS decision in an independent forum and to a fair and just tax system*.<sup>27</sup> Instead, far from reducing overall costs, Appeals' proposed procedures will increase costs for both the IRS and the taxpayer by shifting issue resolution to more expensive litigation venues or downstream to the IRS compliance functions or the Taxpayer Advocate Service, increasing unnecessary rework. Either way, taxpayer confidence in and patience with the IRS is eroded.

Initiatives designed to save IRS resources are too often focused inward on the IRS's own needs — how it can gain cost savings in one area so it can reapply them elsewhere. Again, while this is understandable in the present environment, it is not right. These decisions do not adequately take account of taxpayer needs and preferences, taxpayer burden, or the downstream costs incurred because taxpayers have not received the assistance they need.

For example, over the last two years, the IRS has been moving slowly to an appointment-only system for assistance in the TACs. These locations were formerly known as “walk-in centers,” but for all intents and purposes, in the 2017 filing season, the IRS will not be accepting “walk-ins.” While the National Taxpayer Advocate has long recommended the IRS offer taxpayers the *option* of making appointments, she is opposed to making TACs available *exclusively* by appointment.<sup>28</sup> The following testimony from the National Taxpayer Advocate Public Forum in San Antonio illustrates the myopia of this policy:

[S]everal months ago I had a client that I was assisting to help make sure that he did not get a lien filed. And so from that perspective he had filed a 2014 tax return and underpaid by several hundred thousand dollars.

Well, he settled that case and came into the money that he needed to pay to the IRS. So I said, okay, well, cut me the check made out to the IRS, folks, of course. And, and I will go

26 See, e.g., Letter from Joan C. Arnold, American College of Tax Counsel, to Kirsten Wielobob, Chief Appeals (Oct. 10, 2016); Coalition for Effective and Efficient Tax Administration, letter to Kirsten Wielobob, Chief Appeals (Oct. 21, 2016); Memorandum from Kenneth M. Horwitz, Texas Society of Certified Public Accountants to Commissioner of Internal Revenue (May 13, 2016) (Preserving and Improving Access to Face-to-Face Appeals Conferences). See also Statement of Jaime Vasquez, Chamberlain, Hrdlicka, White, Williams & Aughtry, National Taxpayer Advocate Public Forum 52 (Aug. 30, 2016):

So what I've seen is that cases that don't need to go to [T]ax [C]ourt can be resolved with the IRS appeals office. And with the cutback of the number of local IRS appeals officers, what's happening is that people's cases are getting shipped to IRS campus offices where they're not getting a face-to-face person who can help resolve their case. And you know, as we all know, sometimes when you're dealing with someone face to face walking them through the particular records and their life circumstances, cases tend to be resolved. These are why such things as mediations are so successful.

27 For a detailed discussion of our concerns about the Office of Appeals concept of operations, see Most Serious Problem: Appeals: The Office of Appeals' Approach to Case Resolution Is Neither Collaborative Nor Taxpayer Friendly and Its "Future Vision" Should Incorporate Those Values, *infra*.

28 See National Taxpayer Advocate 2014 Annual Report to Congress 122-33 (Most Serious Problem: Access to the IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues); National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 42-45; National Taxpayer Advocate 2012 Annual Report to Congress 302-18 (Most Serious Problem: The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services).



and walk it into the IRS office. Well, that was just when I found out that that local office had just been closed. So there I was with a [\$240,000] check and, you know, I was like, you know, I made several phone calls. No success.

And after a week of sitting with this \$240,000 check, I was getting really embarrassed, of course. No one wants to sit on that much, you know, money for, for someone else. Finally got in touch with an IRS revenue officer who put me in touch with the collection officer for the day who said that, and who had finally, they could accept the [\$240,000] check. And I thought to myself, you know, this is ridiculous.

You know, here I am trying to, you know, help my client getting in compliance with the IRS and we can't even pay the IRS.<sup>29</sup>

### *The Role of Congressional Oversight in Achieving Effective 21st Century Tax Administration*

As stated above, the IRS has to make difficult choices every day, and those choices have consequences for taxpayers and tax administration. The National Taxpayer Advocate believes there are many things the IRS can do to apply its resources more effectively, particularly with respect to compliance initiatives (indeed, the National Taxpayer Advocate publishes over 1,000 pages a year, via her Annual Reports to Congress, identifying areas for improvement and making recommendations). But the simple fact remains, even with these improvements, the IRS needs more funding. It cannot become a 21st century tax administration without adequate support from Congress.

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**Sometimes nothing can replace the sound and the tone of a human voice, especially in a crisis situation. IRS must present a human side to the agency to foster and keep voluntary compliance.**

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That support is not just financial. The National Taxpayer Advocate believes there is a key role for congressional oversight both as a preliminary to and a consequence of additional funding. This oversight should focus on the effectiveness of IRS service and compliance activities with respect to the 150 million individual taxpayers and ten million business taxpayers, especially small businesses and self-employed individuals. Is the IRS availing itself of the most important insights of behavioral science?<sup>30</sup> For example, during the first two weeks of January before the 2016 filing season, the National Taxpayer Advocate sent out about 7,100 letters to taxpayers who had claimed the Earned Income Tax Credit (EITC) on their 2014 returns but whose claims were flagged by the IRS Dependent Database (DDb) as being highly questionable. The IRS did not audit these taxpayers because of insufficient resources. The letters were strictly educational and tailored to the specific rule “broken” by the taxpayer; they were written in a helpful tone and clearly stated the taxpayer was not under audit. These letters had a statistically significant positive impact on the EITC compliance of this group of taxpayers. Thus, projected against the population of EITC filers who violated these particular rules, for the cost of a letter and postage, the IRS could prevent \$47 million in EITC noncompliance.<sup>31</sup> TAS is repeating this test in the 2017 filing season; in this version, we will be offering some EITC taxpayers

29 Statement of Jaime Vasquez, Chamberlain, Hrdlicka, White, Williams & Aughtry, National Taxpayer Advocate Public Forum, 48-49 (Aug. 30, 2016).

30 For a discussion of the application of behavioral insights to tax administration, see *Most Serious Problem: Voluntary Compliance: The IRS Is Overly Focused on So-Called “Enforcement” Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *infra*. See also *Literature Review: Behavioral Science Lessons for Taxpayer Compliance*, vol. 3, *infra*.

31 For a copy of the letters sent, and a detailed discussion of this research study, see *Research Study: Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits Apparently in Error and Were Sent an Education Letter from the National Taxpayer Advocate*, vol. 2, *infra*.

a dedicated “Extra Help” line in which trained TAS employees will answer taxpayer questions *before* the taxpayers file their returns.

Nevertheless, the IRS relies on audits as its primary compliance tool for maintaining reporting compliance — closing nearly 874,000 individual taxpayer audits in FY 2016, with 84 percent of those through correspondence.<sup>32</sup> To understand the effectiveness of this application of resources, we need to know what percentage of IRS audits result in no change, by type of audit. Research has shown that when an audit results in no change, the taxpayer is more likely to report less income in the future.<sup>33</sup> Where there is an assessment, what percentage of audits are reopened later as audit reconsiderations, resulting in unnecessary downstream re-work? Of the audits that result in a Tax Court case, what percentage are settled — and why — by IRS Appeals or Chief Counsel employees? How much audit activity results in future voluntary compliance? Since the point of an audit is not just to assess additional tax but to ensure that the same errors or positions do not occur again, what percentage of audited taxpayers understand why the adjustments were made? These are just a few of the questions that overseers should be asking of the IRS to ensure that current and additional funding is spent wisely and effectively.

As part of the reorganization mandated by Congress in the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Congress held joint annual hearings, over five years, to review the IRS strategic plan.<sup>34</sup> The hearing participants included three members (two majority and one minority) from each of the congressional committees with jurisdiction over the IRS — Senate Finance Appropriations, and Governmental Affairs; and House Ways and Means Appropriations and Governmental Reform and Oversight. The hearings were to cover the following topics:

- (1) IRS progress in meeting its objectives under its strategic and business plans;
- (2) IRS progress in improving taxpayer service and compliance;
- (3) IRS progress on technology modernization; and
- (4) The annual filing season.<sup>35</sup>

The National Taxpayer Advocate recommends that Congress reinstitute this commendable practice. By holding recurring joint oversight hearings, the IRS will have the opportunity to articulate, with specificity, its need for additional resources and its plans for applying them. Hearing from both the IRS and outside experts — including tax professional organizations, business representatives, Low Income Taxpayer Clinics, and behavioral scientists — Congress will better understand the challenges that both the IRS and taxpayers face. It can then make informed decisions about the level and general application of resources necessary for the IRS to provide U.S. taxpayers with a 21st century tax administration they can trust and admire.

32 IRS, Compliance Data Warehouse, Automated Information Management System (AIMS) Closed Case Database.

33 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 67-98 (Research Study: *Audit Impact Study*); National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 27-42 (Research Study: *Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Results*).

34 Pub. L. No. 105-206, § 4001, enacting IRC § 8021(f), and § 4002, amending IRC § 8022, 112 Stat. 685, 783-84 (1998).

35 H. REP. No. 105-364, at 84-85 (1997). The Restructuring Commission earlier recommended that Congress create a joint committee on IRS administration, which would conduct joint hearings on similar topics. National Commission on Restructuring the IRS, *A Vision for a New IRS* 2-3 (June 15, 1997).

## Recommendations

The National Taxpayer Advocate recommends that Congress:

- Reinstating the joint review of the IRS strategic plans and budget provided for under IRC §§ 8021(f) and 8022.
- Requiring the IRS to submit a comprehensive “Future State” plan that describes, in sufficient detail, its vision for a 21st century IRS, including an explanation of how that vision meets the needs and preferences of different U.S. taxpayer segments, and describes the challenges and obstacles the IRS faces in achieving this “Future State.”
- Providing funding for IRS initiatives that enhance and maintain voluntary compliance, align with the specific needs and preferences of taxpayers as they attempt to comply with the tax laws, and eliminate unnecessary downstream re-work.

## IRS CULTURE: To create an environment that encourages taxpayer trust and confidence, the IRS must change its culture from one that is enforcement-oriented to one that is service-oriented.

In its *Snapshot of A Better Way for Tax Reform* blueprint, the House Republicans' Tax Reform Task Force describes "A Service First IRS," noting that "[a] simpler, fairer tax code will require a simpler, fairer IRS with one mission: Put the taxpayers first."<sup>36</sup> Congress has addressed this issue before. In the IRS Restructuring and Reform Act of 1998 (RRA 98), it directed the IRS to "restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs."<sup>37</sup>

Yet today, the IRS's annual appropriation of \$11.2 billion allocates 43 percent to Enforcement, with only 21 percent attributable to taxpayer service. Of the \$2.3 billion allocation for Taxpayer Service, 73 percent is attributable to operational items like receiving and processing tax returns and payments, and only 27 percent is attributable to functions such as outreach and education.<sup>38</sup> In other words, outreach and education activities constitute less than six percent of the IRS budget.

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If a tax agency views its primary mission as "enforcing" the tax laws, it will design its procedures and apply its resources to "hunt down" those taxpayers it views as noncompliant.<sup>39</sup> It justifies this approach by rationalizing that law-abiding taxpayers want to know that all taxpayers are paying their fair share. The problem with this approach is that it undermines the willingness of taxpayers to comply by focusing most of its resources on those who are not willing to comply. Taxpayers who are willing to comply are left without adequate support.

In an enforcement-oriented tax agency, if taxpayers don't get the help they need to comply and they make a mistake, they are treated as if they are tax evaders. This treatment in turn breeds resentment and increases the risk that the taxpayer who was willing to comply is no longer willing to do so. In this way, the underlying assumption by the tax agency that taxpayers will evade tax becomes a self-fulfilling proposition. The agency ends up converting a compliant taxpayer into a noncompliant one.<sup>40</sup>

What if the tax agency adopted a different approach toward taxpayers? What if it assumed that taxpayers, by and large, wanted to obey the law and that the primary mission of the tax agency was to facilitate that compliance by providing taxpayers with the assistance, education, and clarity they need to meet their tax obligations? What if we started out accepting that taxpayers will make mistakes and, until proven otherwise, assume those mistakes are not attributable to a tax evasion motive? This matters because tax noncompliance, like most human behavior, is driven by a broad spectrum of factors, from just plain

36 House Republicans' Tax Reform Task Force, *A Better Way for Tax Reform*, [http://abetterway.speaker.gov/\\_assets/pdf/ABetterWay-Tax-Snapshot.pdf](http://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-Snapshot.pdf).

37 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998).

38 Consolidated Appropriations Act, 2016, Pub. Law 114-113, enacted Dec. 18, 2015. FY 2016 Operating Plan, Integrated Financial System (IFS).

39 See Written Statement of Pam Olson, PricewaterhouseCoopers, National Taxpayer Advocate Public Forum 20-22 (Feb. 23, 2016):

Those of you who know me know that I've not been fond of use of the word enforcement when it comes to the IRS because I think enforcing the law is an action that compels people to do something and it is not something that has to be visited on the average taxpayer. The average taxpayer wants to voluntarily comply and we just need to make sure they have the tools and the resources to do it. They may need advice or assistance but rarely do they need an enforcement action to compel them to pay their tax or to punish them for failing to do so.

40 For a discussion of the drivers of voluntary compliance, see Most Serious Problem: *Voluntary Compliance: The IRS Is Overly Focused on So-Called "Enforcement" Revenue and Productivity, and Does Not Make Sufficient Use of Behavioral Research Insights to Increase Voluntary Tax Compliance*, *infra*.

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This is not to say we should ignore those who are actively evading tax. Rather, it is to say we should *design* our tax system around the taxpayers who are trying to comply, instead of those who are actively trying not to.

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carelessness to ignorance to confusion to polemics to avarice. By focusing on the source or reasons for a taxpayer’s noncompliance, and not just on the end result of the behavior, we have a better chance of changing the behavior and improving tax compliance going forward.<sup>41</sup>

This is not to say we should ignore those who are actively evading tax. Rather, it is to say we should *design* our tax system around the taxpayers who are trying to comply, instead of those who are actively trying not to.

### *Bringing About a Cultural Shift: You Get What You Measure*

The National Commission on Restructuring the IRS summarized the agency’s culture in this way:

The culture of IRS is overly risk averse, based on a tradition of valuing checks and controls over creative approaches to solving problems. In order to evolve into a more taxpayer focused, responsive organization, a cultural shift must occur at the IRS. The positives of the culture are that employees will execute orders and follow directions. The negatives are that the IRS environment often does not encourage personal or organizational growth, and stifles creativity, innovation, and quick problem resolution.<sup>42</sup>

Changing an organization’s culture begins with understanding what drives employees’ and officers’ behavior. Basically, you get what you measure. The IRS’s own annual announcement of measures and successes reflects this enforcement-heavy mentality — enforcement dollars assessed (via liens and levies), enforcement dollars collected, liens filed, levies issued.<sup>43</sup> It includes five pages of “enforcement” results and only one page — six items — of taxpayer service results. There is no mention of how much in the way of tax or penalties are abated annually because they were incorrectly or inappropriately assessed, or how many TAS cases resulted in full or partial relief, or how many outreach or education events were held in-person so that IRS employees and officers (including those in the audit and collection functions) could hear directly about taxpayer concerns. The IRS does not track how many people were turned away from TACs (formerly known as “walk-in sites” but now appointment-only).<sup>44</sup>

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41 See Written Statement of Leslie Book, Professor, Villanova Law School, National Taxpayer Advocate Public Forum 55 (Feb. 23, 2016):

I think, however, getting back to trust and how that relates to taxpayers there is no question that sanctions alone is really not the way, a sanctioned based approach is not the only way to encourage voluntary compliance. There needs to be an emphasis on insuring that interactions with taxpayers enhances trust and trust between the taxpayer and the IRS is a two-way street but if the taxpayers have an absence of trust in what the IRS is doing it leads to kind of spirals and increases non-compliance.

42 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 12-13 (June 25, 1997).

43 IRS, *Fiscal Year 2015 Enforcement and Service Results*, <https://www.irs.gov/uac/newsroom/fiscal-year-2015-enforcement-and-service-results>.

44 Since 2014, the National Taxpayer Advocate has published in the Annual Report to Congress a “report card” on the IRS, listing measures that would give a sense of whether the IRS is treating taxpayers right. This list of measures is organized under each of the ten taxpayer rights stated in the Taxpayer Bill of Rights and could serve as a starting point for a more comprehensive and balanced set of performance measures. See *Taxpayer Rights Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights*, *infra*.

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If we want IRS employees to focus on increasing taxpayer confidence and trust in the tax system, if we want taxpayers to feel engaged in the tax system they are all a part of, then we need to find ways to encourage and reward the IRS workforce for engaging with the population and viewing the taxpayer as a partner in trying to achieve or maintain voluntary compliance.

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If we want IRS employees to focus on increasing taxpayer confidence and trust in the tax system, if we want taxpayers to feel engaged in the tax system they are all a part of, then we need to find ways to encourage and reward the IRS workforce for engaging with the population and viewing the taxpayer as a partner in trying to achieve or maintain voluntary compliance.<sup>45</sup>

Notwithstanding the ubiquitous use of the term “enforcement” throughout IRS training, guidance (including the Internal Revenue Manual), and testimony, there is only one true “enforcement” function in the IRS, and that is the Criminal Investigation function. Every other taxpayer-facing part of the IRS is in the business of serving the taxpayer by encouraging voluntary compliance. Yes, there are some employees who utilize tools that compel action, like liens and levies. But activities such as audits and appeals should be viewed first and foremost as educational opportunities, not “enforcement” mechanisms. In an audit, the IRS can learn about the challenges taxpayers face in complying with the laws, and taxpayers can learn about what, in the eyes of the IRS, they reported incorrectly on the return. In some instances, taxpayers can learn that they can’t get away with something they thought they could; on the other hand, the IRS might just learn that it was wrong about an issue, or actually change its position on an aspect of tax law.

As we discuss in the Most Serious Problem about IRS structure herein, the greatest economies for a service-oriented organization are achieved by operating as small units that are located in the proximity of their customers.<sup>46</sup> Through structural design, performance measures, and, most importantly, training that reinforces engagement with the taxpayer and understanding taxpayer needs and preferences, the IRS can promote voluntary compliance and become a respected and appreciated federal agency.

### Recommendation

The National Taxpayer Advocate recommends that the IRS publish an annual report card on comprehensive measures that not only show traditional “enforcement” measures but disclose how the IRS performed in providing assistance and service in meeting taxpayer needs and preferences, as well as increasing voluntary compliance over time. These measures, in turn, should form the basis for Executive performance commitments and assessments.

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45 See Written Statement of Elizabeth Atkinson, LeClair Ryan, National Taxpayer Advocate Public Forum 29 (May 13, 2016):  
Our tax code is very, very complicated and it’s better for the IRS to be in a position of listening to the taxpayer than having an authoritarian type of regime that not only makes the taxpayer feel like he or she is not being listened to, but sometimes leads to incorrect results and downstream compliance problems because the person is so turned off to the tax system by their experience, they don’t feel like complying anymore.

46 See Most Serious Problem: *IRS Structure: The IRS’s Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *infra*.

**IRS MISSION STATEMENT: To ensure the IRS recruits, hires, and trains employees with the appropriate skill sets, the IRS must revise its mission statement to explicitly acknowledge the IRS’s dual mission of collecting revenue and disbursing benefits, as well as the foundational role of the Taxpayer Bill of Rights.**

In RRA 98, Congress directed the IRS to restate its mission statement with an emphasis on taxpayer service.<sup>47</sup> Accordingly, the IRS adopted the following mission statement: “Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and *by applying the tax law* with integrity and fairness to all.”<sup>48</sup> (Emphasis added.) In 2009, with no public discussion, the IRS quietly made a profound change to that mission statement, which now reads: “Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and *enforce the tax law* with integrity and fairness to all.” (Emphasis added.) As noted in the preceding discussion of IRS culture, this shift in tone and emphasis, from “apply” to “enforce,” has significant consequences for taxpayers, and is closely related to the issue of agency culture.

A second problem with the agency’s current mission statement is its failure to acknowledge and articulate that the 21st century IRS has two specific lines of business: both revenue collector and benefits administrator. The IRS collects over \$3 trillion annually and issues over \$403 billion in refunds.<sup>49</sup> The Earned Income Tax Credit (EITC), a refundable credit for low and moderate income working families and individuals, accounts for almost \$67 billion in credits paid to 27 million taxpayers.<sup>50</sup> The tax code is increasingly used to promote various social and economic policies through the mechanism of tax credits and other tax expenditures.<sup>51</sup> Taking an enforcement-oriented approach to these inherently complex provisions, instead of one based on problem identification and understanding of the root causes of noncompliance, can deter eligible taxpayers from claiming benefits to which they are entitled under the law and prevent ineligible taxpayers from understanding what they did wrong.

Instead, by explicitly recognizing the IRS’s role as a benefits administrator in its mission statement, the IRS will have to rethink how it conducts major aspects of its work.<sup>52</sup> To fulfill this aspect of its mission, it will have to hire employees whose skills are better suited for this educational and compliance work. Thus, for the EITC and other tax provisions specifically targeted to the low income population, the IRS will have to hire or train employees with skills that are drawn from the social work profession.<sup>53</sup> These

47 RRA 98, Pub. L. No. 105-206, Title I, § 1002, 112 Stat. 685 (1998).

48 IRM 1.1.1.1.1 (Mar. 1, 2006).

49 IRS Pub. 55B, IRS Data Book 2015 (Mar. 2016), Table 1. Figures are for FY 2015.

50 IRS, *About EITC*, <https://www.eitc.irs.gov/EITC-Central/abouteitc> (last visited Dec. 31, 2016). For Tax Year 2015, 27.3 million taxpayers had claimed \$66.9 billion in EITC (after math error processing, but prior to any audit of the tax return). IRS, Compliance Data Warehouse, *Individual Returns Transaction File* (includes Tax Year 2015 returns posted as of cycle 47).

51 For a discussion of the complexity and lack of transparency these provisions create, see Legislative Recommendation: *Simplify the Internal Revenue Code Now*, *infra*. For recommendations about reforming the EITC and other Family Status provisions, see Legislative Recommendation: *Tax Reform: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden*, *infra*. The National Taxpayer Advocate has previously discussed design elements that should be considered when running social benefit programs through the tax code. See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, 75-104 (*Running Social Programs Through the Tax System*).

52 See Statement of Pam Olson, PricewaterhouseCoopers LLP, National Taxpayer Advocate Public Forum 47 (Feb. 23, 2016): I think the most important thing is for the IRS to fully embrace the multifaceted responsibilities that it has with respect to both collecting tax as well as administering benefit system and administering lots of other things and making sure that it is factoring that into how it plans its service.

53 For a detailed discussion of the challenges faced by EITC taxpayers, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

employees will have the skills not only to employ interviewing techniques that are designed to elicit information without fear, but also to focus on educating the taxpayer going forward.

Finally, the IRS mission should explicitly acknowledge that the Taxpayer Bill of Rights (TBOR) underlies all of its actions. As we discuss later in this report, while the IRS has done a commendable job publicizing the TBOR to taxpayers, it still has considerable work to do integrating the TBOR in the life, training, and ethos of the agency.<sup>54</sup> Explicit mention in the mission statement would reinforce to IRS employees, and reassure taxpayers, that the TBOR is a guiding principle for all IRS actions.

### Recommendation

The National Taxpayer Advocate recommends that the IRS revise its mission statement to re-emphasize a non-coercive approach to tax administration, recognize the IRS's dual roles of revenue collector and benefits administrator, and explicitly affirm the role of the TBOR as the guiding principle for tax administration.

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54 See Most Serious Problem: *Taxpayer Bill of Rights (TBOR): The IRS Must Do More to Incorporate the TBOR into Its Operations*, *infra*.



**UNDERSTANDING TAXPAYER NEEDS AND PREFERENCES: To ensure that the IRS designs its Current and Future State initiatives based on actual taxpayer needs and preferences, the IRS must actively and directly engage with the taxpayer populations it serves as well as undertake a robust research agenda that furthers an understanding of taxpayer compliance.**

In 2005, Congress directed the IRS to conduct a comprehensive review of its current portfolio of services and develop a five-year strategic plan for taxpayer service.<sup>55</sup> That plan, the Taxpayer Assistance Blueprint (TAB), has since been updated annually, by congressional directive.<sup>56</sup> Far from being a strategic plan, the TAB has deteriorated into a list of unrelated initiatives. Meanwhile, IRS budget cuts and consequent elimination or radical restructuring of core taxpayer services have increased taxpayer burden and cost.

An understanding of taxpayer needs and preferences is a prerequisite for effective tax administration.<sup>57</sup> As Figure S.2 shows, the IRS and TAS have separately undertaken different surveys attempting to identify taxpayer needs. The way one asks questions on the surveys, and the very method of conducting the survey, has consequences for the reliability and usefulness of the data collected. For example, a recent Pew Research Center analysis of survey techniques concluded that online-only surveys have a bias against African-Americans and Hispanics.<sup>58</sup>

55 H. REP. No. 109-307, at 209 (2005).

56 See S. REP. No. 113-80, at 27 (2013); see also IRS Pub. 4701, *Annual Report to Congress: The Taxpayer Assistance Blueprint Taxpayer Service Improvements* (Nov. 2015), <http://core.publish.no.irs.gov/pubs/pdf/p4701-2015-11-00.pdf>.

57 See Statement of Leslie Book, Professor, Villanova School of Law, National Taxpayer Advocate Public Forum 27 (Feb. 23, 2016): I think a fundamental starting point in thinking about service is that the IRS needs to know whom it is serving and the characteristics and challenges associated with a particular group of taxpayers or parties it is regulating. It sounds easy enough but knowing the taxpayer actually is a very resource intensive endeavor. An agency fixated on efficiency and delivering services at lowest possible short term costs without knowing the impact and burdens of its actions may find itself pushing more serious problems down the road while at the same time jeopardizing taxpayer rights.

58 Pew Research Center, *Evaluating Online Nonprobability Surveys: Vendor Choice Matters; Widespread Errors Found for Estimates Based on Blacks and Hispanics* (May 2, 2016), <http://www.pewresearch.org/2016/05/02/evaluating-online-nonprobability-surveys/>. “Online nonprobability survey vendors want to provide samples that are representative of the diversity of the U.S. population, but one important question is whether the panelists who are members of racial and ethnic minority groups are representative of these groups more broadly. This study suggests they are not.” *Id.* at 4.

**FIGURE S.2, Summary of Taxpayer Surveys**

Survey	Description/Purpose	Methodology	Sample Size	Data Collection Frequency	Survey Conducted
<b>Low Income Taxpayer Clinic Survey</b>	<p>The Low Income Taxpayer Clinic (LITC) Program provides tax representation or advice to low income individuals who need help resolving issues with their federal income tax returns.</p> <p>TAS multi-purpose study to learn more about taxpayers who are eligible for help from LITCs. The study gathered information on:</p> <ul style="list-style-type: none"> <li>• eligible taxpayers' awareness and use of LITC services,</li> <li>• the types of issues for which they would consider using clinics,</li> <li>• demographic information, and</li> <li>• other items.</li> </ul>	Telephone Random Digit Dialed (RDD) landline and cellphone	1,143 934 English 204 Spanish	One time	2014
<b>The Taxpayer Advocate Service: Hispanic Survey</b>	<p>Findings are representative of the low income population (household income at or below 250% of the poverty level), including Spanish speakers of this population.</p> <p>TAS Multi-purpose study to evaluate taxpayer knowledge, beliefs, barriers and perception of TAS and the IRS among US Hispanics.</p>	Telephone Random Digit Dialed (RDD) landline and cellphone	1,014 US General Population Hispanics ages 18 and older 432 English 582 Spanish	One time	2014
<b>Service Priorities Survey</b>	<p>TAS Multi-purpose taxpayer survey to explore:</p> <ul style="list-style-type: none"> <li>• Taxpayers' use of IRS services by delivery channels, as well as service users satisfaction and issue resolution with services, and willingness to use and importance of delivery channels;</li> <li>• Taxpayers' understanding of their rights and responsibilities with IRS</li> <li>• Internet use and abilities</li> </ul>	Telephone Random Digit Dialed (RDD) landline and cellphone	4,000 By mid-November, 1,910 completed 1,106 landline, 804 cell phone	Depends on funding	2016
<b>Taxpayer Experience Survey</b>	<p>Multi-purpose taxpayer survey to explore:</p> <ul style="list-style-type: none"> <li>• Taxpayers' awareness and use of IRS services and service channels, as well as service users satisfaction with services;</li> <li>• Taxpayers' behavior patterns and potential areas for improvements based on their pre-filing, filing, and post-filing experiences (includes experience with refunds &amp; notices); and</li> <li>• Knowledge of ACA requirements.</li> </ul>	Online Panel / Phone	3,689 (2,986 online English; 403 online Spanish; 300 Phone English)	Annually	2016

Table continued on next page. ▶

**FIGURE S.2, Summary of Taxpayer Surveys (continued)**

Survey	Description/Purpose	Methodology	Sample Size	Data Collection Frequency	Survey Conducted
<b>TAC Expectations Survey</b>	Survey of TAC users designed to capture TAC customer demographic profile, measure overall and service delivery satisfaction, and the extent to which TAC customer service and performance expectations were met from the taxpayer perspective. Data from this research endeavor helps Field Assistance assess and modify its business model.	<p>Paper / In-person</p> <p>Used cluster analysis to categorize TACs. 3 visits (pre-filing, filing, post-filing) to each of the 5 different TAC types for a total of 15 visits:</p> <ul style="list-style-type: none"> <li>• High volume, High wait; Medium Volume, High Overhead;</li> <li>• Medium volume, Low overhead;</li> <li>• Low Volume, Less complex; and</li> <li>• Low Volume, Complex Task.</li> </ul>	1,519 in FY 2013	Every three years	FY 2013 completed, 2016 in analysis
<b>Web - First Strategy Conjoint</b>	<p>Conjoint survey aimed at understanding how taxpayers' preferences shift with changes to service offerings. This conjoint survey offers participants different scenarios for services, with tradeoffs to see which options are the most important to participants. The study objectives are to:</p> <ul style="list-style-type: none"> <li>• Determine the effect of potential service changes on preference for TAC and phone.</li> <li>• Assess baseline preferences for online services and identify potential methods for increasing preference for online services.</li> <li>• Explore how potential service changes, including the addition of new online service options, affect taxpayer preference for higher cost channels, such as TAC and phone.</li> <li>• Suggest how the IRS can facilitate a preference shift to web-first service options.</li> </ul>	Online Panel	1,604	Every year or two depending on funding	2015 - 2016
<b>IRS Oversight Board - Comprehensive Taxpayer Attitude Survey (CTAS) 2015</b>	Telephone survey which captures taxpayers' tax compliance attitudes, service channel preference, and behaviors (can be compared to findings from previous surveys)	Random Digit Dialed Telephone - landline and cell phone	1,000 - 707 landline, 293 cell phone	Annually. Survey may be discontinued given the uncertain status of the IRS Oversight Board.	2015

The IRS has heavily relied upon the Web-First Strategy Conjoint Survey to build its online account. That survey, conducted fully online, is helpful in understanding what taxpayers who are *already online* are willing to do with regard to *online tax administration*. But the survey ignores those taxpayers who are not online or who are unwilling to participate in online surveys.<sup>59</sup>

During the last year, TAS has conducted a survey by telephone (landline and cellphone) of U.S. taxpayers, including those taxpayers who have used IRS service channels in the recent past.<sup>60</sup> Although our analysis is preliminary, TAS is able to report results on particular segments of the individual taxpayer population, including:

- Not Low Income taxpayers (taxpayers with total positive income (TPI) above 250 percent of the federal poverty level);<sup>61</sup>
- Low Income taxpayers (taxpayers TPI at or below 250 percent of the federal poverty level);
- Elderly taxpayers (taxpayers age 65 or older); and
- Disabled taxpayers (taxpayers who self-identified as having a significant disability).

The survey findings for these categories of taxpayers, reported below, are statistically representative of all taxpayers in these categories.<sup>62</sup> The importance of the responses of the low income taxpayer population is particularly significant, since these taxpayers constitute over 46 percent of the individual taxpayers filing returns in 2016.<sup>63</sup> TAS conducted this survey entirely by telephone (landline and mobile phone) in order to ensure it was not biased against taxpayers who were not online or unwilling to answer surveys online.

The study found that Low Income, Senior, and Disabled taxpayers are less likely to have broadband access and more likely to have no internet access than the Not Low Income taxpayers. More than 33 million U.S. taxpayers have no broadband access at home, including 14 million U.S. taxpayers who have no internet access at home. Notably, 28.5 percent, 40 percent, and 31.9 percent of the Low Income, Senior, and Disabled taxpayers, respectively, had no broadband access at home, significantly limiting their online activities.

59 For a more detailed discussion of our concerns about the IRS online account, see Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences Is Critical as the IRS Develops an Online Taxpayer Account System*, *infra*. See also Literature Review: *Customer Considerations for Online Accounts Introduction*, vol. 3, *infra*.

60 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

61 Total Positive Income (TPI) is calculated by summing the positive values from the following income fields from a taxpayer's most recently filed individual tax return: wages; interest; dividends; distribution from partnerships, small business corporations, estates, or trusts; Schedule C net profits; Schedule F net profits; and other income such as Schedule D profits and capital gains distributions. Losses reported for any of these values are treated as zero.

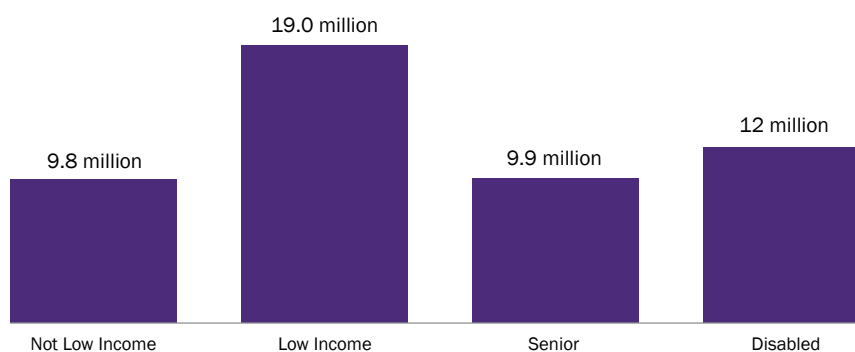
62 For this interim analysis, the confidence interval ranges from +/- 3 percent to 10 percent, depending on the sample size for each question, with most questions falling into the +/- range of 5 percent or better. TAS Research expects confidence levels to improve upon receipt of the complete data set of 4,000 surveys. For a more detailed discussion of the survey design and methodology, see Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

63 Of the 135.8 million individual taxpayers who had filed TY 2015 individual income tax returns through Cycle 43 of 2016, nearly 63 million taxpayers (46.2 percent) had TPI at or below 250 percent of federal poverty level. These numbers exclude filers who are claimed as a dependent on another tax return. Individual Returns Transaction File for Tax Year 2015 (returns processed through October 31, 2016) on the IRS Compliance Data Warehouse.

The IRS has heavily relied upon the Web-First Strategy Conjoint Survey to build its online account. That survey, conducted fully online, is helpful in understanding what taxpayers who are *already online* are willing to do with regard to *online tax administration*. But the survey ignores those taxpayers who are not online or who are unwilling to participate in online surveys.

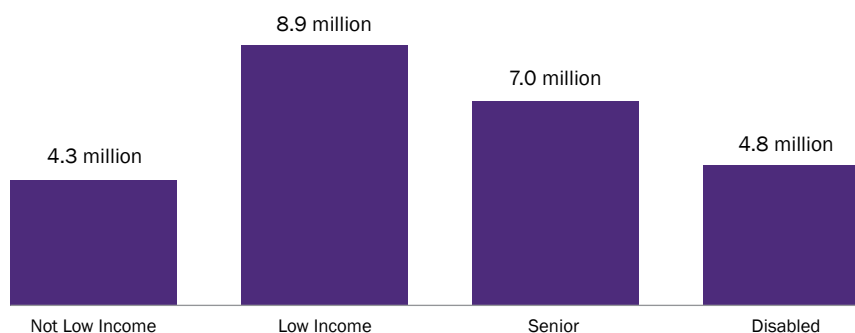
**FIGURE S.3**<sup>64</sup>

**Taxpayers Without Broadband Access at Home by Demographic Group**



**FIGURE S.4**<sup>65</sup>

**Taxpayers Without Internet Access at Home by Demographic Group**



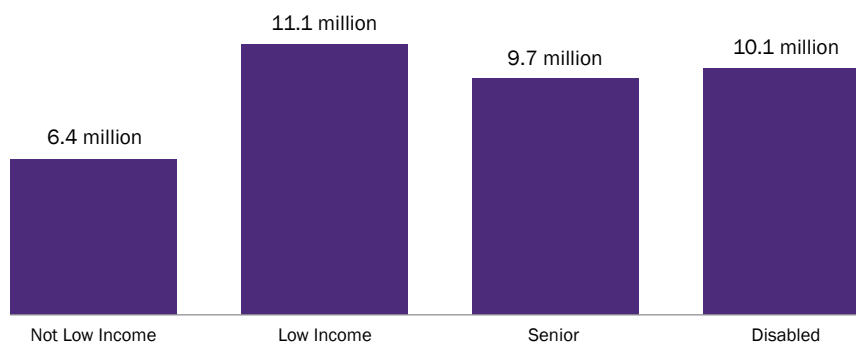
64 See Research Study: *Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

65 *Id.*

The Not Low Income taxpayer group is online more frequently (from home, work, or elsewhere) than the vulnerable groups. Almost 19 percent of the combined Low Income, Senior, and Disabled taxpayer populations said they go online less than once a week or never.

**FIGURE S.5**<sup>66</sup>

**Taxpayers Who Access the Internet Less Than Once a Week, or Not at All, by Demographic Group**



Low Income Taxpayers are more likely than Not Low Income taxpayers to access the internet from libraries or through their smartphones.<sup>67</sup> Access to IRS online accounts via public computers can create serious risks to the privacy of taxpayer data. Moreover, taxpayers whose internet access is through their smartphones report being seriously disadvantaged in performing tasks like uploading resumes and filling out online job applications.<sup>68</sup> Other complex tasks such as filing a tax return may also pose similar challenges. These findings have significant consequences for a large part of the taxpayer population as the IRS shifts to online accounts, audits, and communication.

The IRS has published several “vignettes” that depict how different types of taxpayers will interact online with the IRS of the future.<sup>69</sup> Both the Individual (EITC) taxpayer and the Small Business taxpayer vignettes contemplate in-home or in-work broadband access and taxpayers who are comfortable with online tasks. The TAS survey findings show that for large portions of the taxpayer population, taxpayers continue to be uncomfortable with many aspects of online interaction. For example, all of the vulnerable groups (Low Income, Elderly, and Disabled) are less comfortable sending emails on the internet than the Not Low Income. Similarly, all of the vulnerable groups, particularly Seniors, feel they are less

<sup>66</sup> See Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, vol. 2, *infra*.

<sup>67</sup> For underlying data, see *id*.

<sup>68</sup> Written Statement of Aaron Smith, Pew Research Center, National Taxpayer Advocate Public Forum 1-2 (Feb. 23, 2016):  
In a recent survey that we conducted about job seeking online, for example, these “smartphone only” users were far more likely than other Americans to have used their smartphone for highly complex tasks, such as filling out a job application or even creating a resume or cover letter. And in general, a substantial number of non-broadband adopters indicate that performing even relatively basic online job-seeking activities — such as emailing an employer, or filling out an online application — can be challenging without the benefit of a dedicated home connection.”

<sup>69</sup> See <https://taxpayeradvocate.irs.gov/public-forums> and <https://www.irs.gov/uac/newsroom/future-state-and-irs-activities>. For a detailed discussion of the flawed assumptions relating to the Individual (EITC) vignette, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

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**More than 33 million U.S. taxpayers have no broadband access at home, including 14 million U.S. taxpayers who have no internet access at home. Notably, 28.5 percent, 40 percent, and 31.9 percent of the Low Income, Senior, and Disabled taxpayers, respectively, had no broadband access at home, significantly limiting their online activities.**

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skilled than the Not Low Income at doing research on the internet. And most importantly, more than half of the Low Income, Senior, and Disabled taxpayers stated they did not feel secure sharing personal financial information over the Internet. Indeed, even among the Not Low Income population, over 43 percent of taxpayers said they do not feel secure sharing their personal financial information over the Internet.

Finally, significant percentages of all taxpayer segments did not feel secure sharing personal information with a government agency. Only 38 percent of the Not Low Income population, 33 percent of the Low Income, 17 percent of the Seniors, and 32 percent of Disabled taxpayers were comfortable sharing personal information with the government. These findings have profound implications for taxpayers' willingness to interact with the IRS online in all but the most rudimentary of actions.

These survey findings were mirrored in testimony and comments made at the National Taxpayer Advocate's Public Forums on Taxpayer Needs and Preferences, as well as the Focus Groups at IRS Tax Forums and TAS employee meetings.<sup>70</sup> From all the data and public suggestions, it is clear that an inadequate emphasis on and provision of in-person assistance will harm U.S. taxpayers in the 21st century.

### Recommendations

To ensure that both the present and future states of the IRS serve taxpayers well, the National Taxpayer Advocate recommends that:

- The IRS, in collaboration with the National Taxpayer Advocate, undertake a comprehensive study of taxpayer needs and preferences by taxpayer segment, utilizing telephone, online, and mail surveys, focus groups, town halls, public forums, and research studies. These initiatives should be designed to solicit *taxpayer* needs and preferences, and not be biased by the IRS's own desired direction.
- Congress require the IRS and the National Taxpayer Advocate to jointly report on the results of this comprehensive study through a re-invigorated TAB.

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<sup>70</sup> See, e.g., Oral Statement of Susan Diehl, PenServ Plan Services, Inc., National Taxpayer Advocate Public Forum 18 (Apr. 8, 2016):

What I have observed is that the new individual and business taxpayer experience of the future model seemed to provide little room for personal contact. Granted, this will fit well into the constraints of the budget, but I fear that many will suffer and suffer greatly. Let's consider retirees who have extremely involved questions. Who will help them? Will this model result in more unanswered phone calls with no resolution, or a resolution that comes too late leaving the taxpayer in a penalty situation.

See also Taxpayer Advocate Service, *Executive Briefing: Future State Discussion Analysis 18* (Sept. 2016):

The IRS will be faceless. A taxpayer's only interactions with a human at the IRS will be when there is an enforcement-type action taken with regard to the taxpayer's account. It will leave many taxpayers without basic services needed to comply with the tax system. On one hand, the described scenario might decrease calls and staffing during the initial processing but it could very easily increase calls and staffing after processing because the taxpayer requires clarification of changes and adjustment to his/her account. We have experienced numerous calls when the bar on the "Where's my refund" application changes unexpectedly.

## TAXPAYER RIGHTS AND THE FUTURE STATE

Since adopting the National Taxpayer Advocate's proposed Taxpayer Bill of Rights (TBOR), the IRS has made commendable efforts to inform taxpayers about their rights.<sup>71</sup> As we observe later in this report, however, the IRS has a more uneven record in complying with the congressional mandate, codified in Internal Revenue Code (IRC) § 7803(a)(3), to educate IRS employees about the TBOR.<sup>72</sup>

The National Taxpayer Advocate believes that taxpayer rights, and the TBOR specifically, should be the foundation for tax administration, including any strategic vision for the future. Yet few documents pertaining to the Future State that have been made available to the National Taxpayer Advocate address the TBOR, and those that do only nominally mention it, utilizing a checklist approach at best. None explains how the proposed Future State design and initiatives will specifically advance the general rights stated in the TBOR and the specific protections afforded by the IRC.<sup>73</sup>

At each of the National Taxpayer Advocate's Public Forums on Taxpayer Needs and Preferences, the panelists and audience members were provided copies of IRS Future State "vignettes" pertaining to individual and small business taxpayers.<sup>74</sup> These vignettes provide the most detailed representation of the Future State made public to date. As such, they offer insight into how the IRS thinks it will interact with the taxpayers of the future.

At every Public Forum, panelists and audience members expressed serious concerns about the interactions described in the vignettes. A threshold concern was that the system the IRS is designing seems to be stacked in the IRS's favor — *i.e.*, in both vignettes, the taxpayer lost; he or she was wrong. Nowhere did the vignette demonstrate how the taxpayer could prevail in the system of the future. Public Forum panelists and audience members alike commented on this aspect of the Future State:

*I find it funny that* in both scenarios, there's more taxes. I think that reflects the idea that this model is about the IRS finding new ways to use technology for their benefit, and not for taxpayer purposes.<sup>75</sup>

*I'm a CPA*, and I've been practicing for 35 years, but my primary reason for coming here, at least — I read your year-end report, and even just seeing these future state diagrams here, and what struck me is there's an arrogance unfortunately of the IRS that they can do this themselves, and they don't need any input from taxpayers. And the examples here — both end up resolving in more tax being owed, is like, we were right, you were wrong, pay us the money.<sup>76</sup>

71 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 now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

72 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)). For a detailed discussion of the IRS's TBOR efforts, see Most Serious Problem: *Taxpayer Bill of Rights (TBOR): The IRS Must Do More to Incorporate the TBOR into Its Operations*, *infra*.

73 The National Taxpayer Advocate has identified specific taxpayer rights concerns relating to "Real Time" tax administration before. See National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-295 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

74 <https://taxpayeradvocate.irs.gov/public-forums>. For a reproduction and discussion of the EITC vignette, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

75 Statement of Audience Member, National Taxpayer Advocate Public Forum 39 (Aug. 18, 2016).

76 Statement of Audience Member, National Taxpayer Advocate Public Forum 55-56 (Aug. 18, 2016).



Other panelists noted that the basic assumptions about the taxpayer population illustrated in the vignettes were seriously flawed.<sup>77</sup> For example, the vignette for individual taxpayers involved an EITC claimant, and as we discuss in a Most Serious Problem later in this report, it assumes that the average EITC recipient has broadband access and a desktop computer in her home, has a high enough education level to hold a middle-school math teacher job, has a sufficient credit history to create an IRS online account, and can navigate and understand the complex provisions of the tax code.<sup>78</sup> None of these assumptions is accurate with respect to the average EITC recipient. For example, in eight of the 11 cities in which the National Taxpayer Advocate held Public Forums, the starting salary of a middle school math teacher is above the EITC income eligibility for a two-person household. In essence, the entire vignette is based on a nonexistent taxpayer profile. Yet this has not stopped the IRS from building its vision upon this illusion or, at a minimum from using this grossly inaccurate profile to illustrate its vision.

Moreover, the IRS Future State vignettes seem to envision a completely digital interaction with taxpayers about intensely factual and specific matters. Participants in every Public Forum, every Tax Forum focus group, and every TAS group meeting felt this vision was unrealistic and harmful to taxpayers.<sup>79</sup> Here are just a few of the statements from Public Forum participants.

*Because real life situations of real people* are so unique that you couldn't make them up, you know, they just — the way that people come to us and with their circumstances, you go, Oh my God how did this happen, but this is the way it is and you have to deal with it. And you're helping them. We couldn't even imagine it.

And again, it's just very arrogant of any computer person who decided to design and think that that's all the options that there are. There's always — you have to be able to think outside the box. That's where a live human being will always be better.<sup>80</sup>

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*The future vision of the IRS* assumes that taxpayers have access to technology and will be able to navigate the IRS's online system to resolve their tax issues. We know from representing vulnerable populations, such as the poor, disabled and elderly, in dealing with our current tax system that they will have no easier time navigating some new online system. There will still be barriers created by poor literacy, mental and physical impairments in the complicated nature of our tax system, as well as new ones, such as access to technology and understanding how to use it. Given this, the IRS's future state vision could make the tax issues of low income and otherwise vulnerable taxpayers worse if they use the online system without fully appreciating what they are agreeing to and what rights they may be foregoing.

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77 See Oral Statement of Polly Bone, Texas RioGrande Legal Aid, Inc., National Taxpayer Advocate Public Forum 54-55 (Aug. 30, 2016):

First of all, this vignette, I'm wondering why whoever wrote it may think this is hardly representative of the people who get the earned income tax credit. ... I looked up the starting salaries of teachers here in SAISD and with what, one child her full year, she would not qualify for an earned income tax credit ... . So this isn't representative at all. My client would more than likely be someone who would be a provider or a health home provider, something that goes in and takes care of elderly people during the day or someone who works in housekeeping at one of our many hotels here in San Antonio.

78 See Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State's Reliance on Online Tools Will Harm EITC Taxpayers*, *infra*.

79 <https://taxpayeradvocate.irs.gov/public-forums>.

80 Statement of Audience Member, National Taxpayer Advocate Public Forum 57-58 (Aug. 18, 2016).

In addition, given the issues the IRS has in replying to mail, I do not have much confidence that electronic communications will be acted upon in a timely manner either.<sup>81</sup>

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***Our first choice of action***, typically, if it is fairly straightforward we can compare numbers and see, okay, yeah, there was a mistake, something was missing. We didn't have certain information. Whatever it might be. We could probably handle that by correspondence. Write a check or write a letter. We will get it resolved. A lot of times we need to get on the phone.

So one concern that I have, I think our office has in general with the future state is really looking towards heavy reliance on electronics, technology, to be able to tell us the information that we need. Our experience has been that tells us half the story. It tells us what the IRS thinks is going on or what's in their system that might be causing a problem. But it doesn't actually resolve everything. We have had access to online services in the past, and it gives us some information about what is going on, why the IRS is sending this notice, what might have triggered it, that we can maybe troubleshoot and figure out here is what is missing, or here's what they don't have. But the rest of the story typically takes a phone call.<sup>82</sup>

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***And again, because people need back tax help***, they need to get copies of their transcripts. In looking at the different ways that the IRS is considering how to get transcripts, I think if you're there on a Tuesday online, the moon is waxing and, you know, there's like a gerbil in the room, you qualify. I think it's like a very narrow set of people that are going to be able to use that.<sup>83</sup>

### ***Digital Communications and the "Mailbox Rule"***

Underlying these general concerns is the potential for erosion of very specific taxpayer rights. For example, under IRC § 7502, if a taxpayer can demonstrate he has mailed a particular document to the IRS on or before the statutory due date, it will be deemed to be timely filed. The Secretary is authorized to promulgate regulations setting forth how "*prima facie* evidence of delivery and the postmark date shall apply to certified mail and electronic filing."<sup>84</sup> This rule is known as the "timely mailed, timely filed" or "mailbox" rule. To date, the IRS has not explained how this rule will be applied in the Future State.

For example, let's look at Jane, the EITC taxpayer described in the IRS's vignette. Suppose Jane receives a math error notice under IRC § 6213 giving her 60 days to request abatement of the tax and receive deficiency procedures. On day 60, Jane logs on to her IRS account and sends an email requesting an abatement. The IRS receives the email on day 61. In discussions with the Office of Chief Counsel, the National Taxpayer Advocate has been advised that the mailbox rule would not apply to this email, and thus Jane did not respond timely, the assessment stands, and she loses her right to deficiency procedures. This means she also loses the opportunity to petition the United States Tax Court, the only judicial

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81 Written Statement of Arthur Bartlett, Legal Services of Southern Piedmont, National Taxpayer Advocate Public Forum 20-21 (Apr. 4, 2016).

82 Oral Statement of Rollin J. Groseclose, Johnson Price Sprinkle, National Taxpayer Advocate Public Forum 25-26 (Apr. 4, 2016).

83 Oral Statement of Robin McKinney, Maryland CASH Campaign, National Taxpayer Advocate Public Forum 44 (May 13, 2016).

84 IRC § 7502(c)(2).

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**For the Future State to succeed, the IRS and Congress should consider how the mailbox rule will apply to digital communications, weighing the alternatives in the light most favorable to the taxpayer.**

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forum in which a taxpayer can challenge a deficiency without paying the tax first, undermining her *right to appeal an IRS decision to an independent forum*. When the National Taxpayer Advocate pointed out that the taxpayer could prove when the email was sent (just as a facsimile log can show when a fax transmission occurred), representatives of the Office of Chief Counsel stated that emails and facsimile dates can be altered by the taxpayer, just as postage meter dates can be altered, and therefore the mailbox rule should not apply to digital communications. Under this approach, only the unsophisticated will utilize digital communications where the date of a document is critical.

Here, then, we have the heart of the problem with the Future State. It is designed around a fundamental suspicion that all taxpayers are likely to cheat, rather than giving taxpayers the benefit of the doubt and assuming they will not manipulate dates. If we really care about taxpayer rights, including the right to appeal to an independent forum, we should design a system that is based on the premise that most taxpayers are willing and trying to comply with the tax laws. For the Future State to succeed, the IRS and Congress should consider how the mailbox rule will apply to digital communications, weighing the alternatives in the light most favorable to the taxpayer.

#### *What's an Audit? Taxpayer Rights and Real-Time Adjustments During the Filing Season*

An even more troubling issue arises when we consider the impact of the IRS's increasing ability to identify errors and questionable returns while a return is being processed and before a refund is issued. In general, the accelerated due date for Forms W-2 and 1099-Misc (used to report non-employee compensation)<sup>85</sup> is an extremely important and positive development, one that the National Taxpayer Advocate has proposed since 2009.<sup>86</sup> But shifting examinations of returns into the filing season has profound implications for taxpayer rights that the IRS has neither acknowledged nor addressed. For example, there is a question about what rights accrue during income-matching and other pre-refund “reviews” of returns.

The National Taxpayer Advocate has previously written about “real” versus “unreal” audits. IRC § 7602(a)(1) grants the IRS the authority to examine any books, papers, records, or other data that may be relevant to ascertain the correctness of any return. The IRS interprets this provision narrowly; thus Automated Underreporter (AUR), Automated Substitute for Return (ASFR), Substitute for Return (SFR), and math and clerical error assessments, along with the entire category of questionable refund and return procedures are not classified as “real” audits.<sup>87</sup> As Figure S.6 shows, this classification system results in the majority of taxpayer compliance contacts being “unreal” audits — far outstripping what the IRS classifies as “audits” and the National Taxpayer Advocate calls “real” audits.<sup>88</sup>

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85 Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015).

86 See National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the “Pay Refunds First, Verify Eligibility Later” Approach to Tax Return Processing*); see also National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

87 An attempt to resolve a discrepancy between a taxpayer's return and third party data does not constitute an examination because the IRS “merely” is asking the taxpayer to explain the discrepancy. Rev. Proc. 2005-32, § 4.03, 2005-1 C.B. (206).

88 See, Nina Olson, *What's an audit, anyway?*, NATIONAL TAXPAYER ADVOCATE BLOG (Jan. 25, 2012), <https://taxpayeradvocate.irs.gov/news/what's-an-audit-anyway>.

**FIGURE S.6, Real vs. Unreal Audits: FY 2015 Occurrences Relating to Returns Filed for Tax Year 2014<sup>89</sup>**

Adjusted Gross Income Category	FY 2015 Exams	Exam Coverage %	FY 2015 ASFR	FY 2015 AUR	FY 2015 Math Error	FY 2015 Combined	Returns Filled in Calendar Year 2014	Combined Coverage %
No adjusted gross income	20,263	1%	184,776	12,544	31,329	248,448	2,401,182	10%
\$1 under \$25,000	427,452	1%		930,554	708,164	2,052,646	54,757,719	4%
\$25,000 under \$50,000	150,191	0%		1,101,847	479,513	1,717,095	34,032,631	5%
\$50,000 under \$75,000	65,710	0%		557,679	283,301	897,614	19,418,889	5%
\$75,000 under \$100,000	56,460	0%		351,880	178,036	580,175	12,574,091	5%
<b>Subtotal - under \$100,000</b>	<b>720,076</b>	<b>1%</b>	<b>184,776</b>	<b>2,954,504</b>	<b>1,680,343</b>	<b>5,495,978</b>	<b>123,184,512</b>	<b>4%</b>
\$100,000 under \$200,000	98,403	1%		600,769	232,752	921,406	17,349,237	5%
\$200,000 under \$500,000	59,395	1%		210,091	47,287	313,689	5,020,982	6%
\$500,000 under \$1,000,000	18,149	2%		34,040	6,339	58,030	808,547	7%
\$1,000,000 under \$5,000,000	14,657	4%		12,546	2,861	29,769	370,989	8%
\$5,000,000 under \$10,000,000	2,174	8%		658	261	3,060	26,559	12%
\$10,000,000 or more	3,529	21%		335	288	4,055	16,797	25%
<b>Total</b>	<b>916,383</b>	<b>0.6%</b>	<b>184,776</b>	<b>3,812,943</b>	<b>1,970,131</b>	<b>6,825,987</b>	<b>146,777,623</b>	<b>4.7%</b>

<sup>89</sup> Data from Individual Returns Transaction File, Individual Master File, and Notice Delivery System from the Compliance Data Warehouse. The audits represent taxpayers where the IRS posted a transaction code 420 to at least one individual taxpayer account in FY 2015. In some cases, the return was accepted as filed prior the IRS contact. The statistics for returns secured through Automated Substitute for Return (ASFR) are from the IRS FY 2015 Collection Activity Report No. 5000-139. Since ASFR returns are not filed by the taxpayer, no adjusted gross income (AGI) is associated with the return. The number of taxpayers receiving an Automated Underreporter (AUR) contact are those who received a CP 2000 or CP 2501 notice from the IRS in FY 2015. The combined coverage rate removes duplicates, so that a taxpayer is only counted once even if affected by two or more of these compliance programs in FY 2015. Taxpayers who received FY 2015 compliance actions on tax returns in more than one AGI category are counted in each AGI category. The coverage rate is computed by dividing by the number of individual income tax returns filed in each AGI category for Tax Year 2014.

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At every Public Forum, panelists and audience members expressed serious concerns about the interactions described in the vignettes. A threshold concern was that the system the IRS is designing seems to be stacked in the IRS's favor — *i.e.*, in both vignettes, the taxpayer lost; he or she was wrong. Nowhere did the vignette demonstrate how the taxpayer could prevail in the system of the future.

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The National Taxpayer Advocate's position is that for purposes of IRC § 7602, an audit includes both pre-refund and post-refund examinations of returns that require the taxpayer to provide some level of documentation. This definition has several consequences relating to the taxpayer's *right to finality* and the *right to appeal an IRS decision in an independent forum*. First, it more accurately states the audit rate, which will be higher than what the IRS currently reports, and it changes the incidence of the audit rate. Second, and more importantly, it protects taxpayers from multiple reviews of the same return — it forces the IRS to identify *all* issues relating to the return that require some sort of documentation and address those issues as early as possible in one proceeding.<sup>90</sup> Third, and most importantly, it provides the taxpayer with an appeal to the IRS Office of Appeals. Currently, when a taxpayer disagrees with an “unreal” audit's proposed assessment, the taxpayer receives a Statutory Notice of Deficiency, with no opportunity to seek an administrative appeal to the IRS Office of Appeals. The taxpayer's only option is to go to the U.S. Tax Court, the cost of which may be prohibitive for many taxpayers. In “real” audits, on the other hand, taxpayers generally receive 30-day letters offering them a chance to request an administrative appeal before petitioning the Tax Court.

#### *Effect of Erroneous IRS Advice Communicated Digitally*

The reliance on online “communications” and “digital notifications” raises the question of whether such communication constitutes erroneous written advice for purposes of interest abatement. IRC § 6404(f)(1) requires the IRS to abate penalties and additions to tax attributable to deficiencies where a taxpayer relied on erroneous written advice from the IRS. The IRS's vision of its Future State, and its current Taxpayer Digital Communication pilot, utilize the online account and secure emails to exchange information, including answers to taxpayer questions. If the IRS provides a “tailored digital communication,” as it does in the vignette about Bennett, the Small Business taxpayer, is that “written advice” under IRC § 6404(f)? Moving people from the phones (oral advice) to emails and other digital communications increases the IRS cost of inaccuracy, because failure to be accurate will cost the public fisc through interest abatements. In the past, the IRS has responded to risks like this by minimizing and dumbing down the specific advice it provides to taxpayers, as it has in the case of declaring entire areas of tax law “out of scope” for purposes of telephone tax law assistance. Thus, by moving to a digital format, the IRS may be reducing the assistance it provides to taxpayers, and this will increase their costs of tax compliance by driving them to tax preparers who charge a fee. Receiving overly broad or unreliable “digital notifications” is not a desirable Future State.

These issues are not new, and they are only the most obvious examples. They were first raised in 2011, both at the public hearing held by the IRS on Real Time Tax Administration,<sup>91</sup> and in the National

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90 IRC § 7605(b) protects taxpayers from unnecessary examinations and inspections and generally allows the Secretary to conduct only one inspection of a taxpayer's books of account for each taxable year.

91 Comments of T. Keith Fogg, Director, Villanova Law School Federal Tax Clinic, Real Time Tax System Initiative (Dec. 8, 2011), [http://www.irs.gov/pub/irs-utl/t\\_keith\\_fogg\\_aba\\_tax\\_section\\_and\\_low\\_income\\_tax\\_clinic.pdf](http://www.irs.gov/pub/irs-utl/t_keith_fogg_aba_tax_section_and_low_income_tax_clinic.pdf) (last visited Aug. 2, 2012).

Taxpayer Advocate's 2011 and 2012 Reports to Congress.<sup>92</sup> In numerous meetings of the IRS senior leadership and Future State teams, the National Taxpayer Advocate has asked the IRS and the Office of Chief Counsel to articulate its position and explain to the public how it will protect taxpayers from repetitive audits in the Future State. To date, neither the IRS nor the Office of Chief Counsel has provided any response. To design a Future State without addressing these and related concerns means that the Future State is not based on taxpayer rights, and taxpayer rights will be layered on as an afterthought rather than serving as a foundation for the future of tax administration.

### Recommendation

The National Taxpayer Advocate recommends that the Office of Chief Counsel, in collaboration with the National Taxpayer Advocate, immediately undertake a comprehensive review of key taxpayer rights provisions in the IRC and issue proposed guidance for public comment, updating these provisions to protect taxpayer rights in the digital environment envisioned by the IRS Future State. These provisions include the application of the mailbox rule and the erroneous advice rule to digital communications, and the definition of an "examination" or "audit" in light of the substantial pre-refund review activity envisioned by the Future State.

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92 National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*).

**GROSSLY OUTDATED TECHNOLOGY AND INFRASTRUCTURE: To enable the IRS to meet the major technology improvements required for a 21st century tax administration even as it fulfills current operational technology demands, the IRS must articulate a clear strategy that will reassure Congress and taxpayers the funding will be well-spent.**

The current state of the IRS’s technology limits how much and how quickly the IRS can advance to its “Future State.” But the impact of technology on *today’s* tax administration cannot be overstated. As we discuss later in a Most Serious Problem on Enterprise Case Management,<sup>93</sup> the IRS has two of the oldest information systems in the federal government.<sup>94</sup> Think about that — the nation’s revenue accounts are accessed and stored on five-decade old technology.

Today, the IRS has at least 60 major case management systems, and estimates range anywhere from 60 to 200 repositories of case data. This means that when a taxpayer calls the IRS for information about his or her account, the employee on the phone often doesn’t have access to the relevant system, can’t answer the taxpayer’s question, and has to send a referral to another IRS function to handle (one that has access to the relevant system). This all but certainly leads to the taxpayer calling or writing again, creating a vicious cycle of ever more work for the IRS and the taxpayer.

In the National Taxpayer Advocate’s Public Forums, taxpayers and practitioners alike spoke with enthusiasm about how an online account could provide them basic information without having to wait endlessly on the telephone. But the IRS’s ability to provide the full and seamless experience taxpayers and representatives want is far from a reality. For example, taxpayer representatives were particularly eager to see copies of notices that had been sent to their clients, since many clients don’t retain them or misplace them.<sup>95</sup> Yet most IRS notices are “vapor” — they don’t exist on IRS systems except as a record that such-and-such notice number was sent. Moreover, most letters and correspondence the IRS sends to taxpayers in audits and collection are not retained on IRS systems as digital images. Even if they were, the IRS would have to program between all of its case management systems and the online account in order for the information to be uploaded into the account. This is years away, and in the meantime, taxpayers and their representatives will continue to call and write.

In the Public Forums, the Nationwide Tax Forum focus groups, and the TAS group meetings, all participants expressed concern about the security of an online account.<sup>96</sup> The IRS shares those concerns and has been consulting with both government and private sector experts on this matter. The IRS cannot

93 See Most Serious Problem: *Enterprise Case Management (ECM): The IRS’s ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

94 Government Accountability Office (GAO), GAO-16-468, *Information Technology: Federal Agencies Need to Address Aging Legacy Systems* (May 2016) (discussing aging IT systems throughout the government and listing the IRS’s Individual Master File (IMF) and Business Master File (BMF) as the two oldest investments or systems at 56 years old each).

95 See Oral Statement of Robert Hamilton, MidPenn Legal Services Low Income Taxpayer Clinic, National Taxpayer Advocate Public Forum 9-10 (Apr. 8, 2016):

Major sources of delay in helping our clients is attempting to locate their notices, letters or records from the IRS, but the IRS already has, or should have, on file, particularly those documents submitted in connection with an audit.

The Form 2848, *Power of Attorney*, which our clients fill out at the beginning of representation, allows me to have access to their online transcripts, where I can obtain a clearer picture of what has transpired on their IRS account and where the taxpayer stands in the audit process; however, these transcripts only provide me with the dates of a notice or a letter that was issued, a short phrase summarizing that notice and the amount of the adjustment made to the client’s account.

It would be much more useful if, for example, all of these documents could actually be uploaded, opened and viewed directly through the online services function; however, while these online upgrades and online interfaces could surely enhance my representation of taxpayers, I have serious doubts about taxpayers utilizing and relying exclusively on online services as a replacement to direct person-to-person contact with the IRS representatives.

96 See <https://taxpayeradvocate.irs.gov/public-forums>.

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The IRS has two of the oldest information systems in the federal government. Think about that — the nation’s revenue accounts are accessed and stored on five-decade old technology.

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*balance* the need for security with the need for access — security must be *paramount*. But the IRS must clearly acknowledge — to Congress, to the taxpaying public, and in its Future State plans — that there are consequences to the high level of security. Such high security means that only a limited segment of taxpayers will be able or willing to use the online account. The most recent data show that only 34 percent of taxpayers who attempted to create an online account were able to do so.<sup>97</sup> The taxpayers who sought to establish online accounts were the early adopters — the ones most eager and comfortable with online financial transactions. Yet even among that group, only one-third got through. That means two-thirds of the U.S. taxpayer population will still need telephone or face-to-face assistance.

As the IRS conducts its Taxpayer Digital Communication pilot this year, it will be interesting to see if taxpayers will be willing to engage digitally with the IRS in audits and other interactions.<sup>98</sup> If they agree to communicate via email, do they continue to do so throughout the audit, or do they revert to more personal methods such as phone calls? Will the IRS leverage technology to provide clear and individual explanations, or will taxpayers feel frustrated with the IRS templates for responses to questions and issues? Will IRS employees be able to respond to specific questions, or will they send canned responses? Will the IRS learn from these dialogues and update its responses and guidance? It hasn’t done that in its analog processes, so what is it about the Future State that makes us think it will do so in the digital environment?

### *The Consequences of Insufficient Information Technology (IT) Funding to Fundamental Tax Administration Operations*

The multiple demands on the IT function of the IRS create the same difficulties as the budget constraints on the IRS overall. In recent years, the IRS understandably has decided to focus most of its IT resources and talent on several major projects, including the Return Review Program (RRP), the Enterprise Case Management (ECM) system, International Data Exchange Service (IDES, for information sharing under FATCA and inter-government agreements), and Information Sharing and Reporting (IS&R, for Affordable Care Act implementation). But this approach leaves most of the IT needs of smaller functions, and even important projects for the larger functions, unfunded and unaddressed. Thus, chronic underfunding of the IRS IT function creates taxpayer burden and wasted resources from manual and unnecessary rework.

Even in areas that are currently the subject of major IT activity, the excuse of “no funding” arises. Currently, the IRS is moving to develop the RRP to replace the aging Electronic Fraud Detection System (EFDS).<sup>99</sup> But, as we discuss in a Most Serious Problem herein, a system is only as good as the intelligence that goes into it.<sup>100</sup> The IRS’s filters and business rules used for detecting fraudulent returns and identity theft had many false positive rates (FPRs) over 50 percent. This means that legitimate

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97 The pass rate was 28 percent on Nov. 16, 2016, 29 percent on Nov. 17, 2016, and increased to 34 percent as of Dec. 18, 2016. IRS response to TAS Fact Check (Dec. 20, 2016).

98 For a discussion of TAS’s participation in the Taxpayer Digital Communication (TDC) pilot, see *TAS Case Advocacy*, *infra*.

99 W&I’s Business Modernization Office Return Review Program is a new integrated system that adds to the Service’s capability to detect, resolve and prevent criminal and civil tax non-compliance and fraud.

100 See Most Serious Problem: *Fraud Detection: The IRS’s Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*. See also Literature Review: “False Positive” Determinations in Fraud Detection, vol. 3, *infra*.



taxpayers are burdened unnecessarily while the IRS goes about its important work of detecting and stopping questionable returns.

In the private sector, financial and other institutions have found that false positives cost the business more through customer base erosion than does actual fraud. Thus, they have a strong incentive to minimize the rate and burden of false positives.

Because taxpayers cannot just leave the IRS and find themselves another tax administrator, it is incumbent on the IRS to respond *in real time* during the filing season to rules that have high false positive rates. Institutions throughout the government and the private sector accept the importance of using incoming data in real time to minimize false positives. When TAS recommended creating a dedicated sub-team of an IT Executive Steering Committee to accomplish programming approvals quickly, the IRS responded it already had an operational structure in place that addresses fraud model modifications in an almost real time atmosphere. Yet the Business Rules and Requirements Management office that must approve all business rule modifications does not meet regularly.<sup>101</sup> Thus, the IRS wastes the funds it does have by having to work the phone calls and letters from 1.2 million legitimate taxpayers whose \$9 billion in refunds were delayed.<sup>102</sup>

### Recommendation

The National Taxpayer Advocate recommends that Congress require the IRS to provide a detailed plan of its ECM strategy, including the RRP and the IRS strategy for reducing FPR in refund fraud detection, as well as a detailed report about the components and progress on the Taxpayer Advocate Service Integrated System (TASIS).<sup>103</sup>

101 See National Taxpayer Advocate FY 2017 Objectives Report to Congress, vol. 2, 23.

102 Most Serious Problem: *Fraud Detection: The IRS's Failure to Establish Goals to Reduce High False Positive Rates for Its Fraud Detection Programs Increases Taxpayer Burden and Compromises Taxpayer Rights*, *infra*.

103 For a discussion of TASIS, see Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Information System as a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

## OFFICE OF THE TAXPAYER ADVOCATE: To protect taxpayer rights and ensure a fair and just tax system, Congress should take steps to strengthen the Taxpayer Advocate Service.

It has been 18 years since the establishment of the Office of the Taxpayer Advocate and the positions of National Taxpayer Advocate and Local Taxpayer Advocates under RRA 98. The Taxpayer Advocate Service (TAS) is now well-established. Since 2001, it has assisted about four million taxpayers in cases involving significant hardship, obtaining in whole or in part the relief taxpayers requested in over 75 percent of those cases. In the area of systemic advocacy, the IRS accepts, on average, more than half of our administrative recommendations, and enacted 32 of our legislative recommendations, including incorporating the Taxpayer Bill of Rights into the Code, and the IRS and Treasury have adopted additional recommendations by regulation.<sup>104</sup> The National Taxpayer Advocate has testified or submitted written testimony at over 60 congressional hearings, and the Annual Report to Congress is recognized as an important source of information about tax administration and taxpayer rights.

Our work in growing and strengthening TAS has not been without its challenges. Maintaining TAS's independence within an agency that is resistant to change and has a predilection for maintaining the status quo demands constant vigilance.<sup>105</sup> But over the years, progress has been made. The IRS senior leadership recognizes the important role TAS plays in reviewing IRS policies and actions, and acknowledges our role as an advocate for the taxpayer in those discussions.

Having sat at the IRS senior leadership table for almost 16 years (to our knowledge, longer than any other IRS official), the National Taxpayer Advocate is well aware of the challenges the IRS faces on a daily basis. But her job, and that of her employees, is to speak up for the taxpayers whose lives are impacted by the decisions the IRS makes daily in response to those challenges. This is very difficult work — trying to alter the course of an organization that is heading full-tilt in a particular direction.

The statutory framework of the Office of Taxpayer Advocate is what underlies the success of TAS. Without the strong language and structure of IRC §§ 7803(c) and 7811, the National Taxpayer Advocate would be a substanceless mouthpiece, and TAS a token gesture. But even a strong foundation can be improved. To enhance the effectiveness of the Office of the Taxpayer Advocate in advocating for taxpayers, the National Taxpayer Advocate offers the following ideas for consideration.

### *Reinforce the National Taxpayer Advocate's Right of Access to Taxpayer and IRS Information and to Meetings Between the IRS and Taxpayers*

By and large, the National Taxpayer Advocate and her employees have significant access to IRS systems and data. Yet over the years, both in the context of specific cases and systemic advocacy, including during the preparation of the Annual Report to Congress, the IRS has:

- Refused to allow the National Taxpayer Advocate and other TAS employees access to the audit files of taxpayers with cases open in TAS;
- Refused to allow the National Taxpayer Advocate and her employees to attend meetings between the IRS and taxpayers with cases open in TAS, even when the taxpayer him or herself requests TAS attendance;

<sup>104</sup> See *National Taxpayer Advocate Legislative Recommendations with Congressional Action*, *infra*.

<sup>105</sup> See *supra* for a discussion of IRS culture; see also *Most Serious Problem: IRS Structure: The IRS's Functional Structure Is Not Well-Suited for Identifying and Addressing What Different Types of Taxpayers Need to Comply*, *infra*.

- Refused to provide the National Taxpayer Advocate with data she requires for analyzing a most serious problem of taxpayers in the context of the Annual Report to Congress; and
- Refused to consent to publication of such data on the basis it is “official use only,” even though no exception or exclusion applies under the Freedom of Information Act.

IRC § 6103 sets out the confidentiality protections of tax returns and return information. It categorically states, “Returns and return information shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes.”<sup>106</sup> Under IRC § 7803(c), the National Taxpayer Advocate’s tax administration duties are extraordinarily broad, encompassing all of tax administration.<sup>107</sup> Therefore, there is no basis for the IRS to decline to make accessible to the National Taxpayer Advocate or her employees a taxpayer’s administrative file (including the audit file) relating to a case open or pending in TAS. Similarly, when a taxpayer requests that TAS participate in conferences or meetings between IRS employees and the taxpayer, there is no basis for the IRS to deny TAS that access.<sup>108</sup> Yet these refusals keep occurring. Therefore, the National Taxpayer Advocate recommends that Congress clarify the extent of TAS’s access to tax returns and tax return information with respect to cases open and pending in TAS, including the ability to participate in meetings between the taxpayer and the IRS, at the taxpayer’s request.

Moreover, where the National Taxpayer Advocate, in the course of exercising her statutory tax administration duties, identifies an issue as a most serious problem of taxpayers, or is investigating the systemic causes of taxpayer problems in general, there is no basis for the IRS to decline to make available to her any data, information, records it has compiled, or is preserving relating to that issue. However, because TAS has encountered numerous instances over the years in which IRS officials have declined to

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<sup>106</sup> IRC § 6103(h)(1).

<sup>107</sup> See IRC § 7803(c)(2)(A)(i)-(iv).

<sup>108</sup> See Oral Statement of Jim Oliver, Jim Oliver & Associates, PC., National Taxpayer Advocate Public Forum 37-38 (Aug. 30, 2016).

This was a very complex problem. The [taxpayer] advocate tracked down the IRS auditor in Ogden who was handling the problem. The IRS auditor in Ogden informed us with the advocate on the phone it was against policy for them to engage in a conference call with the advocate and a taxpayer representative at the same time. I don’t know that policy, but that’s what this person said and refused, refused to engage in a conference call where I needed to talk to how complex this problem was and how it needed to be fixed.

provide her access to certain information, the National Taxpayer Advocate recommends that Congress clarify her right to such information.<sup>109</sup>

### *Include Local Taxpayer Advocate Office Phone Numbers and Addresses in Statutory Notices of Deficiency*

IRC § 6212(a) provides that any notice proposing a deficiency of tax “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.” IRC § 7803(c)(2)(D)(i)(I) requires the National Taxpayer Advocate to “appoint local taxpayer advocates and make available at least 1 such advocate for each State.” Since the year 2000, when TAS first began its formal operations, the National Taxpayer Advocate has tried to get the IRS to include *on the Statutory Notice of Deficiency (SNOD)* the actual “location and phone number of the appropriate office.” As we discussed in an earlier Annual Report, the IRS has consistently declined to do so.<sup>110</sup>

In the past, the IRS and Chief Counsel maintained it satisfied this statutory mandate by including in the SNOD a stuffer notice listing all of the TAS local taxpayer advocate offices (Notice 1214), rather than the information pertaining to the *appropriate* office. With the IRS’s declining budget, the IRS in recent years has presented the National Taxpayer Advocate with a Hobson’s Choice — either agree to putting an internet address on the SNOD for taxpayer’s to look up the “appropriate” TAS location and phone number, or agree to TAS paying for the annual cost of printing at least three million Notices 1214 for inclusion in the SNODs.<sup>111</sup>

As we discussed earlier in this report, about one-third of the U.S. individuals do not have home broadband access, concentrated in lower income, elderly, and minority populations.<sup>112</sup> For these millions of taxpayers to access the internet to complete a search for a TAS local office, they must seek out wi-fi. And even so, they often have pay-as-you-go cell phone contracts. Thus, the use of a general internet address on the SNOD does not provide the mandated TAS contact information to a large swath of the taxpayer population. The alternative proposal of TAS endlessly paying for stuffer notices reduces funds available for its direct case advocacy on behalf of taxpayers. Instead, for a modest upfront investment, the IRS could develop a technology-based solution.

109 This issue arose recently in the context of this Annual Report to Congress. In an unprecedented move, the IRS declined to respond to the Enterprise Case Management (ECM)-related information requested by TAS as part of our development of a Most Serious Problem. The IRS took the position that ECM is internal to the IRS and “cannot be categorized as a most serious problem ‘encountered by taxpayers.’” IRS response to TAS research request (Nov. 3, 2016). Thus it declined to provide us with data and financial information the National Taxpayer Advocate had deemed necessary to her analysis of the problem. As such, TAS was unable to obtain the bulk of the information it sought to prepare this Most Serious Problem. TAS obtained the information used in this Most Serious Problem from external sources and from IRS information outside of the formal Most Serious Problem process. See Most Serious Problem: *Enterprise Case Management (ECM): The IRS’s ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Information System as a Quick Deliverable and Building Block for the Larger ECM Project*, *infra*.

110 See National Taxpayer Advocate 2014 Annual Report to Congress 237-44 (Most Serious Problem: *Statutory Notices of Deficiency: Statutory Notices of Deficiency Do Not Include Local Taxpayer Office Contact Information on the Face of the Notices*).

111 The estimate of the cost for one year’s worth of Notice 1214 for SNODs issued by the Small Business/Self-Employed Operating Division was \$47,000. This does not include any SNODs issued by W&I with respect to Earned Income Tax Credit audits.

112 See discussion of taxpayer needs and preferences, *supra*; see also Most Serious Problem: *Online Accounts: Research into Taxpayer and Practitioner Needs and Preferences is Critical as the IRS Develops an Online Taxpayer Account System* and Research Study: *Taxpayers’ Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*, *infra*.

Since 2013, TAS has proposed that the IRS program its notice-generation system to allow for matching between the taxpayer's last known address (used on the notice) and the "location and phone number of the appropriate [local TAS] office." TAS has submitted Unified Work Requests (UWRs) to the IRS requesting such programming. To date, the IRS has denied all such requests. Therefore, in order to ensure that all taxpayers have the *right to a fair and just tax system*, the National Taxpayer Advocate recommends that Congress establish a date certain by which the IRS shall be required to complete programming for including the specific phone number and address of the appropriate local TAS office, based on the taxpayer's last known address.<sup>113</sup>

*Provide the National Taxpayer Advocate the Authority to Hire Independent Counsel, Comment on Regulations, and File Amicus Briefs in Litigation Raising Taxpayer Rights Issues*

The National Taxpayer Advocate is required by law to assist taxpayers in resolving problems with the IRS, to identify areas in which taxpayers have frequent problems or that are the subject of frequent litigation, and to identify administrative and legislative solutions to reduce controversy and mitigate such problems.<sup>114</sup> The mission of the Office of the Taxpayer Advocate would be advanced by additional statutory authority in three areas: *amicus curiae* briefs pertaining to taxpayer rights; the administrative rulemaking process; and the ability to hire independent counsel.

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The National Taxpayer Advocate is not authorized to participate in litigation.<sup>115</sup> While the conduct of relevant trials themselves may be best left to trial lawyers equipped to advocate zealously on behalf of individual clients, precedential issues of interest to numerous taxpayers may come before the judiciary with no one representing the rights of taxpayers in general. In the case of the Small Business Administration (SBA), the Chief Counsel for Advocacy has statutory authority to represent the interests of small businesses by appearing as *amicus curiae*.<sup>116</sup>

Although the National Taxpayer Advocate is charged with representing the interests of individuals, including low income taxpayers, there is no statutory requirement that the IRS address the National Taxpayer Advocate's comments before publishing final regulations. In the case of the SBA, the Chief Counsel for Advocacy has statutory authority to represent the interests of small businesses by providing comments that the IRS must consider before publishing any final regulation.<sup>117</sup> In the case of small businesses, Congress recognized this need by legislatively mandating regulatory review on their behalf by a counsel dedicated to this function. The rights of individual taxpayers, including low income taxpayers, may fall in a gap in regulatory review. While the National Taxpayer Advocate is often included in pre-publication circulation

<sup>113</sup> The right to a fair and just tax system means "[t]axpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels." IRS Pub. 1, *Your Rights as a Taxpayer* (Dec. 2014).

<sup>114</sup> IRC § 7803(c)(2)(A)(i)-(iv).

<sup>115</sup> See 28 U.S.C. § 516 ("Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice"); 5 U.S.C. § 3106 ("Except as otherwise authorized by law, the head of an Executive department or military department may not employ an attorney or counsel for the conduct of litigation in which the United States, an agency, or employee thereof is a party"); IRC § 7452 (indicating that the Secretary of the Treasury "shall be represented by the Chief Counsel"). See also Program Manager Tech. Assistance 00566, *Authority for the National Taxpayer Advocate to File Amicus Briefs with the Courts of the United States* (Oct. 2, 2002).

<sup>116</sup> 5 U.S.C. § 612(b).

<sup>117</sup> IRC § 7805(f).

of proposed or temporary regulations, the IRS is not required to address her comments in the published preambles to final regulations. The National Taxpayer Advocate believes that tax administration would be improved if the public knew what her concerns were with respect to regulations and how the IRS addressed (or did not address) those concerns.

When Congress reorganized the IRS in 1998, the Senate passed legislation providing for counsel to the National Taxpayer Advocate to be appointed by and report directly to the National Taxpayer Advocate and to operate within the Office of the Taxpayer Advocate.<sup>118</sup> In sponsoring this provision, Senator Charles Grassley (R-Iowa) offered the following rationale:

The purpose of doing this is to give the Taxpayer Advocate ready access to legal opinions and legal judgments. Currently, the Taxpayer Advocate must put requests into the Office of Chief Counsel. In order to make the Taxpayer Advocate more independent, which is what this bill does, it logically follows that the Taxpayer Advocate should have its own legal counsel. This will guarantee it fast, confidential legal advice to help those taxpayers in greatest need. Because it is the taxpayers in greatest need who go to the Taxpayer Advocate.<sup>119</sup>

This provision was eliminated in the conference agreement. Still, the conference report noted that the “conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate.”<sup>120</sup>

Accordingly, to assist the National Taxpayer Advocate in fulfilling her statutory duties, TAS employs several attorney-advisors and has done so for more than a decade. The first round of hiring began in 2003 after the National Taxpayer Advocate briefed the Commissioner, and it has continued since that time. TAS requires independent attorney-advisors because the office 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. TAS attorney-advisors do not purport to offer formal legal advice or represent the agency, but they are indispensable in enabling the National Taxpayer Advocate to develop an independent perspective and advocate as the law intends.<sup>121</sup>

In 2015, we were informed that TAS’s longstanding ability to hire attorney-advisors within TAS is inconsistent with 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. On November 29, 2016, the National Taxpayer Advocate submitted a memorandum to the Acting General Counsel, Department of the Treasury, requesting that Treasury General Counsel Directive No. 2 be modified to include the Office of the Taxpayer Advocate

118 H. REP. NO. 105-599, at 215 (1998) (Conf. Rep.).

119 144 Cong. Rec. § 4460 (May 7, 1998) (statement of Sen. Grassley).

120 H. REP. NO. 105-599, at 216 (1998) (Conf. Rep.).

121 The Office of Chief Counsel has created the position of “Special Counsel to the National Taxpayer Advocate” to manage and coordinate Office of Chief Counsel support for the National Taxpayer Advocate and her headquarters employees. The Special Counsel and her staff are responsible for providing legal advice for programs and services related to the mission of TAS. The Special Counsel’s work is very helpful to the functioning of TAS in working many taxpayer cases, reviewing proposed regulations, coordinating with other divisions within the Office of Chief Counsel, reviewing training materials, and the like. However, the Special Counsel to the National Taxpayer Advocate reports to the IRS Chief Counsel and receives her performance reviews from the Chief Counsel. When the National Taxpayer Advocate wishes to articulate a position in her independent role that is contrary to the Office of Chief Counsel’s position, the Special Counsel is obligated to follow the position of the Chief Counsel.

along with the Inspectors General offices and the Office of the Comptroller of the Currency as Treasury offices excepted from the policy against hiring and employing attorney-advisors.<sup>122</sup>

### *Set TAS's Annual Appropriations Level Through a Separate Account Rather Than as Part of the IRS's Taxpayer Services Account*

The IRS is currently funded through four appropriations accounts — Taxpayer Services, Enforcement, Operations Support, and Business Systems Modernization. Funding for TAS is provided through the Taxpayer Services account, and except to the extent specified in an appropriations act, the IRS may decide how much funding to provide to TAS. This “power of the purse” may compromise TAS’s independence because the IRS can — explicitly or implicitly — penalize TAS if the National Taxpayer Advocate or other TAS employees criticize IRS policies and programs that they believe fail to respect taxpayer rights.

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In most years since FY 2006, the Appropriations Committees have addressed this concern by including language in appropriations acts that provides a minimum funding level for TAS. But the decision to provide a minimum TAS funding level is not institutionalized. It is made on an *ad hoc* basis from year to year. In most years, in fact, the Administration’s budget request asks that Congress *not* provide TAS with a minimum funding level,<sup>123</sup> and in some years, one house of Congress has specified a minimum funding level for TAS while the other has not.<sup>124</sup>

By creating a separate appropriation for TAS within the IRS budget — much like the Inspectors General have a separate appropriation with the Treasury Department’s budget — this independence issue can be resolved on a permanent basis.

### *Codify the Authority to Issue a Taxpayer Advocate Directive (TAD) and Clarify the Appeal Process Applicable to Taxpayer Assistance Orders (TAOs) and TADs*

IRC § 7811 authorizes the National Taxpayer Advocate to issue a TAO if she “determines the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.”<sup>125</sup> Only the National Taxpayer Advocate, the Commissioner of Internal Revenue, or the Deputy Commissioner of Internal Revenue may modify or

122 It is worth noting that as of Oct. 20, 2016, there were 278 attorney-advisors in the IRS whose positions were outside the Office of Chief Counsel. In addition to the attorneys in TAS, there were 238 attorney-advisors in the Small Business/Self-Employed Division’s estate and gift tax area (pursuant to an express waiver from General Counsel Directive No. 2), 14 attorneys in the Office of Professional Responsibility, six attorneys in the Large Business & International Division, four attorneys in the Human Capital Office, two attorneys in the Return Preparer Office, and one attorney each in the Commissioner’s Office, the Chief Financial Officer’s Office, and the Tax Exempt & Government Entities Division. IRS Human Resources Reporting Center (Oct. 10, 2016).

123 See, e.g., IRS, *Congressional Justification for FY 2015 Budget at IRS 95* (“The IRS supports adequate funding for the Taxpayer Advocate Service. Specifying the TAS funding level in law prevents the IRS from proposing an operating plan that allocates resources in the best interest of taxpayers”), <https://www.treasury.gov/about/budget-performance/CJ15/10.%20-%202015.%20IRS%20CJ.pdf>.

124 For FY 2016, for example, the Senate bill provided a minimum funding level for TAS, but the House bill did not. Compare S. 1910, 114th Cong. (2015) with H.R. 2995, 114th Cong. (2015). For FY 2017, both houses provided a minimum funding level for TAS. See S. 3067, 114th Cong. (2016); H.R. 5485, 114th Cong. (2016).

125 IRC § 7811(a)(1)(A). IRC § 7811(b) establishes the terms of the Taxpayer Assistance Order (TAO).

rescind the TAO, and “only if a written explanation of the reasons for the modification or rescission is provided to the National Taxpayer Advocate.”<sup>126</sup>

Similarly, in the course of assisting taxpayers in resolving problems or identifying areas in which taxpayers have problems in dealing with the IRS, the National Taxpayer Advocate from time to time confronts procedural obstacles. In such cases, the Commissioner of Internal Revenue has delegated to the National Taxpayer Advocate the authority to issue TADs that direct IRS units to change procedures “to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.”<sup>127</sup> However, the IRS may not comply with or even respond to a TAD because it comes not under a statute but merely a delegated power that the Commissioner could revoke. In practice, the Commissioner or Deputy Commissioner, along with the National Taxpayer Advocate, may rescind or modify a TAD.<sup>128</sup>

### Recommendations

To enhance the independence of the Office of the Taxpayer Advocate and ensure that the rights of taxpayers, including the most vulnerable and unrepresented, are considered and protected in tax administration, regulations, and litigation, the National Taxpayer Advocate recommends that Congress:

1. Amend IRC § 7803(c) to clarify, pursuant to IRC § 6103(h)(1), that the National Taxpayer Advocate shall have access to tax returns and return information with respect to cases open and pending in TAS, and shall have the right to participate in meetings between taxpayers and the IRS when asked to do so by the taxpayer.
2. Amend IRC § 7803(c) to clarify that, in furtherance of her tax administration duties, the National Taxpayer Advocate shall have access to all data, statistical information, and documents necessary to perform a “full and substantive analysis” of the issues.<sup>129</sup>
3. Amend IRC § 6212(a) to require the IRS to include on and within the SNOD itself the specific phone number and address of the appropriate local TAS office, based on the taxpayer’s last known address.
4. Authorize the National Taxpayer Advocate to submit *amicus curiae* briefs in federal appellate litigation on matters relating to the protection of taxpayer rights.
5. Require the IRS to submit proposed or temporary regulations to the National Taxpayer Advocate on a pre-publication basis for comment within a reasonable time, and address those comments in the preamble to final regulations.
6. Authorize the National Taxpayer Advocate to appoint independent counsel who report directly to the National Taxpayer Advocate, provide independent legal advice, help prepare *amicus curiae* briefs and comments on proposed or temporary regulations, and assist the National Taxpayer Advocate in preparing the Annual Report to Congress and in advocating for taxpayers individually and systemically.
7. Create a separate appropriation for TAS within the IRS budget to ensure that TAS funding is controlled by Congress and not by IRS.

<sup>126</sup> IRC § 7811(c).

<sup>127</sup> Delegation Order 13-31 (formerly DO-250, Rev. 1), *reprinted* as IRM 1.2.50.4 (Jan. 17, 2001); see also IRM 13.2.1.6 (July 16, 2009).

<sup>128</sup> *Id.*

<sup>129</sup> IRC § 7803(c)(2)(B)(i).



8. Grant to the National Taxpayer Advocate non-delegable authority to issue a TAD with respect to any IRS program, proposed program, action, or failure to act that may create a significant hardship for a segment of the taxpayer population or for taxpayers at large, and require that, to object to a directive, the IRS would have to respond timely in writing.
9. Amend IRC § 7811 to clarify the process by which the IRS shall appeal a TAO, and require the Commissioner of Internal Revenue or the Deputy Commissioner of Internal Revenue to raise his or her objections to a TAO (*i.e.*, appeal the Order) issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the TAO. If the order is modified or rescinded, a detailed explanation of the reasons for such modification or rescission should be provided.<sup>130</sup>

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<sup>130</sup> See Taxpayer Rights Act of 2015, S. 2333, 114th Cong. §§ 401 & 402 (2015); Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. §§ 401 & 402 (2015) (addressing aspects of Taxpayer Assistance Orders and Taxpayer Advocate Directives).

## LR #2 TAX REFORM: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

### PROBLEM

A taxpayer's "family status" is central to the calculation of his or her taxable income and computation of tax. Despite several legislative improvements<sup>2</sup> and recommendations by the National Taxpayer Advocate and others,<sup>3</sup> this fundamental component of taxation remains one of the most complex facing each and every taxpayer. The Family Status provisions include:

- Filing status (*i.e.*, single, married filing jointly, married filing separately, and head of household);<sup>4</sup>
- Personal and dependency exemptions;<sup>5</sup>
- Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC);<sup>6</sup>
- Earned Income Tax Credit (EITC);<sup>7</sup>

- 1 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 now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 Congress adopted a Uniform Definition of a Child (UDOC) in the Working Families Tax Relief Act of 2004, effective for tax years beginning after December 31, 2004. Pub. L. No. 108-311, §§ 201, 208, 118 Stat. 1166, 1169, 1178 (2004). Congress made further revisions to UDOC in Pub. L. No. 109-135, § 404(a), 119 Stat. 2577, 2632 (2005) and Pub. L. No. 110-351, § 501, 122 Stat. 3949, 3979 (2008). The National Taxpayer Advocate first recommended adoption of a UDOC in National Taxpayer Advocate 2001 Annual Report to Congress 82-100.
- 3 See, e.g., National Taxpayer Advocate 2005 Annual Report to Congress, 397-406; National Taxpayer Advocate 2008 Annual Report to Congress, 363-369; National Taxpayer Advocate 2012 Annual Report to Congress, 508-512; Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>; Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, Tax Policy Center (TPC), <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults>; The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (November 2005); Adam Carasso, Jeffrey Rohaly, and C. Eugene Steuerle, *A Unified Children's Tax Credit*, National Tax Association Proceedings (May 15, 2005), <http://www.urban.org/uploadedPDF/1000790.pdf>; Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Sized Adjustment to the Minimum Wage*, 57 TAX LAW REV. 301 (Spring 2004); Max B. Sawicky, Robert Cherry and Robert Denk, *The Next Tax Reform: Advancing Benefits for Children*, Economic Policy Institute (2002).
- 4 IRC §§ 1-2.
- 5 IRC §§ 151-152.
- 6 IRC § 24.
- 7 IRC § 32.

- Child and Dependent Care Credit (CDCC);<sup>8</sup> and
- Separated spouse rules.<sup>9</sup>

While literally every tax return involves at least two of these Family Status provisions, the IRS is hard-pressed to independently verify the accuracy of the status claimed. Over the years, it has used different government databases and developed “rules” that assist it in identifying questionable claims of filing status or credits. But these rules fail to account for the fluid nature of household composition. A recent study by the Tax Policy Center found that between 1996 and 2008 the number of households made up of “traditional” families (married parents with only biological children) has declined while alternative family types, such as families led by a single parent and cohabitating parents, has increased.<sup>10</sup> Thus, a narrow conception of a “family” can deny Family Status benefits to many households with children. On the other hand, an overly expansive definition may be impossible for the IRS to administer without unacceptably intrusive inquiries.

Nowhere is this conflict more apparent than in EITC administration. Enacted as a work incentive in the Tax Reduction Act of 1975,<sup>11</sup> the EITC has become one of the government’s largest means-tested anti-poverty programs.<sup>12</sup> Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy “application” process by allowing an individual to claim the benefit on his or her tax return. This approach does not require an infrastructure of case workers and local agencies to make eligibility determinations. For tax year (TY) 2015, over 27 million taxpayers claimed nearly \$67 billion in EITC.<sup>13</sup> Thus, the EITC enjoys a participation rate of between 75 and 79 percent<sup>14</sup> — one of the highest participation rates of any federal government benefit program — and 87 percent of children claimed for the EITC were correctly claimed.<sup>15</sup> However, the easy application process of the EITC is also associated with a high improper payment rate, which must be addressed in any efforts to improve the EITC.<sup>16</sup>

8 IRC §§ 21, 129.

9 IRC § 7703.

10 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, Tax Policy Center (TPC), *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits* 19 (Mar. 3, 2016). The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

11 See Pub. L. No. 94-12, § 204, 89 Stat. 26, 30 (1975) (codified at IRC § 32).

12 Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

13 IRS, *About EITC*, <https://www.etc.irs.gov/EITC-Central/abouteitc>. For tax year (TY) 2015, 27.3 million taxpayers had claimed \$66.9 billion in EITC (after math error processing, but prior to any audit of the tax return). IRS, Compliance Data Warehouse (CDW), *Individual Returns Transaction File* (includes TY 2015 returns posted as of cycle 47).

14 Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005* 178-179, IRS Research Bulletin (2009). See also Maggie R. Jones, *Changes in EITC Eligibility and Participation, 2005-2009*, U.S. Census Bureau.

15 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 5 (Pub. 5162, August 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf> (hereinafter referenced as *IRS EITC Compliance Study*). The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (*i.e.*, in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (*i.e.*, the default exam exclusion is correct). The upper bound estimate for correctly-claimed children is 73 percent.

16 An improper payment is defined as “any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements” and “includes any payment to an ineligible recipient.” Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e), 124 Stat. 2224, 2227 (2010) (amending Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002) by striking § 2(f) and adding (f)(2)). The IRS currently estimates that the EITC improper payment rate is about 24 percent (which accounts for an estimated \$16.8 billion in improper payments). Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 224 (Nov. 15, 2016).

The IRS National Research Program (NRP) is helpful in identifying the sources of EITC errors. The most common type of EITC error is income misreporting: 65 percent of EITC overclaim returns show some income misreporting and it is the *only* error on 50 percent of overclaim returns.<sup>17</sup> Many of these improper payments should be eliminated by the recent enactment of accelerated due dates for Forms W-2 and 1099-MISC (reporting nonemployee compensation) and the delayed EITC refund issuance date, in effect for the 2017 Filing Season.<sup>18</sup> What remains are some of the more factually complex sources of error, particularly the requirement that the child reside with the taxpayer for more than half the year. Other errors include competing claims for the same child, particularly by separated parents or by persons not having a required relationship with the child, and whether separated parents are considered “unmarried” under the tax code and thus able to file as single or head of household.<sup>19</sup> These issues also arise under other Family Status provisions.

The EITC also provides an extremely small benefit to low income childless workers between the ages of 25 and 64. The participation rate for this benefit is extremely low, even though it is very easy to calculate, because it based on the earnings of a single taxpayer.<sup>20</sup> The IRS does not adjust a taxpayer’s return to claim this credit where the taxpayer has not done so and appears eligible.<sup>21</sup>

Finally, there are areas of EITC administration that can be vastly improved. For example, the IRS has not yet embraced its dual mission as a tax collection and benefits disbursement agency. This failure to acknowledge its role as an administrator of one of the largest anti-poverty programs in the federal government leads to enforcement-oriented compliance approaches that are particularly unsuitable and counter-productive, given the characteristics of the EITC population.<sup>22</sup>

## EXAMPLE

The Tax Court case of *Cowan v. Commissioner* illustrates the counterintuitive operation of the current Family Status rules.<sup>23</sup> In this case, the state of Ohio appointed Ms. Cowan to be the guardian of a child, Marquis, from 1991 until 2004. Under state law, the guardianship automatically terminated when Marquis turned 18, which occurred in 2004. However, Ms. Cowan continued to provide Marquis a home and provided his support after he turned 18, and they continued to regard themselves as a family unit. (The court noted “Ms. Cowan regards Marquis as her son, and Marquis regards Ms. Cowan as his mother.”) Ms. Cowan never adopted Marquis, the legal significance of which she did not understand. Ms. Cowan stipulated for trial that had she known of the importance of adoption, she would have adopted Marquis.

Later, Marquis had a daughter, and they both lived with Ms. Cowan. The court found Ms. Cowan provided most of the household’s support during 2011. In 2011, Ms. Cowan claimed Marquis’s daughter as her granddaughter for the EITC. The court disallowed this claim since Marquis’s daughter was not a qualifying child of Ms. Cowan for purposes of the EITC, *i.e.*, she did not meet the relationship test,

17 IRS EITC Compliance Study (known errors) IV.

18 Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015).

19 IRC § 32(d) requires taxpayers who are married to file jointly in order to receive the EITC; IRC §§ 7703(a) and (b) provide general and special rules for determining marital status.

20 One study estimates the childless worker participation rate at 55.6 percent. Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005* 179, IRS Research Bulletin (2009).

21 The IRS will send the taxpayer a notice, advising of the potential eligibility for the credit.

22 For a discussion of the implications of IRS Future State plans for the EITC population, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *supra*.

23 T.C. Memo. 2015-85. See also National Taxpayer Advocate 2015 Annual Report to Congress 242.

despite the fact that Ms. Cowan cared for Marquis's daughter as her own. Moreover, because Marquis's daughter only lived with Ms. Cowan for 11 months of the taxable year, she did not meet the test for Qualifying Relative, which requires the child to have the same principal place of abode as the taxpayer and live as a member of the taxpayer's household for the taxable year.<sup>24</sup>

## RECOMMENDATION

To provide the Code's Family Status provisions with the necessary flexibility to adapt to the evolving U.S. family composition, and to improve the administration of the EITC and other Family Status provisions, including reducing the EITC improper payment rate, the National Taxpayer Advocate reiterates below her 2005 and 2008 legislative recommendations for simplifying the family status provisions in the Internal Revenue Code, and further recommends that Congress:

1. Require the IRS to revise its mission statement to re-emphasize a service-oriented, non-coercive approach to tax administration, recognize the dual roles of revenue collector and benefits administrator, and explicitly affirm the role of the Taxpayer Bill of Rights as the guiding principle for tax administration.<sup>25</sup>
2. Consolidate the numerous family status provisions into two: the refundable Family Credit, which would reflect the cost of maintaining a household and raising a family; and the refundable Earned Income Tax Credit, which would be awarded per individual worker and provide a work incentive and subsidy for low income workers.
3. Repeal the personal and dependency exemptions, Child Tax Credit/Additional Child Tax Credit, Head of Household filing status, and the family-size differential of the EITC, all of which would be replaced by the Family Credit.
4. Make the Family Credit available to all taxpayers regardless of income and refundable to low income taxpayers; the Family Credit would consist of a Personal Credit (for taxpayer and spouse) and a Child Credit available to eligible individuals claiming a "qualifying child" or "qualifying relative" (subject to tie-breaker rules).
5. Amend the Qualifying Relative test of IRC § 152(d)(2)(H) to provide a child must share the same principal place of abode as the taxpayer and be a member of the taxpayer's household for more than six months of the taxable year.
6. Provide for certain add-on credits under the Family Credit for child and dependent care, disabled taxpayers or family members, and consider providing for noncustodial parents of qualifying children who pay substantially all child support legally due for that tax year.
7. Amend IRC § 152(d)(1)(D) to provide the term "qualifying relative" includes an individual "who is not claimed as a qualifying child of such taxpayer or any other taxpayer for any taxable year in the calendar year in which such taxable year begins."
8. Amend IRC § 152(f) to provide a definition of "support" that excludes any means-tested federal, state, or local benefits paid on behalf of or for the benefit of the qualifying child or qualifying relative.
9. Expand the eligibility age for the modified refundable EITC to include workers 18 years of age and older, with no age cap.

<sup>24</sup> Treas. Reg. § 1.152-1(b) explains that the phrase "for the taxable year" means the *entire* taxable year.

<sup>25</sup> For a detailed discussion of the IRS Mission Statement, see *Special Focus: IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

10. Amend IRC § 7703(b) to permit taxpayers who have a legally binding separation agreement and who live apart on the last day of the tax year to be considered “not married” for purposes of filing status.
11. Amend IRC § 6402 to limit offsets of refunds attributable to the Family Credit and EITC to 25 percent of the taxpayer’s refundable portion of these credits.
12. Amend IRC § 6402 to authorize the IRS to calculate overpayments and make refunds with respect to the new per-worker EITC refundable credit, where the taxpayer’s reported income demonstrates eligibility and the taxpayer has not claimed the credit on his or her return.
13. Mandate the IRS assign one employee to each audit involving a questionable Family Credit claim where the taxpayer has responded (by phone or in writing) to an IRS audit notice.
14. Mandate the IRS establish a dedicated, year-round toll-free help line staffed by IRS personnel to respond to Family Credit questions.

## PRESENT LAW

The following discussion describes the uniform definition of a child as well as the eligibility requirements for the Family Status provisions of the Code.

### Uniform Definition of a Child

In the Working Families Tax Relief Act of 2004, Congress created a uniform definition of child in IRC § 152(c) of the Code. Beginning in tax year 2005, the Code defines the term “dependent” as a qualifying child or a qualifying relative.<sup>26</sup> The single definition of qualifying child, with certain modifications, applies for purposes of claiming the EITC, CTC, CDCC dependency exemption, and head of household filing status.

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<sup>26</sup> IRC § 152(a). If an individual does not meet the definition of a qualifying child under § 152(c), he or she may meet the definition of a qualifying relative under IRC § 152(d).

An individual must meet four tests in order to be a qualifying child under IRC § 152(c): relationship,<sup>27</sup> age,<sup>28</sup> residency,<sup>29</sup> and support.<sup>30</sup> If an individual can be claimed as a qualifying child by more than one taxpayer, IRS § 152(c)(4) establishes a tie-breaker rule to determine which taxpayer can claim the child.<sup>31</sup>

In order to be a qualifying relative of a taxpayer, an individual must: (A) bear a certain relationship to the taxpayer, (B) have gross income for the calendar year that is less than the exemption amount (as defined in IRC § 151(d)), and (C) derive over one-half of his or her support for the calendar year from the taxpayer.<sup>32</sup> In addition, the individual cannot be a qualifying child of the taxpayer or of “any other taxpayer” for the taxable year.<sup>33</sup> A qualifying relative may include an individual who has the same principal place of abode as the taxpayer and who is a member of the taxpayer’s household.<sup>34</sup>

### Earned Income Tax Credit — IRC § 32

The Earned Income Tax Credit (EITC) entitles certain working low income taxpayers to claim a refundable credit of up to \$6,269 for 2016.<sup>35</sup> The EITC is available to taxpayers either with or without a qualifying child. To qualify for the EITC generally, a taxpayer must meet certain general eligibility requirements related to residency,<sup>36</sup> filing status,<sup>37</sup> certain foreign benefits,<sup>38</sup> and status as a qualifying child

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- 27 A qualifying child must be a taxpayer’s son, daughter, stepson, stepdaughter, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them. IRC § 152(c)(2), (f)(1)(A), and (f)(4). In the case of an adopted child, the child is treated as the child of the taxpayer. IRC § 152(f)(1)(B). In the case of an eligible foster child, the child is treated as the child of the taxpayer provided the child was placed with the taxpayer by an authorized placement agency or by the courts. IRC § 152(f)(1)(A)(ii) and (f)(1)(C).
- 28 A qualifying child must be under the age of 19 at the end of the year, under age 24 at the end of the year and a full-time student, or any age if permanently and totally disabled. IRC § 152(c)(3).
- 29 A qualifying child must have the same principal place of abode as the taxpayer for more than half of the taxable year. IRC § 152(c)(1)(B). The Code makes special exceptions for temporary absences, children who were born or died during the taxable year, kidnapped children, and children of divorced or separated parents. IRC § 152(e) and (f)(6); Treas. Reg. §§ 1.152-1(b), and 1.152-2(a)(2)(ii).
- 30 A qualifying child must not have provided more than one-half of his or her own support for the calendar year in which the taxable year begins. IRC § 152(c)(1)(D).
- 31 In cases where more than one taxpayer can claim an individual as a qualifying child, the taxpayers can decide who will treat the child as a qualifying child. The taxpayer who claims the qualifying child is entitled to the dependency exemption for the child, head of household filing status, the Child Tax Credit (CTC), the EITC and the Child and Dependent Care Credit (unless the rule for divorced or separated parents applies and assuming all other eligibility requirements are met). If, however the taxpayers cannot decide who will treat the child as a qualifying child, the tie-breaker rule in IRC § 152(c)(4) determines which taxpayer can claim the child. If only one of the taxpayers claiming a child is the child’s parent, then the child will be treated as the qualifying child of the parent. IRC § 152(c)(4)(A)(i). If both taxpayers claiming a child are the child’s parents, then the child will be treated as the qualifying child of the parent with whom the child resided for the longest period of time during the taxable year. IRC § 152(c)(4)(B)(i). If the child lived with both parents for the same amount of time during the taxable year, then the child will be treated as the qualifying child of the parent with the highest adjusted gross income. IRC § 152(c)(4)(B)(ii). If neither of the taxpayers claiming a child is the child’s parent, then the child is treated as the qualifying child of the taxpayer with the highest adjusted gross income for the taxable year. IRC § 152(c)(4)(A)(ii).
- 32 IRC § 152(d)(1)(A)-(C). The relationship between the qualifying relative and the taxpayer must meet one of the relationships set forth in IRC § 152(d)(2).
- 33 IRC § 152(d)(1)(D).
- 34 IRC § 152(d)(2)(H).
- 35 IRC § 32. The maximum amount of the credit is available to a taxpayer with three or more qualifying children. For tax years beginning in 2016, the maximum credit available for a taxpayer with one qualifying child is \$3,373, with two qualifying children is \$5,572, and with no qualifying children is \$506. Rev. Proc. 2015-53, 2015-44 I.R.B. 615. The actual amount of the EITC varies depending on the earned income of the taxpayer.
- 36 A taxpayer is not eligible for the EITC if he or she is a nonresident alien for any portion of the taxable year, unless the taxpayer files a joint return with a spouse who is a United States citizen or resident alien. IRC § 32(c)(1)(D).
- 37 A taxpayer is not eligible for the EITC if he or she is filing married filing separately. IRC § 32(d).
- 38 A taxpayer is not eligible for the EITC if he or she claims a foreign earned income exclusion or deducts or excludes a foreign housing amount. IRC § 32(c)(1)(C).

of another taxpayer.<sup>39</sup> The taxpayer must also have a taxpayer identification number,<sup>40</sup> earned income,<sup>41</sup> and limited amounts of income.<sup>42</sup> Taxpayers wishing to claim the EITC without a qualifying child must meet additional eligibility requirements, including being between the age of at least 25 and under 65.<sup>43</sup> To be considered a qualifying child for the EITC, an individual must meet the definition of a qualifying child in IRC § 152(c),<sup>44</sup> he or she must be unmarried at the end of the taxable year (unless the taxpayer is entitled to a deduction under IRC § 151 (or would be so entitled but for IRC § 152(e)) for the married individual),<sup>45</sup> and his or her principal place of abode must be in the United States.<sup>46</sup>

### Child Tax Credit — IRC § 24

The CTC entitles a taxpayer to claim a credit of up to \$1,000 for each qualifying child, as defined in IRC § 152(c), who is under age 17 at the end of the tax year.<sup>47</sup> The amount of the credit is applied to any taxes due and in some instances is refundable (known as the Additional Child Tax Credit, or ACTC).<sup>48</sup>

### Child and Dependent Care Credit — IRC § 21

The Child and Dependent Care Credit (CDCC) entitles a taxpayer to claim a credit for expenses incurred so the taxpayer (and spouse, if married) can work or look for work.<sup>49</sup> To qualify for the credit, a taxpayer

39 A taxpayer is not eligible for the EITC if he or she is the qualifying child of another taxpayer. IRC § 32(c)(1)(B).

40 A taxpayer cannot claim the EITC if he or she does not have a valid social security number. IRC § 32(c)(1)(E) and (m).

41 A taxpayer cannot claim the EITC unless he or she has earned income. IRC § 32(a).

42 A taxpayer's earned income, adjusted gross income, and investment income must all be within limits established annually. IRC § 32(a)(2) and (j).

43 A taxpayer is not eligible to claim the EITC without a qualifying child unless the taxpayer's principal place of abode is in the United States for more than half the taxable year, the taxpayer is at least 25 but under age 65 at the close of the taxable year, and the taxpayer does not qualify as a dependent of another taxpayer under IRC § 151 for the taxable year. IRC § 32(c)(1)(A)(ii).

44 IRC § 32(c)(3)(A). For purposes of the EITC, a qualifying child under IRC § 152(c) is determined without regard to IRC § 152(c)(1)(D) (requiring a qualifying child not have provided over one half of his or her own support for the taxable year) and IRC § 152(e) (describing special rules for divorced parents).

45 IRC § 32(c)(3)(B).

46 IRC § 32(c)(3)(C).

47 IRC § 24(a) and (c). The amount of the Child Tax Credit is reduced by \$50 for each \$1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the threshold amount (\$110,000 in the case of a joint return, \$75,000 in the case of a taxpayer who is not married, and \$55,000 in the case of a married taxpayer filing separately). IRC §§ 24(b)(1) and (2).

48 IRC § 24(d).

49 IRC § 21. The amount of the credit is a percentage, based on adjusted gross income, of the amount of employment-related expenses paid by the taxpayer during the taxable year. IRC § 21(a)(2) and (c). A taxpayer may claim a credit of up to 35 percent of child and dependent care expenses paid during a taxable year, up to a maximum of \$3,000 for a taxpayer with one qualifying individual or \$6,000 for a taxpayer with two or more qualifying individuals. IRC § 21(a)(2) and (c). This percentage is reduced one percentage point for every \$2,000 (or fraction thereof) by which the taxpayer's adjusted gross income exceeds \$15,000. IRC § 21(a)(2). A taxpayer may not claim this credit based on household or care expenses paid to a relative who is a dependent of the taxpayer or the taxpayer's child who is not over 19. IRC § 21(e)(6).



must maintain a home for one or more qualified individuals.<sup>50</sup> Additionally, a taxpayer must have earned income,<sup>51</sup> and must meet certain filing status requirements.<sup>52</sup>

### Dependency Exemption — IRC § 151

The dependency exemption entitles a taxpayer to claim an additional exemption for each dependent who is a qualifying child or qualifying relative of the taxpayer, as defined in IRC § 152. A qualifying child must be under the age of 19 at the close of the taxable year, under 24 and a full-time student, or be permanently or totally disabled.<sup>53</sup>

### Head of Household — IRC § 2(b)

Head of household filing status entitles a taxpayer to a larger standard deduction and a more favorable tax rate than a taxpayer filing single or married filing separately.<sup>54</sup> To qualify as a head of household, a taxpayer must be unmarried or “considered unmarried” at the end of the taxable year.<sup>55</sup> For more than half of the taxable year, a taxpayer must maintain, as the taxpayer’s home, a household that is the principal place of abode of a qualifying child<sup>56</sup> or a qualifying relative as defined under IRC § 152(d)(2)(A)-(H), for whom the taxpayer can claim a dependency exemption under IRC § 151.<sup>57</sup> Additionally, the taxpayer can qualify for head of household status if he or she maintains a household which is the principal place of abode of the taxpayer’s mother or father for whom the taxpayer can claim a dependency exemption under IRC § 151.<sup>58</sup>

### Separated Spouse Rule Under IRC § 7703(b)

Under IRC § 7703(a), the determination of whether an individual is married is generally made as of the last day of the individual’s tax year. IRC § 7703(a) prevents taxpayers from being considered as “not

50 IRC § 21(a)(1). A qualified individual is a dependent, defined as a “qualifying child” under IRC § 152(a)(1) who is under the age of 13, a dependent who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the tax year, or a spouse of the taxpayer who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the tax year. IRC § 21(b)(1). Special rules apply for children of divorced or separated parents, allowing only the custodial parent to claim the CTC even if the noncustodial parent claims the child as a dependent under the rules of IRC § 152(e). IRC § 21(e)(5).

51 IRC § 21(d)(1). Special rules apply for calculating the earned income with regard to the spouse of a taxpayer who is a student who is physically or mentally unable to care for himself or herself. IRC § 21(d)(2).

52 IRC § 21(e)(2).

53 IRC §§ 151(c)(1), 152(a) and (c). For tax year 2016, the dependency exemption amount is \$4,050. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

54 For tax year 2016, the standard deduction for head of household is \$9,300. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

55 IRC § 2(b). A taxpayer whose spouse died during the taxable year is considered married for that year. IRC § 2(b)(2)(C). A taxpayer is not considered as married if he or she is legally separated from his or her spouse under a decree of divorce or separate maintenance or if his or her spouse is a nonresident alien at any time during the taxable year. IRC § 2(b)(2)(A) and (B). A taxpayer is also considered unmarried if he or she is treated as unmarried under the provisions of IRC § 7703. IRC § 2(c).

56 IRC § 2(b)(1)(A)(i), which also contains specific rules for married children. Additionally, for purposes of head of household status, a qualifying child is determined under the rules of IRC § 152(c) but without regard to the rules for divorced or separated parents under IRC § 152(e).

57 IRC § 2(b)(1)(A)(ii). A taxpayer is considered as maintaining a household if the taxpayer provides over half of the cost of maintaining the household for the taxable year. IRC § 2(b).

58 IRC § 2(b)(1)(B).

married” even when they have separated from their spouses pursuant to a binding separation agreement.<sup>59</sup> It provides:

(a) General rule.--For purposes of part V of subchapter B of chapter 1 and those provisions of this title which refer to this subsection--

(1) the determination of whether an individual is married shall be made as of the close of his taxable year; except that if his spouse dies during his taxable year such determination shall be made as of the time of such death; and

(2) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

Neither the statute nor the regulations define the requirements for a “decree of separate maintenance,” but the term may encompass “bed and board” divorces, discussed below.

As an exception to the general rule, IRC § 7703(b) provides that certain married persons who are living apart from their spouses may be treated as unmarried. A married taxpayer (as determined under the general rule of IRC § 7703(a)) living apart with a dependent child will qualify as an unmarried person if each of the following conditions is met:

- The taxpayer must file a separate tax return;
- The taxpayer must pay more than half the cost of maintaining his or her household for the tax year;
- The taxpayer’s spouse must not be a member of the household during the last six months of the tax year; and
- The household must, for more than six months of the year, be the principal home of the taxpayer’s child (as defined in IRC § 152(f)(1)) for whom the taxpayer can claim a dependency exemption, or could claim such an exemption except for the special rules for divorced parents under IRC § 152(e).

### Accelerated Information Reporting and Delay of Certain Refund Issuance

In 2015, Congress enacted two provisions that will assist the IRS enormously in ensuring that credits, deductions, and exclusions that are income-based are correctly claimed. Specifically, Section 201 of the Protecting Americans From Tax Hikes (PATH) Act of 2015 amended IRC § 6071 to require that certain information returns (Forms W-2 and 1099-MISC reporting nonemployee compensation) be filed by January 31, generally the same date as the due date for employee and payee statements, and are no longer

<sup>59</sup> IRC § 7703(b) also prevents taxpayers from being considered “not married” in two ways. First, the statute retains an outdated “cost of maintaining a household” test that disproportionately affects members of racial and ethnic minorities who work and have children. Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year’s end. In her 2012 Annual Report to Congress, the National Taxpayer Advocate recommended that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.” National Taxpayer Advocate 2012 Annual Report to Congress 513 (Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married”*).

eligible for the extended filing date for electronically filed returns under section 6071(b).<sup>60</sup> Section 201 of the PATH Act further requires the IRS to hold all refunds that include EITC or the ACTC until February 15 for calendar year filers to allow the IRS more time to verify the validity of the refunds and detect fraud.

### Overpayments and Refund Offsets

IRC § 6402 authorizes the Secretary to both offset a taxpayer's refund against certain liabilities and refund the balance of the overpayment to the taxpayer. The debts against which the refund can offset include outstanding federal tax liabilities, past due child support, debts owed to other federal agencies, state income tax obligations, and Old Age, Survivors and Disability Insurance (OASDI) payments. There is no provision for exclusion of the EITC portion of the overpayment from the offset provisions.<sup>61</sup>

## REASONS FOR CHANGE

The above Present Law discussion demonstrates the mind-numbing complexity of the Code's Family Status provisions. In earlier Reports to Congress, the National Taxpayer Advocate laid out many reasons for amending these provisions.<sup>62</sup> First and foremost, she believes that the tax law should not "entrap" taxpayers, by which she means the laws should not run counter to or disregard the ways taxpayers generally live their lives and conduct their business. Where the laws provide for refundable credits, they should be designed in a way that the IRS can effectively administer.<sup>63</sup> Thus, in the context of the Family Status provisions, we can minimize both IRS and taxpayer burden if we understand the structure of families and households in the U.S. However, the challenge for any simplification proposal relating to the family is how to accommodate evolving family structures without imposing undue burden on taxpayers or creating additional compliance risks. By studying both the demographics of the American family and the sources of error occurring with the current web of Family Status provisions, we can design a statutory scheme that is flexible enough to adapt to the evolution of the family while minimizing taxpayer burden and risk of fraud.

### Demographic Changes in the American Family Unit

A recent paper by the Tax Policy Center (hereinafter TPC Study) found that the number of households made up of "traditional" families (married parents with only biological children) has declined while alternative family types, such as families led by a single parent or cohabitating parents, has increased.<sup>64</sup>

60 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015). This legislative change is consistent with prior National Taxpayer Advocate recommendations. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 45-55; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-88; National Taxpayer Advocate 2012 Annual Report to Congress 180-91; National Taxpayer Advocate 2011 Annual Report to Congress 284-95; National Taxpayer Advocate 2009 Annual Report to Congress 338-45.

61 In *Sorenson v. Secretary of the Treasury*, 475 U.S. 851 (1986), the Supreme Court held that a refund involving EITC that was due to a taxpayer who had failed to meet his child support obligations, could be offset.

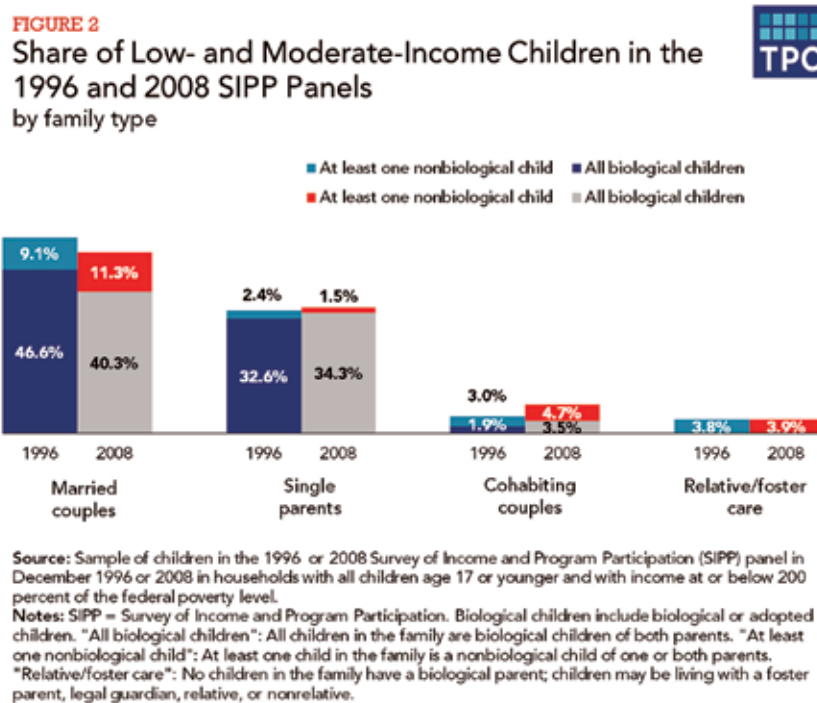
62 See, e.g., National Taxpayer Advocate 2005 Annual Report to Congress, 397-406; National Taxpayer Advocate 2008 Annual Report to Congress, 363-369; National Taxpayer Advocate 2012 Annual Report to Congress, 508-512.

63 The National Taxpayer Advocate previously articulated these and other principles in a presentation to the President's Advisory Panel on Federal Tax Reform. See Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) (statement of Nina E. Olson, National Taxpayer Advocate), [http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/olson\\_03032005.ppt](http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/olson_03032005.ppt). For more detail, see National Taxpayer Advocate 2005 Annual Report to Congress 375-380 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*).

64 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits*, TPC 10 (Mar. 3, 2016), [http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full\\_report](http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full_report). The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

The TPC Study found that between 1996 and 2008, the proportion of children living with married couples dropped from 70.9 percent to 67.3 percent and the number living with cohabitating parents increased from 3.6 percent to 6.2 percent.<sup>65</sup> Furthermore, the TPC Study found that in 2008, nearly 20 percent of children living in single-parent households also lived in multigenerational households.<sup>66</sup> Only 51.6 percent of children living in families with income at or below 200 percent of the federal poverty level (FPL) were in families headed by married couples. The percentage of children living with cohabitating couples at or below 200 percent of FPL increased from just under five percent in 1996 to 8.2 percent in 2008.<sup>67</sup>

FIGURE 2.1.1<sup>68</sup>



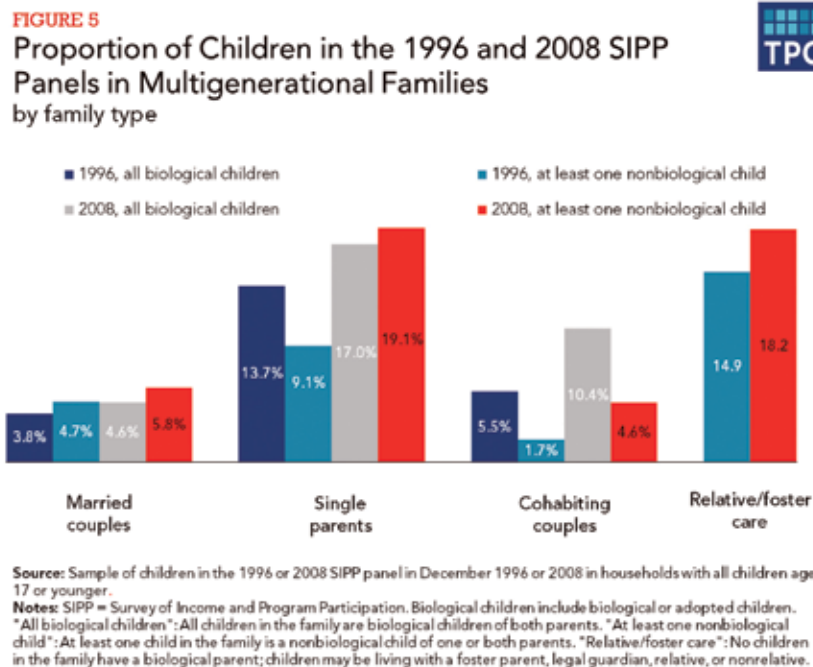
The percentage of children living in multigenerational households also increased from 1996 to 2008, across all household types. By 2008, almost one-fifth of children living with a single parent also lived in a multi-generational household, as was the case with households headed by non-parent relatives or foster parents.

65 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits*, TPC 10 (Mar. 3, 2016), [http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full\\_report](http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full_report). The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

66 *Id.* at 18.

67 *Id.* at 11.

68 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

FIGURE 2.1.2<sup>69</sup>

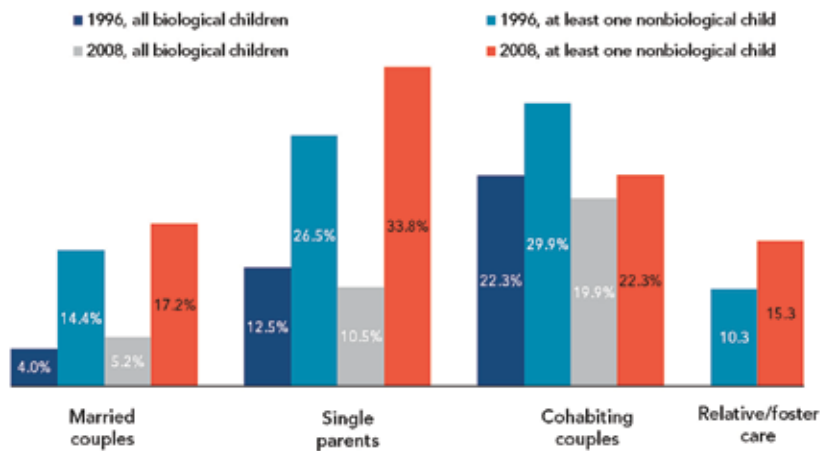
Children who lived in families with married parents and only biologically related children were unlikely to move to different family types from one year to the next, or within a given year, regardless of income level. However, children in low and moderate income single parent families, cohabiting couple families, and relative/foster care families all experienced greater change in family type from one year to the next. For example, in 2008, a third of low and moderate income children in single parent families with some biological children changed family type.<sup>70</sup>

69 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

70 *Id.* at 12, 13.

FIGURE 2.1.3<sup>71</sup>

**FIGURE 4**  
**Change in Family Type One Year Later, Children in the 1996 and 2008 SIPP Panels in Low- and Moderate-Income Families by family type**



Source: Children in the 1996 or 2008 SIPP panel in December 1996, 1997, 2008, 2009, 2010, or 2011 in households with all age 17 or younger and with income at or below 200 percent of the federal poverty level, for whom the child's parents or household reference person appear in the SIPP one year later.  
 Notes: SIPP = Survey of Income and Program Participation. Biological child includes biological or adopted child. "All biological children": All children in the family are biological children of both parents. "at least one non biological child": At least one child in the family is a nonbiological child of one or both parents.  
 \*Relative/foster care\*: no children in the family have a biological parent; children may be living with a foster parent, legal guardian, relative, or nonrelative.

Finally, across all income levels, “[t]he same types of families who were more likely to change across different tax years are also more likely to change within a tax year (children in cohabiting couple families, single parent families with at least one-biological child, and foster care families).”<sup>72</sup>

71 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

72 *Id.* at 16. The TPC Study authors note that these results are likely a lower bound estimate, because families that experience a change within years are likely to drop out of the survey and thus the changes won't be observed. *Id.* at 15.

FIGURE 2.1.4<sup>73</sup>

TABLE 4

Number of Parent Changes per Year, Children in the 1996 and 2008 SIPP Panels by family type



	1996 panel			2008 panel		
	0	1	2+	0	1	2+
<b>Married couples</b>						
All children are biological	97.3	2.3	0.4	97.3	2.3	0.5
At least one nonbiological child	84.5	13.8	1.7	84.4	12.6	3.0
<b>Single parents</b>						
All children are biological	95.1	4.2	0.7	95.5	3.8	0.8
At least one nonbiological child	76.2	17.9	5.9	72.0	24.4	3.7
<b>Cohabiting couples</b>						
All children are biological	88.7	10.6	0.8	87.4	9.5	3.1
At least one nonbiological child	88.3	9.6	2.2	87.7	9.4	3.0
<b>Relative/foster care</b>	86.4	11.8	1.8	86.7	11.1	2.2
<b>All children</b>	94.8	4.5	0.7	94.4	4.6	1.0

Source: Sample of children in the 1996 or 2008 SIPP panel in January 1997, 1998, 2009, 2010, 2011, or 2012 in households with all children age 17 or younger, for whom the child's parents or household reference person appear in the SIPP in the subsequent December.

Notes: SIPP = Survey of Income and Program Participation. Biological children include biological or adopted children. "All children are biological": All children in the family are biological children of both parents. "At least one nonbiological child": At least one child in the family is a nonbiological child of one or both parents. "Relative/foster care": No children in the family have a biological parent; children may be living with a foster parent, legal guardian, relative, or non-relative. A parent change is defined as any child in the family not living with the same parent or parents as in the next month. If a child was not observed but his or her parent or household reference person from January was observed, it is assumed that the child left the household and this is counted as a change. Changes may be underestimated for children who are not observed for all 12 months (or have lived with other children who are not observed all 12 months) because children may have additional parent changes in the months they are not observed. Changes may be underestimated for up to 13 percent of children in 2008 (13 percent if no parent changes, 54 percent if one change, and 57 percent if two or more changes); and up to 12 percent of children in 1996 (9 percent if no parent changes, 58 percent if one change, and 64 percent if two or more changes). Further, changes are underestimated for children with one biological parent who has a cohabiting partner because we only track whether the child is separated from the biological parent because of difficulty establishing the relationship between children and their parents' cohabiting partners that are not biological parents.

The above-described changes in family composition and mutation within and between years is reflected in the EITC data: about one-third of the EITC population changes from year to year.<sup>74</sup> Because the Family Status rules generally contemplate more "traditional" households and award tax benefits to only one person with respect to each child, the disconnect between the Code and the reality of many taxpayers' lives has led to mistakes on the part of taxpayers who misunderstand the rules; it also prevents some primary caregivers for children in certain low income households from receiving the EITC.

The IRS is not alone in facing these challenges. Tax administrations around the world are moving to incorporate some aspects of their benefits system into their tax codes. For example, Australia offers a similar tax credit to the EITC, called the Family Tax Benefit (FTB). The eligibility rules for the FTB are more expansive than for the EITC. For instance, a child qualifies for the FTB if he or she meets these general rules:

- Must be in the adult's care;
- Must meet citizenship requirements;
- Must not meet any exceptions; and

73 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

74 IRS, *EITC Fast Facts*, <http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff> (last visited Dec. 30, 2015). For more information on the changing population of taxpayers eligible for EITC, see National Taxpayer Advocate 2013 Annual Report to Congress 109-10.

- When more than one adult is involved, the child must be in the adult's care for at least 35 percent of the time.<sup>75</sup>

The act of caring for a child in Australia counts for more than just the amount of time the adult resides with the child. The “primary carer” is considered the “member of a couple” having the greater responsibility for the child. This is determined by identifying who has major daily responsibility for the child, looks after the child's needs (such as dressing and bathing), makes appointments for the child, is the primary contact for daycare or school, and transports the child to and from school.<sup>76</sup> When it is determined that more than one adult cares for a child, the percentage of FTB allocated to each individual is based on “issues of fairness and appropriateness, taking into account equity considerations and sharing and pooling within a family unit that can result in a 50:50 split in FTB.”<sup>77</sup> Under this system there is an acknowledgement that many families operate on a fluid, day-to-day basis where the care of a child does not fall on just one relative. There is also a provision for splitting the FTB between two primary carers, by agreement between the parties.<sup>78</sup>

### *The Administrative Justification for Running Social Benefits Through the Tax System*

Any analysis of Family Status benefits must confront the issue of whether the tax system is the appropriate entity for administering social benefit programs. As we discuss in this and earlier reports, running social programs through the Code requires the tax administrator to think differently about its mission and develop new approaches to compliance and education.<sup>79</sup> The IRS may be an appropriate conduit for social expenditures where it possesses significant data that are key components of eligibility determinations.

One area of tax administration that has both warranted and received a great deal of attention over the years is refundable credits, particularly the EITC.<sup>80</sup> Most credits merely reduce the amount a taxpayer owes, but in the case of *refundable* tax credits, the IRS may end up paying a taxpayer more than the taxpayer paid in tax, resulting in a “negative” tax. Refundable credits may have become familiar in the context of benefits to low income taxpayers and therefore may be viewed as a form of “welfare.” Nevertheless, these credits are no longer limited to this population but are now available to middle-income taxpayers and businesses as well.<sup>81</sup>

75 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.10, FTB Child, <https://guides.dss.gov.au/familyassistance-guide/2/1/1/10>.

76 Australian Department of Social Services, *Family Assistance Guide*, 1.1.P.120, Primary Carer (FTB, Baby Bonus), <http://guides.dss.gov.au/family-assistance-guide/1/1/p/120>.

77 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.25, Shared Care of an FTB Child, <http://guides.dss.gov.au/family-assistance-guide/2/1/1/25>.

78 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.10, <https://guides.dss.gov.au/family-assistance-guide/2/1/1/10>. Here is an example provided: Emily lives primarily with her parent Dave and his new partner Anthony. Emily is an FTB child of both Dave and Anthony. They agree that Anthony should receive FTB for Emily, as he is the stay-at-home parent.

79 See Legislative Recommendation: *Tax Reform: Simplify the Internal Revenue Code Now*, *supra*; National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-19 (*Evaluate the Administration of Tax Expenditures*). See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (*Running Social Programs Through the Tax System*).

80 For a comprehensive discussion of the challenges in administering the EITC, see *Improper Payments in the Administration of Refundable Credits*, *Hearing Before the H. Comm. on Ways and Means*, 112th Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate).

81 See, e.g., the adoption credit (IRC § 36C) and the American Opportunity Tax Credit (IRC § 25A) for low and moderate income taxpayers and the fuel tax credit for purchasers of gasoline used on farms or local buses or of fuels for certain other purposes (IRC §§ 34, 4081(b)(2), 6420, 6421, 6427).



Enacted as a work incentive in the Tax Reduction Act of 1975,<sup>82</sup> the Earned Income Tax Credit (EITC) has become one of the government's largest means-tested anti-poverty programs. Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy "application" process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of caseworkers and local agencies. According to the IRS, EITC administration costs are less than one percent of benefits delivered, as compared to other non-tax benefits programs in which administrative costs related to determining eligibility can range as high as 42 percent of program expenditures, as shown in Figure 2.1.5 (see endnote in Appendix A). Moreover, a front-end application process would not eliminate improper payments. To assess how well the EITC stacks up against other social benefits programs, the sum of each program's overhead costs and improper payments should be considered (rather than just overhead costs or improper payments in isolation).

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82 See Pub. L. No. 94-12, § 204, 89 Stat. 26, 30 (1975) (codified at IRC § 32).

**FIGURE 2.1.5, Costs and Benefits of Federal Payment Programs**

Program	SNAP	WIC	SSI	TANF	HUD	CHIP	Medicaid	School Lunch	EITC
Year	FY 2013	FY 2010	FY 2012	FY 2011	FY 2013	FY 2012	FY 2013	FY 2013	FY 2014
Number of Recipients	47.6 mil	9.1 mil	8.3 mil	4.6 mil	4.7 mil	8.1 mil	55.0 mil	30.7 mil	27.8 mil
Number of Eligible Persons	51.9 mil	14.6 mil	13.0-14.3 mil	12.2-14.4 mil	9.1 mil	11.8-12.2 mil	76.0-80.6 mil	49.2 mil	22.7 mil
Participation Rate (# of Recipients/ # of Eligible Persons)	79.0%	62.6%	58.0%	32.0%	49.3-51.5%	66.9 - 68.8%	68.2%	54.3-64.3%	78.8%
Year Participation Rate Measured	FY 2011	CY 2010	1998	2009	2013	FY 2012	2009	2012	TY 2009
Total Benefits Paid Out	\$76.1 bil	\$4.6 bil	\$51.1 bil	\$15.2 bil	\$30.9 bil	\$8.5 bil	\$248.3 bil	\$11.3 bil	\$60.3 bil
Average Benefit per Recipient	\$133.07	\$500.86	\$6,156.54	\$3,300.84	\$6,574.47	\$1,047.64	\$4,514.55	\$368.39	\$2,384.32
Overhead Costs	\$3.9 bil	\$1.9 bil	\$3.8 bil	\$1.5 bil	\$4.3 bil	\$3.1 bil	\$11.7 bil	\$1.2 bil	\$0.6 bil
Overhead Costs as % of Total Benefits Paid Out	5.1%	41.8%	7.4%	9.7%	13.8%	36.3%	4.7%	10.3%	1.0%
Improper Payments	\$2.6 bil	\$0.04 bil	\$4.7 bil	\$2.3 bil	\$1.3 bil	\$0.7 bil	\$14.4 bil	\$1.8 bil	\$14.5 bil
Improper Payments as a % of Total Benefits Paid	3.4%	1.0%	9.2%	15.0%	4.3%	8.2%	5.8%	15.7%	24.0%
Overhead Costs + Improper Payments	\$6.5 bil	\$1.9 bil	\$8.5 bil	\$3.8 bil	\$5.6 bil	\$3.8 bil	\$26.1 bil	\$3.0 bil	\$15.1 bil
Overhead Costs + Improper Payments as a % of Total	8.5%	42.8%	16.6%	24.7%	18.1%	44.5%	10.5%	26.0%	25.0%

See figure and related end notes in Appendix A following this Legislative Recommendation.

This table demonstrates that for a program of such significant size, administered at a federal level, the EITC reaches an extraordinary number and percentage of eligible taxpayers at a modest cost, when overhead and overclaims are considered together.<sup>83</sup> The Treasury Inspector General for Tax Administration has noted that for “other non-tax benefits programs ... administrative costs related to determining eligibility can range as high as 20% of program expenditures.”<sup>84</sup> The IRS reports that it paid \$66.7 billion in EITC claims for TY 2014. If this amount had been paid by another agency that spent 20 percent of program expenditures verifying eligibility, the administrative costs to the government would have been \$13.3 billion — more than 90 percent of the amount of improper payments that the IRS estimates were made.<sup>85</sup>

However, ease of application and the absence of eligibility interviews result in greater overclaims for the EITC than traditional anti-poverty programs. In other words, the front-end administrative costs of traditional anti-poverty programs have shifted to the post-claim compliance costs of the EITC.

A significant positive difference is that the EITC has far higher participation rates than other anti-poverty programs (*i.e.*, the percentage of eligible individuals and families who receive the benefit is much greater, at between 75 and 79 percent).<sup>86</sup> Assuming we want the intended beneficiaries to receive the benefits enacted by Congress, the EITC is a highly effective, and even efficient, method of delivery.

### Understanding the Types of EITC Errors Will Improve the Design of Family Status Benefits

Notwithstanding the EITC’s effectiveness and efficiency, it has frequently been identified as a significant source of improper payments,<sup>87</sup> with Treasury estimating them as averaging about 25 percent of EITC claims over the last five years.<sup>88</sup> Although the improper payment rate is often presented as a worsening problem, it may actually be less severe than in TY 1999.<sup>89</sup> For context, EITC overclaims account for just 3.4 percent of the gross tax gap, 3.8 percent of the net tax gap, and 5.9 percent of gross individual income

83 Unless otherwise noted, the amount of benefits is taken directly from or imputed from the federal government’s improper payment website (see endnotes in Appendix A). Administrative costs were often difficult to determine, and it is not clear that they are computed uniformly by each agency. The figures in the chart were computed by TAS Research from publicly available sources. See Endnotes, *infra*, for more details on the sources of data for each program as well as other information and caveats regarding the data.

84 See TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income tax Credit Payments Each Year 1* (2011) (IRS response).

85 Department of the Treasury, *Fiscal Year 2015 Agency Financial Report* 196 (Nov. 16, 2015). The lower bound estimate of improper EITC payments in FY 2015 is \$14.2 billion.

86 See IRS, *EITC Participation Rate by States*, <http://www.eitc.irs.gov/EITC-Central/Participation-Rate>. See also Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005 178-79*, IRS Research Bulletin (2009); Maggie R. Jones, *Changes in EITC Eligibility and Participation, 2005-2009*, U.S. Census Bureau.

87 See footnote 14, *supra*. See also GAO, GAO-09-628T, *Improper Payments: Progress Made but Challenges Remain in Estimating and Reducing Improper Payments*, App. I, at 20 (Apr. 22, 2009) (identifying EITC as the Treasury improper payment).

88 Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 197 (Nov. 15, 2016) (“The most recent projection is based on a tax year 2012 reporting compliance study that estimated the rate of improper over claims for fiscal year 2016 to range between 22.2 percent (lower bound) and 25.9 percent (upper bound). This amounts to between \$15.5 and \$18.1 billion of approximately \$65.2 billion in total program payments ... [these estimates are] consistent in magnitude with the five-year average 24 percent error rate.”). See also Government Accountability Office (GAO), *Government-Wide Estimates and Use of Death Data to Help Prevent Payments to Deceased Individuals*, GAO-15-482T 4 (Mar. 16, 2015) (suggesting that for FY 2014 there were \$17.7 billion in improper EITC payments, representing an error rate of 27.2 percent).

89 See IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 3 (Feb. 28, 2002), [https://www.irs.gov/pub/irs-utl/1999\\_compliance\\_study\\_022802.pdf](https://www.irs.gov/pub/irs-utl/1999_compliance_study_022802.pdf) (“Of the estimated \$31.3 billion in Earned Income Tax Credit (EITC) claims made by taxpayers who filed returns in 2000 for tax year 1999, it is estimated that between \$8.5 and \$9.9 billion (27.0 percent to 31.7 percent) should not have been paid.”).

tax noncompliance, while business income underreported by individuals accounts for 47.3 percent.<sup>90</sup> Improper EITC payments nonetheless continue to present a problem that cannot be ignored.

While the improper payment rate provides us with a consistent net measure of improper EITC payments (*i.e.*, improper payments actually made), it is important to understand the sources of error for total (gross) EITC overclaims in order to develop targeted strategies to reduce the Improper Payment rate. The most recent IRS National Research Program (NRP) EITC results are useful in this regard, because they provide a statistically representative sample from which to draw observations of taxpayer behavior and better understand the sources of EITC noncompliance and, by extension, identify opportunities for legislative reform of the Family Status provisions.<sup>91</sup>

As a threshold matter, the NRP Compliance Study found that *about 87 percent lower-bound estimate, or LBE, of the qualifying children claimed for EITC are claimed correctly.*<sup>92</sup> Moreover, many EITC overclaims are less than \$500 (44 percent LBE), and relatively few overclaims are above \$3,000 (11 percent LBE). NRP data show that income misreporting is by far the most common type of EITC error.<sup>93</sup> Sixty-seven percent of EITC overclaim returns show some income misreporting, and it is the *only* error on 50 percent of overclaim returns. The average overclaim on income-error-only returns is \$673.<sup>94</sup> Although the average amount of this type of overclaim is relatively modest, if the IRS is able identify the income misreporting upfront, it will eliminate a significant number of overclaims. The recent legislative changes accelerating third-party information reporting and delaying EITC refund issuance until February 15 go a long way to addressing this source of error.

90 IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012). The IRS estimates \$264 billion in individual income tax underreporting for tax year (TY) 2006 with \$125 billion of this amount attributable to business income underreported by individuals as sole proprietors on Schedule C (Profit or Loss from Business) or as farmers on Schedule F (Profit or Loss from Farming). Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 197 (Nov. 15, 2016). The IRS provided a lower bound estimate of \$15.5 billion in EITC overclaims for FY 2016 (\$15.5 billion / \$264 billion is about 5.9 percent).

91 The IRS created the National Research Program (NRP) in 2000 to “develop and monitor strategic measures of taxpayer compliance.” National Research Program, at [http://www.irs.gov/uac/National-Research-Program-\(NRP\)](http://www.irs.gov/uac/National-Research-Program-(NRP)) (last visited on Feb. 19, 2014). NRP is a comprehensive effort by the IRS to measure payment, filing, and reporting compliance for different types of taxes and various sets of taxpayers and to deliver the data to the Business Operation Divisions to meet a wide range of needs including support for the development of strategic plans and improvements in workload identification. Internal Revenue Manual (IRM) 4.22.1.3, *The National Research Program (NRP)* (Apr. 25, 2008). The NRP Compliance Study distinguishes between “known errors” and “unknown errors.” It estimates that 30 percent of total possible overclaim returns and 41 percent of total possible overclaim dollars stem from unknown errors (*i.e.*, cases where compliance and errors are unknown mostly because of audit non-participation). Nevertheless, based on audit participants, the IRS believes it can reliably project 8.4 million overclaim returns and \$11.4 billion overclaim dollars to the EITC population. IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 15 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

92 The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (*i.e.*, in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (*i.e.*, exam exclusion is correct). IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 5 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

93 The IRS uses the NRP to meet its need for current compliance information. The IRS established the NRP office in 2000 as part of its efforts to develop and monitor strategic measures of compliance. The program seeks to increase public confidence in the fairness of the tax system by helping the IRS identify voluntary compliance problems. Information from NRP intranet site, <http://nrp.web.irs.gov/default.aspx>.

94 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 17 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

Qualifying child (QC) errors occur less than half as often and they are less likely to be the only error:

- About 30 percent of overclaim returns show a qualifying child error, and it is the *only* error on 15 percent of overclaim returns.
- The average overclaim on QC-error-only returns is \$2,327.<sup>95</sup>

Finally, nine percent of overclaim returns have *both* QC errors and income misreporting, and twelve percent of overclaim returns have *neither* QC nor income errors.<sup>96</sup> Figure 2.1.6 shows the five *most costly* error types and their percentages of total overclaim dollars.

**FIGURE 2.1.6, Most Costly EITC Errors<sup>97</sup>**

Error Type	Lower Bound Estimate
Qualifying Child Error	51.4%
Self-Employment Income Misreporting	22.9%
Filing Status Errors	16.4%
Income Reporting of Investment Income and AGI (excluding earned income)	7.9%
Wage Income Misreporting	5.7%

Figure 2.1.7 shows the four *least costly* error types and their percentages of total overclaim dollars. Note that “tiebreaker” errors — where more than one eligible person claims a qualifying child — are now trivial, compared with the 1999 Compliance Study, when tiebreaker errors accounted for 17 percent or more of overclaim dollars.<sup>98</sup> The tiebreaker rules were significantly modified and clarified in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA);<sup>99</sup> the NRP Compliance Study data show the positive impact legislative clarification can have on compliance.

95 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 17 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

96 *Id.* at 16.

97 *Id.* at 19, Table 5.

98 See IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 21 (Feb. 28, 2002), [https://www.irs.gov/pub/irs-utl/1999\\_compliance\\_study\\_022802.pdf](https://www.irs.gov/pub/irs-utl/1999_compliance_study_022802.pdf).

99 Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 303, 115 Stat. 38, 55 (2001). Tiebreaker rules under EGTRRA stipulate that if a child is claimed by more than one eligible person, the credit would first go to the biological parent. If there are two claims between non-parental family members, the credit will go to the family member with the highest adjusted gross income. If two parents do not file a joint return, the credit will go to the parent with whom the child resided for the longest time during the tax year. If residency was split equally between two parents, the credit will go to the parent with the highest adjusted gross income.

**FIGURE 2.1.7, Least Costly EITC Errors<sup>100</sup>**

Error Type	Lower-Bound Estimate
Rules for All Taxpayer Claiming the EITC Having a Valid SSN, Being a U.S. Citizen or Resident Alien All Year, Not Filing Form 2555 or Form 2555-EZ, Not Being a Qualifying Child of Another Person	5.0%
Errors Corrected in Processing Includes Math Errors and Other Adjustments Made Prior to NRP Exam	3.0%
Tiebreaker Errors	1.0%
Rules for Taxpayers Claiming EITC Without Children (Being Age 25-64, Not a Dependent of Another Taxpayer, and Having a Home in the U.S. for More Than Half the Year)	0.0%

As a practical matter, low income taxpayers have considerable difficulty documenting relationship and residence — principal components of the qualifying child test — because of a lack of clarity from the IRS as well as their personal circumstances.<sup>101</sup> In the past, TAS has reported that the “two main problems are inconsistency as to which documents the IRS will accept (a document is accepted in one office, but not in another) and inflexibility in accepting proof (failure to accept other types of documents where the taxpayer cannot provide standard documentation).”<sup>102</sup> On the low income taxpayers’ part, one of the biggest issues is “their tendency to be transient or even temporarily homeless” coupled with literacy challenges.<sup>103</sup> The TPC Study findings relating to changes in household composition add to these challenges in proving eligibility. The combination of byzantine requirements with the lack of a home in which to store documents, not to mention the skills needed to read or retain them, frequently results in a lack of documentation.

Of the 13 percent of “knowable” QC errors,<sup>104</sup>

- 75 percent were attributable to the residency test;
- 20 percent were attributable to the relationship test;
- Seven to ten percent were each attributable to the age test, an invalid Social Security number, and the tiebreaker rules;
- One percent to a married child;
- One percent to errors corrected in processing; and
- 11 percent to unknown errors (*i.e.*, the taxpayer acknowledged the error but gave no detail, or it was an “operational exam”).

100 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Return* 19, Table 5, (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

101 See Leslie Book, *EITC Noncompliance: What We Don't Know Can Hurt Them*, 2003 TAX NOTES TODAY 121-27 (June 23, 2003); Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 KANS. L. REV. 1145 (2003), [http://works.bepress.com/leslie\\_book/8](http://works.bepress.com/leslie_book/8); National Taxpayer Advocate 2002 Annual Report to Congress 50 (Most Serious Problem: *EITC Eligibility Determinations Can Be Made Less Burdensome*).

102 National Taxpayer Advocate 2005 Annual Report to Congress 106-07 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*).

103 Leslie Book, *The IRS's EITC Compliance Regime: Taxpayers Caught in the Net*, 81 ORE. L. REV. 351, 393 (2002). See also National Taxpayer Advocate 2015 Annual Report to Congress, Introduction: *The IRS Can Do More to Improve Its Administration of the Earned Income Tax Credit and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights* 235-39.

104 IRS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 23 (Pub. 5162, Aug. 2014).

Thus, not surprisingly in light of the demographic data presented above, the residency test appears to present the greatest challenge to EITC claimants. Reform efforts should focus on improving otherwise eligible families' ability to satisfy this requirement while minimizing opportunities for error or fraud. By combining the "family" component of the EITC with the other Family Status provisions, the "qualifying relative" definition will apply. Households that were previously ineligible because the primary caregiver did not have the requisite relationship under IRC § 32 will now be eligible for family benefits. Moreover, by requiring the IRS to utilize a Household/Residency Affidavit(s) as an attachment to the tax return where a non-biological primary caregiver is claiming the EITC, Congress can minimize the risk of error or fraud in such claims.<sup>105</sup>

### Age Eligibility for Childless Worker EITC or Reformed Worker Credit

In TY 2017, the maximum amount of EITC benefits available to taxpayers without children will be \$510, whereas the maximum amount of benefits for taxpayers with just one child will be \$3,400.<sup>106</sup> This is a troubling disparity, considering that a little over 20 percent of Millennials with only a high school education are living in poverty.<sup>107</sup> Additionally, 4.2 million people aged 65 and older were living in poverty in 2015 (representing a poverty rate of 8.8 percent among people age 65 and over).<sup>108</sup> Yet, the childless worker portion of the EITC is limited to workers between the ages of 25 and 64.<sup>109</sup> As the data discussed below show, this age limitation harms significant segments of the population that could benefit from this income supplement.

For example, the allocation of benefits provided to childless workers does not address the recent trend in delaying the decision to start a family. The birth rate for women ages 20–24 has fallen to approximately 77 percent, a measurement which has steadily declined since 2007.<sup>110</sup> One report ties this trend to the increased cost of childrearing and the bleak financial situation for many taxpayers in this age bracket (referred to as Millennials).<sup>111</sup>

When Congress initially implemented the EITC, one explanation for not making EITC universally available to everyone was that students and retired individuals "often have low amounts of earned income because they work part-time or for short periods of time and may receive most of their support from family relatives or through social security or private pension plans."<sup>112</sup> However, only 33 percent of Americans have a Bachelor's degree or higher, meaning it is a mistake to assume taxpayers under age 25

105 For a discussion on the use of affidavits and EITC cases, see National Taxpayer Advocate 2015 Annual Report to Congress 253-54.

106 See Rev. Proc. 2016-55, 2016-45 I.R.B. 707. See also IRS, *2017 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates*, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts-next-year> (last visited Dec. 31, 2016).

107 Pew Research Center, *The Rising Cost of Not Going to College* (Feb. 11, 2014), <http://www.pewsocialtrends.org/2014/02/11/the-rising-cost-of-not-going-to-college/>.

108 U.S. Census Bureau, *Income and Poverty in the United States: 2015* 14 (Sept. 2016).

109 IRC § 32(c)(1)(A)(ii)(II).

110 Center for Disease Control, *National Vital Statistics Report 2* (June 6, 2016).

111 Jessica Grose, *For Many Millennials, Children Are Out of Reach*, N.Y. TIMES, Dec. 25, 2014.

112 *Tax Reduction Act of 1975: Report of the Sen. Comm. on Finance Together with Supplemental Views on H.R. 2166*, S. REP. NO. 94-36 at 33 (1975).

are primarily students.<sup>113</sup> Furthermore, ignoring the needs of this population may go against the intent of the EITC since earnings can be tied to level of education, meaning those with less education will earn less.<sup>114</sup>

It is also no longer realistic to assume older taxpayers can safely rely on pensions and Social Security. One survey by the Board of Governors of the Federal Reserve System found that 31 percent of non-retired respondents had no retirement savings or pension.<sup>115</sup> Congress's original rationale for age limits results in the EITC being unavailable for younger taxpayers who do not obtain a college education and who work lower-paying jobs, as well as elderly taxpayers who have little or no savings or pension.

Figure 2.1.8 shows the number of workers eligible for the childless worker EITC under current income eligibility rules, if the age limits were expanded as recommended.

**FIGURE 2.1.8, Workers Eligible for the Childless Worker EITC Under Current Income Eligibility Rules, If Age Limits Were Expanded As Recommended<sup>116</sup>**

Category	Count	Average	Sum
Single no child filers <25 or >64	3,131,980	\$291.52	\$913,043,008.00
Married no child filers <25 or >64	319,354	\$308.36	\$98,475,444.00
<b>Total</b>	<b>3,451,334</b>	<b>\$293.08</b>	<b>\$1,011,518,452.00</b>

Expansion of the childless worker EITC credit appears to have bipartisan support.<sup>117</sup> In addition to expanding the age eligibility for the EITC, Congress should also consider converting the work incentive component of the EITC to a per person credit. One policy aspect of this reform is whether the amount of the “worker” credit should be increased, with a requisite adjustment to the amount of the bifurcated

113 U.S. Census Bureau, *Educational Attainment in the United States: 2015* 1 (Mar. 2016), <http://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf>. Education levels vary among race and other characteristics. For instance, 36.2 percent of non-Hispanic Whites aged 25 years and older had a Bachelor's degree or more, whereas only 22.5 percent of Blacks and 15.5 percent of Hispanics aged 25 years and older attained a Bachelor's degree or more. U.S. Census Bureau, *Educational Attainment in the United States: 2015* 2 (Mar. 2016), <http://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf>.

114 While many factors affect a worker's lifetime earnings, workers with an education to eighth grade can expect to earn \$936,000 in life-time earnings, compared to \$4,159,000 in life-time earnings for a worker with a professional degree. U.S. Census Bureau, *Work-Life Earnings by Field of Degree and Occupation for People With a Bachelor's Degree: 2011* 4 (Oct. 2012), <http://www.census.gov/prod/2012pubs/acsbr11-04.pdf>.

115 Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014* 38-39 (May 2015). According to the survey, the rate of retirement savings is tied directly to an individual's income. Eighty-two percent of the respondents making over \$100,000 per year had at least some retirement savings or pension. Meanwhile, among respondents making under \$40,000 per year, only 42 percent had any retirement savings. Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014* 38-39 (May 2015).

116 Figure 2.1.8 is based on Tax Year 2015 data from the Individual Returns Transaction File (returns posted through week 47 of 2016) for single filers without children under age 25 or over age 64 and returns for married filers without children where both taxpayers are under age 25 or over age 64.

117 Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2017* 48 (2016) (including a proposal to double the childless worker credit). See also Richard Rubin and Eric Morath, *Obama, Ryan See Potential for a Tax-Policy Compromise*, WALL ST. J., Feb. 2, 2016; and Center on Budget and Policy Priorities, *Reports Bolster Calls to Expand EITC For Childless Workers* (Sept. 6, 2016), <http://www.cbpp.org/blog/reports-bolster-calls-to-expand-eitc-for-childless-workers>.



Family Credit.<sup>118</sup> Now that the IRS has access to the majority of earned income information returns during the early part of the filing season, the IRS can easily verify eligibility for an income-based, per-person credit in real time, thereby minimizing improper payments. Because the revised EITC would be granted on a per-worker basis (and no longer a function of family composition), the IRS should adjust returns (post-income verifications) that appear eligible for the credit but did not claim it, and issue refunds in the appropriate cases.

### The Definition of “Not Married” Under IRC § 7703(a) Should Be Amended to Reflect 21st Century Family Law

As noted above, IRC § 7703(a) prevents taxpayers from being considered as “not married” even when they have separated from their spouses pursuant to a binding separation agreement. Specifically, it provides an individual legally separated from his spouse on the last day of the taxable year under a “decree of divorce or of separate maintenance” shall not be considered as married. Neither the statute nor the regulations define the requirements for a “decree of separate maintenance.”

Judicially-sanctioned separations generally may have arisen due to the historical unavailability in Anglo-American law of decrees of absolute divorce.<sup>119</sup> Some Southern colonies — Virginia, Maryland, North Carolina, South Carolina, and Georgia — that did not permit absolute divorce did allow divorce *a mensa et thoro*, or bed and board divorce.<sup>120</sup> Bed and board divorce, still available in some jurisdictions, refers to spousal separation in which the parties do not live together, but the marriage itself, with attendant support obligations, is left undisturbed.<sup>121</sup>

Judicial separation is now available in at least 40 States.<sup>122</sup> However, judicial separation is not necessarily a prerequisite to divorce. Some form of no-fault divorce is now available in all States, and is the *sole* ground for divorce in at least 17 States. The need for decrees of legal separation (or, to the extent they differ, decrees of separate maintenance) is presumably lessened. At the same time, separation agreements executed by spouses, who may serve the same purpose as a “decree of separate maintenance,” are encouraged as a matter of public policy.<sup>123</sup> Thus, amending IRC § 7703(a)(2) to clarify that the term “decree of separate maintenance” includes a separation agreement entered into by spouses and in existence as of the last day of the calendar year (or adding a separation agreement clause to the statute), would align the Code’s Family Status determinations to present-day family law practice and reclassify some EITC claimants as eligible, thereby reducing the improper payment rate.

118 See Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, TPC, <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults> (estimating a 15.3 percent per worker benefit up to \$1,500 would reach almost 42 million workers currently not eligible for today’s childless worker EITC). See also Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>.

119 See Mary Frances Lyle and Jeffrey L. Levy, *From Riches to Rags: Does Rehabilitative Alimony Need to be Rehabilitated?* 38 FAM. L.Q. 3, 4-5 (Spring 2004).

120 See Michelle L. Evans, *Wrongs Committed During A Marriage: The Child That No Area of the Law Wants to Adopt*, 66 Wash. & Lee L. Rev. 465 n 47 (Winter 2009) (citing Nelson Manfred Blake, *THE ROAD TO RENO: A HISTORY OF DIVORCE IN THE UNITED STATES* 34-47 (Greenwood Press 1977) (1962)).

121 See Mary Frances Lyle and Jeffrey L. Levy, *From Riches to Rags: Does Rehabilitative Alimony Need to be Rehabilitated?* 38 FAM. L.Q. 3, 4-5 (Spring 2004). See also, e.g., Va. Code § 20-95, providing that “A divorce from bed and board may be decreed for cruelty, reasonable apprehension of bodily hurt, willful desertion or abandonment.”

122 Some statutes refer to decrees for maintenance. See, e.g., Ark. Code § 9-12-313. Others refer to legal separation. See, e.g., Conn. Gen. Stat. § 46b-40; 750 Ill. Comp. Stat. 5/402; Mont. Code § 40-4-104; Vt. Stat. tit. 15 § 555. Yet others refer to bed and board. See, e.g., DC Code § 16-904; Ky. Rev. Stat. § 403.050; NJ Stat. § 2A:34-6; NC Gen. Stat. § 50-7; Va. Code Ann. § 20-95. For details about judicial separation in the 50 states, see [http://www.americanbar.org/content/dam/aba/publications/family\\_law\\_quarterly/vol45/4win12\\_chart4\\_divorce.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/family_law_quarterly/vol45/4win12_chart4_divorce.authcheckdam.pdf).

123 See, e.g., Uniform Marriage and Divorce Act, § 306, <http://www.uniformdivorce.com/UMDA.pdf>.

IRC § 7703(b) also prevents separated taxpayers from being considered “not married” in two ways. First, the statute retains an outdated “cost of maintaining a household” test that disproportionately affects members of racial and ethnic minorities who work and have children.<sup>124</sup> Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year’s end. The National Taxpayer Advocate previously recommended that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.”<sup>125</sup>

### IRS Mission Statement and Administration of Family Status Provisions

The IRS has not fully embraced its role as a public benefits administrator. Presently, the roles of tax collector and benefits administrator create tension because of the differences present in agency culture, mindset, skills sets, and training. By explicitly stating the IRS’s benefits administration role as a separate agency mission in the context of service and non-coercive compliance, the IRS will be required to align its procedures, goals, and measures with those of other agencies serving similar populations.<sup>126</sup>

Toward this end, for years the National Taxpayer Advocate has recommended to the IRS that it reform its audits of EITC taxpayers (and other Family Status provisions) so that one employee is assigned to work the audit if the taxpayer calls or writes the IRS in response to the IRS audit notice.<sup>127</sup> The importance of this approach cannot be understated — family matters are some of the most personal matters a taxpayer can discuss. Thus, a single employee working the taxpayer’s case would gain familiarity with the taxpayer’s issues, be able to suggest alternate sources of documentation given that familiarity, and reassure the taxpayer who may be understandably apprehensive and anxious, incorporating some of the skills and traits associated with social workers. Such an arrangement may reduce the number of default assessments in EITC exams (where the EITC was denied because the taxpayer did not respond or stopped responding). Default assessments currently constitute over half of all assessments and are the primary type of audit closure.<sup>128</sup>

A single assigned employee is even more important where a taxpayer is *not* entitled to a Family Status benefit. An audit should result in a taxpayer being educated and knowledgeable about the rules governing the audit issues — and since EITC eligibility and family composition change so frequently (with

124 See The Ohio State University Research and Innovation Communications, *Marital Separations an Alternative to Divorce for Poor Couples* (Aug. 13, 2013), describing research by Dmitry Tumen and Zhenchao Qian, <http://researchnews.osu.edu/archive/maritalsep.htm>. This study found couples in prolonged separations tended to be racial and ethnic minorities have young children, and have low family income and education.

125 National Taxpayer Advocate 2012 Annual Report to Congress 513 (Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married”*).

126 For a detailed discussion of the need to amend the IRS Mission Statement, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

127 See *generally*, National Taxpayer Advocate 2014 Annual Report to Congress 134-44; National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 78; National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 63-90 (Research Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2008 Annual Report to Congress 232.

128 National Taxpayer Advocate 2015 Annual Report to Congress 252-53 (Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process As an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*).

one-third of the EITC population shifting each year), an ineligible taxpayer today may be an eligible taxpayer tomorrow.<sup>129</sup>

Instead of catching incorrect claims after the fact, in certain cases the IRS could rely on determinations by federal or state agencies that are already making eligibility decisions for similar public benefits. Although none of the federal or state administered benefit programs, including Temporary Assistance for Needy Families (TANF),<sup>130</sup> Supplemental Nutrition Assistance Program (SNAP),<sup>131</sup> and Section VIII housing assistance,<sup>132</sup> fully overlap with the EITC, state workers arguably have the knowledge and experience to understand the needs of low income applicants. Additionally, the state workers determining eligibility for TANF are investigating many of the same elements as EITC audits: U.S. citizenship, family structure, and household finances. In particular, because children must not be absent from the household for more than 45 days for TANF benefits, the state employees are also familiar with determining the residency of children.<sup>133</sup> This is important to consider because IRS data show that of the known errors involving qualifying children on EITC claims, 75 percent of the errors resulted from the residency test.<sup>134</sup>

The IRS Dependent Database (DDb) data show that almost 31 percent of the EITC claimants who broke a DDb rule were Title IV recipients.<sup>135</sup> It is unclear from this data whether these taxpayers received Title IV benefits with respect to the particular child claimed on the return, or for themselves or another child. But the law creates a complexity trap where the EITC definition of qualifying child differs from basic household requirements in other federal or state benefit programs. For a taxpayer, it seems irrational and incorrect for a person to receive federally funded benefits for a child from one anti-poverty program and not be eligible with respect to that same child for another anti-poverty program.

By combining the “family” component of the EITC with other Family Status provisions, resulting in a single Family Credit, refundable at lower income levels, taxpayers will be able to prove eligibility under either the Qualifying Child or the Qualifying Relative provision. Moreover, expanding the Qualifying Relative definition to include non-biological primary caregivers who are required to submit with their return a third-party affidavit(s) verifying their caregiver role and the residency requirements, will simplify the documentation process that snags so many low income taxpayers and protect against improper payments. The IRS has previously tested the use of an official IRS form whereby third parties with either personal or official knowledge of a child’s residence can so attest, under penalties of perjury. The 2005

129 In response to the National Taxpayer Advocate’s recommendations, the IRS maintains its current correspondence exam system is sufficient. It questions what would happen if a taxpayer called and the employee assigned the case is unavailable. The National Taxpayer Advocate finds this objection unconvincing. Taxpayers can be provided the option of receiving a call-back from the assigned employee, or speaking with the next available representative. Moreover, the National Taxpayer Advocate’s proposal promotes individual employee accountability in the correspondence exam program, which is sorely lacking. National Taxpayer Advocate Fiscal Year 2016 Report to Congress vol. 2, 48-51.

130 42 U.S.C. §§ 601-679c.

131 42 U.S.C. § 1786.

132 42 U.S.C. § 1437f.

133 42 U.S.C. § 608(a)(10)(A)

134 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 22 (Pub. 5162, Aug. 2014).

135 IRS Dependent Database (DDb) for processing year (PY) 2015. In particular, 1,753,285 taxpayers broke DDb rules associated with Title IV whereas 5,701,546 taxpayers broke some DDb rule.

test found the affidavit was more reliable than other forms of documentation traditionally accepted by the IRS.<sup>136</sup>

## EXPLANATION OF RECOMMENDATION

Our proposals attempt to redefine the eligibility rules for the Code's Family Status provisions in a way that allows the tax system to get to "yes" in most instances without imposing intolerable compliance burdens on taxpayers. They build on improvements accomplished with the enactment of the Uniform Definition of a Child. The proposals also incorporate and improve upon the IRS's current technology and revenue protection strategies, and establish eligibility requirements based on the IRS's ability to verify those requirements either systemically or with minimal burden to the taxpayer. They are designed to accommodate the reality of U.S. family structures while minimizing compliance risk. They also recognize that family structures are inherently complex, and some element of "good enough" is required for a program like this to be perceived as fair and just.

In making our proposals, we do not flesh out all relevant rules, nor do we take a position on the distribution of family or work benefits. We expect that Congress will hear from many sources on these very points, and indeed, there are many studies to guide one in making these decisions.<sup>137</sup> However, as Congress works through reform of these family tax provisions, it should keep in mind that in the family status area, a trade off exists between rigidity, complexity, and taxpayer burden on the one hand, and flexibility, simplicity, and taxpayer compliance on the other.

A multitude of rules that focus on the perceived abuse-of-the-day ends up creating traps and burdens for *all* taxpayers. By combining several provisions into one Family Credit, we eliminate complex and often contradictory eligibility requirements still extant in the Code today. The Family Credit includes a basic credit for the taxpayer, another credit for the taxpayer's spouse (although under our earlier proposal for repealing Joint and Several Liability,<sup>138</sup> each spouse would claim his or her own credit), and a credit for each qualified child or qualified relative. By retaining the UDOC provisions of Qualifying Child and Qualifying Relative, we bring consistency to tax reform. However, we expand the definition of Qualifying Relative by clarifying that non-relatives meet the "principal place of abode" test if the child and the taxpayer share the same home as a member of the household for more than six months of the year. Moreover, we update the archaic "decree of separate maintenance" provision in IRC § 7703(a)

136 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* (Oct. 2005). This study found that affidavits had the highest rate of acceptance at 82%, compared to an overall acceptance rate of 64% for all substantiation types (letters, documents, notarized statements). *Id.* at 33. The IRS recently published a report about a later study of residency requirement affidavits. TAS raised significant concerns about the design of this test and the first draft of the study. While we continue to have concerns, the final report has revised some of its conclusions and entered more caveats. Nevertheless, we believe the study is flawed because, unlike the 2005 study, it only tested the "accuracy" of affidavits and did not test the accuracy of other forms of documentation. Therefore, unlike the 2005 study, it cannot conclude that affidavits are more or less accurate than other forms of documentation currently accepted by the IRS. See IRS, *EITC Third-Party Affidavit Study* (Aug. 2016).

137 See, e.g., Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>; Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, TPC, <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults>; The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (November 2005); Adam Carasso, Jeffrey Rohaly, and C. Eugene Steuerle, *A Unified Children's Tax Credit*, National Tax Association Proceedings (May 15, 2005), <http://www.urban.org/uploadedPDF/1000790.pdf>; Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Sized Adjustment to the Minimum Wage*, 57 *Tax L. Rev.* 301 (Spring 2004); Max B. Sawicky, Robert Cherry and Robert Denk, *The Next Tax Reform: Advancing Benefits for Children*, Economic Policy Institute (2002).

138 See National Taxpayer Advocate 2005 Annual Report to Congress 407-32 (Key Legislative Recommendation: *Another Marriage Penalty: Taxing the Wrong Spouse*).

by including a written separation agreement by year end as proof of being “not married.” We modify the “principal place of abode” rule under IRC § 7703(b) to require only “more than six months” of cohabitation with the qualifying child or relative, so that families like that headed by Ms. Cowan can receive the benefit of Family Status provisions.

We reduce burdens associated with the residency requirement by requiring the IRS to publish and accept an affidavit form on which third parties can certify periods of residence. Similarly, the IRS would be authorized to develop data-matching applications for Title IV and Title VIII benefits, and accept a proxy for the residency and relationship tests and public agency certifications that a taxpayer received public benefits with respect to a child for more than half the year.

Because there is no cap on the number of children who can be claimed by a taxpayer and the Family Credit is refundable at lower income levels but also available to taxpayers with higher incomes, taxpayers will not find themselves having to “lend” or “borrow” children. Where there are no “dueling” claims for children, the IRS will pay out the Qualifying Child or Qualifying Relative component of the credit so long as the IRS verifies that the child exists and is of the requisite age (via the Social Security database). Where there are competing claims, Congress can refine the current EITC tie-breaker rules to address these concerns.

The new credit for noncustodial parents who pay their entire child support obligations for the calendar year addresses the fundamental concept of taxing persons based on their ability to pay. The credit will also reduce many of the current competing claims for dependency exemptions, child credit, head of household filing status, and EITC.<sup>139</sup> Taxpayers can demonstrate child support payment compliance through affidavits from the payee or from the appropriate child support enforcement agency.

Repeal of head of household filing status eliminates some tax benefits for persons maintaining a home for parents or other persons who are not the taxpayer’s child. Thus, we propose to allocate some of the tax benefits associated with head of household filing status to the proposed add-on credit for dependent care, which would be available to taxpayers who provide primary care for members of their extended family either inside or outside of their homes.

Taxpayers will be eligible for the modified EITC on a per-worker basis. Expanding the age eligibility will extend important work incentives and income supplements to currently underserved populations. Clarifying the IRS’s authority to adjust a return and issue a refund where the income data demonstrates the taxpayer is eligible will ensure an almost 100 percent participation rate for this important program. Moreover, because the presence or absence of a child is not an eligibility factor, the IRS can check eligibility on the basis of income reporting in real time during the filing season, given the accelerated reporting of Forms W-2 and 1099-MISC (NEC). The proposal retains the refund issuance date of February 15 as a compliance mechanism.<sup>140</sup>

139 For processing year 2016, 69.7 percent of the returns which had a DDb duplicate dependent rule break had the relationship for all children established. Another 8.9 percent of the taxpayers had the relationship for some children established. Data is from a Business Object interface with the DDb, showing returns claiming EITC scored by the DDb for processing year 2015, which generally corresponds to returns filed for tax year (TY) 2014. By recognizing the child support contribution of noncustodial parents through the proposed add-on credit, we reduce the incentive to file duplicate claims.

140 For a recommendation that the Department of Treasury utilize the Direct Express debit card and payroll debit cards as low-cost electronic refund delivery options, see Most Serious Problem: *Payment Cards: Payment Cards Are Viable Options for Refund Delivery to the Unbanked and Underbanked, But Security Concerns Need to Be Addressed, supra.*

The proposed per-person EITC retains its purpose of incentivizing work for low and middle income taxpayers and minimizing the regressivity of the Social Security payroll tax. Similarly, the Family Credit reflects an acknowledgment of the minimum cost of basic living expenses by household size. Thus, the National Taxpayer Advocate recommends that Congress consider limiting the offset provisions under IRC § 6402 to 25 percent of the overpayment attributable to the refundable EITC as well as the refundable Family Credit.<sup>141</sup>

The net effect of these proposals is to take the IRS out of the business of looking intrusively into taxpayers' family situations. The tax provisions relating to family status will be subject to common sense rules that recognize the variety of family circumstances in the United States. While there are winners and losers (as with all reform proposals), these proposals eliminate conflicting, counter-intuitive eligibility rules (thereby converting currently noncompliant taxpayers into compliant ones), remove the IRS from custody and divorce contests, and focus much of its compliance work in this area on data that can be verified through third-party reporting, other government and private databases, and in a relatively few instances, from the taxpayer him or herself, with a minimum of taxpayer burden.

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141 For processing year 2015, 1,308,146 (4.8%) refunds associated with returns claiming EITC were offset against other IRS tax liabilities.

## APPENDIX A

FIGURE 2.1.5, Costs and Benefits of Federal Payment Programs

Program	SNAP	WIC	SSI	TANF	HUD	CHIP	Medicaid	School Lunch	EITC
Year	FY 2013	FY 2010	FY 2012	FY 2011	FY 2013	FY 2012	FY 2013	FY 2013	FY 2014
Number of Recipients	47.6 mil	9.1 mil	8.3 mil	4.6 mil	4.7 mil	8.1 mil	55.0 mil	30.7 mil	27.8 mil
Number of Eligible Persons	51.9 mil	14.6 mil	13.0-14.3 mil	12.2-14.4 mil	9.1 mil	11.8-12.2 mil	76.0-80.6 mil	49.2 mil	22.7 mil
Participation Rate (# of Recipients/ # of Eligible Persons)	79.0%	62.6%	58.0%	32.0%	49.3-51.5%	66.9 - 68.8%	68.2%	54.3-64.3%	78.8%
Year Participation Rate Measured	FY 2011	CY 2010	1998	2009	2013	FY 2012	2009	2012	TY 2009
Total Benefits Paid Out	\$76.1 bil	\$4.6 bil	\$51.1 bil	\$15.2 bil	\$30.9 bil	\$8.5 bil	\$248.3 bil	\$11.3 bil	\$60.3 bil
Average Benefit per Recipient	\$133.07	\$500.86	\$6,156.54	\$3,300.84	\$6,574.47	\$1,047.64	\$4,514.55	\$368.39	\$2,384.32
Overhead Costs	\$3.9 bil	\$1.9 bil	\$3.8 bil	\$1.5 bil	\$4.3 bil	\$3.1 bil	\$11.7 bil	\$1.2 bil	\$0.6 bil
Overhead Costs as % of Total Benefits Paid Out	5.1%	41.8%	7.4%	9.7%	13.8%	36.3%	4.7%	10.3%	1.0%
Improper Payments	\$2.6 bil	\$0.04 bil	\$4.7 bil	\$2.3 bil	\$1.3 bil	\$0.7 bil	\$14.4 bil	\$1.8 bil	\$14.5 bil
Improper Payments as a % of Total Benefits Paid	3.4%	1.0%	9.2%	15.0%	4.3%	8.2%	5.8%	15.7%	24.0%
Overhead Costs + Improper Payments	\$6.5 bil	\$1.9 bil	\$8.5 bil	\$3.8 bil	\$5.6 bil	\$3.8 bil	\$26.1 bil	\$3.0 bil	\$15.1 bil
Overhead Costs + Improper Payments as a % of Total	8.5%	42.8%	16.6%	24.7%	18.1%	44.5%	10.5%	26.0%	25.0%

## End Notes for Cost and Benefits of Federal Payment Programs

### SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP)

The number of recipients, benefits paid, average benefit, and overhead costs are from *Supplemental Nutrition Assistance Program Participation and Costs* (March 6, 2015). The number of improper payments and their percent of benefits paid are from <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The participation rate is from *Supplemental Nutrition Assistance Program Participation Rates: Fiscal Years 2010 and 2011* (Feb. 2014).

### WOMEN, INFANTS, AND CHILDREN (WIC)

WIC recipients, eligible, and participation rate are from *Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) Eligibles and Coverage – 2010: National and State Level Estimates of the Population of Women, Infants, and Children Eligible for WIC Benefits Executive Summary* (Jan. 2013). Benefits are from: WIC Program Food Cost (March 6, 2015). Overhead costs are from: *WIC Program: Nutrition Service and Administrative Costs* (March 6, 2015). Improper payments: *Nutritional Assistance Program Report Series, Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). Erroneous Payments to Vendors: Annual Estimates for FY 2010 Office of Research and Analysis Report No. WIC-12-EP2010WIC*.

### TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF)

The recipients, overhead costs (includes administration and systems costs), and participation rate are taken from U.S. Department of Health and Human Services, Administration for Children and Families Office of Family Assistance, *Temporary Assistance for Needy Families Program (TANF) Tenth Report to Congress*. The benefits are from the report to Congress, Appendix Table 1:1. HHS has not estimated TANF improper payments because the program is administered by the various states that distribute federal funds and the states have not performed improper payment reviews. The improper payment rate shown has been estimated by the *Federal Safety Net*, available at: <http://federalsafetynet.com/tanf.html>. HHS claims there is a statutory prohibition against requiring states to report improper payments. In 2007, HHS did a study in three states with the improper payment rate ranging from 11.5 percent to 40 percent. The 15 percent estimate is from a private source (Federal Safety Net). The participation rate is based on families, not individuals. Overhead costs do not include other expenditures on non-assistance, which are defined as, “benefits are those that do not fall within the definition of assistance, and include expenditures such as child care, transportation, and other work supports provided to employed families, non-recurrent short-term benefits, work subsidies to employers, and services such as education and training, case management, job search, and counseling.” The administrative expenses portion of non-assistance was tabulated as the overhead expense of the program.

### SUPPLEMENTAL SECURITY INCOME (SSI)

Recipients are from *Table IV.B9.—SSI Recipients with Federally-Administered Benefits in Current-Payment Status as of December, 1974-2036*. The benefits are imputed from the FY 2012 improper payments and improper payment rates at <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The participation rate is from Kathleen McGarry, University of California, Los Angeles and NBER, and Robert F. Schoeni University of Michigan, *Understanding Participation in SSI*, Prepared for the 16th Annual Joint Meeting of the Retirement Research Consortium (Aug. 7–8, 2014). The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants



are assumed eligible and are thus divided by the participation rate to form the upper bound. Overhead costs are from the Social Security Administration's 2012 Annual Report of the SSI Program Table IV.E1., available at [http://www.ssa.gov/OACT/ssir/SSI12/IV\\_E\\_AdminCosts.html](http://www.ssa.gov/OACT/ssir/SSI12/IV_E_AdminCosts.html).

#### DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

The number of recipients (households) is taken from HUD, *Rental Assistance Reform Frequently Asked Questions* (Mar. 2013). The total benefits are from improper payments and improper payment rate for FY 2013 from the federal government's improper payment website, <https://paymentaccuracy.gov/about-improper-payments>. The overhead costs are from the National Health Care for the Homeless Council compilation of items in the *Enacted Funding Levels FY2011–FY2013* (Mar. 2013). The number of households in poverty is used as a benchmark to compute the participation rate; however, the actual formula to compute eligible families involves the determination of average income and housing prices on a county-by-county basis. The number of 2013 households in poverty is from a U.S. Census Bureau Current Population Survey report, Carmen DeNavas-Walt and Bernadette D. Proctor, *Income and Poverty in the United States: 2013* (Nov. 2014). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Therefore, this is only an estimated participation rate range.

#### CHILDREN'S HEALTH INSURANCE PROGRAM (CHIP)

The total benefits are imputed from improper payments and improper payment rate for FY 2012 from the federal government's improper payment web site, <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The recipients and participation rate are taken from "CHIPRA Mandated Evaluation of the Children's Health Insurance Program: Final Findings Harrington and Kenney, *et al.* 2014 ..." Mathematica Policy Research, report submitted to the Office of the Assistant Secretary for Planning and Evaluation. Ann Arbor, MI (Aug. 2014). This report shows benefits paid as \$9.2 billion instead of the \$9.1 billion imputed from the federal improper payment website. All participants are assumed eligible and are thus divided by the sum 48 of the participants and the number of children eligible, but still uninsured (3.7 million: see *CHIPRA Mandated Evaluation* report cited above) to form the upper bound estimate of the participation rate. The lower bound participation rate estimate reduces the number of participants by the quotient obtained from dividing improper payments by the average benefit to obtain the average number of ineligible participants and the result is divided by the estimated eligible participants and the number of eligible, but uninsured children. The range of eligibles is computed at the lower bound by dividing the number of participants by the sum of the number of participants and the number of eligible, but uninsured children (see above). At the upper bound, the number of participants is reduced by the quantity of the dividing improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the lowest estimated participation rate. The Overhead Costs are taken from *Medicaid Financial Management Report net CHIP Expenditures FY 2012* and include the National Health Insurance Technology (HIT). The HIT costs for FY 2012 were divided by the FY 2012 imputed benefits.

#### MEDICAID

The numbers of recipients is from the Kaiser Family Foundation, *Medicaid Enrollment: June 2013 Data Snapshot*, <http://kff.org/report-section/medicaid-enrollment-june-2013-data-snapshot-total-enrollment>. The paper goes on to state that Medicaid enrollment is expected to increase as a result of the Affordable

Care Act. In fact, Medicaid enrollment has increased to over 60 million in 2014, according to *Medicaid/CHIP Participation Among Children and Parents*, Medicaid / CHIP FY 2014 September enrollment data, with the number of CHIP participants subtracted from the total. The participation rate is from the highest recent rate cited in *Understanding Participation Rates in Medicaid: Implications for the Affordable Care Act*: Ben Sommers, Rick Kronick, Kenneth Finegold, Rosa Po, Karyn Schwartz, and Sherry Glied (Mar. 2012), <http://aspe.hhs.gov/health/reports/2012/MedicaidTakeup/ib.shtml>. The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants are assumed eligible and are thus divided by the participation rate to form the upper bound. The improper payments, total benefits paid, and improper payment rate are from the Federal government website: <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The overhead costs are from *Medicaid's National Health Expenditures* administrative costs for FY 2013.

#### SCHOOL LUNCH PROGRAM

The recipients are from *National School Lunch Program: Total Participation* (FY 2013). The total benefits, improper payments, and improper payment rate for FY 2013 are from the federal government's improper payment website: <https://paymentaccuracy.gov/about-improper-payments>. The amount of improper payments and the improper payment rate also come from this source. There is a slight discrepancy between the amount of imputed payments and the amount in a 2014 GAO report (\$0.1 billion difference). The eligibles are determined from the National Center for Educational Statistics, Table 216.60 *Number and Percentage of public school students eligible for free or reduced price lunch by school level, locale and student race/ethnicity 2011-12*, [https://nces.ed.gov/programs/digest/d13/tables/dt13\\_216.60.asp](https://nces.ed.gov/programs/digest/d13/tables/dt13_216.60.asp) (last visited April 9, 2015). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Census data indicate more children may receive free lunches than are entitled to do so, but this should be reflected in improper payments. Overhead costs are determined from the Federal Register's *National School Lunch Program: School Food Service Accounts Revenue Amendments Related to the Healthy-Hungry Free Kids Act* (2010), <https://www.federalregister.gov/articles/2011/06/17/2011-14926/national-school-lunch-program-school-food-service-account-revenue-amendments-related-to-the-healthy#t-7>. The report is from school year 2005 and 2006 and reports a percentage only. The percentage is applied to the benefits paid in FY 2013.

#### EARNED INCOME TAX CREDIT (EITC)

The number of EITC recipients is from IRS Compliance Data Warehouse, *Individual Returns Transaction File for Tax Year 2013*. The benefits are from the FY 2014 improper payments and improper payment rates at <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The amount of improper payments and the rate of improper payments are also from this source. The EITC participation rate and number of eligibles is from the CARRA Working Paper Series, *Working Paper #2014-04 Changes in EITC Eligibility and Participation, 2005-2009*, Maggie R. Jones, U. S. Census Bureau Center for Administrative Records Research and Applications (2009), <http://www.eitc.irs.gov/EITC-Central/Participation-Rate>. This site only provides the percent eligible. The overhead costs are from GAO testimony, GAO/T-GGD-97-105, *Tax Administration Earned Income Noncompliance* (May 8, 1997).

Chairman Buchanan. Thank you very much.

At this time, we will now proceed to the question-and-answer session. I think we are going to have to limit the questioning to four minutes instead of five, because we have a briefing at 10:00, so I would ask all the Members to adhere to that.

As is my custom, I will hold my question until the end. I now recognize the gentleman from Arizona, Mr. Schweikert, for any question he might have.

Mr. Schweikert. Thank you, Mr. Chairman, and Ms. Olson.

This is sort of unique for a couple of us up here because we are so used to actually having witnessed, particularly in the IRS, where we have a series of dodging stories and things that are frustrating.

When we have reached out to Arizona, we actually had people say nice things about the organization, a little concern on speed, but actually said nice things. So you win a prize for having a unique conversation with us today.

Can I start with one thing, though, that did come up in the conversations we had in Arizona about this hearing that was coming up, and that was, with outreach to our office and then also to your office, individuals who are -- were called in the gig economy, the Uber driver, the person who crowdsources their work through the internet, and the discussion of how they access information saying, "Hey, here are the rules for me to save for my retirement, here are my rules on what must be set aside."

First, as the Advocate, do you believe your organization is doing enough to make it easy to access that information? The way you post it up on your website, the way you deliver that information? And then the same thing for, as you observe, how the IRS delivers that information to those folks in that part of our economy?

Ms. Olson. Well, I am very concerned about this population as it is growing. It is a very fast growing part of it. And I am concerned they will get into trouble with self-employment tax, not save for retirement, et cetera.

One thing that my office is working on right now, that we receive suggestions about from other sectors, is to develop a wizard where people who are starting in the gig economy can actually go on to our taxpayer toolkit online and see all the steps that they need to do and get to the different places: Get an employer identification number, understand about calculating self-employment tax and when they need to pay it; get to the place where they can calculate or learn about the different forms of retirement saving, et cetera; and then, most importantly, if they have problems, how they can resolve them, including getting to the Taxpayer Advocate Service. That is something we are developing right now.

Mr. Schweikert. And I know that may be slightly different than as you viewed your charter as the Advocate, but sometimes the Advocate may be proactive. And this is

something that we all, as Committee Members, are going to have to deal with right now is that associated mother organization, if they were to give advice saying, “You know you can save for your retirement.” They may have just set them off as becoming an employee and no longer being an independent contractor. And we are going to have to sort of figure out, you know, what are we going to do to help this population be able to have that future?

Now, on the IRS side, do we see the agency itself doing enough? Does the public access have access to the organization you are contracted with? Where does that person go right now to get that information?

Ms. Olson. So, the IRS did create a web page in response to a small business hearing last year to address some of the issues for the gig economy. I think, as always, we can all do more.

This goes back to the fact that there are only 98 employees conducting outreach and education to the self-employed population in the United States. And there are 14 States that do not have one of those employees located in them.

Mr. Schweikert. And I know we are in our last 30 seconds. I have a fixation that the use of technology as a way to direct folks who are having difficulties with the IRS.

Do you actually, as the Advocate, almost publish saying this is a problem that comes to us quite often, here is how it has been resolved, here is the form you need? What are you doing proactively in that part of the world?

Ms. Olson. Well, we identified the needs of the gig economy as a most serious problem in my annual report to Congress, and we made recommendations. And we have also created materials from my local taxpayer advocates in each State to actually conduct outreach proactively to groups, and that is one of their assignments to identify stakeholders in their communities.

Mr. Schweikert. Thank you, Mr. Chairman. I yield back.

Chairman Buchanan. I now recognize the distinguished Ranking Member, Mr. Lewis, for any questions he might have.

Mr. Lewis. Thank you, Mr. Chairman.

Ms. Olson, it is my understanding that you held a dozen public meetings around the country. What did you learn?

Ms. Olson. You know, it was remarkable. We learned a number of things: One was how hard people are trying to communicate with the IRS and how much they actually want to. We learned that people thought that having digital online tools would be very,

very helpful, but they were no replacement for talking to the IRS; and that there was a very strong desire for the IRS to hear them and listen to them.

We learned that -- from all sorts of different populations, the concern about identity theft and the scams that are going on out there. Those were very strong issues. We learned about issues about payroll service providers ripping off taxpayers who are securing their services.

And then we heard from experts about how best to design digital services to make them usable by people, but not replace the communication, the person-to-person communication, whether it is on the phone or in person. And that was a very strong message.

Mr. Lewis. I know, as the Taxpayer Advocate, you don't believe that quality service can be provided on the cheap.

Ms. Olson. Taxpayer service is, to me, the key way that you build trust with taxpayers. And you can do taxpayer service whether you are trying to do outreach and education or within an audit or within collection activities.

If you take that approach that you are trying to bring the taxpayer into voluntary compliance and understand why they are having compliance difficulties, and you are listening to the taxpayer, then that is how you bring taxpayer service and taxpayer rights into what I call the ethos of the organization.

And there is no conflict with exercising the enforcement and compliance tools that you have. Providing taxpayer service doesn't eliminate a single one of those powers that the IRS has when they need to use them.

Mr. Lewis. Do you think the 1998 Reform Act was successful?

Ms. Olson. I think the 1998 Reform was very successful. I think that what we need to do is go back -- and that is partly why I gave you all the list of some of the provisions that I saw that weren't successfully implemented from the IRS.

I think what Congress focused on in 1998 was very key, and we need to make sure that the IRS does what you all directed them to do, or learn why they couldn't do it and then revise it so that it fits into 21st century tax administration.

Mr. Lewis. Did it achieve its goals?

Ms. Olson. I think that it achieved it. It made the IRS focus on taxpayer service, but with these budget cuts, it sort of moved away from that as a primary focus. And it is really moving away from that person-to-person contact.

And I keep saying to people in the IRS, people are giving up their money. We are taking their money for the greater good. Why would we not want to talk to them and hear from them and listen to their concerns, even if we have to tell them, you know, we can't solve your problem in the way you want, this is the law. By listening to them, we gain trust, and that is what we need to do. And we have gotten away from that.

Mr. Lewis. Again, thank you for being here, and thank you for your years of service.

Chairman Buchanan. I now recognize the gentlelady, Mrs. Walorski, from Indiana.

Mrs. Walorski. Thank you, Mr. Chairman.

Thanks, Ms. Olson. Again, many thanks from my constituents in Indiana's Second District. You have helped -- in the five years I have been here, you have been able to mitigate and help somewhere over 90 percent of the questions that we have had. And I am very, very grateful to you for what you have done. You have probably seen everything in 16 years.

So I just wanted to pick up on what you said that you learned from the hearings that you guys had on the issues of ID theft, tax fraud, and scams. That is what we really get burdened by, folks in our district that have gotten caught in these issues.

And my question is this: On this Return Review Program, the RRP, that started in 2009, this thing has tended to end up to be like a boondoggle. I just kind of wanted to hear from you on its predecessor, the Electronic Fraud Detection System, or the EFDS, which, in 2010, the IRS said was too risky to maintain, upgrade, or operate beyond 2015. But here we are in 2017. The EFDS is still the principle fraud detection system, because the RRP still isn't ready for prime time.

In fact, TIGTA said there is no estimated date for full implementation, and GAO estimates that the program has incurred over \$86.5 million in cost overruns. So when the RRP has run as a pilot, it yielded a high false-positive rate, and it missed \$313 million in fraudulent filings.

So let's set aside the numbers and stats and talk about the actual people behind them. You have documented well what taxpayers go through in your annual reports. But for the benefit of everyone here, can you walk us through what happens to a single mom, a small business owner, a person who either gets flagged as a false positive or a fraudulent return?

Can you just go through how do you find out what hoops they go through and what this really means to people?

Ms. Olson. Right. Depending on what system triggers them as a suspected fraudulent return, they either get a letter or they are just -- their refund is just held up and they have to call the IRS.

If they get a letter, they are told that they have to verify themselves either online or they may have to go into a walk-in site. And to do that, they just can't walk in. There are no longer walk-in sites; they have to make an appointment. And sometimes you are told it might take weeks to get an appointment, and you won't be able to get your refund before you do that.

And, then, even if you go through that, it may be that your return is stopped by some other filter once it goes back into the processing, so then you have to go through it all again.

Identity theft and refund fraud have been the top two case receipts in TAS, Taxpayer Advocate Service, for the last 5 years, and they really are a significant part of our inventory. It is devastating to people.

Mrs. Walorski. So aside from the time element and the frustration, does it not cost taxpayers money as well if they need to seek professional services to be their Advocate?

Ms. Olson. Well, absolutely. Absolutely. And this affects people who are low income, high income. It doesn't matter. And people are having to get their preparers to call, and people often submit documentation multiple times.

There is no one person assigned to their case, so every time they call, they have to tell their story to a different person. These are all recommendations we have made.

You know, the other thing on the filters is that we have recommended that the IRS create sort of a dedicated team during the filing season on the IT side. So as we start seeing filters that have very high false positive rates, that you have a team that can get in there and adjust those filters. Don't wait until later.

Mrs. Walorski. I apologize about interrupting, but what about commercially available technology that is there? Is it your opinion that just from a commonsense perspective, this would be where we would move to with an unbelievable amount of errors in fraud and money that is being spent and this whole lack of accountability on the system?

Would you not agree that that would be someplace that we could look at and say let's mitigate this as quickly as we can on behalf of the taxpayers?

Ms. Olson. Certainly, the financial sector has tried to figure out about financial fraud and, you know, electronic fraud. And the IRS is meeting with those people. The commissioner established the security summit, and I think that is a significant step.

Mrs. Walorski. I appreciate it. We are out of time.

I yield back. And thanks again. Thanks, Mr. Chairman.

Chairman Buchanan. I now recognize the gentlelady from Washington, Ms. DelBene.

Ms. DelBene. Thank you, Mr. Chair.

And thank you, Ms. Olson, for being with us today and for all of your service.

I wanted to talk to you about technology in particular, because you talked so much about that in your testimony and kind of the dire state that it is in right now. Can you give us a brief overview of how technology decisions are made at the IRS today, and kind of, briefly, whether you think the organizational chart is working well in terms of helping make those decisions?

Ms. Olson. Well, I think, you know, there are lots of executive steering committees on the technology side that review the priorities of how the IRS is going to spend its money. And the IRS, in addition to the cybersecurity concerns that we have, which are very great, the major concern that we have got, in addition to the RRP system, which is our return fraud detection system, is our enterprise case management system.

We have about over 60 systems, and they don't communicate with one another. And so employees have to get permission to get into things, and often they can't. It slows things down. It is manual. It is not virtual. Our case files aren't virtual.

It is astonishing. And that is a heavy lift that the IRS, in my opinion, is very far behind on, but is finally beginning -- after spending millions of dollars, to get up to speed.

And then we have the fact that we are still on -- we have the two oldest information systems in the Federal Government, according to GAO, where we are keeping our taxpayer information on. And that is a significant concern, getting from those systems to something that is 21st century is going to be a huge lift.

Ms. DelBene. And I assume, when we talk about cyber having old systems, that is very concerning, and it is concerning because access to information is so cumbersome, as you said, it slows down your ability -- IRS's ability to do so its job.

Ms. Olson. Right.

Ms. DelBene. Why do you think things have gotten so bad? Why are we so outdated?

Ms. Olson. My personal opinion, from observing it while I have tried to develop my own case management system for my own employees, is that partly, we don't have the talent inside the IRS. We haven't been able to recruit the people that we need to.

And then I think that there is not enough communication between the IT function and the business operating divisions who are going to use these systems, so that things go -- get developed that actually aren't what the operating divisions need, but then the operating divisions don't have a chance to tell that. And then money gets wasted, and I have seen that a lot.



Ms. DelBene. You know, I think that is a common problem that we have seen in technology implementations in government generally and something we need to continue to focus on. Do you have current modernization plans within the IRS that you think are going to help address these issues?

Ms. Olson. I think particularly for the ECM, the IRS has just put out a request for information to hear from off-the-shelf products that are doing a case management system to see what is out there, and then they will build to request for a proposal.

I think that is the appropriate approach to really get a sense of the universe, instead of focusing on one thing that turns out not to be good, but we have invested \$80 million in it or something like that. So they are finally on the right track in that regard.

They do need more funding to be able to bring in the talent, but they also need more oversight from you all so that you all are understanding that that funding is being spent appropriately.

Ms. DelBene. Thank you so much. My time has expired.

I yield back, Mr. Chair.

Chairman Buchanan. Thank you.

I now recognize the gentleman from Pennsylvania, Mr. Meehan.

Mr. Meehan. Thank you, Mr. Chairman.

And thank you, Ms. Olson, for your work.

Ms. Olson, oftentimes, the IRS has a direct relationship with taxpayers because it relates to the taxpayer paying his or her taxes. But they serve another role, and it implicates a lot of people in which the information that one puts into his or her IRS tax return is relevant for another purpose.

And I speak to something which is touching families all across America today, and that is, college applications, including for financial aid. And so as colleges and universities interact with their students, they are reliant on the ability for the applicants to let people know what their financial status is, and that means they need to get into IRS databases.

Outward facing tools have been used by the IRS so that I authenticate who I am, and then you allow me to go back into my tax return and forward that information onto my financial aid application. As a parent who has gone through this process -- and I know I am speaking for many -- it is so incredibly frustrating to begin with.

But now, we are seeing that this system, which has purportedly been put in place, the outward-facing tools, has actually been compromised. Hundreds of thousands of

Americans trying to make this application have found that their identities have been stolen.

And as a result, now we not only can't utilize the tool, but you have people who are trying to make those applications who are now frustrated, feeling time deadlines for applying to their schools, don't know where to go to get the information.

And it is particularly egregious because oftentimes, the very people making these applications, may be a student who doesn't know the information that his or her parents have.

Can you speak to me about the outward-facing tools that the IRS is using, what you know about this compromised situation, about what the IRS is doing to make that taxpayer relationship move more slowly -- flow more appropriately.

Ms. Olson. Well, first, the information the IRS has is such a valuable asset of the Federal Government and the taxpayers of the United States that we have to make sure that it is protected in every way possible. And that means that there has to be very high -- high-level screens for people to authenticate who they are, because identity thieves are very sophisticated.

And last year, the IRS learned that there were risks to the way that people were getting access to IRS data through this FAFSA system. And while they tried to work with the Department of Education over time, they learned that what the IRS needed for the protection of that data, the Department of Education couldn't put into their system. And they had to make -- they gave several workarounds, and those workarounds weren't able to be implemented by the DOE.

Mr. Meehan. Was the problem on the Department of Education part?

Ms. Olson. It was my understanding it was on the level of, you know, the types of systems that DOE has, and we were setting very high standards for access to that information. And so the IRS had to -- really felt, according to their risk analysis, that they had to stand down.

And now they have just put it back up again. They have worked through some issues. But I think that it is going -- this is where you have some difficulty where you have one agency and the another agency, and you need to get them together.

Mr. Meehan. Well, what is your sense? Is the Department of Education collaborating and cooperating with the IRS?

Ms. Olson. I think they are now, and I think -- this is my personal opinion, but I think they are now. I think it is a matter of technology. But it is also that I think they didn't understand initially the level of concern that we have about people getting access to this incredibly important data and misusing it.

Mr. Meehan. Well, thank you. I would ask for your continuing oversight on that particular issue, because as we speak, millions of Americans --

Ms. Olson. Certainly.

Mr. Meehan. -- are dealing with this very frustrating system. Thank you.

Ms. Olson. Certainly.

Mr. Meehan. I yield back.

Chairman Buchanan. I now recognize the gentleman from Connecticut, Mr. Larson.

Mr. Larson. Thank you, Mr. Chairman. I especially appreciate the opportunity to meet the committee. I want to thank you and Mr. Lewis for this opportunity.

Ms. Olson, I have nothing but great respect and admiration for you and the job that you have done.

Representative Courtney and myself have been dealing with an issue, along with Representative Neal up in New England, that deals with foundation crumbling, not dissimilar to a case that happened many years ago in the south with what they referred to as a Chinese drywall.

And in both cases, the circumstances are that, through no fault of the individual, they all of a sudden find themselves in a situation in the case of Connecticut where their foundations are crumbling. There is no insurance coverage. And so we are pursuing relief -- in this case, from the IRS, to use this as a casualty loss.

And as I said, there is ample precedent for this in the China drywall situation. And our initial discussions with both the Commissioner and Secretary Mnuchin have been very positive, but -- and we also know that in Connecticut, the Taxpayer Advocate Service has been incredibly supportive.

Any advice or recommendations, and could we beseech you for the support of the National Taxpayer Advocate?

Ms. Olson. Well, I have been aware of this problem and had my staff attorneys meet with chief counsel attorneys of the IRS to look at the law pertaining to casualty loss deductions and why it -- how it could apply in this instance. And just this week, we submitted to the IRS chief counsel a request for priority guidance that they put this issue on their priority guidance plan to give guidance.

And we have actually -- it wasn't just a request, we pointed out how they could do it to grant relief to these taxpayers. And I will be more than happy to share that request with you so you can see what we wrote up.

Mr. Larson. I would be delighted to receive that. And we appreciate your continued advocacy. And as I said earlier, this is something that impacts people, and now it is estimated that more than 30,000 people in Connecticut will be impacted by this. But the straining actually runs from Canada all the way down to the Sound, so we are trying to forewarn people as well with this.

But I can't thank you enough as well as both the cooperation that we have received today from the IRS and Treasury. And I view that, in large part, because of your involvement and the Taxpayer Advocate Service involvement.

Ms. Olson. Thank you.

Mr. Larson. With that, Mr. Chairman, I would -- I would just like to also ask you at some point -- not for here -- but I would love to get your opinion on the Japanese system of collecting and simplifying their Tax Code and what opinions you might have on that. That is not a question for here, but perhaps later I could follow up with you on that.

Ms. Olson. Certainly.

Mr. Larson. With that, Mr. Chairman, I thank the committee for indulging me and yield back my time.

Chairman Buchanan. Anytime, Mr. Larson.

I now recognize the gentleman from North Carolina, Mr. Holding.

Mr. Holding. Thank you, Mr. Chairman.

Ms. Olson, I would like to ask you about a subject that came up at one of your public forums last year. A tax practitioner in Red Oak, Iowa, raised concerns about statistical audits, meaning audits that are done for research purposes by the IRS.

And although you acknowledge the importance of these research audits, you also recognize that they can be painful for taxpayers, and you even described the taxpayer under audit as, quote, "a guinea pig." So I have significant concerns about these audits. You mentioned a couple of potential solutions at the forum last year. At the time, you said you had only been discussing these options internally. So has your thinking evolved any on these suggestions?

Ms. Olson. So, you know, the audit -- as a representative -- I represented taxpayers for 27 years, and as a representative, I had to sit through the predecessor to these audits, the tax compliance measurement program. And it was expensive and painful for the taxpayer, painful for the representative.

But I also recognize the importance of these audits so that we don't go out and willy-nilly audit people that shouldn't be audited. You know, we need some kind of statistical gathering thing.

And my thinking about these taxpayers being guinea pigs is that they are actually doing a service for the public. These are random audits. There may be nothing wrong with their returns at the end of the day, but the IRS is using it for data gathering.

And so if they are doing that public service, they should be paid. And either that or either/and maybe we don't assess the tax at the end of the audit. You know, we found the errors, but they have sat through this for the public good, and so maybe we don't assess the tax that we found. Or we give them compensation for sitting through it. And I would suggest that that compensation be nontaxable so we don't, you know --

Mr.  Holding. Well, let me ask you this: Yesterday, GAO released a report on the national research program and employment taxes. And the GAO concluded that the IRS doesn't even have a formal plan to timely analyze, let alone actually use, the data it collected.

So do you believe the IRS should continue to subject taxpayers, in your words, guinea pigs, to these burdensome, random audits if there is no plan to even use the information? And shouldn't the IRS actually use the data? If it is going to pay folks for the data, you know, of your suggestion, shouldn't they use it or shouldn't they just shut down the program? I mean, if GAO says there is no plan to even use it. So that is kind of doubly disturbing.

Ms.  Olson. Yeah. I don't think they should shut down the program. I mean, they need to use the data. And I will look very carefully at the GAO audit, because I think GAO -- that gives a plan for how the IRS could use it.

I think the IRS needs to be an organization that uses the data that it has. And often, it doesn't develop strategies based on the data or it takes a long time to get it into operation, and that is just inexcusable.

Mr.  Holding. Well, listening to your answer to Ms. DelBene's question on technology in the IRS, it seems like the IRS has difficulty with technology just in its basic functions, and this is something above its basic function. And it makes it, perhaps, triply disturbing now that Ms. DelBene asked the probing question.

Ms.  Olson. I think that the IRS is challenged in a lot of ways. I do believe that --

Mr.  Holding. That is the understatement of the day.

Ms.  Olson. Yes.

Mr.  Holding. Mr. Chairman, I yield back.

Chairman Buchanan. Thank you. I now recognize the gentleman from New York, Mr. Crowley.

Mr. Crowley. Thank you, Mr. Chairman. Thank you for holding this hearing today.

Thank you, Ms. Olson, for participating here, as well.

Ms. Olson, recently, my good friend and colleague, John Lewis, introduced a bill, the Taxpayer Protection Act of 2017, which I am a cosponsor of, to repeal the private debt collection program. Do you think the IRS should outsource Federal tax collection, and should a new IRS have the authority to do this, hire private companies to collect unpaid taxes?

Ms. Olson. Well, it is my personal and professional opinion that the collection of tax is an inherently governmental function, because it requires the exercise of judgment and discretion to do it right, and take into consideration the facts and circumstances of taxpayers.

But Congress has made the decision to create this outsourcing, and now, my focus has been on how the IRS is implementing this provision. And I have a lot of concerns about how it is being implemented.

Mr. Crowley. For for-profit motive. Is that it?

Ms. Olson. I think that is part of the fundamental flaw with the program, that at least whatever you say about IRS -- I mean, I think that IRS collection employees understand that the goal of collection is to bring taxpayers into voluntary compliance. And that may mean that you are focusing on the future that they be able to pay going forward, and will deal with their debt later.

And the private debt collectors have the incentive to collect tax, just the amount that is before them, and get their commission. They don't -- they would have no incentive to think about voluntary compliance going forward.

Mr. Crowley. The consequence as it pertains to the taxpayer as well. Kind of, in my mind, my concern about criminal justice reform and privatizing of prisons, you know, you create beds. They need to fill them. That is how they get paid.

In terms of the EITC, I know there has been a great deal of concern about fraud existing within the program itself. I would like to get your thoughts in terms of how much is really fraud and how much is basically mistakes that are made in terms of filling out the proper requisite papers.

Ms. Olson. Well --

Mr. Crowley. Hank Paulson, for instance, I went into Goldman Sachs, he filed and he did it wrong, just to demonstrate, even the most brilliant, so to speak, can make mistakes.

What recs do you have to make it an even more efficient -- and more accessible and more efficient as well?

Ms. Olson. Right. Well, this year, in my annual report to Congress, I made a legislative recommendation that was really designed around trying to minimize the errors and fraud in the EITC, and we have attached it to my testimony.

I do think that most of the errors are attributable to the complexity of the law, but the complexity of the law also creates opportunities for others to game it. And a lot of the fraud, the pure fraud, comes from some unregulated preparers that, you know, are preying upon an unsophisticated population and selling them something that is too good to be true.

So you have got a lot of different things playing around there. But I believe that there are things that you can do, both administratively and legislatively, to minimize the improper payments. Some of that is going to the design, and others are going into the kind of both outreach and education and oversight that the IRS needs to do on this issue.

Mr. Crowley. Thank you. I think for the integrity of the program itself, we need to be vigilant, mindful, but also understand, I think, the complexities in terms of the clientele --

Ms. Olson. Yeah.

Mr. Crowley. -- and their ability to actually fill out those forms properly.

And, Mr. Chairman, just let me thank you for holding this hearing today as well in a very bipartisan spirit.

Mr. Roskam and I have been working together on issues in relation to taxpayers' relationship with the IRS. We know it is not always pleasant. We know you all don't always get it right, and that is why I think we need a Congress, a vigilant Congress, Mr. Chairman, and a committee like this to keep an eye on it to help you do your job, help us do our job, but help, most importantly, protect the interest of our constituents, the U.S. taxpayer.

So, thank you, Mr. Chairman.

Chairman Buchanan. Thank you.

I now recognize the gentlelady from Tennessee, Mrs. Black.

Mrs. Black. I thank the Chairman. I thank you for allowing me to sit in on the Subcommittee, although I am not a Member of the Subcommittee.

But, Ms. Olson, I want to thank you for the work that you and your folks do at your agency. And as you said at the beginning of your comments that most people do want to pay their fair share and just to be left alone. They understand that they have a responsibility to pay their taxes. The U.S. has about 98 percent of voluntary tax compliance rate and has always been linked to be perceived fair and impartial.

But in the most recent years, we have seen more of that impartiality, and I think that that is part of what we are seeing in the general population, that they have really lost trust in the IRS. So your agency is particularly important for helping us to be sure that we do at least have one reach into helping with that.

One of the things that I wanted to go to is, of course, the complexity of the Tax Code doesn't help, and that is up to Congress to reform the Tax Code so that it can be something much simpler, which we are working on on our side.

But the IRS is also a unique creature in that it doesn't really have a regulatory process like other Federal agencies do. And so they issued these guidances, and they don't solicit any public comments like you would in a Federal agency where there would be a change and there would be an opportunity for those public comments.

And, in fact, on the IRS website, it actually has a section that says, "Understand the IRS guidance." And it has seven kinds of guidance to taxpayers that they should be familiar with. And I will note the irony of this is that the IRS actually acknowledges within that statement that they say, and I quote, "It may be puzzling and a mystery."

And so I wanted to ask you to talk a little bit about those guidances and what we can do to keep that from happening, and how that actually rolls out and takes place?

Ms. Olson. The IRS has many different types of guidances you point out, and some of them do go through the Administrative Procedure Act, you know, notice and comment, the regulations that we do.

But it has -- you know, it believes that getting out guidance is helpful to taxpayers. And, so, rather than going through what it views as the cumbersome regulatory process, which would require notice and comment, it does stuff to get out guidance faster.

The downside about that is, as you say, there is no vehicle that they have designed for public comment on that. That doesn't mean you couldn't do it that way, but they don't. And I am very concerned about that.

I am even more concerned -- and I have written about this as a most serious problem -- that they are moving more toward FAQs, you know, which are great in the



sense that you get things up quickly, but you can't tell when a change has been made in the FAQ unless you print out the FAQ every single day and track it word for word.

And they are not reliable, so that if you say you rely on an FAQ, and then the IRS says, Well, that is wrong, that is no defense. So you are -- and as that gets done more, you are really leaving the taxpayer in a very vulnerable situation.

Mrs. Black. And I want to reference that that is one of the things that I hear from my constituents is they call into to get the guidance, and they give the guidance, and they ask, can you please send me an email or something that I can use to verify if I use what your recommendations are.

And the IRS will refuse to send them anything in writing. And this, to me, is a really big problem, where people are trying so hard to do it the right way, and then they get caught on it. And they say, "But I called in, and I asked a question," and what they got from the IRS was, "We cannot give you that in writing."

Ms. Olson. Right.

Mrs. Black. And so I see this as a big area that has to be looked at. And I appreciate you being here today and, again, thank you --

Ms. Olson. I am very happy to work with you on that.

Mrs. Black. Thank you.

Chairman Buchanan. I now recognize the gentleman from Michigan, Mr. Bishop.

Mr. Bishop. Good morning. Thank you. Thank you, Mr. Chairman, for the hearing today.

I am looking at -- the IRS is responsible for processing approximately 150 million tax returns every year, issuing refunds to taxpayers for about 70 percent of those 150 million tax returns. According to the IRS estimates, it says that the cost for a refund check is about a dollar.

And I am wondering what the cost would be for a direct deposit -- instead of a check, and also, how we might address that issue, the cost and the time using prepaid debit cards, and whether or not the IRS uses, for the tax returns, the debit express cards.

Ms. Olson. You know, this is something we identified in my annual report this year, is that it is so much -- and it is so less expensive to do direct deposit, and then we have a large part of our population that is un-banked.

And, so, rather than them going through check cashing places, et cetera, if they are already participants in this direct express program that is run by Treasury, why couldn't we put tax refunds on it?

And, frankly, I am baffled why we don't do it. The Treasury can negotiate very good rates and charges. They already have this product. And it just makes sense. So I really don't have a good answer for you. That is why we made it a most serious problem: Why aren't we using it?

Mr. Bishop. So doesn't that open this wide open for fraud if we don't utilize this system?

Ms. Olson. Well, I think the concern about the fraud is obviated by the fact that people have to go to a bank to prove their identity. So you have all the PATRIOT Act requirements that were put in about proving your identity to open a bank account, and that is what they have to do for direct express. It is actually much more than what they would have to do to just get a card from, you know, some check cashing place.

Mr. Bishop. That is assuming that you could use that product for the refund.

Ms. Olson. Right.

Mr. Bishop. But we now use prepaid debit cards that don't have to go through that process.

Ms. Olson. Exactly.

Mr. Bishop. So that is what I am talking about to expose yourself to fraud; whereas, if we utilized it at the direct express debit card, we wouldn't have that problem.

Ms. Olson. Right, exactly.

Mr. Bishop. Has there been any discussion about allowing taxpayers to use prepaid debit cards for tax payments?

Ms. Olson. For payments?

Mr. Bishop. Yes.

Ms. Olson. I think that they can, actually. If they haven't, then the IRS is working on that to accept that online. They are really trying to work on the different ways that you can make electronic payments online directly.

Part of the problem, though, is they now have on their online account you can make those payments, but you do have to be able to sign on as a taxpayer, and some of the security is very, very high for that.

Mr. Bishop. What is the cost to process a check from a taxpayer?

Ms. Olson. You had said a dollar. I don't have that information right here, but I can get you it between the check versus direct deposit versus a debit card.

Mr. Bishop. We can agree it would probably be significant savings?

Ms. Olson. Oh, significantly less -- yeah.

Mr. Bishop. Thank you very much.

And, Mr. Chairman, I yield back.

Ms. Olson. Thank you.

Chairman Buchanan. Thank you.

Ms. Olson, I want to thank you upfront for your leadership and service over a lot of years. Like I said, I have heard a lot of good things. But I have got a litany of things I wanted to run down and touch on. We have got a few minutes.

Identity theft. It has been huge in Florida. A CPA is coming to me -- I think the CPA even had maybe his identity stolen. And I have got to tell you, to be candid about it, I think this is more, maybe two or three years ago, two years ago. It seems like it is a little better today, but I would like to get your take on where are we at with identity theft?

Ms. Olson. I think it is going better than it has been. The IRS has improved its processes somewhat. But three things have happened that have really made a difference: One is the legislation that you all passed, getting us the W-2 information by January 31, because that lets us be -- if we can get the employer W-2s, we can see which is the legitimate W-2 versus the altered, fake W-2.

The other thing that is happening is that the IRS is now, you know, requiring the software companies to ask for driver's licenses when they are filing electronic returns, and that really helps us identify whether this is a legitimate taxpayer or an identity thief, in many instances.

And the third thing is there is a program that we are trying to get more and more employers to use where there is a code that is unique to that taxpayer's W-2 from that employer. And when they go to file electronically, if that code is put in, then we can tell that this is the correct W-2 and it is not an identity theft W-2.

Chairman Buchanan. Let me ask you, just for the sake of time, you know, how many of the criminals, or the syndicates, are outside the U.S.? Do you have any sense of that? Someone claims a lot of this is done by Russia and others --

Ms. Olson. I really don't know. The criminal investigation division is working with so many other enforcement agencies to really monitor that. And, you know, it is so hard to track this stuff down.

Chairman Buchanan. Because you say there is a bunch in the States, but you also hear that it is outside the country --

Ms. Olson. You hear about India and elsewhere, yeah.

Chairman Buchanan. -- different organizations, Eastern bloc countries or something like that.

Mr. Crowley brought up earned income tax credit. I know there are some complications probably in filing, but 24 percent fraud, tens of billions of dollars, I guess, a year. What is your take on that? I mean, why is it we can't seem to improve it somewhat? Is it lack of resources to educate people? I am sure that is part of it. He asked how much that was a part of it, but I was curious, just from your standpoint, where are we at on that?

Ms. Olson. I don't think there is any one thing we can do to bring that rate down. I think it is a sum of multiple things: It is education; it is doing really specific audits on it; it is doing other kinds of compliance activities; and it is doing a redesign of the provisions. Knowing what we know about where the errors and fraud are, we can change the design a little bit legislatively.

Chairman Buchanan. Does it make sense to have higher standards for preparers, do you think, a lot of people are doing a lot of this work? Would that make a difference, education, training, and maybe some licensing?

Ms. Olson. I do think there would have to be minimum competency standards for preparers, primarily in the EITC area, because that is where we see -- we know that the unregulated, unaffiliated preparers, not with the large preparation firms, are the greatest source of errors for the EITC population in the preparer base.

Chairman Buchanan. Now, you were here, I think, 20 years ago, at the IRS. Were you here then when they did the IRS reforms?

Ms. Olson. I was actually a witness before this committee as the representative of a low-income taxpayer clinic.

Chairman Buchanan. Okay. In your thought, it seemed like that made a big difference. I thought I heard you say that in your testimony. So in terms of where we are at today, it sure seems like 20 years, we could work together on a bipartisan basis to make some real reforms that make a big difference to the country. Do you think -- you agree with that?

Ms. Olson. Yes. And I think the way that it was done in 1998, where you heard from a diverse group of people, internal and external, experts in government, experts in business,

you know, it made an incredible record. And when you read those hearings again, they are just very impressive.

Chairman Buchanan. Well, we want to work with you and get all the stakeholders at multiple hearings. We are going down the road to see if we can't make a difference in that space.

One other thing that has come up, or a couple of things that have come up in our area, is small business disputes. They seem like -- it is usually sometimes not a lot of money, but it is a dispute. But they could end up spending more in professional fees and outsiders than just paying the check itself. Where are we at on that, or what is your sense of that?

Ms. Olson. You know, I think that that raises the issue of not just the audit side where there are these disputes, but the appeals function. And that, again, is one of my concerns that the IRS has moved to a more centralized, remote, impersonal appeals function, which really was the safety valve for small businesses.

There are 12 States that don't have an appeals officer in them, so they don't understand the conditions of that State. And I think that it really takes -- we should take a look at that appeals function and see how we really make it work as the safety valve that it was intended to be.

Chairman Buchanan. And then my last question is just protecting taxpayers' rights is a key foundation. What additional tools could you use to make you even more effective on behalf of taxpayers?

Ms. Olson. Yeah. I think -- I have written about this in my annual report. I have made recommendations about codifying, strengthening the taxpayer assistance order authority, and codifying something called the taxpayer advocate directive, where I can order the IRS to change its processes that would affect groups of taxpayers.

And those are very important tools. But right now, they are just -- the taxpayer advocate directive is just administrative.

Chairman Buchanan. Okay. Thank you.

I would like to thank our witness for appearing before us today. Please be advised that Members have two weeks to submit written questions to answer later in writing. Those questions and your answers will be made part of the formal hearing record.

With that, this Subcommittee stands adjourned.

[Whereupon, at 9:58 a.m., the Subcommittee was adjourned.]

## **MEMBER QUESTIONS FOR THE RECORD**

**Chairman Buchanan (FL-16) Questions for the Record**  
**Ways and Means Subcommittee on Oversight**  
**Hearing entitled IRS Reform: Lessons Learned from the National Taxpayer Advocate**  
**May 19, 2017**

**Questions for Ms. Olson, National Taxpayer Advocate, IRS**

Ms. Olson, as noted during your testimony, the IRS has sought to more expeditiously provide guidance to taxpayers by issuing Frequently Asked Questions (FAQs) in lieu of formalized regulations, which would be subject to Administrative Procedure Act provisions such as public comment. To clarify, if the IRS issues FAQs as the only form of guidance on a particular tax topic, can a taxpayer who comes under IRS review cite those FAQs as a valid reason for or in defense of their position?

Conversely, if guidance such as FAQs is non-binding, can the IRS legally enforce a decision on a taxpayer based on those FAQs? For example, the IRS virtual currency guidance instructing taxpayers to treat virtual currencies as property was only issued in FAQ form. Does the Taxpayer Advocate believe that the IRS can enforce this guidance on taxpayers under audit based solely on the FAQs?

Do you have any recommendations on how to remedy this situation while still ensuring that IRS guidance is provided in a timely manner to taxpayers?

**Response:**

Taxpayers deserve a simple answer to the question of what guidance they can rely on. Unfortunately, the answer is not simple at all.

Generally speaking, there are three buckets of tax guidance:

1. Regulations – Treasury (tax) regulations are subject to a public notice-and-comment period pursuant to the Administrative Procedures Act (APA). Accordingly, Treasury regulations are deemed to be binding on both the IRS and taxpayers, except in rare instances where a taxpayer is able to persuade a court to invalidate the regulation. Treasury (tax) regulations are published in the Federal Register.
2. Other “Official” Tax Guidance – The IRS publishes various forms of guidance in the Internal Revenue Bulletin (IRB). This is referred to as “published guidance” and includes revenue rulings, revenue procedures, notices, and announcements. Documents published in the IRB generally do not go through a notice-and-comment process. The IRS is generally required to follow published guidance and to administer the law in accordance with it. However, it represents merely the IRS’s interpretation of the law, so taxpayers may challenge the position in court and seek to persuade a judge that their own interpretation of the law is correct.
3. Other “Unpublished” Guidance – The IRS provides guidance in many other forms. It

issues tax forms and instructions as well as publications. It issues press releases. And it posts Frequently Asked Questions (FAQs) and answers on IRS.gov. These forms of guidance are generally not reviewed by the Treasury Department, and sometimes do not even go through an internal review process. For that reason, the IRS takes the position that taxpayers may not rely on them and that the IRS may change its position at any time.

Many FAQs are posted on IRS.gov and therefore are not considered to be “published guidance.” However, some FAQs are published in the IRB and are considered binding on the IRS. In your question, you note that the IRS virtual currency guidance instructing taxpayers to treat virtual currencies as property was only issued in FAQ form. I want to point out that these FAQs were included as part of a notice that was published in the IRB. Accordingly, they represent the official position of the IRS, and the IRS is bound to maintain the position taken in the virtual currency FAQs unless and until it publishes further guidance in the IRB modifying or revoking them.

If an FAQ is not published in the IRB, the IRS may change its position at any time. Indeed, the IRS recently reminded its examiners that FAQs “and other items posted on IRS.gov that have not been published in the *Internal Revenue Bulletin* are not legal authority . . . and should not be used to sustain a position unless the items (e.g., FAQs) explicitly indicate otherwise or the IRS indicates otherwise by press release or by notice or announcement published in the Bulletin.”<sup>1</sup> However, the fact that an FAQ had been posted may provide taxpayers with some degree of protection from penalties. In general, a taxpayer may avoid penalties if it is determined he or she had “substantial authority” for the position taken, and “IRS information or press releases” are considered “authorities” for this purpose.<sup>2</sup> The regulations regarding “substantial authority” are complex, and I will not discuss them in detail in this response.

Apart from penalties, however, the IRS may change the answer to an FAQ (or unexpectedly reinterpret an FAQ) to the detriment of taxpayers who rely on them. One recent example that illustrates the problem with FAQs involves the Offshore Voluntary Disclosure Programs (OVDPs). The OVDPs are a series of IRS settlement programs. In the past, the IRS published its settlement programs in the IRB after incorporating comments from stakeholders and obtaining approval from the Treasury Department.<sup>3</sup> Beginning March 23, 2009, however, the IRS issued an internal memorandum and a series of FAQs to promulgate the 2009 OVDP terms, which were not vetted by internal or external stakeholders or approved by the Treasury Department.<sup>4</sup> All

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<sup>1</sup> Memorandum from Director, Examination - Field and Campus Policy to Area Directors, Examination – Field, SBSE-04-0517-0030, *Interim Guidance on use of Frequently Asked Questions (FAQs) and other items posted to IRS.gov* (May 18, 2017), <https://www.irs.gov/pub/foia/ig/spder/sbse-04-0517-0030.pdf>.

<sup>2</sup> IRC § 6662(d)(2)(B); Treas. Reg. §§ 1.6662-4(a) and -4(d)(3)(iii). In general, a taxpayer may also avoid penalties by disclosing the position in question. *Id.*

<sup>3</sup> See, e.g., Rev. Proc. 2003-11, 2003-1 C.B. 311 (describing the terms of the Offshore Voluntary Compliance Initiative, a predecessor to the OVDP).

<sup>4</sup> Memorandum for Commissioner, Large and Mid-Size Business (LMSB) Division and Commissioner, Small Business/Self-Employed (SB/SE) Division from Deputy Commissioner for Services and Enforcement, *Authorization to Apply Penalty Framework to Voluntary Disclosure Requests Regarding Offshore Accounts and Entities* (Mar. 23, 2009); Memorandum for SB/SE Examination Area Directors and LMSB Industry Directors from Deputy Commissioner, *Emphasis on and Proper Development of Offshore*



subsequent OVDPs have been governed by FAQs posted to the IRS website, rather than published in the IRB.<sup>5</sup>

The OVDP FAQs were issued in such haste and so poorly drafted that the IRS had to clarify them repeatedly.<sup>6</sup> As a result, they treated similarly situated taxpayers inconsistently.<sup>7</sup> These FAQs are frequently the subject of disputes.<sup>8</sup> The IRS changes them regularly without providing any formal record of what changed and when.<sup>9</sup> Only certain practitioners know how the IRS interprets them.<sup>10</sup> Disputes arise when it does not interpret them in accordance with their plain language. Taxpayers and practitioners who do not work on OVDP cases often are at a disadvantage because they do not know how the IRS interprets its OVDP FAQs.

This approach is unfair to taxpayers. Although the IRS may have felt an urgent need to provide OVDP guidance as FAQs in 2009, I see no compelling justification for continuing to run its OVDPs this way over seven years later. At the very least, the IRS should publish its FAQs and all updates to them in the IRB. It should also give serious consideration to issuing the OVDP FAQs using the notice and comment process established under the APA. Such a procedure could help avoid the problems large numbers of taxpayers have experienced with the OVDPs to date.

More generally, my view is that the IRS should use FAQs when there is a need to provide guidance on an emergency or highly expedited basis. Examples include relief provided to victims of Hurricane Katrina or victims of the Bernard Madoff Ponzi scheme. However, my recommendation is that the IRS convert FAQs into published guidance as quickly as possible whenever an issue affects a significant number of taxpayers or will have continuing application. U.S. taxpayers are entitled to finality, and the prospect that the IRS may change its position and assess additional tax after a tax return has been filed in reliance on an IRS's position is simply unfair.

In addition, to ensure taxpayers understand the limitations of FAQs and other unpublished guidance, we recommend the IRS prominently display a disclaimer near such guidance that says something along the following lines: "Taxpayers may only rely on official guidance that is

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*Examination Cases, Managerial Review, and Revocation of Last Chance Compliance Initiative* (Mar. 23, 2009).

<sup>5</sup> See, e.g., National Taxpayer Advocate 2017 Objectives Report to Congress 164-176 (discussing prior reports).

<sup>6</sup> See, e.g., National Taxpayer Advocate 2017 Objectives Report to Congress 164-176; Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011) (same).

<sup>7</sup> See *id.*

<sup>8</sup> National Taxpayer Advocate 2017 Objectives Report to Congress 164-176 (discussing prior reports).

<sup>9</sup> For example, between March 1, 2011, and August 29, 2011, the IRS made 12 changes to the 2011 Offshore Voluntary Disclosure Initiative FAQs (another version of the OVDP), which were entirely removed from the IRS's website in 2016. See IRS, *2011 Offshore Voluntary Disclosure Initiative* (Sept. 16, 2016), <https://www.irs.gov/uac/2011-offshore-voluntary-disclosure-initiative> (revisions on file with TAS).

<sup>10</sup> National Taxpayer Advocate 2018 Objectives Report to Congress (Area of Focus: *The Offshore Voluntary Disclosure Programs Still Lack Transparency, Violating the "Right to Be Informed"*).

published in the Internal Revenue Bulletin. Various IRS functions try to provide unofficial guidance to taxpayers by posting Frequently Asked Questions (FAQs) and other information on IRS.gov. Unless otherwise indicated, however, this information is not binding, and taxpayers may not rely on it because it may not represent the IRS's official position.”

**Rep. Schweikert (AZ-06) Questions for the Record**  
**Ways and Means Subcommittee on Oversight**  
**Hearing entitled IRS Reform: Lessons Learned from the National Taxpayer Advocate**  
**May 19, 2017**

**Questions for Ms. Olson, National Taxpayer Advocate, IRS**

Ms. Olson, should the IRS allow a business or company to assist in the provision of tax information to individuals operating on its platform?

**Response:**

Workers, also referred to as “service providers” in the sharing economy, would benefit and likely become more tax compliant if companies provide relevant tax information. According to a recent survey conducted by the National Association for the Self-Employed (NASE), 69 percent of entrepreneurs who participate in the sharing economy received absolutely no tax guidance from the companies with which they work.<sup>11</sup> The NASE survey results underscore the importance of educating sharing-economy entrepreneurs and merchants about the fact that they are operating a self-employed, small business and need to understand certain basic tax obligations (*i.e.*, making required quarterly estimated payments throughout the year to avoid penalties).

Companies are in the best position to provide this information because they have a direct line of communication with their workers and they understand the nature of the work performed. Accordingly, the IRS should encourage companies in the sharing economy to provide tax guidance to workers as soon as they enter the platform to educate them about their tax obligations at the outset. To alleviate any concerns companies may have that providing tax information to workers could affect worker classification determinations, the IRS should publicly clarify that the mere provision of tax information to workers will not be used as a factor in classifying workers as employees or independent contractors.

**Question: Should a business or company who assists by withholding taxes on behalf of independent contractors operating on its platform should be reclassified as an employer? If not, does your calculus change if the company actually files taxes on behalf of an independent contractor operating on its platform?**

**Response:**

A worker’s classification as either an employee or independent contractor should not depend solely on whether the company withholds taxes or files a return on behalf of a service provider. The basis for determining the status of a worker as an independent contractor or employee

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<sup>11</sup> NASE, [http://www.nase.org/about-us/Nase\\_News/2016/04/29/nase-releases-new-survey-data-on-sharing-economy](http://www.nase.org/about-us/Nase_News/2016/04/29/nase-releases-new-survey-data-on-sharing-economy). The survey was sent in March 2016 to more than 40,000 small businesses and received over 500 responses, mainly from the self-employed, about their participation in the sharing economy.

primarily rests on a common-law test of 20 factors that enumerates the degree of control a person engaging the services of another has on the work, detail, and means by which the work is performed.<sup>12</sup> Congress has also addressed employment status by enacting Section 530 of the Revenue Act of 1978.<sup>13</sup> This section prohibits the IRS from reclassifying independent contractors as employees, provided that the payor consistently treats the payee as a contractor in good faith. It also bars the IRS from issuing guidance on the employment status of individuals.<sup>14</sup> I have previously recommended that Congress repeal § 530 and replace it with safe harbors applicable to both employment and income tax determinations.<sup>15</sup>

The test to determine proper worker classification is complex and subjective, and it does not always produce clear answers. The potential for errors and abuse is high in areas where not all factors yield the same result, particularly because there are no weighting rules.<sup>16</sup> To provide more certainty in this area, I recommended in my 2008 Annual Report to Congress that the IRS develop an electronic self-help tool, similar to a tool known as an “Employment Status Indicator” (ESI) in the United Kingdom. Her Majesty’s Revenue and Customs (HMRC) provides taxpayers with this free, web-based service that asks service recipients a series of questions and, based on the answers given, supplies an “indication of employment status.”<sup>17</sup> Employers should be able rely upon the classification generated from the online tool, unless they misrepresent the information input into the system while answering questions or circumstances have materially changed.<sup>18</sup>

Moreover, because research shows taxpayers are most compliant in paying taxes on income subject to withholding, the IRS should encourage taxpayers to enter into voluntary withholding agreements with service recipients.<sup>19</sup> Service recipients would need an incentive to take on this

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<sup>12</sup> See Rev. Rul. 87-41, 1987 C.B. 296.

<sup>13</sup> Section 530, Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (1978), as amended.

<sup>14</sup> Section 530(b), Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (1978), as amended.

<sup>15</sup> See National Taxpayer Advocate 2012 Annual Report to Congress 19-20; National Taxpayer Advocate 2010 Annual Report to Congress 371; National Taxpayer Advocate 2008 Annual Report to Congress 375-90. Repeal would also remove restrictions on IRS guidance. Our initial recommendation published in the 2008 Annual Report to Congress required the Secretary of the Treasury to issue guidance. However, based on our discussions with small business groups, we subsequently refined the recommendation to propose that Congress mandate the IRS to hold a series of consultations with the industry and report back to the tax-writing committees on the findings.

<sup>16</sup> In Revenue Ruling 87-41, 1987-1 C.B. 296, the IRS developed a list of 20 factors, based on cases and rulings decided over the years, to determine whether an employer-employee relationship exists. To complicate the matter even further, the Department of Labor issued a memorandum in which it adopted an expansive interpretation of the definition of “employees” under the Fair Labor Standards Act, which may result in many workers currently treated as independent contractors being reclassified as employees. United States Department of Labor, Administrator’s Interpretation No. 2015-1 (July 15, 2015).

<sup>17</sup> For more information on the ESI, see <http://www.hmrc.gov.uk/calcs/esi.htm> (last visited May 12, 2016).

<sup>18</sup> National Taxpayer Advocate 2008 Annual Report to Congress 375-390 (Legislative Recommendation: *Worker Classification*).

<sup>19</sup> For more information about the tax gap, see IRS, *The Tax Gap*, <https://www.irs.gov/uac/The-Tax-Gap> (last visited May 9, 2016).

extra administrative burden. However, we believe that many of the large companies participating in the sharing economy already have experience with income tax withholding obligations for their administrative employees who are classified as employees, so the voluntary withholding agreements would not require new systems.

Nevertheless, in order to encourage companies to take on any additional tax compliance burdens associated with voluntary withholding agreements, the IRS could, on a case-by-case basis, provide a safe-harbor worker classification in which it essentially agrees not to challenge the classification of workers who are a party to such agreements. Thus, these agreements could reduce both underreporting by payees and the controversy associated with worker classification. The IRS has authority to accept such agreements under IRC § 3402(p)(3) but it may need to work with the Department of the Treasury to issue regulations before it can use such authority. It may also prefer to receive additional and specific legislative authority to enter into such deals.<sup>20</sup>

For that reason, I have recommended in the past that Congress direct the IRS to take the following actions: (i) set up a program whereby taxpayers can enter into voluntary withholding agreements under IRC § 3402(p)(3); (ii) determine the feasibility of the IRS agreeing to not challenge the classification of workers who are party to such agreements; and (iii) work with the Department of the Treasury to issue regulations setting forth the requirements for such agreements.

**Question: Could a company track the wear and tear of a vehicle, gas consumption, hours worked, and other data without being considered an employer?  
Does this calculus change if the independent contractor uses this data for tax deductions?  
Does this calculus change if the company assists in the preparation of these deductions?**

**Response:**

As described above, the classification of a worker as an employee or an independent contractor is subject to a complex 20-factor test, which evaluates the degree of control that the company maintains over the work, detail, and means by which the work was performed.<sup>21</sup> It is a detailed and specific fact-and-circumstances analysis as to whether tracking data about a worker's performance rises to the level of exertion of control over the worker's job performance. The calculus should not change if the company provides the data collected in an information report to be given to the worker in order to assist in tax return preparation.

**Question: When, in regards to actions surrounding tax, does an independent contractor breach the independent contractor model and move into that of an employer?**

**Response:**

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<sup>20</sup> National Taxpayer Advocate 2005 Annual Report to Congress 55-75 (Most Serious Problem: *The Cash Economy*).

<sup>21</sup> See Rev. Rul. 87-41, 1987-1 C.B. 296.

Again, the 20-factor test is a complex facts-and-circumstances-based test that aims to evaluate the level of control the company exerts over the worker's performance of a particular job. The provision of assistance to the worker to increase the worker's tax compliance should not generally impact the worker's worker classification because it does not amount to the exertion of control over the performance of the worker's job.

**Rep. Curbelo (FL-26) Questions for the Record**  
**Ways and Means Subcommittee on Oversight**  
**Hearing entitled IRS Reform: Lessons Learned from the National Taxpayer Advocate**  
**May 19, 2017**

**Questions for Ms. Olson, National Taxpayer Advocate, IRS**

The Volunteer Income Tax Assistance Program (VITA) provides a means for taxpayers living in low-income and underserved communities to seek help filing tax returns. The IRS has traditionally supported the VITA program through training resources. Since FY2008, the IRS has also provided financial assistance to some VITA programs through matching grants. In FY 2014, VITA grantees helped prepare more than 1.4 million taxpayers.

Ms. Olson, as you know, the Volunteer Income Tax Assistance Program, or VITA, provides assistance for low-income and residents in underserved communities in filing tax returns. Can you talk about the program's impact on reaching underserved communities, especially for non-English taxpayers?

**Response:**

The Volunteer Income Tax Assistance (VITA) program plays a critical role in helping underserved populations, including non-English speaking taxpayers, comply with their tax obligations. The VITA and Tax Counseling for the Elderly (TCE) programs provide free basic income tax return preparation with electronic filing for taxpayers who generally make \$54,000 or less, including low-wage workers, persons with disabilities, taxpayers living in rural communities, and taxpayers with limited English proficiency.<sup>22</sup> Together, they serve several million taxpayers every year.

In past years, the IRS itself prepared tax returns for low income taxpayers in its roughly 400 Taxpayer Assistance Centers (TACs) around the country. But in 2014, the IRS ceased all tax return preparation in the TACs. At the same time, it sharply curtailed the scope of tax law questions it would answer during the filing season, and it stopped answering any tax law questions at all after April 15.

Not surprisingly, the reduction in IRS return preparation support has led to increased demand for assistance from VITA programs. In FY 2016, VITA and TCE volunteers prepared about 3.8 million tax returns, a 12 percent increase as compared with about 3.4 million returns in FY 2013.<sup>23</sup> It is worth noting that these totals do not reflect the number of taxpayers who sought

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<sup>22</sup> VITA and TCE sites provide free tax return preparation services for qualified individuals in conjunction with IRS assistance and direction. See IRS, *Free Tax Return Preparation for Qualifying Taxpayers*, <https://www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers> (last visited May 17, 2017). The income amount changes each taxable year.

<sup>23</sup> IRS SPEC FY 2015/2016 Comparative Scorecard, Ending Sept. 30, 2016, IRS SPEC FY 2013/2014 Comparative Scorecard, Ending Sept. 30, 2014. VITA prepared 1,507,239 returns in FY 2013; 2,128,765 returns in FY 2014; 2,168,981 returns in FY 2015, and 2,186,054 returns in FY 2016; while TCE prepared

assistance from VITA or TCE sites but were turned away because the issues they sought help with are deemed “out-of-scope.”<sup>24</sup> I anticipate more taxpayers will be using VITA and TCE services in FY 2018. Thus, Congressional support and oversight for these programs is extremely important to provide assistance to eligible taxpayers. VITA and TCE programs need an authorizing statute establishing permanent funding, clear rules, and qualifying conditions that can be modeled after section 7526 of the Internal Revenue Code, which governs low income taxpayer clinics (LITCs). Such legislation would create more certainty for VITA and TCE partners, volunteers, and the taxpayers they assist.

**Question: The 2014 annual report to Congress put out by your office raised concerns that certain scope-limitations were making it difficult for VITA programs to serve some taxpayers, can you elaborate on these concerns?**

**Response:**

Because VITA programs are staffed primarily by volunteers who are not tax professionals, the IRS has understandably been concerned about allowing them to prepare returns that involve legal complexity. Topics the IRS prohibits VITA programs from addressing are referred to as “out of scope” topics. Yet the consequence of the out-scope restrictions is that some categories of taxpayers are unable to obtain assistance. At the top of that list are self-employed taxpayers. Sole proprietors in non-farm businesses are required to file a Schedule C. Unincorporated farm businesses are required to file a Schedule F. IRS rules prohibit VITA programs from preparing the Schedule F. Regarding the Schedule C, the IRS now allows VITA to prepare them in some cases, but it imposes significant limitations. For example, the IRS’s *VITA/TCE Volunteer Resource Guide* cautions that “[b]usinesses with inventory, employees, contract labor, depreciation, business use of the home, expenses over \$25,000 or a net loss are out of scope.”<sup>25</sup> There are many other out-of-scope topics that prevent other groups of taxpayers from obtaining VITA assistance.

If Congress enacts legislation authorizing the VITA program, I believe it would be helpful if the authorization or the accompanying committee report directs the IRS to provide a portion of the grant funds to programs that prepare Schedules C and F for taxpayers at or below certain income levels (for instance, at or below 250 percent of the federal poverty level),<sup>26</sup> thereby avoiding potential competition issues with the private sector. The legislation also could benefit VITA programs by mandating that sites commit to hiring a tax expert to train volunteers on out-of-scope topics such as these and to conduct quality reviews.

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1,595,860 returns in FY 2013, 1,343,931 returns in FY 2014, 1,366,162 returns in FY 2015, and 1,407,219 returns in FY 2016.

<sup>24</sup> See IRS Publication 5220, *VITA/TCE Volunteer Site Scope & Referral Chart* (Dec. 2016).

<sup>25</sup> IRS Publication 4012, *VITA/TCE Volunteer Source Guide* D-29 (revised December 2016).

<sup>26</sup> The Department of Health & Human Services (HHS) issues poverty guidelines that are often referred to as the “federal poverty level.”



**Question: What are some of the common challenges that you observed facing the VITA program over the past couple years? Are there actions the IRS could take to address these challenges and further support the VITA program?**

**Response:**

As I have discussed in my reports to Congress, I am concerned that the restrictions placed on VITA programs prevent them from providing assistance to many taxpayers who require tax return preparation assistance and meet the program's general income and other eligibility requirements.

In March 2015, I sent the Commissioner a memorandum that, among other things, recommended the IRS remove VITA program grant restrictions for specific tax forms, schedules, and issues, including Schedules C, D, and F, and Individual Taxpayer Identification Numbers (ITINs); and allow grant funds to be used to pay for staff serving as quality reviewers or Certified Acceptance Agents (CAAs), or to manage year-round services at select sites.<sup>27</sup> To date, these recommendations have not been implemented by the IRS.

The IRS responded that expanding the complexity and scope of VITA assistance would increase the burden on IRS employees to develop training materials for VITA partners and to manage the quality of returns prepared. The IRS also stated that expanding the scope would burden volunteers to learn topics that come up infrequently and that they may not actually encounter.<sup>28</sup> One response is that some out-of-scope decisions can be made on a regional basis. For example, a VITA program in rural Iowa should be equipped to prepare a Schedule F for a farmer, even if a VITA program in New York City is not.

The IRS grants do not allow VITA sites to pay preparers for quality reviews or screening activities. Nor does the IRS authorize VITA sites to fund activities involving CAAs who assist non-citizens in obtaining ITINs, which they need to file U.S. tax returns. The IRS contends that paying volunteers for quality review with VITA or TCE grant funds would contradict the intent of the volunteer program and would "add[] complexity to managing volunteers, liability of volunteers, volunteer recruitment, and ensuring appropriate use of federal funds."<sup>29</sup> In my view, the IRS's argument regarding extra burdens and liability imposed on the sites is overstated because VITA and TCE sites are already responsible for managing day-to-day activities.

Although volunteers certified at the advanced level may now prepare certain Schedules C, they are subject to significant limitations and therefore fail to meet the needs of some taxpayers. Moreover, many farmers need help in preparing the Schedule F. The IRS's approach to managing volunteer tax return preparation programs is not based on data or research about taxpayer needs, but rather on what is convenient for the IRS itself. The IRS makes it difficult and sometimes impossible for VITA and TCE sites to assist taxpayers who are not Form W-2 wage earners. By prohibiting grant recipients from preparing certain forms and by not allowing

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<sup>27</sup> National Taxpayer Advocate 2014 Annual Report to Congress 66.

<sup>28</sup> National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress, Vol. 2, 20-23.

<sup>29</sup> *Id.* at 21.

grant funding to be used for quality review, CAAs, or screening activities, the IRS limits the effectiveness and reach of VITA and TCE programs.

I agree with the goal of the legislation you have sponsored to authorize the VITA program and would be pleased to work with your staff on augmenting the proposed legislation if helpful.<sup>30</sup> I think enacting authorizing legislation would be helpful in signaling the support of the tax-writing committees for the program and would create a degree of permanence for the VITA program that is lacking when funding depends entirely on the annual appropriations process. An authorizing statute is essential for the proper administration of the VITA and TCE programs by the IRS and for Congressional oversight. Such permanent VITA legislation modeled after the LITC provision in IRC § 7526 would provide the IRS and the public, including VITA volunteers and the taxpayers they assist with clear expectations regarding the manner in which the program will be run in terms of funding, grant management, taxpayer eligibility, volunteer qualifications, scope parameters, and other issues.

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<sup>30</sup> See National Taxpayer Advocate 2015 Annual Report to Congress 288. On November 30, 2015, Senator Cardin and Representative Becerra introduced companion bills entitled the Taxpayer Rights Act of 2015 (TRA 2015). See, e.g., Taxpayer Rights Act of 2015, S. 2333, § 201, 114th Cong. (2015); Taxpayer Rights Act of 2015, H.R. 4128, § 201, 114th Cong. (2015). Among other things, TRA 2015 proposed to establish a Community Volunteer Income Tax Assistance Matching Grant Program (VITA grant program). The VITA grant program would be administered in a manner that is substantially similar to the Community Volunteer Income Tax Assistance matching grants demonstration program established under Title I of Division D of the Consolidated Appropriations Act, 2008. The VITA grant program would establish tax return preparation sites for low income taxpayers and operate in a manner similar to the LITC program.

**Rep. Bishop (MI-08) Questions for the Record**  
**Ways and Means Subcommittee on Oversight**  
**Hearing entitled IRS Reform: Lessons Learned from the National Taxpayer Advocate**  
**May 19, 2017**

**Questions for Ms. Olson, National Taxpayer Advocate, IRS**

Ms. Olson, in your testimony you mentioned that the IRS has costs associated with processing tax payments. Can you please provide what you have found to be the costs to the IRS of receiving payments via check, wire transfer/electronic payment from a bank, and payment from a debit and or prepaid card?

**Response:**

In my 2016 Annual Report to Congress, we noted that it costs the IRS more than \$1 per refund check issued, compared to only ten cents for each direct deposit made.<sup>31</sup> The IRS says it cannot differentiate between direct deposits made to a traditional bank account or to a debit card, so the costs of these refund methods are presumably identical.<sup>32</sup>

**Question:** Has your office identified any statutory barriers that prevent the IRS from using the Direct Express program to provide tax refunds to citizens?

**Response:**

No, we are not aware of any statutory barriers that would prevent the IRS from participating in the Direct Express debit card program. Because Direct Express is a Treasury-recommended debit card, I find it perplexing that the IRS does not participate in the Direct Express program.

**Question:** In your response to the recent TIGTA Report on civil asset forfeiture you said, “I believe the IRS should clarify that CI employees must act in accord with taxpayer rights, even in the context of grand jury investigations or the administration of laws not codified in Title 26.” Instead of relying on the IRS to make this clarification, has your office been able to identify a legislative solution to this issue?

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<sup>31</sup> IRS, *Direct Deposit Your Refund*, [www.irs.gov/individuals/get-your-refund-faster-tell-irs-to-direct-deposit-your-refund-to-one-two-orthree-accounts](http://www.irs.gov/individuals/get-your-refund-faster-tell-irs-to-direct-deposit-your-refund-to-one-two-orthree-accounts) (last visited June 8, 2017).

<sup>32</sup> IRS, Wage & Investment (W&I) response to TAS information request (Sept. 22, 2016).

## Response:

Yes. The IRS Criminal Investigation function (CI) takes the position that taxpayer rights, such as those included in the Taxpayer Bill of Rights (TBOR), only apply when it is conducting investigations under Title 26 of the U.S. Code (*i.e.*, the Internal Revenue Code). CI says taxpayer rights do not apply in the cases described in the March 2017 TIGTA report, either (1) because CI is acting at the direction of the Justice Department in a grand jury investigation or (2) because the structuring laws are codified in Title 31 of the U.S. Code (rather than Title 26), so the subject of the investigation should be viewed as a “property owner” rather than a “taxpayer.”

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I find that position deeply concerning. First, when CI conducts structuring investigations, the investigations may lead to tax assessments or even criminal charges under Title 26, blurring the distinction between investigations under Title 31 and Title 26. Second, section 7803(a)(3) of the Internal Revenue Code requires the Commissioner to ensure that “employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by [Title 26], including [the ten rights in the TBOR].” That blanket statement identifies Title 26 as a source of taxpayer rights applicable to all IRS employees. Neither the TBOR the IRS initially adopted nor the statute Congress enacted makes exceptions for CI employees or for IRS employees conducting investigations under other titles. To reach the conclusion that CI employees may ignore taxpayer rights when conducting investigations under Title 31, CI seems to be reading the statute as if the words “but only where IRS employees are investigating potential violations under Title 26” were appended at the end. Those words are not there.

If the IRS were to adopt CI’s interpretation that the TBOR does not apply outside the context of Title 26, all IRS employees would be able to ignore taxpayer rights when responding to Freedom of Information Act requests, making determinations, or promulgating regulations under Title 5; administering bankruptcy laws under Title 11; or enforcing the structuring laws under Title 31. Such a narrow interpretation would gut the TBOR and is unlikely to have been the IRS’s or Congress’ intent.

Although my memorandum did not discuss this point in detail, I note that the TIGTA report found CI invoked the concept of a “grand jury investigation” very broadly to avoid triggering constitutional rights. According to the report, CI has issued guidance which takes the position that constitutional rights are not required during “grand jury investigations” and which defines the term “grand jury investigation” to include “the issuance of grand jury subpoenas.” TIGTA found that “[g]rand jury subpoenas were used in most of the civil forfeiture cases in [its] sample to obtain bank records,” yet “CI’s explanation that ‘special agents must follow the procedures directed by the AUSA *assisting the grand jury*’ does not account for situations in which a grand jury subpoena is used to obtain records but the matter never appears before a grand jury.” By CI’s loose definition, taxpayers in a large number of cases that do not involve true grand jury investigations can be deprived of their rights.

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<sup>33</sup> TIGTA, Ref. No. 2017-30-025, *Criminal Investigation Enforced Structuring Laws Primarily Against Legal Source Funds and Compromised the Rights of Some Individuals and Businesses* (March 2017), <https://www.treasury.gov/tigta/auditreports/2017reports/201730025fr.pdf>.

To ensure that taxpayer rights are respected, Congress could modify IRC § 7803(a)(3) to clarify that the provision applies to all IRS employees and to all official actions taken within the scope of their employment. To the extent there may be rare cases involving suspected terrorism or similar concerns, I recommend determining whether exceptions already exist in law or whether a narrowly crafted exception is warranted. However, I am concerned that CI has consistently interpreted relevant statutes in an unduly narrow manner, and for that reason, I recommend ensuring that any statutory language is clear and supported by report language describing the committee's intent.

**Rep. Holding (NC-02) Questions for the Record**  
**Ways and Means Subcommittee on Oversight**  
**Hearing entitled IRS Reform: Lessons Learned from the National Taxpayer Advocate**  
**May 19, 2017**

**Questions for Ms. Olson, National Taxpayer Advocate, IRS**

Ms. Olson, do you believe Enforcement is a necessary component for maintaining the current 98% taxpayer compliance rate?

In the Special Focus section of your 2016 annual report you stated, “there is only one true ‘enforcement’ function in the IRS, and that is the Criminal Investigation function.” Do you believe the Criminal Investigation division plays an important role at the IRS?

Ms. Olson, Given the increasing number of extremely serious and very grave areas of concern currently before the Internal Revenue Service, including but not limited to, the need, as you have pointed out, for the agency to orient itself with its taxpayer service responsibilities, and the ongoing IRS failures to secure private taxpayer data, are you confident in the ability of the agency to fulfill its current responsibilities, let alone take on any new initiatives?

**Response:**

Effective tax administration requires a combination of high-quality taxpayer service, compliance measures like audits and collection activities to pursue unreported or unpaid taxes, and law-enforcement actions to pursue taxpayers who flagrantly evade their tax obligations.

In FY 2016, the IRS collected \$3.3 trillion in tax revenue. Of that amount, about 98 percent was paid voluntary, and about two percent was collected through enforcement activities.<sup>34</sup> There is no doubt that both IRS civil compliance and IRS criminal enforcement measures are necessary components for maintaining high levels of tax compliance. While those actions only bring in two percent of tax revenue directly, they deter taxpayers who might otherwise evade their tax obligations due to fear of possible detection and punishment. That deterrent effect is sometimes referred to as an “indirect” impact of tax compliance activities.

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<sup>34</sup> See GAO, GAO-17-140, *Financial Audit: IRS's Fiscal Years 2016 and 2015 Financial Statements 25* (Nov. 2016), <https://www.gao.gov/assets/690/680957.pdf> (showing the IRS collected \$3.3 trillion in FY 2016); IRS, *Fiscal Year 2016 Enforcement and Service Results*, [https://www.irs.gov/PUP/newsroom/fy\\_2016\\_enforcement\\_and\\_service\\_results.pdf](https://www.irs.gov/PUP/newsroom/fy_2016_enforcement_and_service_results.pdf) (showing the IRS collected \$54.3 billion through enforcement activities in FY 2016). The question asks whether I believe enforcement “is a necessary component for maintaining the current 98% taxpayer compliance rate?” As a point of clarification, the IRS’s most recent study of tax compliance found that the voluntary compliance rate is 81.7 percent, and the net compliance rate after compliance actions is 83.7 percent. IRS, *Tax Gap Estimates for Tax Years 2008-2010* (April 2016), <https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>.

As I said in my written statement, I see no conflict whatsoever between providing high quality taxpayer service and taking steps to ensure tax compliance, particularly on the part of persons actively seeking to evade tax. Taxpayer service and enforcement should not be viewed as an “either/or” proposition. Indeed, I have made many recommendations in the past to improve IRS compliance programs.<sup>35</sup>

I have several concerns about the way the IRS operates today: (i) the agency seems to me to exhibit an enforcement mentality that emphasizes enforcement over service; (ii) the agency, despite adopting the Taxpayer Bill of Rights (TBOR), has not done enough to incorporate the principles of the TBOR into its dealings with taxpayers; (iii) taxpayer service is poor, partly because the agency has faced significant budget cuts that have limited its performance; and (iv) the agency’s compliance programs are not as effective as they could be.<sup>36</sup>

To elaborate, I believe the IRS historically has viewed itself first and foremost as an enforcement agency, and that approach to tax administration continues to predominate.<sup>37</sup> More than 43 percent of the IRS budget is allocated for Enforcement (a figure that rises to more than 60 percent with Operations Support dollars apportioned), as compared with four percent for Pre-filing Taxpayer Assistance and Education.<sup>38</sup> By contrast, the IRS currently has fewer than 500 employees in its Stakeholder Partnerships, Education and Communication (SPEC) and Stakeholder Liaison (SL) outreach functions out of a workforce of roughly 80,000 (*i.e.*, about one-half of one percent).<sup>39</sup> The IRS revised its mission statement in 2009, without any public discussion, to change its focus from “applying” the law to “enforcing” the law. In illustrating its “Future State” vision, the IRS developed and posted on IRS.gov four “vignettes” to illustrate the

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<sup>35</sup> See, *e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, at 63-90 (*An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).

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

<sup>37</sup> National Taxpayer Advocate 2016 Annual Report to Congress 1-41 (Special Focus: *IRS FUTURE STATE: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21<sup>st</sup> Century Tax Administration*).

<sup>38</sup> See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015); U.S. Department of the Treasury, *Internal Revenue Service FY 2017 Budget-in-Brief 1*, <https://www.irs.gov/pub/newsroom/IRS%20FY%202017%20BIB.pdf>, which shows [FY 2016 enacted funding levels of about \\$4.86 billion for Enforcement and about \\$630 million for Pre-filing Taxpayer Assistance and Education](#) out of a total appropriated budget of \$11.235 billion. The Pre-filing Taxpayer Assistance and Education category includes about \$173 million for Taxpayer Advocate Case Processing, which generally does *not* involve pre-filing taxpayer assistance or education. After backing out that amount, the remaining Pre-filing Taxpayer Assistance and Education budget comes to about \$457 million, or four percent of the total IRS budget. In addition, about \$3.75 billion, or 33 percent of the IRS budget, is appropriated for the Operations Support account. When Operations Support dollars are apportioned to the Taxpayer Services and Enforcement accounts in rough proportion to their respective allocations (\$2.33 billion for Taxpayer Services and \$4.86 billion for Enforcement), overall spending on Enforcement activities comes to more than 60 percent of the IRS budget.

<sup>39</sup> IRS response to TAS fact check request (Dec. 16, 2016).

taxpayer experience; all involve IRS compliance activities and all reach the conclusion that the IRS is right and the taxpayer is wrong.

Lastly, I do believe the IRS is capable of fulfilling the responsibilities Congress assigns to it. As I have repeatedly recommended, however, I believe it would be helpful for Congress to conduct greater oversight to make sure the agency is fulfilling its responsibilities as you intend and to make clearer to the IRS leadership what congressional expectations are. At first blush, I don't know whether the IRS leadership would welcome that recommendation. But at the end of the day, I believe it would benefit the agency – and ultimately taxpayers – if Congress and the IRS can get on the same page regarding priorities and strategies. There is no doubt that the cuts to the IRS budget in recent years have been driven, in large part, by congressional mistrust. If the IRS works more closely with Congress, it will have an opportunity to win back trust, and that ultimately is likely to lead to additional funding and other support that will enable the IRS to do a better job.



# **PUBLIC SUBMISSIONS FOR THE RECORD**



May 19, 2017

House Committee on Ways and Means, Oversight Subcommittee  
1100 Longworth House Office Building  
1 Independence Avenue SE  
Washington, DC 20003

**RE: Political Activity Guidance for Nonprofit Organizations**

Dear Chairman Buchanan, Ranking Member Lewis, and Subcommittee Members;

As the Committee begins the difficult work of reforming the Internal Revenue Service and the Internal Revenue Code, we at the Bright Lines Project write to urge the committee to pay particular attention to ensuring that the Code's definition of political activity for nonprofit organizations is workable for the Service and especially for nonprofits themselves.

The Bright Lines Project (BLP) has been advocating for clarity in this area of the law for years, because we have seen first-hand that imprecision in the Code has not only caused confusion at the Service, but also has chilled the activities of nonprofit organizations, particularly those organized under section 501(c)(3). A better system of rules, such as that the BLP has proposed, would enable groups to engage fully in nonpartisan civic participation activities, while making enforcement easier for the Service.

As the Committee considers the best way forward for this area of law, we ask that you encourage your colleagues on the Appropriations Committee to lift the budget rider preventing the Treasury Department and the Service from providing any guidance on the rules governing political activity for 501(c)(4) organizations. The rider was initially included in the 2016 Consolidated Appropriations Act and has remained in force ever since. At a time when new rules are urgently needed in this space, the rider has now for years halted progress in this area affecting all nonprofits. Even when the changes to be proposed by this Committee are final, nonprofits will need the valuable advice Treasury and the Service can provide, and the rider could serve to tie their hands and prevent them from offering clear, predictable advice.

We also strongly encourage you to preserve the ban on 501(c)(3) electioneering on candidates for public office. The law as it is written allows those organizations to speak out on issues

important to them, no matter how controversial, but protects them from partisan manipulation and exploitation. We join with the thousands of faith-based and secular groups that have asked that this valuable provision remain in force.

The BLP has been working for years to perfect a clear, fair, system of rules that are easy to follow and easy to enforce. We have proposed a series of bright lines closely defining political violations as well as safe harbors so that tax-exempt organizations can engage in nonpartisan speech freely without fear of IRS interference. One of our safe harbors would protect individual oral statements made during church services and other nonprofit meetings without subjecting the organization to any financial examination. For additional information, we've attached our letter encouraging the Treasury Department to make better rules for (c)(3)s and more information about our plan to reform the rules in this area.

Sincerely,

Greg Colvin and Beth Kingsley, Co-Chairs  
Bright Lines Project Drafting Committee