National Taxpayer Advocate

2013 Annual Report to Congress

VOLUME ONE

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TAXPAYER ADVOCATE SERVICE

YOUR VOICE AT THE IRS

www.TaxpayerAdvocate.irs.gov/2013AnnualReport

December 31, 2013

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At their core,
taxpayer rights are human rights.
They are about our inherent humanity.

Particularly when
an organization is large, as is the IRS,
and has power, as does the IRS,
these rights serve as a bulwark
against the organization's tendency
to arrange things in ways that
are convenient for itself,
but actually dehumanize us.

Taxpayer rights, then, help ensure that
taxpayers are treated in a humane manner.

Nina E. Olson
Laurence Neal Woodworth
Memorial Lecture
May 9, 2013

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PREFACE: A Path to Strengthening Tax Administration and Improving Voluntary Tax Compliance

HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate's 2013 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

This report arrives at the close of a very difficult year for the IRS. It found itself mired in a scandal relating to tax-exempt organizations, resulting in the resignation or retirement of the acting Commissioner and other members of the IRS senior leadership.[1] It went through seven difficult months — from May to December — during which, under the leadership of a very able senior civil servant, it attempted to right both its operations and its reputation. During this time, it experienced a 16-day shutdown that has delayed the start of the 2014 filing season and exposed thousands of taxpayers to harm from enforcement actions initiated just before or during the shutdown.[2] In the midst of all this, it is a credit to the talent and professionalism of IRS employees that they managed to conduct the business of the agency as well as they have.

I submit that all of these short-term crises mask the major problem facing the IRS today — unstable and chronic underfunding that puts at risk the IRS's ability to meet its current responsibilities, much less articulate and achieve the necessary transformation to an effective, modern tax agency.

Throughout the Most Serious Problems section of this report, we recount the ways in which chronic underfunding drives the agency to develop short-term solutions that merely patch over problems and impose unnecessary burden and even harm on taxpayers. These short-term solutions also create more work for the IRS in the end, thereby wasting precious resources. As the IRS spends its resources to address problems in this *ad hoc* manner — to put fires out — it is unable to direct attention and talent to the long-term challenges it faces as it attempts to modernize. Simply put, without a stable funding stream and adequate resources to invest in the future, the IRS will fall short of fulfilling its mission to serve the U.S. taxpayer and collect revenue.

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1 For a discussion of problems relating to exempt organizations, see Most Serious Problem: *Exempt Organizations: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status, infra*. *See also* National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress (Special Report to Congress: *Political Activity and the Rights of Applicants for Tax-Exempt Status*).

2 For example, during the shutdown period, the IRS issued 3,902 levies on Social Security recipients. IRS Compliance Data Warehouse, Individual Master File (Processing Year 2013).

A Vision for the IRS in the 21st Century

A 21st century tax administration would:

- Be founded on a Taxpayer Bill of Rights and use that document as an analytical tool for its operations and initiatives.[3]
- Be operated on the principle that voluntary compliance is the least expensive, most effective method of collecting tax revenue.
- Recognize that modern tax administration not only involves collecting revenue but also disbursing benefits (tax expenditures) to targeted populations, including low income and business taxpayers, and it would design its activities, staffing, and training around the specific characteristics and needs of those populations.
- Be built on the understanding that only two percent of the revenue it collects comes from direct enforcement actions and that the provision of taxpayer service, assistance, and education is one of the most influential factors for maintaining voluntary compliance, particularly for the self-employed.
- Be open to emerging research that its existing enforcement approach — based on targeting large delinquencies ahead of recent delinquencies and focused on the use of liens and levies instead of timely, personal contact — may be less effective than it believes.
- Use findings from its own and the international research community to develop approaches to voluntary compliance and enforcement that incorporate behavioral, psychological, and educational approaches.
- Develop localized compliance initiatives, building on the finding that one of the most significant influences of compliance behavior is a taxpayer's networks and norms, particularly local ones.[4]
- Educate its workforce about the foundational principles of tax administration and how those principles are applied in the different aspects of their work.[5]
- Be on the cutting edge of electronic tax administration, providing taxpayers with access to their electronic accounts so they can check on filing requirements, track receipt and processing of documents they have filed, identify problems with their accounts, and resolve those problems through submissions, explanations, etc.
- Provide taxpayers with online access to all third-party information reports received by the IRS, in time for them to download or populate their return preparation software — whether government-provided, purchased from a commercial software provider or used by a commercial return preparer.[6]

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3 See Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration, infra*.

4 See Volume 2: *Small Business Compliance: Further Analysis of Influential Factors, infra*, and National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

5 See Most Serious Problem: *Taxpayer Rights: Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights, infra*.

6 See Volume 2: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments, infra*.

- Provide taxpayers with face-to-face (including virtual face-to-face) and telephonic communication rather than relying solely on correspondence that generates confusion, low response rates, and re-work for the IRS.
- Develop a comprehensive suite of taxpayer service, compliance, and enforcement measures that can serve as a basis for funding decisions, while holding the IRS accountable for delivery of effective tax administration.[7]
- Lastly but most crucially, the IRS would receive the funding necessary to achieve the transformation into a 21st century tax administration and to sustain its operations at that level.[8]

In short, what taxpayers need and deserve is the transformation of the IRS from a traditional enforcement-focused tax agency to a forward-looking modern agency that embraces technology even as it recognizes the specific needs of taxpayers for personal assistance in their efforts to comply voluntarily with the tax laws. In this latter construct, the use of enforcement is informed by an understanding of taxpayer behavior. The overriding strategic goal for this system should be to increase and maintain voluntary compliance; all IRS activities should be designed to further that goal.

I want to make clear that I believe the IRS can make that transformation. It has many, many talented people, who know what needs to be done and would love to be able to receive the education and funding necessary to utilize the most advanced approaches for their jobs. But as we have noted since the 2006 Annual Report to Congress,[9] the IRS has been chronically underfunded for years now, at the same time it has been required to take on more and more work, including administering benefit programs for some of the most challenging populations. In such an environment, the IRS can only solve problems *ad hoc;* undertaking transformational approaches to tax administration has seemed, unfortunately, like a luxury it has not been able to afford.

What the IRS — and by extension, U.S. taxpayers — need is for Congress, the Administration, Treasury, and the Commissioner of Internal Revenue to work together to provide the funding, vision, direction, and accountability required to enable the IRS to become an agency that we are all proud of, that we find easy to navigate and work with, and that we trust and believe is fair. This is not a luxury. This is a necessity.

In the pages that immediately follow, I discuss two areas that are foundational for this transformation: taxpayer service and collection. Throughout the rest of the report's discussion of the Most Serious Problems of taxpayers, we identify other components of tax administration that must change and modernize to be effective, and we attempt to identify the consequences to taxpayers — and the public fisc — if we fail.

A central theme of this report is that without adequate funding, the IRS will fail at its mission. But additional funding alone will not bring the IRS into the 21st century. The funding must be accompanied by a commitment to rethinking its approach to tax administration and intense self-scrutiny about how it should best deploy those resources. The IRS must be open to new approaches and research, even if it shakes traditional assumptions. We offer this discussion, and the following report, in the hope that under new leadership and with the support of Congress, the IRS will again be able to undertake this challenge.

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7 See Volume 2: *The Service Priorities Project: Developing a Methodology for Optimizing the Delivery of Taxpayer Services, infra*.

8 See Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance, infra*.

9 See National Taxpayer Advocate 2006 Annual Report 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

The Case for Taxpayer Service as One of the Most Significant Influences on Voluntary Compliance

The classic economic model of compliance — that compliance depends upon the risk (or perception of risk) of being caught and the cost (punishment) if caught — does not fully explain the high compliance rate in our tax system. Research shows that other factors, such as taxpayers' attitudes about government and their perception that they are being treated fairly by the tax system, also influence taxpayer compliance decisions. Many researchers refer to these factors collectively as "tax morale."[10]

In recent years, the Taxpayer Advocate Service (TAS) has explored the factors influencing taxpayer compliance decisions. In Volume 2 of this year's Annual Report, we discuss three studies that provide empirical evidence on several points:

(1) Taxpayer service and trust are a significant factor in influencing compliance behavior and perhaps the most significant factor for self-employed taxpayers, who are subject to little information reporting and to whom the largest portion of the tax gap is attributable;[11]

(2) Accuracy-related penalties, a classic economic deterrent, do not increase the long-term voluntary compliance of the taxpayers against which they are assessed;[12] and

(3) Local collection personnel outperformed remote, centralized collection personnel, but neither groups' enforcement actions had a significant impact on taxpayers' future compliance.[13]

This research suggests we need to adopt a new paradigm of tax compliance and the relationship between the IRS and the taxpayer. For example, our surveys have shown that for the most noncompliant group of taxpayers (sole proprietors), trust in the government, trust in the IRS, and trust in the tax system highly correlate with compliant behavior.[14] Further analysis has found that delivery of taxpayer service is the single most influential factor for compliant behavior by this group of taxpayers.[15] Thus, the new paradigm for tax administration should include a robust, well-funded, well-researched system of taxpayer services, designed to make it easier for taxpayers to comply with the laws and for noncompliant taxpayers to come into compliance.

Now, I am not suggesting that the IRS should not undertake enforcement actions. Such activity certainly has a direct effect (*i.e.,* it corrects the specific taxpayer's noncompliant behavior for the period under review) and indirect effect (economists have estimated the indirect effect of an examination on voluntary compliance is between six and 12 times the amount of the proposed adjustment).[16] But the IRS is very quick to pull out its hard core enforcement tools — and our research shows that indiscriminate use of these tools does not bring about significant long-term voluntary compliance. The goal of any compliance

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10 For an introduction to the concept of tax morale, see National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-182 (*Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

11 *See* Volume 2: *Small Business Compliance: Further Analysis of Influential Factors, infra*.

12 *See* Volume 2: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?, infra*.

13 *See* Volume 2: *A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies, infra.*

14 *See* National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

15 *See* Volume 2: *Small Business Compliance: Further Analysis of Influential Factors, infra*. Economic deterrence, while a factor, is counterbalanced by other economic concerns, including the taxpayer's ability to stay in business.

16 Alan H. Plumley, *The Determinants of Individual Income Tax Compliance: Estimating The Impacts of Tax Policy, Enforcement, and IRS Responsiveness*, Publication 1916 (Rev. 11-96), Washington, DC, 35-36; Jeffrey A. Dubin, Michael J. Graetz and Louis L. Wilde, *The Effect of Audit Rates on the Federal Individual Income Tax*, 1977-1986, 43 NAT. TAX J., 395, 396, 405 (1990).

action is that you don't have to address that taxpayer's noncompliance over and over again, resulting in an endless loop of enforcement action. For all but the most determinedly noncompliant taxpayers, the use of "softer" tools, like timely personal contacts (whether by phone or in-person), educational notices, installment agreements, and offers in compromise, make it more likely to bring that taxpayer into future compliance even as you address the current issue.[17]

IRS Taxpayer Service Delivery is Deteriorating to a Point That Will Impact Voluntary Compliance.

I believe that any attempt to develop a framework for IRS service delivery should begin with a discussion of the mission of the Internal Revenue Service and how taxpayer service relates to the mission. It is universally acknowledged that the IRS is the principal organization responsible for collecting the revenues necessary to fund the numerous and diverse functions performed by the federal government, *i.e.*, that taxes are "the life blood" of government.[18] As noted above, however, it should be clear that the mission of the IRS is broader than merely collecting tax revenue. In fact, with the expansion of refundable tax credits for individuals and businesses, the IRS today is a significant disburser of government payments.

There is also general agreement that the IRS is supposed to collect the *correct* amount of tax. This implies that the IRS's responsibility extends beyond ensuring that everyone pays the taxes they owe. We also have a responsibility to ensure that taxpayers do not pay *more* taxes than they owe. Further, there is general recognition that the IRS must weigh the burden it imposes on taxpayers against its mission to collect the taxes owed. For example, Congress has never funded the IRS to conduct extensive audits of every taxpayer every year. Besides being far too intrusive, this would place an unreasonable financial burden on the vast majority of honest taxpayers.

Our system is based on self-assessment, but the tax laws are so complicated (and become more so each year) that computing the correct amount of tax poses a daunting challenge for many of our citizens, and they frequently require assistance. While some can readily afford to pay for the assistance they need, tens of millions cannot. For these taxpayers, paying for tax assistance creates a significant financial burden.

Yet today, IRS-provided taxpayer service is increasingly and unacceptably limited. First, telephone calls and correspondence are the two main ways taxpayers communicate with the IRS. Yet the IRS is projecting it will answer only 61 percent of its calls this year from taxpayers seeking to speak to a live assistor. Waiting times are approaching 20 minutes for those lucky enough to get through. If you are a tax professional trying to resolve a problem for a client, you have a 20-minute wait on the line inaptly named "Practitioner Priority Service."[19] Similarly, our ability to process correspondence has declined. Comparing the final week of FY 2004 with the final week of FY 2013, the backlog of taxpayer correspondence in the tax adjustments inventory jumped by 217 percent (from 348,000 to 1.1 million),[20] and the

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17 *See* Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 5 Kans. L. Rev. 1, 23-33 (2003). *See also* Her Majesty's Revenue and Customs (HMRC), *HMRC Hidden Economy Strategy and Customer Segmentation* (Nov. 2013). For a fascinating report on the results of a campaign applying this methodology to increasing compliance among electricians, see Her Majesty's Revenue and Customs, *HMRC Electricians Tax Safe Plan Research Report 260*, TNS-BMRB (April 2013).

18 *Bull v. U.S.*, 295 U.S. 247, 259 (1935).

19 IRS, Joint Operations Center, *Snapshot Reports: Product Line Detail – PPS* (week ending Sept. 30, 2013) (showing that the hold for FY 2013 on the Practitioner Priority Service telephone line was 1,183 seconds). Even worse, the hold time for the final quarter of the fiscal year was 2,221 seconds, or 37 minutes.

20 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 30, 2004) and *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

percentage of taxpayer correspondence in this inventory classified as "over-age" increased by 361 percent (from 11.5 percent to 53.0 percent of correspondence).[21] Correspondence generally is considered over-age when it is 45 days old or older and the issue it addresses has not been resolved.[22]

Second, the IRS has abandoned return preparation in its walk-in sites, which was already limited to the most vulnerable populations of taxpayers — the elderly, the disabled, and the low income. It also has shut down tax law assistance on the phones after April 15, and has significantly limited the scope of questions it is willing to answer during the filing season. Thus, in the United States today, tax preparation and filing assistance is now, for the most part, privatized. That is, for a taxpayer to comply with his or her requirement to file a tax return, the taxpayer generally must pay for assistance, pay for software, and pay for advice. This is an unprecedented change in tax administration and it is not a good one. It is particularly devastating when one considers that over 50 percent of prepared individual returns are completed by unenrolled return preparers[23] — the very preparers the IRS is now hamstrung over regulating because of pending litigation in the federal courts. So while we hash out this issue in the courts, millions of taxpayers are exposed to the risk of incompetent and even fraudulent return preparers.[24]

In addition, millions of low and middle income taxpayers are "touched" annually by IRS programs that propose additional assessments, such as correspondence audits, math error, and automated underreporter (AUR) programs. Other programs hold refunds that IRS filters have identified as questionable or potentially fraudulent.[25] These proposed additional assessments and refund holds are not always correct, and taxpayers frequently need help understanding IRS notices and other communications.[26]

Low and middle income taxpayers generally cannot afford to pay practitioners to work with the IRS to resolve these kinds of issues. They rely on IRS assistance through our various channels, such as the toll-free line, correspondence, and walk-in sites. If, as I propose in the Taxpayer Bill of Rights, we accept that these taxpayers have a *right to pay the correct amount of tax*, *i.e.,* that they should not pay taxes they do not actually owe, and should not be subjected to unreasonable financial (or other) burden, the IRS has an obligation to provide a reasonable level of service to help them do so. Similarly, practitioners who interface with the IRS on behalf of taxpayers require a reasonable level of service. I think we must acknowledge

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21 IRS, Joint Operations Center, *Adjustments Inventory Reports: July – September Fiscal Year Comparison* (FY 2004 Through FY 2013).

22 Wage and Investment Division (W&I) FY 2012 Account Management Program Letter and Operating Guidelines (Dec. 12, 2011). In some instances, the definition of over-age varies based on factors such as the type of work, the program, the site, and inventory levels. TAS conversation with Joint Operations Center Paper Inventory Analyst (Dec. 13, 2011).

23 IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database (Tax Year 2011).

24 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013), *motion to suspend injunction pending appeal denied but injunction modified by* 920 F. Supp. 2d 108 (D.D.C. Feb. 1, 2013), *appeal docketed*, No. 13-5061 (D.C. Cir. Feb. 22, 2013), *motion for stay pending appeal denied*, 111 A.F.T.R.2d (RIA) 1384 (D.D.C. Mar. 27, 2013), *oral argument*, No. 13-5061 (D.C. Cir. Sept. 24, 2013). *See* Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing its Efforts to Effectively Regulate Return Preparers, infra*. *See generally*, Nina E. Olson, *More Than a "Mere" Preparer: Loving and Return Preparation*, 2013 TNT 92-13, Tax Notes Today (May 13, 2013).

25 *See* Most Serious Problem: *Revenue Protection: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds, infra*.

26 For example, in tax year 2009, nearly 300,000 returns contained errors with dependent taxpayer identification numbers (TINs). During math error processing, the IRS disallowed over $200 million of credits claimed on these returns, but subsequently reversed at least part of its dependent TIN math errors on 55 percent of them. Ultimately about 150,000 taxpayers had their refunds restored. On average, the IRS allowed nearly $2,000 per return after the initial disallowance, with a delay of nearly three months. The total restored to taxpayers was about $292 million. This amount exceeds the amount of credits that were initially disallowed, because it includes both restored credits and related tax reductions (*e.g.*, taxpayers got the benefit of exemptions that were initially disallowed when the credits were disallowed). Furthermore, analysis of a sample of taxpayers who did not contest these assessments showed that about 40,000 taxpayers were denied refunds they were probably entitled to receive. *See* National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 116-120 (*Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*).

that service delivery is as integral to the IRS mission as collecting taxes and enforcing the tax laws, and fund it accordingly.

Automation Is Not a Complete Solution

To address ongoing budget pressures, the IRS is increasingly turning away from personal service toward automation, and it is clear that cost-effective innovations could yield improvements in taxpayer service. For example, the IRS allows taxpayers to conduct simple actions through IRS.gov. However, taxpayers cannot use the site for such tasks as:

- Correcting computational errors;
- Checking account status; or
- Obtaining prior year return information immediately.

By requiring a taxpayer to write, call, or visit a Taxpayer Assistance Center (TAC) to complete these tasks, the IRS creates a higher volume of calls, correspondence, and TAC visits, burdening taxpayers and creating additional work for itself. Moving tasks to the Internet would enable computer-savvy taxpayers to use this channel for these actions and could reduce stress on IRS walk-in, telephone and correspondence resources, allowing IRS assistors to focus on taxpayers who need and prefer the TACs, the phone or correspondence.

While automated options are an important component of a comprehensive taxpayer service strategy, the IRS cannot rely solely on these options to close gaps. As the tax code grows more complex, taxpayer issues become increasingly difficult and harder to resolve through automation. Additionally, IRS research shows that taxpayers prefer personal service for some activities, and that certain segments of the taxpaying public are unable or unwilling to use automation. In a congressionally mandated update to a Taxpayer Assistance Blueprint, the IRS stated:

> [T]axpayers report they use IRS.gov most often to complete transactional tasks (*i.e.*, tasks that require minimal in-person assistance, such as obtaining a form or publication). However, when responding to a notice or obtaining payment information, taxpayers said that they are more likely to call the IRS toll-free telephone lines…. Research also suggested that age, income, and education are correlated to taxpayer behavior, and recent findings show that taxpayers with lower household incomes reported higher use of non-web-based IRS service channels than taxpayers in higher income households…. Low income, limited English proficient (LEP), and elderly taxpayers tend to report a somewhat higher preference for the TAC channel and a lower preference for the electronic channel than the majority of taxpayers as a whole…. Low income and LEP taxpayers report using the telephone channel more than the overall taxpaying population.[27]

The IRS is Judged on Measures that Undercut Taxpayer Service

Unfortunately, many of the measures stakeholders routinely apply to the IRS do not acknowledge the importance of service delivery. Invariably, the focus is on reducing the tax gap through enforcement

27 See IRS, *Annual Report to Congress: Progress on the Implementation of The Taxpayer Assistance Blueprint Five-Year Progress Report: FY 2008–FY 2012* 7-8 (Apr. 22, 2013).

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efforts, or improving efficiency as measured by return on investment (ROI). Each year, for example, the IRS publishes a document entitled "Enforcement and Service Results" on its website. The data is viewed with considerable interest by the tax administration community. At this writing, the FY 2012 results are the most recent posted. They contain seven pages of "Enforcement" data that show Enforcement Revenue Collected broken out by Examination, Collection, Appeals, and Document Matching; staffing for "key enforcement occupations"; audit rates for individuals overall and by income range; audit rates for various types of business entities; the number of levies, liens and seizures during the past year; and data on criminal investigations. At the end, there is just a single page of basic "Service" data. This heavy emphasis on enforcement measures relative to service delivery measures is indicative of IRS priorities, and suggests the need for a stronger commitment to providing high quality service to taxpayers.

The IRS's service activities compete with its enforcement programs for funding. While research shows that taxpayer service contributes to voluntary compliance, measuring the direct dollar impact of service on compliance (*i.e.,* the ROI of IRS services) is at best very difficult. Thus, we recommend IRS funding be based on its *obligation* to deliver an acceptable level of service to the nation's taxpayers rather than a return on investment approach that emphasizes enforcement at the expense of service. In other words, if we acknowledge that quality taxpayer service is a fundamental taxpayer right and an integral component of the IRS's mission, then funding for IRS services should be based on service measures and set at a level that ensure the IRS will fulfill that right and achieve its mission.

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IRS Needs Better Taxpayer Service Measures that Will Drive Better Funding and Resource Allocation Decisions

The IRS should develop and publish a comprehensive suite of service measures that can serve as the basis for funding decisions, while holding the IRS accountable for efficient and effective service delivery. Elsewhere, I have offered detailed guidelines for the creation of a portfolio of measures that would enable both the IRS and external stakeholders to evaluate the effectiveness of IRS service delivery.[28] These measures would also enable the IRS to identify performance gaps that could guide the creation of performance improvement goals. A principal feature of this proposed framework is the inclusion of the following types of measures for each of the IRS service delivery channels (telephone, face-to-face, electronic, correspondence):

- Access – level of service, wait time (including, where applicable, time waiting for service, and time waiting for a response).
- Customer satisfaction.
- Accuracy.
- Issue resolution – *i.e.,* did the IRS completely resolve the taxpayer's problem(s)?

Stakeholders are also keenly interested in how well the IRS is delivering each of its major services (*e.g.,* return preparation, refund inquiries, tax law inquiries). The IRS could report select service delivery measures for each of its major service activities:

- Taxpayer awareness of the availability of the various service types by channel.

28 See IRS, *Annual Report to Congress: Progress on the Implementation of the Taxpayer Assistance Blueprint* (April 2009 to September 2010) 54-57 (May 2011).

- Customer satisfaction with each service type by channel.
- Issue resolution for each service type by channel.
- Access for Limited English Proficiency and disabled taxpayers for each service type by channel.
- Number of returns prepared by Taxpayer Assistance Centers and Volunteer Income Taxpayer Assistance programs.

In this year's annual report, we discuss a project that TAS and the Wage and Investment (W&I) Operating Division have developed to enable the IRS to identify a proper balance between automated and personal service delivery.[29] We are developing a ranking methodology for IRS taxpayer services that takes taxpayer needs and preferences into account. The goal of the project is to identify, from both the government perspective and the taxpayer perspective, the value of each of the major taxpayer services offered by the IRS. This approach enables the IRS to identify the core service activities that taxpayers need in order to comply with the tax laws. In the face of budget or staffing constraints, the IRS will be able to use this ranking methodology to make resource allocation decisions based on highest valued services. Moreover, by weighting the values of criteria differently, the IRS can change the ranking of a given service. For example, if we believe that our system should make a special effort to assist vulnerable taxpayer populations, we should give more weight to the "vulnerable populations" criterion in our ranking formula.

Taxpayer Service Is Not an Isolated Function But Must Be Incorporated Throughout All IRS Activities, Including Enforcement.

The goal of a comprehensive, modern taxpayer service plan should be to maintain and increase voluntary compliance. In order to achieve that goal, the IRS should stop approaching service and enforcement as separate tracks. The IRS enforcement functions, such as audit and collection, should not be excused from having to address the issue of taxpayer service. If a taxpayer makes a reporting error, for example, the enforcement functions should not only seek to assess and collect any underpayment of tax but should also educate the taxpayer to reduce the likelihood that the taxpayer will make the error again. In this way, the IRS can and should integrate service within its enforcement activities.

It is a truism that "you get what you measure." IRS enforcement functions are measured primarily by the tax dollars assessed and collected, and the audits closed, liens filed, and levies issued. These measures have the effect of telling IRS employees that enforcement activity is what counts, and taxpayer education, problem resolution, and long-term voluntary compliance do not.

To change this mindset and to bring IRS enforcement into alignment with the observation that taxpayer service is the most influential compliance factor, I provide a "report card" of measures at the end of this preface that, from the Taxpayer Advocate Service's perspective, would provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance. Some of the measures are available today; others still need to be developed. Significantly, measures that show the impact IRS activities have on voluntary and future compliance and how effective the IRS has been in protecting taxpayer rights are missing from the IRS's current suite of measures. I encourage the IRS to work with TAS to develop these measures. In future reports, we will publish and track IRS performance on these measures.

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29 See Volume 2: *The Service Priorities Project: Developing a Methodology for Optimizing the Delivery of Taxpayer Services, infra*.

In a budget-constrained environment, the IRS tends to fall back on automated enforcement activity instead of personal contacts, regardless of whether that automated activity is productive or detrimental to voluntary compliance. In many cases, the IRS ignores its own research findings and persists in unproductive and taxpayer-harmful activity. This pattern is no more obvious than in the area of IRS Collection activities, as I discuss in the following section.

15 Years After RRA 98, The IRS Collection Operation Is Entrenched in Unproductive Methods that Do Not Promote Voluntary Compliance.

Earlier this year, the Treasury Inspector General for Tax Administration (TIGTA) released a report on *Trends in Compliance Activities Through Fiscal Year 2012*.[30] The report discusses the challenges the IRS is currently facing with reductions in resources available for IRS enforcement activities, and what TIGTA identified as a significant decline in enforcement revenue. In regard to the IRS Collection function, the TIGTA report notes that "new Taxpayer Delinquent Account (TDA) receipts continue to outpace closures," and devotes a separate section to the decreases in the IRS's use of liens, levies, and seizures.[31] While TIGTA does not directly link the decline in enforcement revenue to the reductions in liens, levies, and seizures, these collection actions are nevertheless highlighted in the discussion of Collection's "mixed results."

TIGTA's observations are strikingly similar to assessments made of the IRS Collection program shortly after the implementation of the IRS Restructuring and Reform Act of 1998 (RRA 98). For example, in its May 2002 report titled *Impact of Compliance and Collection Program Declines on Taxpayers,* the General Accounting Office (GAO, now the Government Accountability Office) reported that IRS Collection programs showed declines in business results and staffing, concluding that "declining staff and productivity, and an emphasis on taxpayer service contributed to compliance and collection declines."[32] The GAO report also made specific mention of the IRS's decreasing use of enforcement sanctions, noting that the number of liens, levies, and seizures "dropped precipitously" between fiscal years (FY) 1996 and 2000.[33]

A commonly held perception following the implementation of RRA 98 was that the reductions in liens, levies, and seizures reflected a general decline in IRS enforcement, particularly in respect to the IRS Collection operations, and that the IRS's new emphasis on taxpayer service was incompatible with a robust collection program. In fact, later discussions of collection program results commonly compared lien and levy activity with pre-RRA 98 levels, and increased activities in these enforcement areas were cited as improvements in IRS performance.[34]

The IRS needs to embrace an expanded understanding of Collection "enforcement" actions.

This unfortunate focus on counting the wrong things — to the detriment of measuring performance factors that truly are important in tax administration — mitigated the positive impact that RRA 98 and the

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30 TIGTA, Ref. No. 2013-30-078, *Trends in Compliance Activities Through Fiscal Year 2012* (Aug. 23, 2013). This review of nationwide compliance statistics for the IRS's Collection and Examination function activities has been conducted annually by TIGTA since FY 2000.

31 *Id*.

32 GAO, GAO-02-674, *Impact of Compliance and Collection Program Declines on Taxpayers* 11 (May 2002).

33 *Id*. at 12 (May 2002).

34 IRS, Statement by IRS Commissioner Mark W. Everson, *IRS Improves Enforcement and Services in 2005* (Nov. 2005). This press release noted that "In our collection activities, levies and liens have recovered to pre-RRA '98 levels." (Emphasis added) IRS, Statement by IRS Commissioner Mark W. Everson, *Fiscal Year 2006 Enforcement and Service Results* (Nov. 2006). The press release noted, "Overall, some of our most common enforcement tools at the IRS also showed increases. In our collection activities, levies and liens *continue to top their 1998 levels*." (Emphasis added)

subsequent IRS restructuring efforts might have had on the IRS Collection program. For example, the GAO report noted that between fiscal years (FY) 1996 and 2001, "cases closed declined by 36 percent, reflecting significant declines in both staff time and productivity."[35] However, the report later mentions that case closures resulting in full paid accounts or installment agreements did not change for field collections and actually increased for telephone collections.[36] In fact, IRS data reveal that the substantial reductions in liens and levies that the IRS experienced post-RRA 98 had *no discernible impact* on the collection of delinquent revenue during this period.[37] Unfortunately, the IRS's preoccupation with the volumes of lien and levy actions hampered efforts to identify the collection treatments that successfully delivered this revenue, with the aid of improved taxpayer service, *e.g.,* timely personal contacts, and more flexibility in the use of payment options such as installment agreements and offers in compromise.

In FY 2013, we see a very similar situation developing with respect to the status of the Collection program. Severe budget cuts have contributed to reductions in Collection staffing, and significant changes in IRS collection policies implemented in FY 2011 and 2012 (*i.e.,* the so-called IRS "Fresh Start Initiative") have placed greater emphasis on more flexible collection decisions, as opposed to increased use of traditional enforcement actions. Consequently, in FY 2013, lien filings by the IRS were 45 percent less frequent than in FY 2010, and levies have been reduced by 51 percent since FY 2011. Yet, these reductions do not appear to have had *any* negative impact on revenue collections. In fact, delinquent tax dollars collected on open TDA accounts, installment agreements, and offers in compromise have actually increased by 16.3 percent from FY 2010 through FY 2013.[38]

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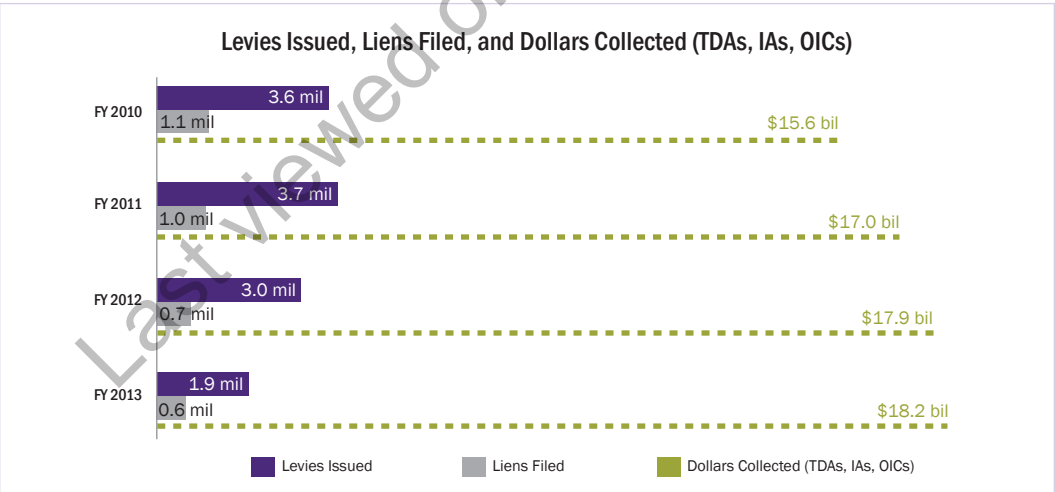

If history continues to repeat itself, observers soon will be pointing to the declines in liens and levies, and questioning whether the IRS enforcement programs are "broken." To counter this cycle, I urge the IRS to

35 GAO, GAO-02-674, *Impact of Compliance and Collection Program Declines on Taxpayers* 12 (May 2002).

36 *Id.*

37 IRS Data Book 1996 to 2001. In FY 1997, the IRS reported a total yield from taxpayer delinquent accounts of $29,913,365, while also reporting the issuance of 3,659,000 levies and the filing of 544,000 liens. In FY 2000, levy issuances had dropped to 220,000 and lien filings totaled 288,000. However, total collection yield for FY 2000 was reported as $29,935,564 — slightly more than FY 1997. In FY 2001, after several years of reduced lien and levy activity, the IRS reported total collection yield of $32,186,839 — an eight percent increase over FY 1997, even though the approximately 674,000 levies issued remained at only 18 percent of the FY 1997 level.

38 IRS, Collection Activity Reports, NO-5000-2, *Taxpayer Delinquent Accounts Report; NO-5000-6, Installment Agreement Report*; NO-5000-108, *Report of Offer in Compromise Activity* (FY 2010 to 2013).

expand the traditional definition of "enforcement" to include collection actions such as installment agreements, offers in compromise, and reminder notices that are demonstrably effective both in collecting delinquent revenue and in ensuring that delinquent taxpayers are compliant with their future tax obligations.

Critical Success Factor #1 for IRS Collection Work: Focus on the use of timely personal contacts for taxpayers who do not self-correct during the collection notice process.

A critical component of any effective and efficient collection operation is a timely, meaningful contact with the debtor, which is designed to address the full scope of the delinquency problem and expeditiously implement a realistic payment solution. In fact, an IRS research study published in FY 2012 noted, "[T]he number one action leading to case closure [in the Automated Collection System or ACS] is a telephone call with the taxpayer."[39] Ironically, even though the IRS data presented in the study indicates that the majority of cases closed by ACS during the study period did not involve levy actions, and a relatively small number of levy issuances actually generated case closing actions, a key recommendation from the study was to *issue more levies*.[40]

For the past several years, I have urged the IRS to review its practices involving the use of liens and levies, and rarely use these enforcement tools to *initiate* taxpayer contacts. These practices are not necessary, nor do they routinely generate productive taxpayer contacts. In fact, considering the high volume of cases not resolved by ACS, the IRS should be concerned that the reliance on "heavy-handed" enforcement may actually be discouraging taxpayers from coming forward to seek assistance from the IRS to resolve their tax debt problems. In this year's annual report, we address concerns with the IRS's over-reliance on automated levies as "calling cards."[41]

Critical Success Factor #2 for IRS Collection Work: Meet the needs of the taxpayer by expediting the assignment of collection cases to employees who are trained and empowered to resolve them.

TIGTA has reported that IRS enforcement revenue declined by nine percent from FY 2011 to 2012, and specifically noted that dollars collected by ACS in FY 2012 declined for the first time in four years. It is interesting to note, however, that Collection enforcement yield — overall — has actually *increased* by eight percent from FY 2010 to 2013. Moreover, although Collection yield did decline by almost three percent from FY 2011 to 2012, upon closer examination, the reductions were primarily in the collection of business taxes.[42] Remarkably, the IRS collected approximately $602 million less in delinquent taxes withheld by employers in FY 2012 — the year the IRS opted to assign a greater percentage of these cases directly to ACS, rather than expedite their delivery to revenue officers in the field.[43] In fact, through FY 2013, the IRS has collected 12 percent less delinquent withholding taxes from business taxpayers than during the same period in FY 2011.[44] Conversely, collections on delinquent taxes related

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39 IRS, SB/SE Research, Project DEN0181, *Automated Collection System (ACS) Closed Case Actions* 35 (Aug. 2012).

40 *Id*. For more details on this research study, see Most Serious Problem: *Collection Strategy: The Automated Collection System's Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers and the Public Fisc, infra*.

41 See Most Serious Problem: *Collection Strategy: The Automated Collection System's Case Selection and Processes Result in Low Collection Yields And Poor Case Resolution, Thereby Harming Taxpayers and the Public Fisc, infra*.

42 IRS, Total Enforcement Revenue Collected (TERC) database, *available at* http://cdw.web.irs.gov/EnforcementRevenueSummary.aspx (last visited Dec. 23, 2013).

43 *Id*. In FY 2012, the IRS reported collecting $4.371 billion in delinquent withholding taxes. In FY 2011, the IRS reported collecting $4.973 billion in delinquent withholding taxes.

44 *Id*. In FY 2013, the IRS reported collecting $4.366 billion in delinquent withholding taxes.

to individual income taxes have increased by 16 percent since the implementation of the "Fresh Start Initiative" in FY 2010, which involved policy changes primarily associated with income tax debts related to individuals.[45]

In addition to timely interventions, another critical success factor for an effective collection operation is to ensure that cases are routinely assigned to employees who are trained and empowered to provide service that meets the specific needs of their customers. Since the implementation of RRA 98, the IRS Collection functions have strayed from this critically important concept. In this report, we discuss how IRS case assignment practices involving business-related tax delinquencies are neither efficient nor effective, and have resulted in billions of dollars of lost revenue.[46]

Critical Success Factor #3 for IRS Collection Work: Provide reasonable payment solutions as early in the collecting process as possible.

Successful collection operations embrace the concept of contacting delinquent customers early, and quickly negotiating agreements for realistic payment solutions. In FY 2011, the IRS revised the collection policies governing the use of installment agreements (IA) and offers in compromise (OIC) to make it easier for more taxpayers to enter into "streamlined" payment agreements or qualify for OICs in appropriate situations. However, since the implementation of the new "streamlined" IA criteria, the number of IAs has actually *declined* by 11 percent,[47] while the IAs granted to business taxpayers have dropped by 17 percent since FY 2011.[48] The IRS collected approximately $11.1 billion with IAs in FY 2013 — more than all other collection treatments on TDA accounts combined.[49] Yet, the IRS continues to struggle with the reality that flexible payment options represent the government's best option to collect much of its current inventory of delinquent tax debts.

At the conclusion of FY 2013, the IRS reported over 848,000 taxpayers with TDA accounts in the Collection Queue, representing $49.9 billion in delinquent taxes.[50] The inventory of TDA cases that the IRS reported as "shelved" stands at an all-time high of $14.4 billion, while the overall inventory of cases reported by the IRS as "currently not collectible" included a staggering $82.8 billion in September 2013.[51] Realistically, without a more proactive approach to using IAs and OICs to resolve these accounts, the majority of this revenue will likely never be collected.

In this year's Annual Report, we identify and discuss how existing systemic and cultural issues serve as barriers for taxpayers attempting to negotiate fair, reasonable payment solutions for tax debt problems.[52]

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45 IRS, Total Enforcement Revenue Collected (TERC) database, *available at* http://cdw.web.irs.gov/EnforcementRevenueSummary.aspx (last visited Dec. 23, 2013). In FY 2013, the IRS reported collecting $23.575 billion on individual income tax delinquencies — a 16 percent increase over the $20.344 billion collected in FY 2010.

46 *See* Most Serious Problem: *Collection Process: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue, infra*. *See also* Volume 2: *TAS Research Study: A Comparison of Revenue Officers and The Automated Collection System In Addressing Similar Employment Tax Delinquencies, infra*.

47 IRS, Collection Activity Report NO-5000-6, *Installment Agreement Report* (FY 2011 to 2013).

48 *Id*.

49 *Id*.

50 IRS, Collection Activity Report NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013). The Collection Queue is an inventory of TDA accounts that are active, but unassigned to the ACS or CFf functions. See IRM 5.1.20.2 (May 27, 2008).

51 IRS, Collection Activity Report NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2013).

52 *See* Most Serious Problem: *Collection Process: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue, infra*.

Critical Success Factor #4 for IRS Collection Work: Focus enforcement efforts on the most serious compliance problems in order to maximize the benefits of available Collection resources.

In a budget environment characterized by severe cuts and limited staffing, the IRS Collection operation needs to focus its resources on programs that maximize the benefits to the government in recovering lost revenue and improving voluntary compliance. However, the improvement of case-processing efficiencies in the application of IRS compliance programs must only be accomplished along with careful consideration of taxpayer rights and taxpayer service.

For several years, I have expressed concerns with the IRS's use of automated levies.[53] Of particular concern are levies on Social Security retirement income, which frequently result in economic hardship for low income taxpayers, who rely on these payments to meet their necessary living expenses. The IRS continues to issue millions of these levies each year through the Federal Payment Levy Program and has not yet adequately addressed my concerns about the impact of this program on some of the most vulnerable members of our society. As a result, many taxpayers, who are currently living on income at or near poverty levels, continue to suffer undue economic and emotional harm while dealing with the IRS to resolve these levies. Most recently, the Deputy Commissioner of Services and Enforcement rescinded my Taxpayer Advocate Directive (TAD) in which I directed the IRS to protect a subset of these taxpayers.[54] In rescinding the TAD, the IRS ignores both case law and a conclusive research study showing harm to these taxpayers. Thus, in this year's annual report, I again urge the IRS to implement more safeguards into the current practices used with automated levies to prevent harm for low income taxpayers, and provide timely relief to taxpayers who have already been harmed by these enforcement actions.[55]

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Conclusion

This year, TAS sponsored a series of focus groups with taxpayers to ascertain their reaction to a proposed Taxpayer Bill of Rights. In these discussions, the one right that taxpayers flat out did not find credible was the *right to quality service*. When we link this observation to a finding from our 2012 survey of noncompliant sole proprietors that they believed the IRS is more interested in collecting the tax than in getting the right answer, and this year's finding that taxpayer service and trust are the most influential factors for small business compliance, one can easily conclude that taxpayer service is one of, if not the, most significant determinant for voluntary compliance and keeping noncompliance from growing. It may not bring in the hard-core noncompliant taxpayers, but it is absolutely critical to many others.

Rather than generating all sorts of automated compliance touches — including Automated Underreporter, Automated Substitute for Return, and math error notices that we later abate, which create work for ourselves and torments taxpayers unnecessarily — the IRS should explore alternative approaches to engendering compliance. What if we came up with a strategy for underreporting and nonfiling that incorporated local compliance initiatives? Working through local networks like local trade and business

53 National Taxpayer Advocate 2011 Annual Report to Congress (Most Serious Problem: *The New Income Filter for the Federal Payment Levy Program Does Not Fully Protect Low Income Taxpayers from Levies on Social Security Benefits* 350-365).

54 Taxpayer Advocate Directive (TAD) 2012-2 (*Taxpayers Whose Incomes Are Below 250 percent of the Federal Poverty Level Set by the Department of Health and Human Services and who receive Social Security or Railroad Retirement Board Benefits Should Be Screened Out of the Federal Payment Levy Program (FPLP) regardless of unfiled returns or outstanding business debts*) (Jan. 12, 2012). *See also* Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, TAD 2012-2, Low Income Filter in the Federal Payment Levy Program (Dec. 20, 2013).

55 See Most Serious Problem: *Hardship Levies: Four Years After the Tax Court's Holding in Vinatieri v. Commissioner, the IRS Continues to Levy on Taxpayers it Acknowledges Are in Economic Hardship and Then Fails to Release the Levies, infra*.

groups, would we be more successful in promoting long-term voluntary compliance?[56] If we incorporated truly virtual face-to-face audit and collection appointments into our enforcement strategy — where the taxpayer or representative could schedule a "virtual" appointment with the IRS and communicate face-to-face in a secure virtual environment, would we achieve higher response rates, better resolutions, and more education of the taxpayer? What would happen if we required local IRS managers and enforcement personnel to go out in the community and conduct outreach? They could learn about the specific challenges taxpayers face in trying to comply with the tax laws, which would be valuable information for developing future compliance and education initiatives.

None of these things is out of reach, and except for the virtual meetings, they could be done tomorrow — for almost no expense (just a redeployment of the same resources). And the virtual technology is available — many federal agencies, including the Social Security Administration, which has the same concerns about the privacy of its proceedings, are using this technology today.

My plea to Congress, then, is to fund taxpayer service, hold enforcement accountable for a more holistic approach, ensure taxpayer rights are the framework of analysis for all IRS initiatives, and provide the appropriate funding and oversight to bring the IRS into the 21st century, both in terms of technology and more importantly in terms of its understanding of taxpayer motivations and the factors influencing compliance behavior.

We are at a crossroads. We can continue to operate as we have in the past, where success is measured by the least productive aspect of our work (enforcement). Or we can be open to the possibility that enforcement dollars, levies, and liens may not be the optimal measures of the IRS's success in maximizing voluntary (and overall) tax compliance — and engage in an open dialogue about alternative ways to most effectively accomplish the IRS's mission.

As we conclude a tumultuous year for the agency, I look forward to working with you to chart a better path forward, and I stand ready to assist you in any way that I can.

Respectfully submitted,

Nina E. Olson
National Taxpayer Advocate
31 December 2013

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56 Her Majesty's Revenue and Customs (HMRC) has undertaken just such an initiative to address the "hidden economy." *See* Her Majesty's Revenue and Customs (HMRC), *HMRC Hidden Economy Strategy and Customer Segmentation* (Nov. 2013).

National Taxpayer Advocate Report Card: Measuring the IRS's Protection of Taxpayer Rights and Promotion of Voluntary Compliance

Phones	Data Available?
Number of calls	Yes
Percentage of taxpayers able to speak to live assistor (LOS) — Toll Free	Yes
Percentage of taxpayers able to speak to live assistor (LOS) — NTA Toll Free	Yes
Percentage of taxpayers able to speak to live assistor (LOS) — Practitioner Priority	Yes
Percentage of calls answered (LOS)	Yes
Average wait time to reach live assistor (speed of answer)	Yes
Accuracy — Percent of times the information given and actions taken were correct	No
Awareness of service (or utilization)	No

Correspondence	Data Available?
IMF volume	Yes
BMF volume	Yes
Average days in inventory (by unit or by IMF/BMF)	Yes
Percentage of inventory overage (by unit or by IMF/BMF)	Yes

Examination	Data Available?
** All items broken out by type of exam — office, correspondence, field*	
No change rates	Yes
Agreed rates	Yes
Non-response rates	Yes
Percentage of cases appealed	Yes

Collection	Data Available?
Offer in Compromise: Number of Offers Submitted	Yes
Offer in Compromise: Percentage of Offers Accepted	Yes
Installment Agreements: Number of Individual & Business IAs	Yes
Streamlined Installment Agreements (ACS): Number of Individual & Business IAs	Yes
Streamlined Installment Agreements (CFf): Number of Individual & Business IAs	Yes
Number of OICs Accepted per Revenue Officer	Yes
Number of IAs Accepted per Revenue Officer	Yes
Percentage of cases in the queue or CNC	Yes
Age of delinquencies in the queue	Yes
Percentage of cases where the taxpayer is fully compliant upon closure	compute
Percentage of cases where the taxpayer is fully compliant after five years	compute

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Appeals	Data Available?
Rate of appeal to Tax Court	Yes
Average number of days in Appeals to reach resolution	Yes
Customer Satisfaction of service in Appeals (Including perceptions of independence and fairness)	Yes

Tax Exempt / Government Entities	Data Available?
Employee Plans: Average age of determination requests	Yes
Exempt Org: Average age of determination requests, including average age for first read, intermediate, and full development cases	No
Toll Free LOS	Yes

Other — Apply to All Functional Areas	Data Available?
IRS Issue Resolution — Percentage of taxpayers who had their issue resolved as a result of the service they received	No
Taxpayer Issue Resolution — Percentage of taxpayers who reported their issue was resolved after receiving service	No
Wait time — Average time taxpayer spent waiting before receiving service	No
Number of complaints (by process) received by phone, by mail, or reported on social media	No
Percentage of calls/letters/issues resolved in a single 2-way communication (single call, single meeting, or single exchange of correspondence)	No
Percentage of noncompliant taxpayers (non-filers, under-reporters, or those with delinquencies) who are compliant after the IRS (or a given IRS business unit) closes their cases	Yes
Percentage of noncompliant taxpayers (non-filers, under-reporters, or those with delinquencies) who are compliant five years after the IRS (or a given IRS business unit) closes their cases	Yes
Percentage of taxpayers subject to IRS burden (*e.g.*, received a notice from math error, AUR, ASFR, audit, collection, or had a refund delayed) who were (or may have been) compliant (*i.e.*, those whose math error, AUR, or ASFR resulted in no net increase in tax, those with delayed refunds that were ultimately paid, those who appeared to have delinquencies but where nothing was ultimately collected)	No
Percentage of closed cases (selected at random and stratified by outcome) where the taxpayer reported that the IRS actually resolved their case and resolved it fairly	No
Average days between the due date of the return and final resolution of any liability	No

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THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS: Introduction

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2013, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 25 such problems.

As in earlier years, this report discusses at least 20 *of* the most serious problems encountered by taxpayers — but not necessarily *the top 20* most serious problems. That is by design. Since there is no objective way to select the 20 most serious problems, we consider a variety of factors when making this determination. Moreover, while we carefully rank each year's problems under the same methodology (described immediately below), the list remains inherently subjective in many respects.

To simply report on the top 20 problems would limit our effectiveness in focusing congressional, IRS, and public attention on critical issues. It would require us to repeat much of the same data and propose many of the same solutions year to year. Thus, the statute gives the National Taxpayer Advocate flexibility in selecting both the subject matter and the number of topics to be discussed and to use the report to put forth actionable and specific solutions instead of mere criticism and complaints.

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Changes in Approach from Prior Years' Reports

This year, we have altered the format of the Most Serious Problem discussions in two important respects. First, we are not including an IRS response to our initial discussions and thus are no longer including the National Taxpayer Advocate's response to the IRS's comments. Second, we will be publishing the IRS formal response in conjunction with the National Taxpayer Advocate's report issued on June 30.[1] In large part, this change was necessary so that we could issue the Annual Report as close as possible to the December 31 statutory deadline, given the 16-day government shutdown, which hit at a particularly crucial time in the report's editing and review schedule.[2]

This change in approach, however, also brings us into conformity with the specific statutory language of IRC § 7803(c)(2)(B)(iii), which requires the National Taxpayer Advocate to submit her reports "directly" to the House Committee on Ways and Means and the Senate Committee on Finance "without any prior review or comment from the Commissioner, the Secretary of the Treasury, the Oversight Board, any other officer or employee of the Department of the Treasury, or the Office of Management and Budget."[3]

This statutory directive was designed to enhance and protect the independence of the National Taxpayer Advocate's observations and comments.[4] It reflects a radical change from prior law, which required the Taxpayer Ombudsman to co-author the report to Congress with the IRS Assistant Commissioner

1 IRC 7803(c)(2)(B)(i).

2 IRC 7803(c)(2)(B)(ii) requires the National Taxpayer Advocate to submit an "activities" report to the tax-writing committees of Congress not later than December 31 of each calendar year.

3 IRC § 7803(c)(2)(B)(iii).

4 The stated objective of these reports is "for Congress to receive an unfiltered and candid report of the problems taxpayers are experiencing and what can be done to address them. The reports by the Taxpayer Advocate are not official legislative recommendations of the Administration; providing official legislative recommendations remains the responsibility of the Department of Treasury." Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 104th Congress*, JCS 12-96, 21 (Dec. 18, 1996).

(Taxpayer Services).[5] Congress provided for the IRS's ability to comment and respond to the National Taxpayer Advocate's recommendations (both in the Annual Reports and elsewhere) by requiring the Commissioner to "establish procedures requiring a formal response to all recommendations submitted to the Commissioner by the National Taxpayer Advocate within 3 months after submission to the Commissioner."[6]

In past years, as noted above, the National Taxpayer Advocate submitted her initial analyses with preliminary recommendations to the IRS responsible officials prior to publication and delivery to Congress. We allowed the IRS 30 days to respond to our preliminary recommendations. Included in that 30-day period was a seven-day timeframe within which the IRS could identify any factual errors we may have made in the analyses. We asked the IRS to respond specifically to our preliminary recommendations in the hope we could reach agreement and thus not include them in the final recommendations. Regrettably, as discussed below, the IRS agreed to very few preliminary recommendations.

The historic approach to the Annual Report to Congress, which appears to have been carried over from at least 2000, is very difficult to square with the direct and explicit statutory language. The IRS Commissioner and his officers and employees are specifically prohibited from "prior review or comment" with respect to the Annual Report. And yet, as many as 500 pages each year were reviewed and commented on by IRS officers and employees prior to direct delivery to Congress.[7]

This year, we have altered the format of the Most Serious Problem discussions in two important respects.

In past years, following publication of the Annual Report, the National Taxpayer Advocate forwarded to the Commissioner of Internal Revenue a memorandum including all of the recommendations contained in the report, which formally triggers the 90-day period for providing the Commissioner's response to those recommendations. Upon receipt of the Commissioner's formal response to her recommendations, the National Taxpayer Advocate and her staff discuss any concerns and ultimately post the IRS response and the National Taxpayer Advocate's position on the IRS website.[8]

Over the years, we have found the 90-day process to be much more meaningful than the responses we receive from the IRS as a result of the (statutorily prohibited) 30-day review. For example, in the 2012 Annual Report to Congress, the National Taxpayer Advocate made preliminary recommendations for 17 Most Serious Problems. As a result of the IRS's 30-day comments, the number of final recommendations remained the same for 11 Most Serious Problems, the number increased for three Most Serious Problems, and the number decreased for three Most Serious Problems. Overall, the IRS agreed to only 17.6 percent

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5 Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, Title VI, Sec. 6235, 102 Stat. 3342, 3737 (Nov. 10, 1988). The Taxpayer Bill of Rights 2 (TBOR 2) amended IRC § 7802 (the predecessor of the IRC § 7803) by replacing the Office of the Taxpayer Ombudsman with the Office of the Taxpayer Advocate and replacing the joint Assistant Commissioner/Taxpayer Advocate Report to Congress with two annual reports to Congress issued directly and independently by the Taxpayer Advocate. Pub. L. No. 104-168, Sec. 101, 110 Stat. 1452, 1453 (July 30, 1996). However, post-TBOR 2, the reports continued to include IRS comments.

6 IRC § 7803(c)(3).

7 We note that the statutory authority for the Treasury Inspector General for Tax Administration (TIGTA) contains no express prohibition as to sharing or including reports with IRS officers or employees or including the IRS's comments. *See* The Inspector General Act of 1978, Pub. L. No. 95-452, as amended by Pub. L. No. 105-206, §1103, 112 Stat. 685, 705 (July 22, 1998). Likewise, IRC § 7803(d), which details additional duties of TIGTA, contains no prohibition on review or comment by the IRS on TIGTA's reports. We speculate that is because the Inspector General and his employees do not report to the Commissioner of Internal Revenue and therefore his independence does not require the extra safeguard of providing the National Taxpayer Advocate and her employees protection from censorship or undue pressure.

8 2012 Annual Report to Congress Report Card, at http://www.irs.gov/Advocate/Annual-Report-to-Congress-Report-Cards.

of our preliminary recommendations. Yet, as a result of the 90-day process for formally reviewing and responding to the National Taxpayer Advocate's recommendations, the IRS agreed to over 46 percent of the final recommendations.[9]

Thus, this year we decided to adhere closely to the statutory language. We have dispensed with the step of sharing the initial analyses with the IRS for its comment. Instead, we have provided the IRS with all of the IRS-sourced data we cite in the Most Serious Problems along with any underlying assumptions that relate to data interpretation. We have provided the IRS ten days in which to identify any factual inaccuracies. Following submission of the report to the tax-writing committees of Congress, the National Taxpayer Advocate will submit the report to the IRS Commissioner. At the same time, she will provide the formal listing of recommendations which will trigger the 90-day period for IRS response.

We plan to publish the IRS responses and our own response on the Internet, and use those responses to identify the "objectives of the Office of the Taxpayer Advocate" in our Objectives Report for the next fiscal year, published in June of each year.[10] In this way, we will retain full transparency regarding the IRS's perspective on our recommendations to address the Most Serious Problems while still complying with the statutory protections. At the same time, we will link the IRS's responses to the Most Serious Problems with the Taxpayer Advocate Service's objectives for the upcoming fiscal year.

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Methodology of the Most Serious Problem List

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. The 25 issues were ranked according to the following criteria:

- Impact on taxpayer rights;
- Number of taxpayers affected;
- Interest, sensitivity, and visibility to the National Taxpayer Advocate, Congress, and other external stakeholders;
- Barriers these problems present to tax law compliance, including cost, time, and burden;
- The revenue impact of noncompliance; and
- Taxpayer Advocate Management Information System (TAMIS) and Systemic Advocacy Management System (SAMS) data.

After reviewing this ranking, the National Taxpayer Advocate identified five issues, which are, in her judgment after taking into consideration all of the above factors, the ones most in need of attention and thus requiring the most prominent placement in the ranking. Finally, the National Taxpayer Advocate and the Office of Systemic Advocacy examine the results of the ranking on the remaining issues and adjust it where editorial or numeric considerations warrant a particular placement or grouping.

9 2012 Annual Report to Congress Report Card, at http://www.irs.gov/Advocate/Annual-Report-to-Congress-Report-Cards. This percentage includes ARC recommendations adopted in full or in part in MSPs where the NTA offered preliminary recommendations.

10 IRC § 7803(c)(2)(B)(i).

Taxpayer Advocate Management Information System List

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy — using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2013, a period spanning October 1, 2012, through September 30, 2013.

Use of Examples

The examples presented in this report illustrate issues raised in cases handled by TAS. To comply with IRC § 6103, which generally requires the IRS to keep taxpayers' returns and return information confidential, the details of the fact patterns have been changed. In some instances, the taxpayer has provided a written consent for the National Taxpayer Advocate to use facts specific to that taxpayer's case. These exceptions are noted in footnotes to the examples.

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MSP #1 TAXPAYER RIGHTS: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration

RESPONSIBLE OFFICIAL

John Koskinen, Commissioner of Internal Revenue

DEFINITION OF PROBLEM

The U.S. tax system is built on voluntary compliance. The IRS estimates that it collects 85.5 percent of all tax owed.[1] Of that amount, 98 percent is paid timely and voluntarily. Only two percent derives from late and enforced collection actions.[2]

For the government, voluntary compliance is much cheaper than enforced compliance, because the government does not have to spend money to collect amounts that are voluntarily paid. Thus, the IRS's overriding goal is to maximize voluntary compliance.[3]

Taxpayer rights are central to voluntary compliance. If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the tax system and be less likely to comply with the laws voluntarily. If taxpayers have confidence in the fairness and integrity of the system, they will be more likely to comply.

The Internal Revenue Code (IRC) provides dozens of real, substantive taxpayer rights. However, these rights are scattered throughout the Code and are not presented in a coherent way. Consequently, most taxpayers have no idea what their rights are and therefore often cannot take advantage of them.

Not surprisingly, in response to a survey of U.S. taxpayers conducted for the Taxpayer Advocate Service (TAS) in 2012, less than half said they believed they have rights before the IRS, and only 11 percent said they knew what those rights are.[4]

We can and must do a better job of making taxpayers aware of their rights and enabling them to assert these rights. Since 2007, the National Taxpayer Advocate has repeatedly recommended adoption of a Taxpayer Bill of Rights (TBOR) that takes the multiple existing rights embedded in the code and groups them into ten broad categories, modeled on the U.S. Constitution's Bill of Rights.[5] A thematic, principle-based list of core taxpayer rights would provide a foundational framework for taxpayers and IRS employees alike that would promote effective tax administration.

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1 IRS News Release, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study* (Jan. 6, 2012).

2 *Id.* Enforcement and Late Payments percentage is computed by dividing enforcement and late payments of $65 billion by total tax liabilities of $2,660 billion.

3 *See* IRS Strategic Plan 2009-2013 ("Goal 1: Improve service to make voluntary compliance easier").

4 Forrester Research Inc., *The TAS Omnibus Analysis*, from North American Technographics Omnibus Mail Survey, *Q2/Q3 2012* 19-20 (Sept. 2012).

5 Congress has passed several pieces of legislation with "Taxpayer Bill of Rights" in the title. *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, Pub. L. No. 105-206, 112 Stat. 685 (1998) (Title III is known as "Taxpayer Bill of Rights III" or TBOR 3). These laws create specific rights in certain instances, but they do not create a thematic, principled-based list of overarching taxpayer rights.

Simply put, labels and presentation matter. Almost all Americans know we have a Bill of Rights, and many can name specific ones. The First Amendment right to free speech, for example, is widely known. When one digs deeper, it becomes clear that the right is not absolute (*e.g.,* the First Amendment does not protect an individual's right to falsely scream "Fire!" in a crowded theater), and there are dozens of Supreme Court decisions that delineate the scope of the right. But the simplicity and clarity of a thematic Bill of Rights help Americans understand their rights in general terms, and this knowledge empowers them to assert their rights and learn the nuances when the need arises.

Taxpayer rights are central to voluntary compliance. If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the tax system and be less likely to comply with the laws voluntarily. If taxpayers have confidence in the fairness and integrity of the system, they will be more likely to comply.

A thematic Taxpayer Bill of Rights would serve the same purpose and its value can scarcely be overstated. A Taxpayer Bill of Rights would serve as an organizing principle for tax administrators in establishing agency goals and performance measures, provide foundational principles to guide IRS employees in their dealings with taxpayers, and provide information to taxpayers to assist them in their dealings with the IRS.

At the same time, the tax system will work best if we provide transparency, not only about taxpayer rights but also about taxpayer responsibilities. The National Taxpayer Advocate views the relationship between the government and its taxpayers as a social contract of sorts — the U.S. government requires its tax collector to treat taxpayers with courtesy and respect and asks taxpayers to cooperate with the tax collector. In recognition of this two-way relationship, we recommend the Taxpayer Bill of Rights also contain a section outlining taxpayer responsibilities.[6] Overall, the document would lay out in general but very clear terms what taxpayers must do to comply with the tax laws and what rights taxpayers possess in that process. The document would serve to heighten awareness of these rights and responsibilities among taxpayers and IRS employees alike.

Thus, the National Taxpayer Advocate recommends that the IRS adopt and promote a Taxpayer Bill of Rights, and actively apply its principles to all IRS strategic planning, compliance and taxpayer service activities, and to outreach and education.[7] Doing so will ensure taxpayers know their rights, enable them to avail themselves of those rights, and restore trust in the tax system.[8] A TBOR provides organizing principles — a framework — for effective tax administration.

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6 While the National Taxpayer Advocate believes a statement of taxpayer responsibilities would promote effective tax administration by providing taxpayers with greater clarity about what is expected of them, the IRS's obligation to respect taxpayer rights should not be contingent on whether a taxpayer has fulfilled these responsibilities. For example, a taxpayer who did not keep all records or did not pay all tax timely does not forfeit his right to retain a representative to assist him in dealing with the IRS.

7 In her preface to the Fiscal Year 2014 Objectives Report to Congress, the National Taxpayer Advocate analyzed the IRS's processing of applications for tax-exempt status and showed that the IRS had violated eight of the ten rights she has proposed. Had there been a published Taxpayer Bill of Rights, organizations applying for tax-exempt status, IRS employees processing their applications, IRS executives overseeing the program, and Congressional offices receiving complaints likely would have flagged the inconsistencies between the applicants' rights and the IRS's actions more quickly. There is no guarantee that would have happened, of course, but the existence and broad awareness of a Taxpayer Bill of Rights would have substantially increased the odds that the problems would have surfaced and been addressed sooner.

8 For a comprehensive analysis of the role taxpayer rights play in effective tax administration, see National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (*Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights*) (Nov. 4, 2013), *available at* www.TaxpayerAdvocate.irs.gov/2013AnnualReport.

ANALYSIS OF PROBLEM

I. TAXPAYER BILL OF RIGHTS SERVES AS AN ESSENTIAL FRAMEWORK FOR EFFECTIVE TAX ADMINISTRATION

> "A bill of rights is what the people are entitled to against every government on earth, general or particular; and what no just government should refuse, or rest on inferences." — Thomas Jefferson[9]

The federal Bill of Rights provides citizens with indispensable freedoms and guarantees rights that were not explicitly granted in the U.S. Constitution, such as the right to free speech and the right to be free from unreasonable searches and seizures.[10] These rights are fundamental to the functioning of our society. Citizens follow the laws because they trust the government to uphold their rights and treat them fairly. Similarly, the federal tax system is based on an unwritten social contract between the government and its taxpayers: taxpayers agree to report and pay the taxes they owe to enable their government to function, and the government agrees to provide the service and oversight necessary to ensure that taxpayers can and will do so.[11] Taxpayers are more likely to uphold their side of this agreement and voluntarily pay taxes when they trust the government and the IRS.[12] In order for taxpayers to trust the IRS, they must understand that they have fundamental rights that apply throughout their dealings with the IRS, and they must believe that the IRS will respect these rights. For this reason, it is vital that the IRS adopt a Taxpayer Bill of Rights.

The Internal Revenue Code includes specific provisions that are crafted to ensure a fair and just tax system and protect all taxpayers from potential IRS abuse. However, the Code contains no organizing principles or formal acknowledgement of the fundamental taxpayer rights from which these statutory rights derive.[13] The National Taxpayer Advocate has recommended numerous times that a statement of taxpayer rights, a Taxpayer Bill of Rights, be formally codified.[14] While codifying a TBOR would require Congressional

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9 Thomas Jefferson to James Madison, 1787. ME 6:388, Papers 12:440.

10 *See* U.S. Const. amends. I, IV.

11 The 16th Amendment to the U.S. Constitution provides Congress with the authority to tax. The Internal Revenue Code, which provides the legal basis for our tax system, is codified in Title 26 of the U.S. Code.

12 *See* National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 13 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

13 For example, the right of a taxpayer to be informed is included in a number of different IRC provisions. IRC § 6213(a) requires the IRS to provide a notice of deficiency giving the taxpayer 90 days (150 days if the notice is addressed to a person outside of the United States) to petition Tax Court and, as required by IRC 7522(a), it should provide the basis for and the amount of tax, interest, and penalties due. IRC § 6330 requires the IRS to notify taxpayers at least 30 days before a notice of intent to levy and provide the amount of unpaid tax, the IRS's proposed action, the IRC provisions relating to levy, the procedures available to the IRS, the administrative appeals available to the taxpayer, and the alternatives available to prevent the levy. IRC § 6320(a) requires the IRS to notify a taxpayer of the notice of federal tax lien within five days of when the lien is filed.

14 *See* National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2007 Annual Report to Congress 478-489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*).

…the National Taxpayer Advocate recommends that the IRS adopt and promote a Taxpayer Bill of Rights, and actively apply its principles to all IRS strategic planning, compliance and taxpayer service activities, and to outreach and education. Doing so will ensure taxpayers know their rights, enable them to avail themselves of those rights, and restore trust in the tax system.

action, the IRS can articulate these rights by adopting a TBOR on its own.[15] Internally, the National Taxpayer Advocate has had several discussions with senior IRS officials over the last few months about publishing a Taxpayer Bill of Rights, and she is hopeful the IRS will decide to do so in the near future if Congress does not act first.

Congress has passed multiple pieces of legislation with the title of "Taxpayer Bill of Rights," but none of these laws provides a foundational, general description of taxpayer rights. Taxpayers need a TBOR to enable them to understand their basic rights without having to consult a multitude of Code sections that apply in specific circumstances. The U.S. Bill of Rights provides taxpayers with a clear statement of general rights so taxpayers understand they have a right to free speech, even if they do not know the court decisions that define and limit its scope. A TBOR would operate the same way. For example, a taxpayer needs to know he or she has a basic right to appeal when facing a collection action such as a levy, even if the taxpayer does not know the specific information in the Code regarding Collection Due Process hearings.

The National Taxpayer Advocate's recommendation that Congress codify a thematic, principle-based Taxpayer Bill of Rights has attracted considerable bipartisan support. This summer, the House of Representatives by voice vote passed an earlier version of the proposal, which is now pending in the Senate.[16] At the same time, we have heard very few concerns about the proposal. That is because it does not aim to create new rights or remedies — only to group existing rights into categories that are easier for taxpayers and IRS employees to understand and remember.

In response to allegations that the IRS used inappropriate criteria to screen applications for tax-exempt status,[17] the Principal Deputy Commissioner issued a "30-day report" providing an initial assessment of the allegations and describing actions the IRS planned to undertake to address underlying causes.[18] Among other things, the Principal Deputy Commissioner asked the National Taxpayer Advocate to provide him with recommendations to:

1) Improve taxpayer and employee awareness of the Taxpayer Advocate Service and the role it plays assisting taxpayers and advocating for systemic improvements; and
2) Raise awareness of taxpayer rights, including updating IRS Publication 1, *Your Rights as a Taxpayer*.

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15 There is ample precedent for the IRS to adopt a TBOR administratively before Congress enacts legislation. In 1977, for example, the IRS established a problem resolution program nationwide to help taxpayers when regular contacts with the IRS failed. In 1979, the IRS created the Office of the Taxpayer Ombudsman to serve as the primary advocate within the IRS for taxpayers, with responsibility for managing the problem resolution program. Yet the first reference to the Taxpayer Ombudsman did not appear in the IRC until 1988. *See* Pub. L. No. 100-647, § 6235, 102 Stat. 3342, 3737 (Nov. 10, 1988). Similarly, in March 1988, then Commissioner Gibbs announced a new initiative authorizing problem resolution officers to issue "taxpayer assistance actions" to suspend enforcement actions or expedite procedures in certain cases. These "taxpayer assistance actions" were the precursor to "taxpayer assistance orders" created by Congress in 1988 with the enactment of IRC § 7811. *See* Pub. L. No. 100-647, § 6230, 102 Stat. 3342, 3733 (Nov. 10, 1988).

16 Taxpayer Bill of Rights Act of 2013, H.R. 2768, 113th Cong. (as passed by House, July 31, 2013).

17 *See* Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013).

18 *See* Principal Deputy Commissioner, *Charting a Path Forward at the IRS: Initial Assessment and Plan of Action* (June 24, 2013).

In response to the first charge, the National Taxpayer Advocate submitted a report to the Principal Deputy Commissioner on August 23, 2013.[19] In response to the second charge, the National Taxpayer Advocate submitted a report, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration,* on November 4, 2013.[20] This latter report is a comprehensive analysis of the role a Taxpayer Bill of Rights could and should play in tax administration, and contains 22 action items for the National Taxpayer Advocate and 23 recommendations to the Commissioner of Internal Revenue. The National Taxpayer Advocate has also developed an updated draft color version of Publication 1, illustrated in Figure 3.

A. OECD and Other Countries Provide Models for a Taxpayer Bill of Rights

In 1988, the Organisation for Economic Co-operation and Development (OECD) sent a questionnaire to its member countries, asking about their systems of taxpayer rights and obligations. OECD published the results of the survey in 1990.[21] The survey found that although most countries did not have an explicit charter or bill of rights, there were certain basic rights present in all tax systems that responded:

- The right to be informed, assisted, and heard;
- The right of appeal;
- The right to pay no more than the correct amount of tax;
- The right to certainty;
- The right to privacy; and
- The right to confidentiality and secrecy.[22]

The OECD also identified certain "behavioral norms" that governments expect of taxpayers and are essential to the proper functioning of tax administration. These taxpayer responsibilities include:

- The obligation to be honest;
- The obligation to be cooperative;
- The obligation to provide accurate information and documents on time;
- The obligation to keep records; and
- The obligation to pay taxes on time.[23]

Many countries have adopted taxpayer charters that officially articulate taxpayer rights and obligations. The charters vary, as some consist of general statements of broad principles while others offer detailed explanations of taxpayer rights for each stage of the tax process."[24] The OECD explains that most taxpayer charters are a guide to the legal rights a taxpayer already has and they generally do not create additional rights that are not granted by legislation.[25]

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19 *Available at* www.TaxpayerAdvocate.irs.gov/2013AnnualReport.

20 *Id.*

21 OECD, Committee of Fiscal Affairs, *Taxpayers' Rights and Obligations – a Survey of the Legal Situation in OECD Countries* (Apr. 27, 1990).

22 *Id*.

23 *Id*.

24 OECD, Centre for Tax Policy and Administration, *Taxpayers' Rights and Obligations – Practice Note* 3-4, (Aug. 2003).

25 OECD, Centre for Tax Policy and Administration, *Taxpayers' Rights and Obligations – Practice Note* 6 (Aug. 2003).

The Canada Revenue Agency (CRA) has adopted and published a TBOR as well as a Commitment to Small Business.[26] Canada's TBOR consists of 16 provisions, including:

- The right to have the law applied consistently;
- The right to expect CRA to be accountable;
- The right to be treated professionally, courteously, and fairly; and
- The right to expect CRA to warn you about questionable tax schemes in a timely manner.[27]

Recently, the Canadian Minister of National Revenue accepted the recommendation of the Taxpayers' Ombudsman to add an additional article to the Taxpayer Bill of Rights, which would "provide assurance to Canadians that lodging a service complaint or requesting a formal review would not lead to biased treatment by the CRA in the future."[28]

The Australian Taxation Office (ATO) also has created and adopted a Taxpayer Charter, which outlines not only a taxpayer's rights and obligations, but also what the taxpayer can expect from the ATO and what a taxpayer can do if he or she is not satisfied.[29] The United Kingdom has a taxpayer charter that outlines what taxpayers can expect from Her Majesty's Revenue and Customs (HMRC), including the expectation to be treated as honest and with respect.[30] The United Kingdom charter, which includes three taxpayer obligations, also commits HMRC to do everything it can to keep the cost of dealing with HMRC as low as possible.[31]

Several states, including New York,[32] Pennsylvania,[33] Indiana,[34] Kentucky,[35] Montana,[36] and Nebraska,[37] have adopted a Taxpayer Bill of Rights. While these charters vary in scope — Montana's is statutory, Nebraska's provides its taxpayers with "Freedom from Red Tape" — all contain most of the fundamental components identified by the OECD, and several outline taxpayer obligations in addition to rights. New York State also has a Consumer Bill of Rights Regarding Tax Preparers, which aims to protect taxpayers that use tax return preparers from unfair treatment.[38]

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26 The CRA Commitment to Small Business is a "a five-part statement through which the CRA pledges to support the competitiveness of the Canadian business community by ensuring that interactions with the CRA are as effective and efficient as possible." *See* http://www.cra-arc.gc.ca/gncy/txpyrbllrghts/tbrfq-eng.html (last visited Sept. 15, 2013).

27 CRA, Taxpayer Bill of Rights, *available at* http://www.cra-arc.gc.ca/gncy/txpyrbllrghts/menu-eng.html (last visited Sept. 15, 2013).

28 Office of the Taxpayers' Ombudsman, Perspectives; Issue 3 (Aug. 2013), *available at* http://www.oto-boc.gc.ca/rprts/nslt3-eng.html.

29 *See* ATO, Taxpayer's Charter: What You Need to Know (2011), *available at* http://www.ato.gov.au/About-ATO/About-us/In-detail/Taxpayers–charter/Taxpayers–charter—what-you-need-to-know.

30 HMRC, Your Charter, *available at* https://www.gov.uk/government/publications/your-charter (last visited Sept. 24, 2013).

31 *Id*.

32 N.Y. Tax Law § 3000. *See* http://www.tax.ny.gov/tra/rights.htm (last visited Sept. 15, 2013).

33 72 Pa. Stat. Ann. § 3310-101 (1996); *see* Taxpayer Bill of Rights, *available at* http://www.portal.state.pa.us/portal/server.pt/community/taxpayers'_rights_advocate/13152 (last visited Sept. 24, 2013).

34 *See* Indiana Department of Revenue, The Taxpayer Bill of Rights, *available at* http://www.in.gov/dor/3660.htm (last visited Sept. 15, 2013).

35 Kentucky Revised Statements Annotated 131.041-131.081, Taxpayer Bill of Rights; *see also* Your Rights as a Kentucky Taxpayer, *available at* http://www.revenue.ky.gov/nr/rdonlyres/c343eebb-2975-4f0b-82a6-855c9d15cdd2/0/10f100713.pdf (last visited Sept. 24, 2013).

36 Montana Codes Annotated 15-1-222; *see* http://revenue.mt.gov/tax_appeal_process/taxpayer_bill_rights.mcpx (last visited Sept. 15, 2013).

37 *See* http://www.revenue.ne.gov/rights.html (last visited Sept. 15, 2013).

38 *See* State of New York, Department of Taxation and Revenue, Publ. 135, *Bill of Rights Regarding Tax Preparers* (Aug. 2011), *available at* http://www.tax.ny.gov/pdf/publications/income/pub135.pdf.

B. It Is Essential that the IRS Adopt a Taxpayer Bill of Rights

A formal acknowledgement of taxpayer rights is vital to restoring and maintaining taxpayers' confidence in the IRS to fairly and impartially administer the tax laws. In a recent lecture, the National Taxpayer Advocate stated:

> At their core, taxpayer rights are human rights. They are about our inherent humanity. Particularly when an organization is large, as is the IRS, and has power, as does the IRS, these rights serve as a bulwark against the organization's tendency to arrange things in ways that are convenient for itself, but actually dehumanize us. Taxpayer rights, then, help ensure that taxpayers are treated in a humane manner.[39]

A TBOR that simply articulates the basic rights and obligations of every taxpayer should provide the organizing principle around which tax administration operates. Whenever the IRS proposes a new initiative, it should analyze the initiative to ensure that it comports with the fundamental taxpayer rights set forth in the TBOR and the Internal Revenue Code. The IRS needs a TBOR to guide not only its big-picture policy and programming decisions but the individual actions of its employees.

The National Taxpayer Advocate has used OECD's guidance to develop a list of taxpayer rights and responsibilities to be included in the TBOR.[40] Taxpayer rights apply to taxpayers in all situations, regardless of whether they have met their obligations, such as filing a tax return on time. That is, taxpayer rights are not conditioned on taxpayers' compliance. Still, including taxpayer responsibilities in the TBOR reinforces the social contract between taxpayers and the IRS. The following make up the TBOR proposed by the National Taxpayer Advocate:

Ten Taxpayer Rights

1. **The Right to Be Informed**
   Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the law and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

2. **The Right to Quality Service**
   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.

3. **The Right to Pay No More than the Correct Amount of Tax**
   Taxpayers have the right to pay only the amount of tax legally due and to have the IRS apply all tax payments properly.

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39 Nina E. Olson, *A Brave New World: The Taxpayer Experience in a Post-Sequester IRS* (the Laurence Neal Woodworth Memorial Lecture), Tax Notes Today 106-118 (June 3, 2013).

40 The National Taxpayer Advocate has shared this TBOR with the IRS Office of Chief Counsel and the Chief of Communications and Liaison, and has adopted several of their suggestions.

4. **The Right to Challenge the IRS's Position and Be Heard**
   Taxpayers have the right to raise objections and provide additional documentation in response to IRS actions or proposed actions, to expect that the IRS will consider their objections and documentation promptly and impartially, and to receive a written response if the IRS finds them insufficient.

5. **The Right to Appeal an IRS Decision in an Independent Forum**
   Taxpayers are entitled to a prompt and impartial administrative appeal of IRS actions and have the right to receive a written response explaining the Appeals Division's decision. Taxpayers generally have the right to take their cases to court to challenge an adverse final determination.

6. **The Right to Finality**
   Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the IRS has to audit a particular tax year. Taxpayers have the right to know when the IRS has finished an audit.

7. **The Right to Privacy**
   Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and a collection due process hearing where applicable.

8. **The Right to Confidentiality**
   Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect the IRS to investigate and take appropriate action against its employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

9. **The Right to Retain Representation**
   Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to be told that if they cannot afford to hire a representative they may be eligible for assistance from a Low Income Taxpayer Clinic.

10. **The Right to a Fair and Just Tax System, Including Access to the Taxpayer Advocate Service**
    Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers 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.

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Five Taxpayer Responsibilities

1. **The Responsibility to Be Honest**
   Taxpayers have the responsibility to be truthful in preparing their tax returns and in all other dealings with the IRS.

2. **The Responsibility to Provide Accurate Information**
   Taxpayers have the responsibility to answer all relevant questions completely and honestly, to provide all required information on a timely basis, and to explain all relevant facts and circumstances when seeking guidance from the IRS.

3. **The Responsibility to Keep Records**
   Taxpayers have the responsibility to maintain adequate books and records to fulfill their tax obligations, preserve them during the time they may be subject to IRS inspection, and provide the IRS with access to those books and records when asked so the IRS can examine their tax liabilities to the extent required by law.

4. **The Responsibility to Pay Taxes on Time**
   Taxpayers have the responsibility to pay the full amount of taxes they owe by the due date and to pay any legally correct additional assessments in full. If they cannot pay in full, they have the responsibility to comply with all terms of any full or partial payment plans the IRS agrees to accept.

5. **The Responsibility to Be Courteous**
   Taxpayers have the responsibility to treat IRS personnel politely and with respect.

By establishing an official taxpayer charter, the IRS can show its current and future commitment to protecting fundamental taxpayer rights. The TBOR will also provide a valuable framework for evaluating IRS policies, programs, actions, and initiatives.

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C. Recognition of Taxpayer Rights Requires Adequate Funding for the IRS

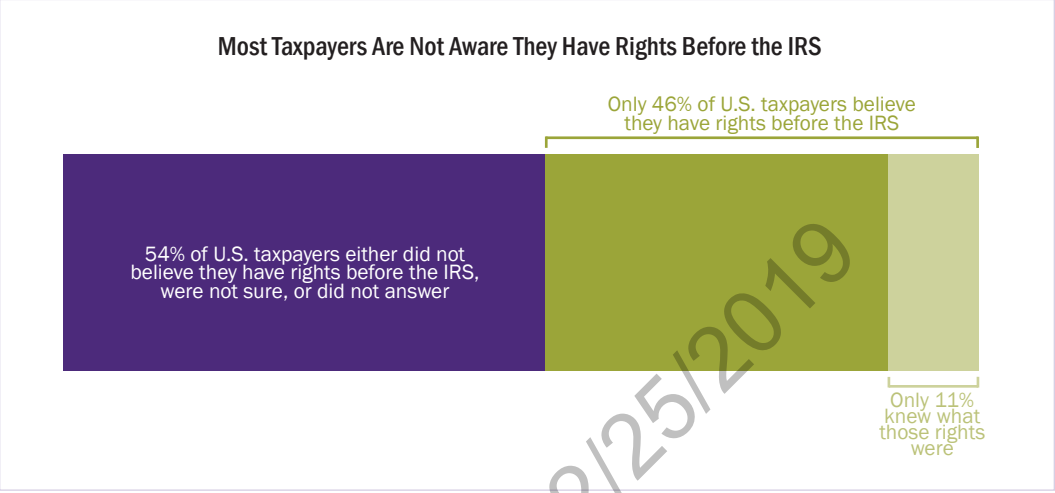
Throughout this report are examples of actions the IRS can take to implement the TBOR. However, taxpayer rights may be impaired if the IRS is not adequately funded. If there is agreement that taxpayers have certain basic rights, then Congress and the Executive Branch have a responsibility to ensure the IRS has sufficient resources to deliver these rights. For example, if taxpayers have the *right to quality service*, then the IRS must be funded so that it has the capability to provide quality service. A TBOR will be limited in its effectiveness without an adequate budget for the IRS to take actions to protect and fulfill taxpayer rights.

II. TAXPAYER AWARENESS OF TAXPAYER BILL OF RIGHTS

As noted above, the Internal Revenue Code includes a number of statutory taxpayer rights that are specific to certain situations, but it contains no organizing principles or formal acknowledgement of the fundamental taxpayer rights from which these statutory protections derive. Thus, taxpayers may not realize they have rights or know what they are. TAS research shows that many taxpayers are not aware they have

rights. The results of a recent nationwide survey of taxpayers found that fewer than half of U.S. taxpayers believed they have rights before the IRS, and only 11 percent said they knew what those rights were.[41]

FIGURE 1.1.1, Taxpayers' Knowledge of Taxpayer Rights



The IRS relies largely on distribution of Publication 1, *Your Rights as a Taxpayer*, to inform taxpayers about their rights. As discussed below, with revisions Publication 1 can be an important vehicle for taxpayer education about their rights, but the IRS should also educate and inform taxpayers through its public website and with posters and brochures in IRS offices. Taxpayers prefer a variety of sources, according to a 2012 TAS study that asked a statistically representative nationwide sample of 8,911 U.S. taxpayers how they would like to learn about their rights.

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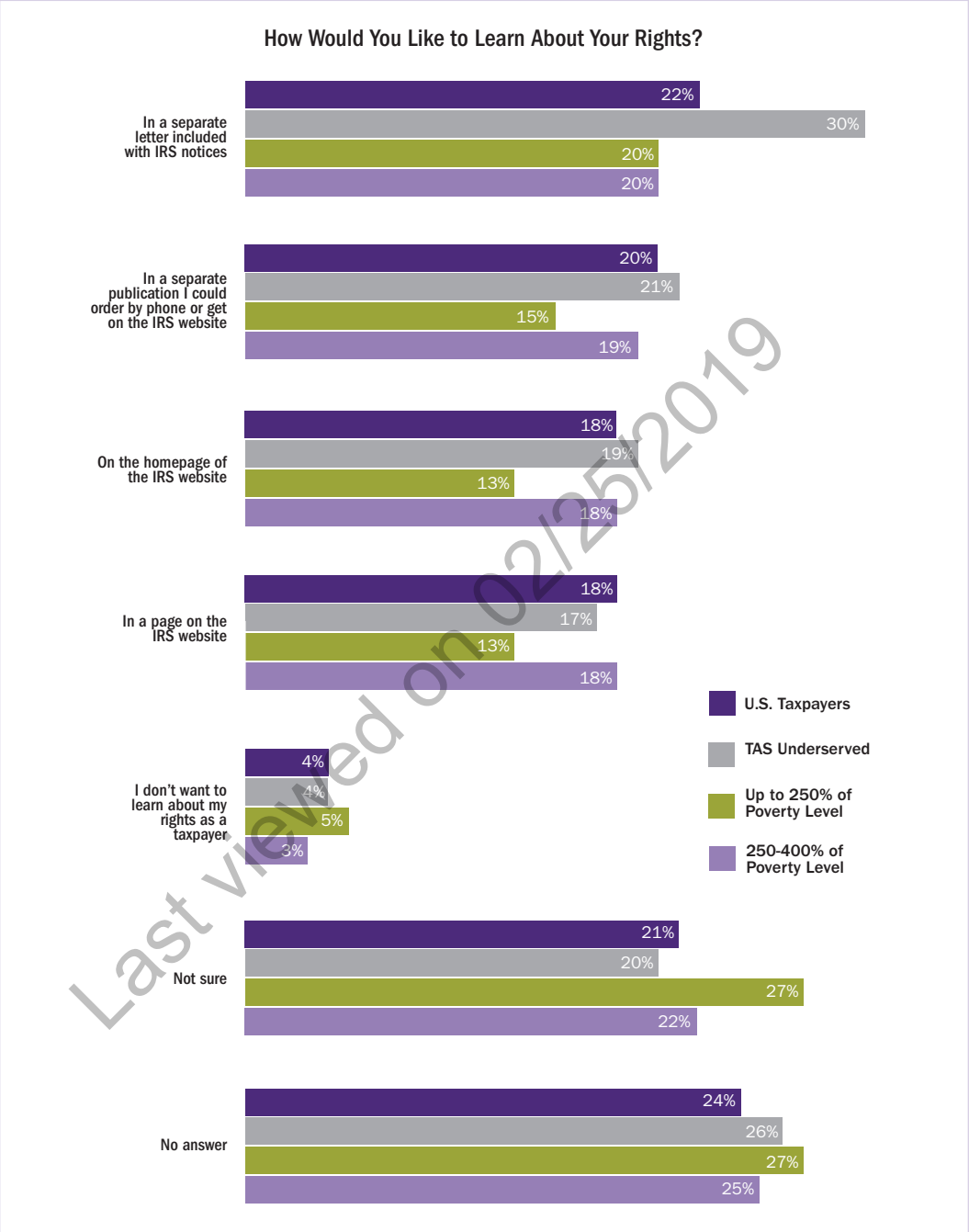
41 Forrester Research Inc., *The TAS Omnibus Analysis, from North American Technographics Omnibus Mail Survey*, Q2/Q3 2012, 19-20 (Sept. 17, 2012).

FIGURE 1.1.2, "How would you like to learn about your rights?"[42]



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Thus, taxpayers are best served if the IRS provides them with multiple channels of taxpayer rights information and education.

42 Forrester Research Inc., *The TAS Omnibus Analysis, from North American Technographics Omnibus Mail Survey*, Q2/Q3 2012, 21 (Sept. 17, 2012). "TAS underserved" refers to taxpayers who qualify for but do not seek TAS help with their tax problems. This survey was conducted only in English; TAS is seeking to administer it to Spanish-speaking taxpayers. See National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (*Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights*) 12-16 (Nov. 4, 2013), *available at* www.TaxpayerAdvocate.irs.gov/2013AnnualReport.

Recent TAS Focus Groups Confirm that Taxpayers Would Like to Know About Their Rights

In November 2013, a contractor for TAS conducted eight focus groups with taxpayers and tax preparers to evaluate the level of taxpayers' knowledge and understanding of their rights and responsibilities relating to federal taxes.[43] Specifically, the focus groups were designed to qualitatively assess:

- The extent of taxpayers' and preparers' knowledge (and desire to know) of taxpayer rights and responsibilities;
- How they would like to learn about their rights and responsibilities;
- From whom, when, where, and in what form would they like to receive this information;
- Their reaction to TAS's proposed TBOR;
- Their reaction to Publication 1 (both original version and a revised version developed by TAS);[44] and
- How they would change or improve this publication.

The report found that taxpayers had little knowledge of, but high interest in, the list of taxpayer rights in our proposed TBOR, and they reacted very positively to it overall.[45] One taxpayer from Los Angeles said:

> It summarizes it in one piece of paper, what everybody wants and needs to know about the IRS and that's rare.

Taxpayers were particularly happy to learn about the *right to challenge the IRS's position and be heard*;[46] the *right to appeal an IRS decision to an independent forum*;[47] and the *right to retain representation*.[48] Overall, taxpayers felt that learning about their rights made them view the IRS in a more favorable light.[49] On the other hand, they felt that publishing the rights alone would have little effect on tax compliance — which is consistent with the observation that it is *how* rights are protected and implemented that has the greatest impact on compliance. Among the rights they questioned, taxpayers found the *right to finality* and the *right to pay no more than the correct amount of tax* unclear. Significantly, they doubted the IRS's ability to fulfill the *right to quality service*.[50]

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43 The focus groups were conducted between November 18, 2013 and November 21, 2013 in four sites: East Rutherford, New Jersey; Chicago, Illinois; Dallas, Texas; and Los Angeles, California. At each site, the contractor conducted one focus group of taxpayers and one focus group of preparers. The taxpayers participating in the focus groups had filed taxes for the past three years, which included a mix of preparer-, professional, and self-prepared returns. Russell Research, *Final Report from a Focus Group Study of Taxpayer Rights & Responsibilities* (Dec. 6, 2013).

44 In the first Taxpayer Bill of Rights legislation (TBOR 1), Congress required the IRS to prepare a statement of taxpayer rights and IRS obligations and distribute it to taxpayers when contacting them regarding the determination of tax or collection of tax. Technical and Miscellaneous Revenue Act of 1988, Pub L. No. 100-67, § 6227, 102 Stat. 3342, 3730-31 (Nov. 10, 1988). Currently, the IRS outlines these rights for taxpayers in Publication 1, *Your Rights as a Taxpayer*.

45 *Id*. at 14.

46 "I've had some experience with the IRS…Like the right to appeal and be heard…There were some issues that I had challenged, and the IRS was overturned and I received full restitution." (Chicago taxpayer). *Id*. at 11.

47 "The one I like best is the right to appeal an IRS decision in an independent forum. I've been through that, so I know how important that was. I think all these are actually very important." (Los Angeles taxpayer). *Id*.

48 "The right to retain representation [is the most important right to me]…In theory they could call you in and have you and them (representation) there and that is basically that." (New Jersey taxpayer). *Id*.

49 "To me, I kind of like it. It looks like they're making an attempt [to be less intimidating]. Maybe they will be a little more fair." (Los Angeles taxpayer). *Id*.

50 "Seriously, if you don't have money to pay an accountant, do they provide quality service that you can go somewhere and have them do your taxes for you?" (New Jersey taxpayer). *Id*. at 10.

Overall, the taxpayers felt most of the responsibilities were "a given" and obvious.[51] Taxpayers had a negative reaction to two of the responsibilities, *to be honest*[52] and *to be courteous*.[53] The National Taxpayer Advocate will use these observations, as well as those from future focus groups, to revise our proposed explanations of rights and responsibilities.[54]

CONCLUSION

The Taxpayer Bill of Rights would reassure taxpayers that they have rights that the IRS must respect, reinforcing the social contract between taxpayers and the IRS. With the adoption of a TBOR, taxpayers may be more likely to perceive the IRS as fair and just, which may increase voluntary compliance. The IRS can make great strides toward protecting taxpayer rights through the adoption of a TBOR and making it the foundation for effective tax administration.

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RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt the Taxpayer Bill of Rights, including ten fundamental taxpayer rights and five taxpayer responsibilities.
2. Prominently display a link on the IRS.gov homepage ("Know Your Rights as a Taxpayer") to a taxpayer rights webpage, which will further link to specific explanations of taxpayer rights and responsibilities.
3. In collaboration with the National Taxpayer Advocate, post taxpayer rights language on the business operating division pages of IRS.gov that refers to TAS, Low Income Taxpayer Clinics, specific taxpayer rights and responsibilities and contains links to the U.S. Tax Court webpage, where appropriate.
4. Require all public- and taxpayer-facing IRS sites and offices to display a poster and brochures about the Taxpayer Bill of Rights, to be developed in collaboration with the National Taxpayer Advocate.
5. Require all IRS operating divisions and functions when proposing initiatives, including budget initiatives, to include in their business case justifications an analysis of the proposed operation in terms of the Taxpayer Bill of Rights.

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51 "I can't imagine that you wouldn't think you were responsible to provide accurate honest information…To me, that's a no-brainer." (Dallas taxpayer). *Id*. at 13.

52 "Obviously if you are not honest you are going to get audited or you could get audited." (New Jersey taxpayer). *Id*.

53 "Well then that shouldn't even be on there. It's common sense to be courteous." (Chicago taxpayer); "You better believe it. If there's anybody I'm going to be courteous, it's, you know, the IRS." (Chicago taxpayer); "That, I would definitely take out…every individual in this room as a professional working adult is professional and courteous." (Dallas taxpayer). *Id*.

54 For an in-depth discussion of the Taxpayer Advocate Service's revised Publication 1 initiative, see National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* 18 (Nov. 4, 2013), *available at* www.TaxpayerAdvocate.irs.gov/2013AnnualReport.

FIGURE 1.1.3, Updated Draft Version of Publication 1

TAXPAYER BILL OF RIGHTS

THE RIGHT TO...

- Be Informed
- Quality Service
- Pay No More than the Correct Amount of Tax
- Challenge the IRS's Position and Be Heard
- Appeal an IRS Decision in an Independent Forum
- Finality
- Privacy
- Confidentiality
- Retain Representation
- A Fair and Just Tax System, Including Access to the Taxpayer Advocate Service

Know Your Rights.

IRS

TAXPAYER ADVOCATE SERVICE
YOUR VOICE AT THE IRS

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Ten Taxpayer Rights

1 The Right to Be Informed

Taxpayers have the right to know what they need to do to comply with tax laws. They are entitled to clear explanations of the law and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

2 The Right to Quality Service

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.

3 The Right to Pay No More than the Correct Amount of Tax

Taxpayers have the right to pay only the amount of tax legally due and to have the IRS apply all tax payments properly.

4 The Right to Challenge the IRS's Position and Be Heard

Taxpayers have the right to raise objections and provide additional documentation in response to IRS actions or proposed actions, to expect that the IRS will consider their objections and documentation promptly and impartially, and to receive a written response if the IRS finds them insufficient.

5 The Right to Appeal an IRS Decision in an Independent Forum

Taxpayers are entitled to a prompt and impartial administrative appeal of IRS actions and have the right to receive a written response explaining the Appeals Division's decision. Taxpayers generally have the right to take their cases to court to challenge an adverse final determination.

6 The Right to Finality

Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the IRS has to audit a particular tax year. Taxpayers have the right to know when the IRS has finished an audit.

7 The Right to Privacy

Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and a collection due process hearing where applicable.

8 The Right to Confidentiality

Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect the IRS to investigate and take appropriate action against its employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

9 The Right to Retain Representation

Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to be told that if they cannot afford to hire a representative they may be eligible for assistance from a Low Income Taxpayer Clinic.

10 The Right to a Fair and Just Tax System, Including Access to the Taxpayer Advocate Service

Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers 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.

Five Taxpayer Responsibilities

1 The Responsibility to Be Honest

Taxpayers have the responsibility to report their income, deductions, and credits accurately according to the law; to answer all questions completely, accurately, and honestly; and to explain all relevant facts and circumstances when seeking guidance from the IRS.

2 The Responsibility to Provide Accurate Information

Taxpayers have the responsibility to answer all relevant questions completely and honestly, to provide all required information on a timely basis, and to explain all relevant facts and circumstances when seeking guidance from the IRS.

3 The Responsibility to Keep Records

Taxpayers have the responsibility to maintain adequate books and records to fulfill their tax obligations, preserve them during the time they may be subject to IRS inspection, and provide the IRS with access to those books and records when asked so the IRS can examine their tax liabilities to the extent required by law.

4 The Responsibility to Pay Taxes on Time

Taxpayers have the responsibility to pay the full amount of taxes they owe by the due date and to pay any legally correct additional assessments in full. If they cannot pay in full, they have the responsibility to comply with all terms of any full or partial payment plans the IRS agrees to accept.

5 The Responsibility to Be Courteous

Taxpayers have the responsibility to treat IRS personnel politely and with respect.

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MSP #2 IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance

DEFINITION OF PROBLEM

In fiscal terms, to be blunt, the mission of the IRS trumps the missions of all other federal agencies. The IRS's stated mission is to "[p]rovide 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."[1] If the IRS lacks adequate funding to do its job effectively, the government will have fewer dollars available to fund all federal programs, including national defense, Social Security, Medicare, Veterans' benefits, medical research, and disaster relief — or simply to reduce the deficit.

Since fiscal year (FY) 2010, the IRS budget has been cut by nearly eight percent.[2] Over the same period, inflation has risen by about six percent, further eroding the IRS's resources.[3] Because of these budget reductions, the IRS has been significantly hampered in its ability to provide "top quality service" and maintain effective enforcement programs that minimize noncompliance.

Consider that in FY 2013:

- The IRS received about 109 million telephone calls. Only 61 percent of calls seeking to reach a customer service representative got through, and those callers had to wait an average of 17.6 minutes on hold.[4]
- The IRS received about 8.4 million letters from taxpayers responding to proposed adjustments to their tax accounts.[5] At the end of the fiscal year, 53 percent of the correspondence in open inventory had not been answered within the timeframes the IRS itself has established.[6]
- The IRS is continuing a trend of reducing and in some cases eliminating services to taxpayers who visit any of its nearly 400 walk-in sites. Ten years ago, it answered more than 1.4 million tax-law questions at its walk-in sites. In FY 2014, the IRS will answer only "basic" tax law questions during the filing season (January through April), and it will not answer any tax law questions at all (even basic ones) beyond April, including questions from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.[7] This new policy applies to taxpayers who seek assistance with tax law questions by phone as well. In addition, the IRS will discontinue

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1 *See* IRS Policy Statement 1-1, IRM 1.2.10.1.1 (Dec. 18, 1993).

2 IRS Chief Financial Officer, Corporate Budget.

3 *See* Office of Management and Budget, *Fiscal Year 2014 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 215 (showing Gross Domestic Product and year-to-year increases in the GDP (Chained) Price Index). Data has been re-based from FY 2005 to FY 2010.

4 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2013). The Accounts Management phones lines (previously known as the Customer Account Services phone lines) receive the significant majority of taxpayer calls and are used by the IRS to compute its "Level of Service." In this discussion, all phone data pertains to the Accounts Management lines, except where otherwise noted. Calls to compliance phone lines and certain other categories of calls are excluded from this total.

5 IRS, Joint Operations Center, *Adjustments Inventory Reports: FY13 July-September Fiscal Year Comparison*.

6 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

7 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

In fiscal terms, to be blunt, the mission of the IRS trumps the missions of all other federal agencies…. If the IRS lacks adequate funding to do its job effectively, the government will have fewer dollars available to fund all federal programs, including national defense, Social Security, Medicare, Veterans' benefits, medical research, and disaster relief — or simply to reduce the deficit.

its longstanding practice of preparing tax returns for low income, elderly, and disabled taxpayers who seek help.[8]

- The IRS workforce has been reduced from nearly 95,000 full-time-equivalent employees in FY 2010 to about 87,000 in FY 2013, a decrease of eight percent.[9]
- The IRS training budget has been slashed from about $172 million in FY 2010 to about $22 million, a staggering 87 percent reduction.[10] Thus, the IRS not only has fewer employees than four years ago, but those who remain are less equipped to perform their jobs.[11]

Recent cuts to the IRS budget are shortsighted and counterproductive for two reasons.

- First, the requirement to pay taxes is generally the most significant burden a government imposes on its citizens. The National Taxpayer Advocate believes the government has a practical and a moral obligation to make compliance as simple and painless as possible. It is not acceptable that taxpayers seeking help cannot get through to the IRS nearly two-fifths of the time, and then when they do get through, they have to wait on hold for extended periods. The taxpaying public deserves better treatment.
- Second, each dollar appropriated for the IRS generates substantially more than one dollar in federal revenue. In FY 2013, the IRS collected about $2.86 trillion[12] on an appropriated budget of about $11.2 billion.[13] That translates to an average return-on-investment (ROI) of 255:1. The marginal ROI of additional funding will not be nearly so large, but virtually everyone who has studied the IRS budget has concluded that it is positive.

The reduction in taxpayer services is particularly concerning because the U.S. tax system is built on voluntary compliance. About 98 percent of the revenue collected by the IRS each year is paid timely and voluntarily. Only two percent comes from IRS enforcement actions.[14] The IRS's overriding goal is to

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8 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

9 IRS Chief Financial Officer, Corporate Budget. Some calculations in this section are affected by rounding. Percentage changes were computed using actual numbers rather than rounded numbers.

10 IRS Chief Financial Officer, Corporate Budget. For a discussion about the impact of training reductions, see Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission, infra*.

11 For a discussion about the importance of taxpayer rights training, see Most Serious Problem: *Taxpayer Rights: Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights, infra; see also* National Taxpayer Advocate Report to the Acting Commissioner of Internal Revenue, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration: Recommendations to Raise Taxpayer and Employee Awareness of Taxpayer Rights* (Nov. 4, 2013).

12 Government Accountability Office (GAO), GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 76 (Dec. 2013), *available at* http://www.gao.gov/products/GAO-14-169.

13 IRS Chief Financial Officer, Corporate Budget.

14 In FY 2013, the IRS collected about $2.86 trillion in revenue. GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 76 (Dec. 2013). Of that total, enforcement revenue accounted for $53.3 billion. *Id*. at 24.

maximize voluntary compliance, because voluntary compliance is much more cost efficient; with enforced compliance, the government must devote significant resources to detecting and collecting amounts that are not voluntarily reported or paid.[15] In addition, several studies published in Volume 2 of this report find that top-quality taxpayer service is a more significant driver of overall tax compliance than IRS enforcement actions.[16]

The main reason the IRS is underfunded is because the congressional budget rules were written with classic spending programs in mind — namely, a dollar spent is treated as increasing the budget deficit by one dollar. As the government's revenue collector, the IRS is the only significant exception to that rule — a dollar spent generates substantially more than one dollar in additional revenue and thus *reduces* the deficit.

To address this anomaly, the National Taxpayer Advocate recommended seven years ago that Congress adopt new procedures to set the IRS's budget.[17] Because any change to the budget rules would require study and ultimately concurrence by the House and Senate budget committees, appropriations committees, potentially tax-writing committees, and other key players, making such a change will require a concerted effort.

The effects of applying across-the-board budget reductions to the IRS over the past three years underscore the importance of making this concerted effort. If the government continues to underserve its taxpayers, it risks further undermining public confidence in the fairness and integrity of the tax system, and thereby reducing tax compliance.

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ANALYSIS OF PROBLEM

Over the past ten years, the workload of the IRS has increased significantly. The upward trend has continued during the last three years. Since FY 2010, however, IRS funding has declined. The combination of more work and less funding predictably has impaired the IRS's ability both to meet taxpayer needs and to collect tax.

A. Taxpayer Services: More Work and Less Funding Means Taxpayer Needs Are Not Being Met.

1. More Work

The increase in the IRS's workload can be demonstrated in several ways. For one, the IRS is receiving significantly more individual and business tax returns today than ten years ago.

For individual income tax returns, the number rose from about 131.3 million in FY 2004 to about 146.0 million in FY 2013, an increase of 11 percent. About one-third of that increase has occurred since FY 2010, when about 141.2 million returns were filed.[18]

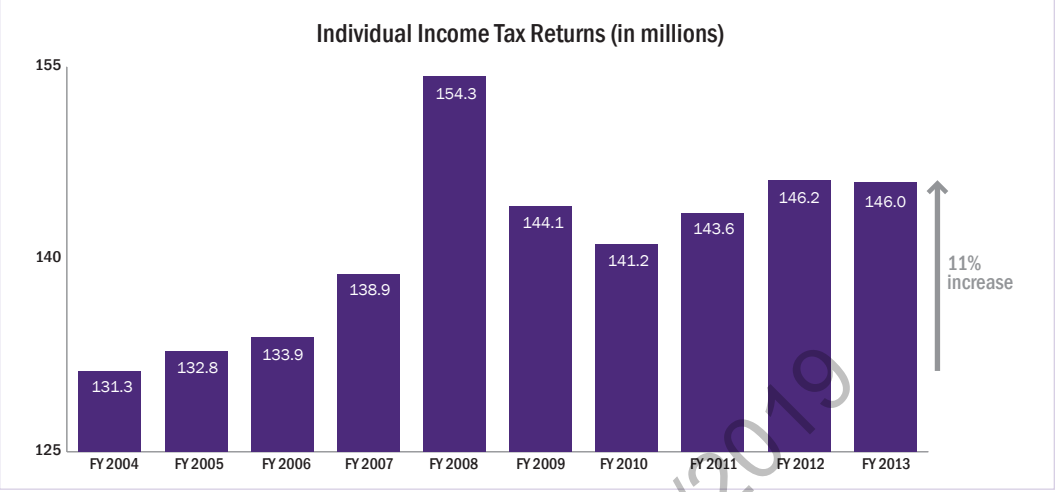
15 See IRS Strategic Plan 2009-2013 ("Goal 1: Improve service to make voluntary compliance easier").

16 See Volume 2: *Research Study: Small Business Compliance: Further Analysis of Influential Factors*, *infra*; Research Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*, *infra*.

17 See National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

18 IRS Data Books, Table 2, for FY 2004 through FY 2012. Data for FY 2013 was provided by the IRS Office of Research, Analysis, and Statistics.

FIGURE 1.2.1



For business income tax returns, which include the returns of C corporations, S corporations, and partnerships, the number rose from about 8.6 million in FY 2004 to about 10.5 million in FY 2013, an increase of 23 percent.[19]

FIGURE 1.2.2

More tax returns mean more work for the IRS. The IRS must answer more taxpayer phone calls, process the additional returns, conduct more compliance checks, and in some cases conduct more audits or take more collection actions. To maintain its audit rate, the IRS would have to examine these additional returns at the same rate it examines other returns. Thus, an increase of ten percent in individual returns and 23 percent in business returns should translate to roughly the same percentage increases in taxpayer service demands, audits, and other processing and compliance activities.

19 IRS Data Books, Table 2, for FY 2004 through FY 2012. Data for FY 2013 was provided by the IRS Office of Research, Analysis, and Statistics.

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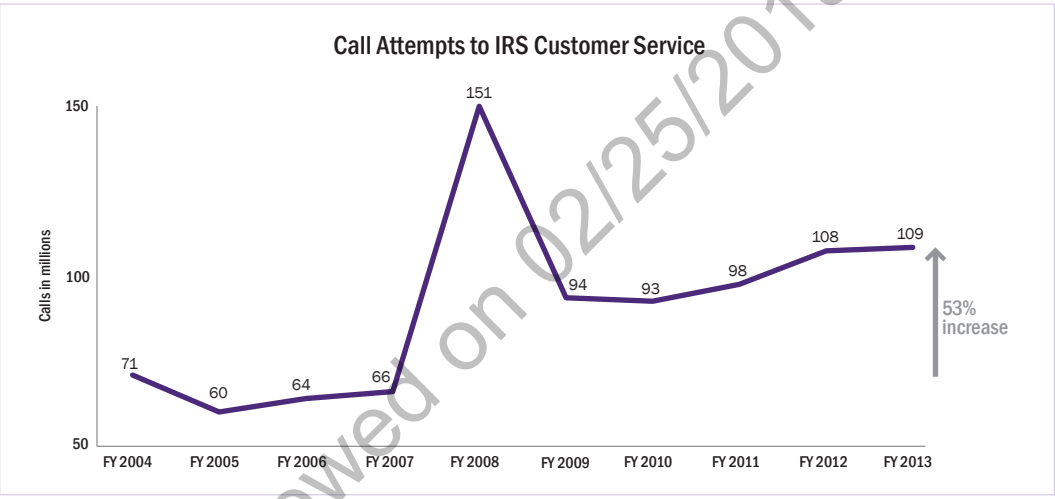
(As these charts and others in this section show, the increase in the IRS's workload has followed a fairly consistent path, with the notable exception of FY 2008, when the IRS was charged with administering the Economic Stimulus Act and was deluged with an unprecedented number of tax returns and phone calls.[20])

Another indicator of the workload increase is the number of phone calls the IRS receives, which has grown substantially.

From FY 2004 to FY 2013, the number of calls received on the IRS's Accounts Management telephone lines rose from about 71 million to about 109 million, or 53 percent. Notably, more than 40 percent of that increase has occurred since FY 2010, when the IRS received about 93 million calls.[21]

FIGURE 1.2.3



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Answering taxpayer telephone calls effectively is labor-intensive. While some callers can be assisted through automation, tens of millions of taxpayers want to speak with an IRS customer service representative (CSR) each year. In FY 2013, CSRs handled some 30 million calls on the Accounts Management lines and another nine million phone calls in other parts of the agency.[22] Nearly 20 million calls to CSRs went unanswered because the IRS does not have enough employees to handle them. There is simply no way for the IRS to deal with this large and increasing volume of work without the funding to hire more CSRs.

20 The Economic Stimulus Act of 2008 required the IRS to make one-time payments to nearly 119 million taxpayers. *See* IRS News Release, IR-2009-10, *IRS Offers Tips to Avoid Recovery Rebate Credit Confusion* (Jan. 30, 2009), *at* http://www.irs.gov/uac/IRS-Offers-Tips-to-Avoid-Recovery-Rebate-Credit-Confusion. The procedures for claiming these "stimulus payments" required millions of individuals otherwise without a filing obligation to file a tax return. The stimulus payments were paid out over several months, and and taxpayers who did not receive their payments early in the process inundated the IRS with telephone calls. As a result, many IRS measures reflect the effects of this one-time event. The number of calls the IRS received on its Accounts Management telephone lines more than doubled, from FY 2007 to FY 2008 (from 66 million to 151 million), and the number of Form 1040-series returns jumped from 139 million to 154 million — the highest annual totals in the past ten years and probably ever.

21 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2004 through FY 2013).

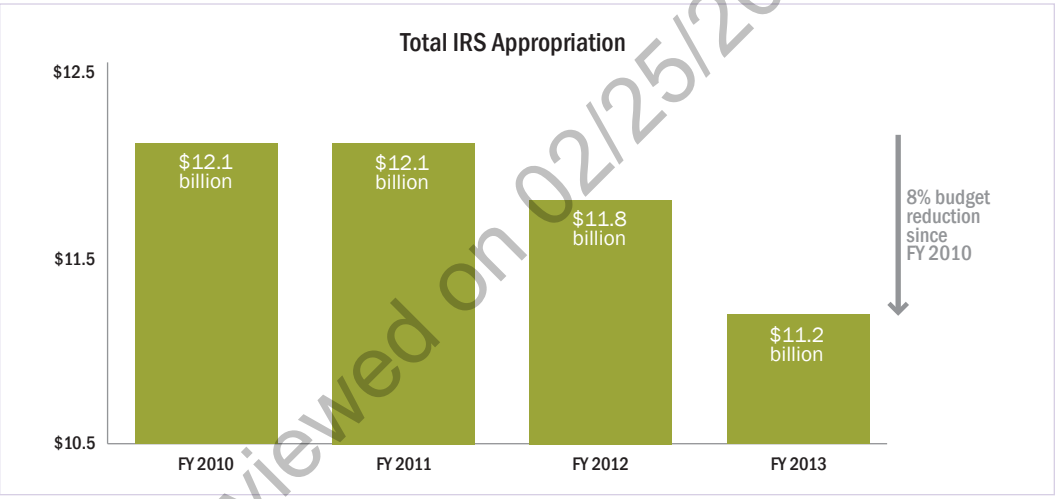
22 *Id.*

During the last few years, the IRS has also had to address a huge spike in tax-related identity theft and refund fraud. In FY 2013, the IRS assigned more than 3,000 employees to work on identity theft cases.[23] Because of the harm identity theft victims suffer, that was the right call to make.[24] But for an overworked agency absorbing budget cuts, the reassignment of so many employees has meant other work in crucial taxpayer service and enforcement areas could not be done.[25]

2. Less Funding and Reduced Resources

Since FY 2010, the IRS's budget has been reduced from about $12.1 billion to about $11.2 billion, or eight percent.[26] Over the FY 2010 through FY 2013 period, inflation has increased by an estimated six percent, and it is expected to increase by an additional two percent in FY 2014, further impacting IRS resources.[27]

FIGURE 1.2.4



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These funding reductions translate to fewer employees and less training. The majority of the IRS's costs are employee-related, so not surprisingly, the eight percent drop in the budget has required a reduction in the number of full-time equivalent IRS employees from nearly 95,000 to some 87,000, or eight percent.[28]

23 *Fiscal Year 2014 Treasury and IRS Budget: Hearing Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 113th Cong. (2013) (statement of Steven T. Miller, Acting Commissioner of Internal Revenue).

24 For a discussion about tax-related identity theft, see Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers, infra*.

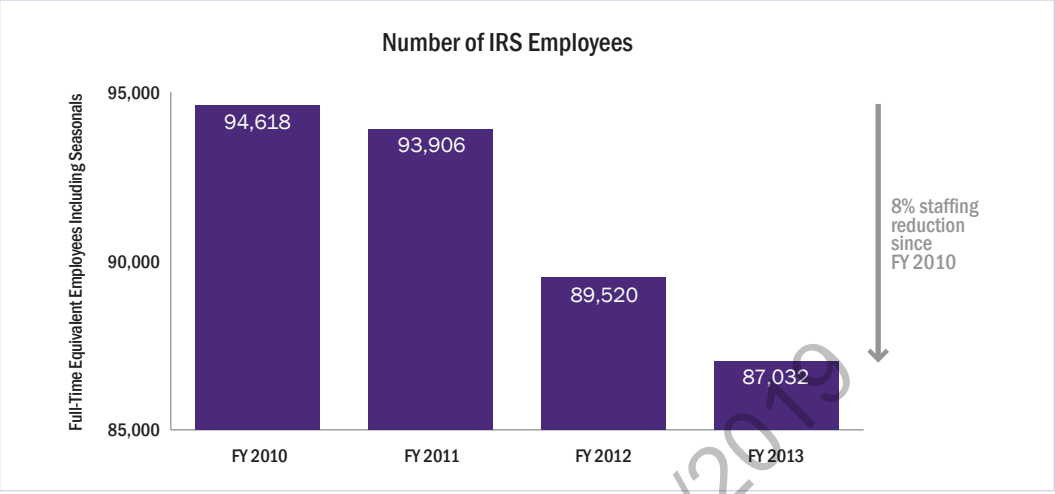
25 See Danny Werfel, Acting Commissioner of Internal Revenue, Address at the American Institute of Certified Public Accountants 2013 National Tax Conference (Nov. 5, 2013).

26 IRS Chief Financial Officer, Corporate Budget.

27 See Office of Management and Budget, *Fiscal Year 2014 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 215 (showing Gross Domestic Product and year-to-year increases in the GDP (Chained) Price Index). Data has been re-based from FY 2005 to FY 2010. Because of the federal pay freeze, it is likely that the IRS's costs have risen by less than the amount of inflation. However, many employees continued to receive within-grade step increases each year (which translate to increases in pay), the costs of non-salary benefits continued to rise, and non-employee costs continued to rise as well. Thus, inflation since FY 2010 has had a significant impact on the IRS budget beyond the eight percent reduction in nominal dollars shown in the chart above.

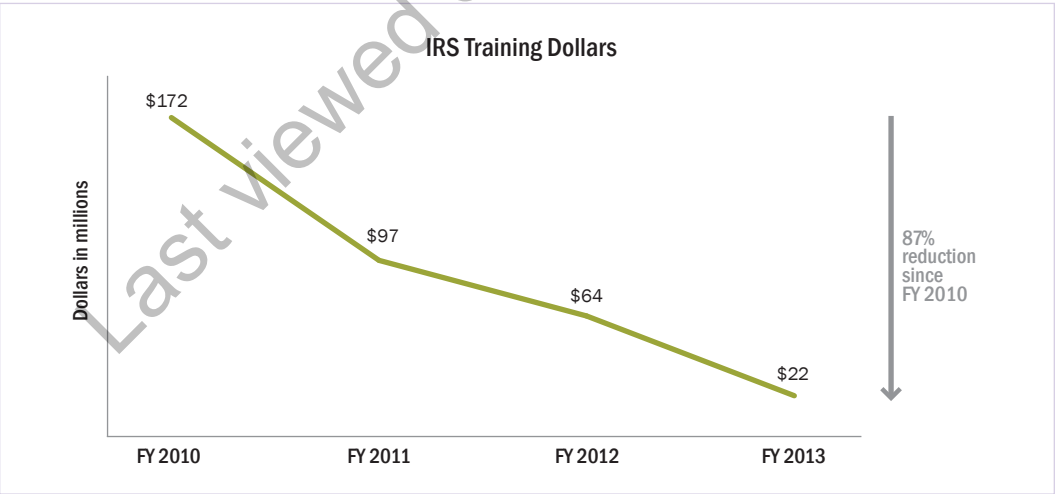
28 IRS Chief Financial Officer, Corporate Budget. This total includes seasonal employees apportioned on a full-time-equivalent basis.

FIGURE 1.2.5



Like most agencies, the IRS has been reluctant to terminate employees other than through attrition, so it has cut costs in other areas. One of the largest and most concerning cuts has been in training. From FY 2010 to FY 2013, the IRS reduced its training budget by 87 percent, from about $172 million to about $22 million.

FIGURE 1.2.6



A large complex organization cannot possibly cut its training budget by 87 percent without undermining the ability of its staff to perform their jobs effectively. This is particularly true at the IRS, where employees must administer an extraordinarily complex tax code and apply it to 146 million individual taxpayers and more than ten million business taxpayers, many of which present unique facts or special circumstances. If IRS customer service employees are not well trained, taxpayers calling for help are more likely to receive incorrect information or no information. If IRS enforcement employees are not well trained, auditors may make inappropriate adjustments and assessments, and collection employees may issue inappropriate levies or file inappropriate liens.

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[T]he requirement to pay taxes is generally the most significant burden a government imposes on its citizens. The National Taxpayer Advocate believes the government has a practical and a moral obligation to make compliance as simple and painless as possible. It is not acceptable that taxpayers seeking help cannot get through to the IRS nearly two-fifths of the time, and then when they do get through, they have to wait on hold for extended periods. The taxpaying public deserves better treatment.

The stakes for taxpayers are simply too high to allow the IRS workforce to be undertrained.[29] In most years, workforce attrition exceeds five percent.[30] When employees leave, the IRS must identify existing employees or find new ones to pick up the slack — sometimes through internal promotions, sometimes with limited new hires. In addition, the IRS employed more than 11,000 seasonal employees during the last filing season and for other limited tasks throughout the year.[31] Even employees who do not change jobs face constant changes in the nature of their workloads. For example, as the problem of tax-related identity theft increased, the IRS trained at least 37,000 employees on various aspects of victim assistance.[32]

The IRS has tried to train employees at lower cost by replacing in-person training with remote or virtual instruction.[33] That is a constructive approach — to a point. Some virtual training can be effective. But other types of training, such as teaching taxpayer-facing employees how to interview taxpayers and working through case studies, do not lend themselves well to a remote setting. In addition, employees of many IRS functions are spread around the country, and it is difficult for managers to do their jobs properly if they cannot meet periodically — face to face — with the employees they supervise.

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3. Taxpayer Needs Are Not Being Met

The combination of more work and less funding has left the IRS stretched too thin, compromising its capacity to meet taxpayer needs.

a. Taxpayer Telephone Calls

The IRS's ability to field taxpayer telephone calls has declined markedly over the past decade. In FY 2004, the IRS answered 87 percent of calls from taxpayers seeking to speak with a CSR (which, in IRS parlance, is referred to as the "Level of Service" or "LOS"). In FY 2013, the IRS answered only 61 percent of such calls, a reduction of 26 percentage points, or 30 percent, in the LOS. Meanwhile, the time successful taxpayers waited on hold rose from 2.6 minutes to 17.6 minutes, a nearly six-fold increase.[34]

29 For a discussion about the impact of training reductions, see Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission, infra*; Most Serious Problem: *Taxpayer Rights: Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights*, *infra*.

30 *See, e.g.*, Partnership for Public Service, *Beneath the Surface: Understanding Attrition at Your Agency and Why It Matters* 3 (Nov. 2010) (finding that attrition in the federal government, although "relatively low," was 7.6 percent in FY 2008 and 5.85 percent in FY 2009).

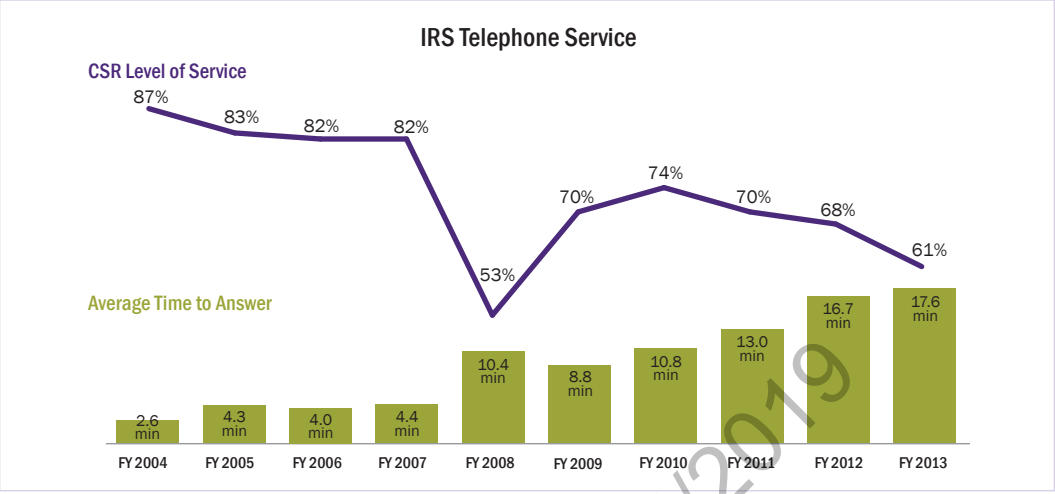
31 See data compiled for IRS 2013 Data Book, Table 30 (not yet published). This total reflects seasonal employees placed on a full-time-equivalent basis. The actual number of employees was higher.

32 *Fiscal Year 2014 Treasury and IRS Budget: Hearing Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 113th Cong. (2013) (statement of Steven T. Miller, Acting Commissioner of Internal Revenue) (stating that the IRS has assigned 3,000 employees to work on identity theft and has trained 37,000 employees who work with taxpayers to recognize identity theft and assist victims).

33 See Danny Werfel, Acting Commissioner of Internal Revenue, Address at the American Institute of Certified Public Accountants 2013 National Tax Conference (Nov. 5, 2013) (stating that the IRS has "expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel").

34 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2004 through FY 2013).

FIGURE 1.2.7



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While the IRS's decline in the LOS and increase in hold times have been a long-term trend, it should be noted that a significant portion of the decline has occurred since FY 2010. Since FY 2010, the LOS has declined by 18 percent (from 74 percent to 61 percent) and the average hold time has increased by 63 percent (from 10.8 minutes to 17.6 minutes).

To try to improve its LOS, the IRS recently announced several "service changes" for FY 2014. During the filing season (January through April), it will answer only "basic" tax law questions; it will not answer "more detailed" questions. After April, it will not answer any tax law questions (even basic ones), including from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.[35] At the risk of vast understatement, it is a sad state of affairs when the government writes tax laws as complex as ours — and then is unable to answer any questions beyond "basic" ones from baffled citizens who are doing their best to comply.

b. Taxpayer Correspondence

The IRS's ability to timely process taxpayer correspondence has taken a similar hit. When the IRS sends a taxpayer a notice proposing to increase his or her tax liability, it typically gives the taxpayer an opportunity to present an explanation or documentation supporting the position taken on the return. Each year, the IRS typically receives around ten million taxpayer responses, known collectively as the "adjustments inventory."[36] The IRS has established timeframes for processing taxpayer correspondence, generally 45 days. During the final week of FY 2004, the IRS failed to process 12 percent of its adjustments correspondence within its timeframes. During the final week of FY 2013, the IRS was unable to process 53 percent of its adjustments correspondence within the timeframes.[37]

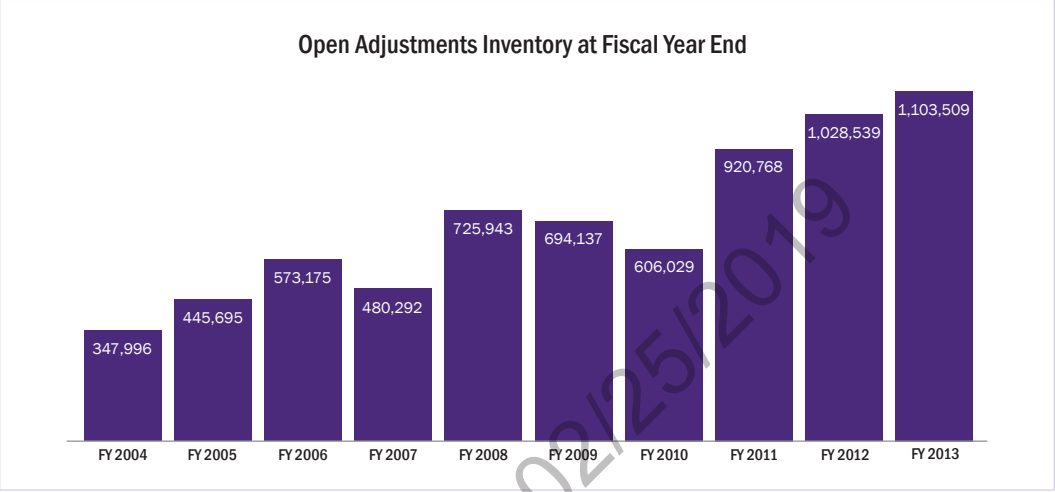
35 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

36 IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2004 through FY 2013)*. In FY 2013, receipts in the Adjustments Inventory were about 8.4 million, as compared with 10.4 million in FY 2012. We are not certain why the number declined. The Adjustments Inventory is one component of the Accounts Management function's overall Paper Inventory. In FY 2013, receipts in the Paper Inventory were about 20.8 million, and the percentage classified as overage at year-end was 47 percent. IRS, Joint Operations Center, *Account Management Information Report (AMIR) – National Summary* (week ending Sept. 28, 2013).

37 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

As a corollary, the number of pending pieces of adjustments correspondence in open inventory increased as well. At the end of FY 2004, open inventory stood at about 348,000 letters.[38] At the end of FY 2013, it consisted of about 1.1 million letters.[39]

FIGURE 1.2.8



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As with telephone performance, correspondence performance has declined since FY 2010. Comparing the final week of FY 2010 with the final week of FY 2013, the percentage of overage correspondence rose from 28 percent to 53 percent, and open inventory grew from about 606,000 to about 1.1 million — in both cases almost doubling.[40]

c. Taxpayer Walk-In Assistance

At the same time that taxpayers have encountered greater difficulty communicating with the IRS by phone and mail, their opportunities to communicate with the IRS in person have also been limited. As an alternative to telephone or correspondence interaction, the IRS maintains walk-in sites known as Taxpayer Assistance Centers, or "TACs." The TACs are designed to provide a "local presence." As we reported earlier this year, the number of TACs declined from 400 to 392 between the start of the 2012 and 2013 filing seasons, and the number of TACs with just one employee increased from 48 to 65.[41] TACs with one employee are subject to unexpected closure due to employee absence and subject to extended wait times when there are more-than-projected taxpayer visits.

We noted above that the IRS has adopted a new policy of declining to answer many tax-law questions — notably, any questions beyond "basic" ones — on its toll-free telephone lines. The same policy applies to

38 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 30, 2004).

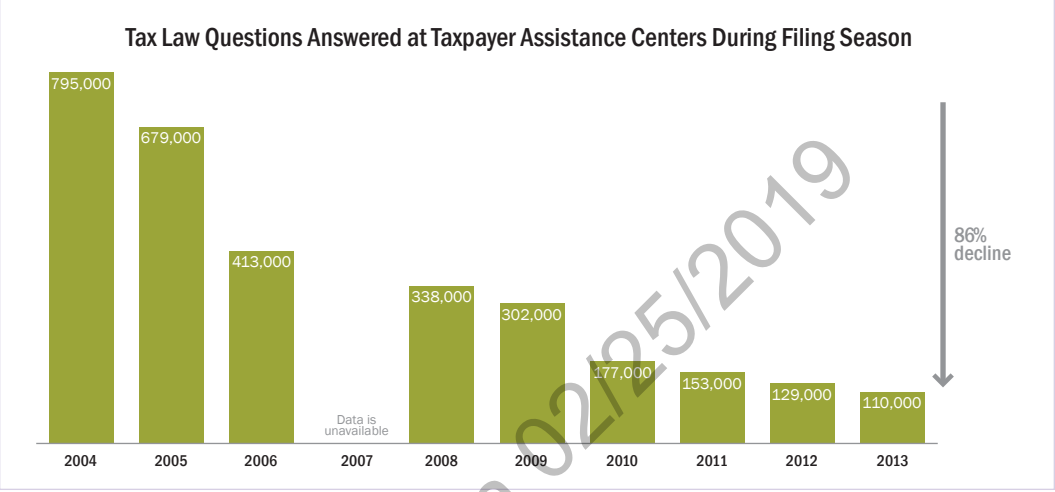
39 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

40 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Oct. 2, 2010); IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 28, 2013).

41 For more detail, see National Taxpayer Advocate FY 2014 Objectives Report to Congress at 59.

the TACs.[42] This continues an unfortunate trend of service reductions for taxpayers who either do not have Internet access or otherwise require or prefer in-person assistance. According to data compiled by the GAO, the number of tax-law questions answered in the TACs over the last ten years during the filing season has declined by 86 percent — from about 795,000 questions to 110,000.[43]

FIGURE 1.2.9



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The annual GAO filing season reports do not list the number of tax-law questions outside the filing season, but the numbers are significant. In FY 2004, for example, IRS data indicate that in addition to handling some 795,000 tax-law questions during the filing season, the IRS handled about 638,000 tax-law questions after the filing season. Thus, 45 percent of the 1.433 million questions received came outside the filing season.[44] None of those 638,000 questions would be answered under the IRS's new policy. It should be emphasized that the reduction in tax-law questions is not necessarily a function of reduced demand. Rather, the IRS has reduced TAC staffing and reduced the scope of the questions it is willing to answer, and wait times have often been unreasonably long. As a consequence, many taxpayers have probably given up.

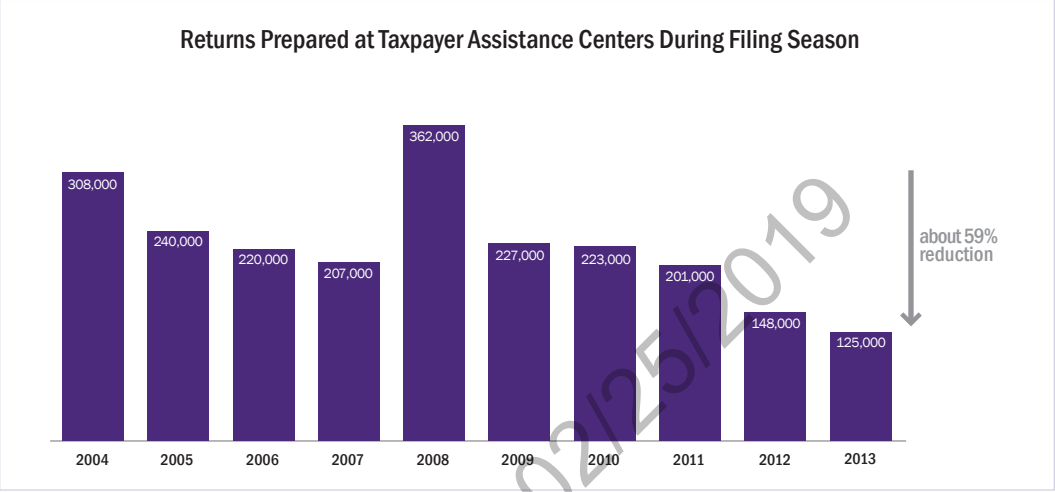
42 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

43 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-08-38, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated* 27-28 (Nov. 2007); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006). TAS does not have data for 2007.

44 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*). TAS does not have data on tax-law questions asked outside the filing season for more recent years.

Historically, the TACs have also prepared tax returns for taxpayers seeking assistance, particularly low income, elderly, and disabled taxpayers. According to the GAO filing season reports, the number of returns prepared during the filing season over the past decade has declined by 59 percent.[45]

FIGURE 1.2.10



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As with tax-law questions, data covering solely the filing season understates the assistance the IRS has provided to taxpayers. In FY 2004, IRS data indicates that in addition to preparing some 308,000 returns during the filing season, the IRS prepared an additional 168,000 returns after the filing season. Thus, roughly 35 percent of the returns prepared by the TACs were prepared after April 15.[46] But with dwindling resources, the IRS has been placing increasing limits on return preparation assistance, and in its recent announcement, it made clear it will discontinue *all* return preparation assistance at the TACs beginning this filing season.[47]

d. Local Availability of Enforcement Personnel

The "local presence" of enforcement personnel has also declined. From FY 2010 through FY 2013, the number of Revenue Agents, who conduct field audits, decreased by 12 percent (from 13,879 to 12,270). The number of Revenue Officers, who perform field collection, declined by 21 percent (from 6,042 to 4,748).[48]

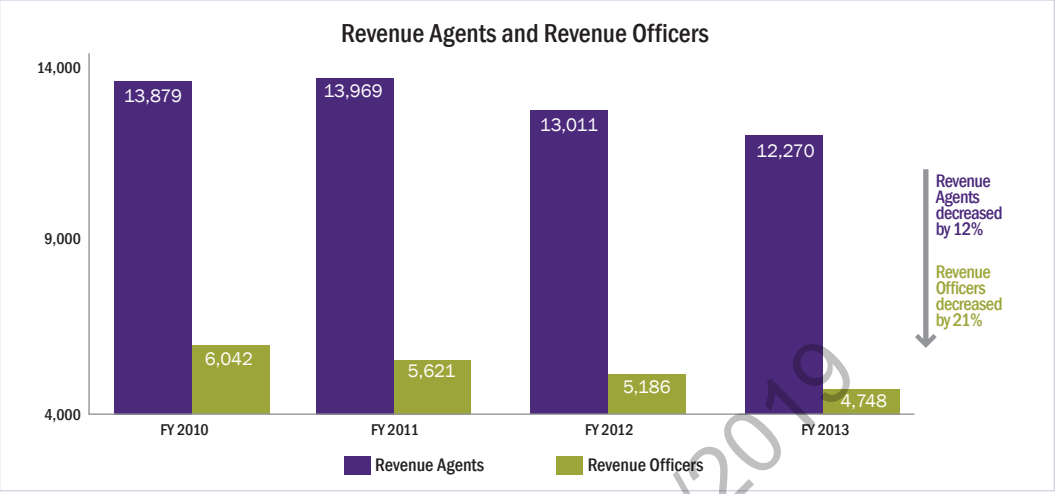
45 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-08-38, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated* 27-28 (Nov. 2007); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006); GAO, GAO-05-67, *Tax Administration: IRS Improved Performance in the 2004 Filing Season, But Better Data on the Quality of Some Services Are Needed* 18 (Nov. 2004). The GAO filing season reports do not provide a total for 2007. However, the report on the 2007 filing season said the number of TAC-prepared returns was almost 74 percent less than the number of TAC-prepared returns in 2001, and the report on the 2004 filing season said the number of TAC-prepared returns in 2001 was about 790,000. We therefore have provided an approximate total for 2007 in the chart above.

46 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*).

47 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

48 IRS Data Books, Table 30.

FIGURE 1.2.11



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In addition, the number of Appeals Officers, with whom taxpayers historically have had the option of meeting personally, declined by four percent (from 847 to 811). Of particular concern, many taxpayers no longer have the practical option of meeting with Appeals Officers personally. Eleven states and Puerto Rico have no Appeals or Settlement Officers with a post-of-duty within their geographic borders.[49]

We find the sharp reduction in local enforcement personnel concerning. While no taxpayer wants to be audited or face collection action, it is important that taxpayers who find themselves in that position have the option of talking with an IRS employee face-to-face. On audit, a taxpayer may have documentation that is difficult to mail in and requires a conversation to explain. In collection, a taxpayer may have special circumstances or face hardships that are obvious in person but difficult to convey by email or over the phone.

A local presence is also important because economic conditions and types of noncompliance vary from community to community. A Revenue Officer (RO) who lives in a community typically is better equipped than employees in a centralized site to determine how to work with a delinquent taxpayer claiming financial hardship. The RO may, for example, know that a large local employer has just laid off workers or that a payroll service provider who kept payrolls for small businesses was just arrested for misappropriating funds. In Volume 2 of this report, we publish a study showing that ROs generally are more effective than the Automated Collection System in resolving employment tax delinquencies.[50]

49 IRS, *Discovery Directory* (searched on Dec. 30, 2013). Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, Rhode Island, South Dakota, Vermont, Wyoming, and Puerto Rico are not listed as having either an Appeals Officer or a Settlement Officer. Settlement Officers hold Collection Due Process hearings under IRC §§ 6320 and 6330, and hear appeals of installment agreement denials and offer in compromise rejections under IRC § 7122(e). The IRS Restructuring and Reform Act of 1998 directed, among other things, that the Office of Appeals ensure that an Appeals Officer is regularly available within each state. *See* RRA 98 §§ 1001(a)(4); 3465(b). In recent years, the Office of Appeals has eliminated offices in some states and substituted a system of traveling Appeals Officers. Under this system, visits may not be sufficiently frequent or sufficiently spread throughout the state to make meetings accessible to taxpayers.

50 *See* Volume 2: *Research Study: A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*, *infra*.

The bottom line is that reduced funding has left the IRS substantially less able to assist taxpayers across all service platforms other than the Internet — by phone, by mail, and in person.[51]

B. Revenue Collection: Reduced Funding Means Reduced Revenue Collection and a Larger Budget Deficit.

The reduction in the IRS's budget since FY 2013 has generally been made pursuant to government-wide cuts designed to reduce the imbalance between federal spending and federal revenue. However, the logic behind budget cuts simply does not apply to the funding of the IRS. The IRS collects more than 90 percent of federal revenue.[52] As noted above, the IRS in FY 2013 took in about $2.86 trillion[53] on an appropriated budget of about $11.2 billion,[54] which translates to an average return-on-investment of 255:1. While the marginal ROI of additional funding will not be nearly so large, virtually everyone who has studied the IRS budget has concluded that the ROI of additional funding is positive. This includes the most recent four IRS commissioners (two appointed by Democratic Presidents and two appointed by Republican Presidents).

At his confirmation hearing in December, IRS Commissioner John Koskinen said:

> [W]e need to solve the funding problem of the IRS. This is not just my opinion. I have met with every IRS Commissioner from the past 20 years and the consensus was that a major challenge and constraint was the funding limitations they faced. This is a view shared today by the IRS Oversight Board, the Taxpayer Advocate and, most recently, the Treasury Inspector General for Tax Administration (TIGTA) and the Internal Revenue Service Advisory Council. As a TIGTA report this fall noted, the government has saved $1 billion in cuts to the IRS budget and lost $8 billion in compliance revenues.
>
> I don't know any organization in my 20 years of experience in the private sector that has said "I think I'll take my revenue operation and starve it for funds to see how it does." The IRS will have 11,000 fewer people working during this upcoming filing season while processing the largest number of returns in its history. I don't care how efficient you become, that is not a recipe for success or improved compliance and taxpayer service.
>
> This is not a new message. It has been delivered before. We often think that a discussion about a problem means we have dealt with it. Let me just say

Because the IRS is the federal government's Accounts Receivable Department and generates a substantially positive return on investment, it is self-defeating to treat the agency like a pure spending program. With most spending programs, a dollar spent is simply a dollar spent from a budget perspective. With the IRS, a dollar spent generates many dollars in additional revenue.

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51 In an effort to reduce costs, the IRS has been trying for years to persuade taxpayers to make greater use of the Internet in the hope it can reduce taxpayer demand for more costly telephone and walk-in services. While Internet usage has indeed increased, the 54 percent increase in telephone calls from taxpayers seeking to reach a CSR over the past decade demonstrates that the need for personal contact, far from decreasing, has risen substantially at the same time.

52 *See* GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 26 (Dec. 2013).

53 *Id*. at 76.

54 IRS Chief Financial Officer, Corporate Budget.

> that we have not dealt with the problem and it is not going away. I look forward to working with you to find a solution.[55]

This issue arises because the federal budgeting rules generally treat the IRS in the same manner as all other federal agencies, giving it no "credit" for the revenue it collects. Once the House and Senate Appropriations Financial Services and General Government subcommittees receive their "Section 302(b) allocations" for the upcoming fiscal year, funding all of the agencies under their jurisdiction essentially becomes a zero-sum game — each dollar allocated to one agency reduces the pool of funds available for others.[56]

As we have noted in prior reports, this procedure makes little sense when applied to the IRS. For virtually every other spending program, a dollar spent is just that — it increases the budget deficit by one dollar. But a dollar spent on the IRS generates substantially more than one dollar in return — it reduces the budget deficit.

If the Chief Executive Officer of a Fortune 500 company were told that each dollar allocated to his company's Accounts Receivable Department would generate multiple dollars in return, it is difficult to see how the CEO would keep his job if he chose not to provide the department with the funding it needed. Yet that is essentially what has been happening with respect to IRS funding for years, and as Commissioner Koskinen indicated, there has been some discussion but little effort to fix this obvious problem.

In the National Taxpayer Advocate's 2006 Annual Report to Congress, we discussed the IRS funding challenge in detail and recommended, among other things, that Congress consider revising its budget rules in a manner that allows the relevant congressional committees simply to set IRS funding at whatever level they believe will maximize tax compliance, particularly voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.[57]

In the course of developing and presenting that recommendation, the National Taxpayer Advocate or her senior advisor met with 14 separate congressional staffs — the House and Senate majority and minority staffs of the appropriations committees, budget committees, and tax-writing committees as well as tax counsel for the House and Senate majority leaders. In our discussions, there appeared to be no disagreement with the premise that the IRS generates a positive return on investment and is underfunded. However, we were repeatedly told that creating a new set of rules to establish IRS funding levels would be a "heavy lift" and would raise jurisdictional issues that have to be worked through.

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55 *Hearing to Consider the Nomination of John Andrew Koskinen to Be Commissioner of Internal Revenue, Hearing Before the S. Comm. on Finance*, 113th Cong. (Dec. 10-11, 2013) (citing Treasury Inspector General for Tax Administration, Ref. No. 2013-30-078, *Trends in Compliance Activities Through Fiscal Year 2012* (Aug. 2013)). *See also* Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 278 (2005) ("When I talked to business friends about my job at the IRS, they were always surprised when I said that the most intractable part of the job, by far, was dealing with the IRS budget. The reaction was usually 'Why should that be a problem? If you need a little money to bring in a lot of money, why wouldn't you be able to get it?'").

56 *See* Congressional Budget and Impoundment Control Act, Pub. L. No. 93-344, § 302(b)(1), 88 Stat. 297, 308 (1974) (providing that the Appropriations Committee of each House shall subdivide its allocation of funding under the annual budget resolution among its subcommittees). The "program integrity cap adjustment" mechanism, which we discuss in the text below, is a limited but in our view flawed exception to this rule.

57 *See* National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*).

In light of the IRS's increasing inability to meet the needs of the taxpaying public, we submit that the time for the "heavy lift" is now. Not only are cuts to the IRS budget harmful from a taxpayer service perspective, but to the extent they are designed to reduce the budget deficit, they are self-defeating.

C. The "Program Integrity Cap Adjustment" Mechanism Has Significant Drawbacks.

In a partial attempt to provide the IRS with additional funding within the existing budget rules, several Appropriations acts in recent years have given the IRS more funding by using a mechanism known as a "program integrity cap adjustment." Under this mechanism, new funding appropriated for IRS *enforcement* programs generally does not count against otherwise applicable spending ceilings provided:

1. The IRS's existing enforcement base is fully funded; and
2. A determination is made that the proposed additional expenditures will generate an ROI of greater than 1:1 (*i.e.,* the additional expenditures will increase federal revenue on a net basis).

For FY 2014, the Administration's budget proposal recommended a change to the Balanced Budget and Emergency Deficit Control Act of 1985 to provide program integrity cap adjustments for the next ten years.[58] While this cap adjustment mechanism may provide an easier path to providing the IRS with more resources than a fundamental change in congressional budget rules, we are concerned that taxpayer service activities have been excluded from this enhanced funding mechanism in the past and would continue to be excluded under the Administration's proposal. The rationale has been that the IRS can measure the direct ROI of its enforcement activities — *i.e.,* it can compute to the dollar the amounts collected by its Examination, Collection, and document-matching functions — but cannot quantify the ROI of taxpayer services. Thus, it is not possible to document whether or to what extent its taxpayer services generate an ROI greater than 1:1.

Creating a mechanism that allows more funding for enforcement actions, while excluding taxpayer service activities like outreach and education, would be a mistake for two reasons. First, common sense tells us that taxpayer services are a significant driver of tax compliance and generate a very high ROI. Publishing tax forms and instructions, conducting outreach and education, assisting taxpayers, tax preparers, and tax-software manufacturers, and otherwise administering the tax filing season are absolute prerequisites for tax compliance. In general, the ROI of these service activities is probably greater than the ROI of enforcement actions.

Three TAS research studies published in Volume 2 of this report illustrate the value of taxpayer service and the limitations of enforcement measures to improve tax compliance:

- A study regarding tax compliance by sole proprietors found that taxpayer service and social norms were the two most influential factors affecting compliance behavior. Contrary to expectation, it found that traditional deterrence theory did not play a significant role in promoting compliance, possibly because the taxpayers were motivated by short-term cash flow needs.[59]
- A study regarding the impact of penalties on tax compliance analyzed the future compliance behavior of two groups of sole proprietors who were audited and whose examinations were closed in 2007. One group faced tax adjustments and was subject to penalties. The other group faced

58 *See* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals* 187 (Apr. 2013).

59 *See* Volume 2: Research Study: *Small Business Compliance: Further Analysis of Influential Factors*, *infra*.

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similar tax adjustments but was not subject to penalties. The study found that the future compliance behavior of the penalized group was no better than the future compliance behavior of the group that was not penalized.[60]

- A study regarding the relative effectiveness of Revenue Officers and the Automated Collection System in addressing delinquent employment tax liabilities found that neither ROs nor ACS affected future compliance.[61] That is a significant finding that should guide IRS strategic and resource-allocation decisions, because long-term revenue collection is much greater where IRS actions improve future voluntary compliance.

These studies underscore that the ROI of taxpayer service, despite being unquantifiable, is significant and should figure prominently in any strategy designed to improve tax compliance.

Second, an enforcement-only cap adjustment will inherently push the IRS to become more of a hard-core enforcement agency. It should be emphasized that in FY 2013, direct enforcement revenue amounted to only $53.3 billion,[62] or two percent of total IRS tax collection of $2.86 trillion.[63] The remaining 98 percent resulted from voluntary front-end tax compliance.

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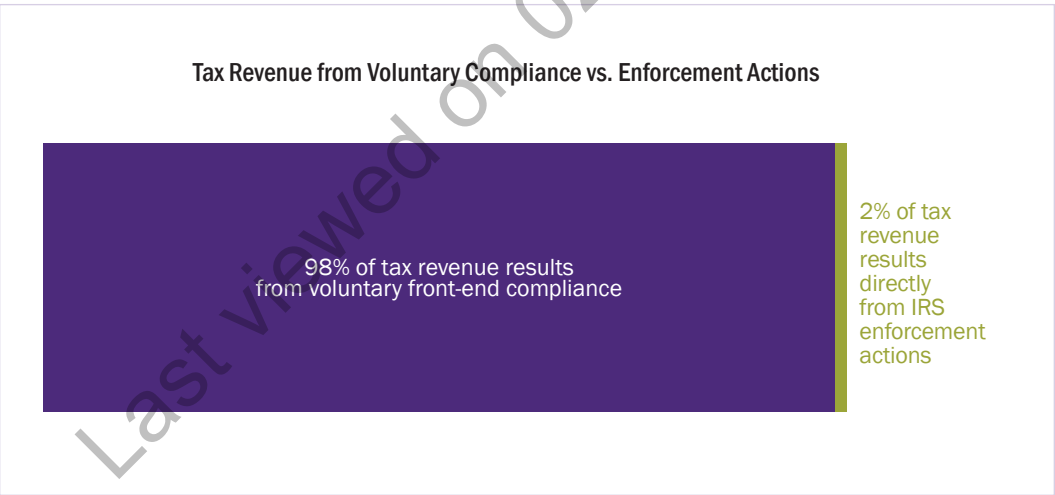
FIGURE 1.2.12



If cap adjustments are applied solely to bolster enforcement funding, the relative allocation of the IRS budget between enforcement and taxpayer service will shift over time in a direction that causes taxpayers to fear the IRS more and voluntarily cooperate less. Primarily because of the proposed cap adjustments, the Administration's ten-year funding projections showed that funding for the IRS Enforcement appropriation would increase by more than twice as much as funding for the IRS's Taxpayer Services

60 *See id*.

61 See Volume 2: *Research Study: A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*, *infra*.

62 GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* 24 (Dec. 2013).

63 *Id*. at 76.

appropriation.[64] In our effort to enforce the laws against noncompliant taxpayers, we must take care to avoid steps that may alienate compliant taxpayers and thereby jeopardize the existing tax base.

For that reason, if program integrity cap adjustments are used, we recommend that compliance initiatives be defined more broadly so they include both an enforcement component and a service component (*e.g.,* better outreach, education, and assistance for small businesses). Because the projected ROI of many enforcement programs is high, a more broadly constructed initiative could still produce a demonstrable ROI of greater than 1:1 even if it contained service components with ROIs that are unquantifiable.[65]

CONCLUSION

Because the IRS is the federal government's accounts receivable department and generates a substantially positive return on investment, it is self-defeating to treat the agency like a pure spending program. With most spending programs, a dollar spent is simply a dollar spent from a budget perspective. With the IRS, a dollar spent generates many dollars in additional revenue, and conversely, a dollar unspent translates to a greater decrease in revenue collection, thereby adding to the budget deficit. Recent cuts in the IRS budget have also limited the IRS's ability to meet the basic service needs of the taxpaying public, which erodes public confidence and trust in the tax system and may also lead to greater noncompliance. For these reasons, we believe the time has come for Congress to "fence off" decisions about IRS funding from the otherwise applicable spending ceilings that apply to discretionary appropriations under the budget rules.

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64 Budget of the United States Government: Analytical Perspectives, Supplemental Materials, Fiscal Year 2014: Table 32-1, Federal Programs by Agency and Account, at 304-305, *available at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/32_1.pdf. Taxpayer service spending is shown on the top line, which is labeled "Taxpayer Services: Appropriations, discretionary . . . 803." Enforcement spending is the sum of the line labeled "Federal law enforcement activities: Appropriations, discretionary … 751" and the line labeled "Central fiscal operations: Appropriations, discretionary … 803." Over the FY 2014 through FY 2023 period, these projections show that Taxpayer Services spending would rise by 23 percent, while Enforcement spending would increase by 54 percent.

65 In our past annual reports, we have written about local compliance initiatives the IRS has undertaken that include integrated enforcement and outreach and education components. *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 176-192 (Most Serious Problem: *Local Compliance Initiatives Have Great Potential but Face Significant Challenges*). One example: In the early 1990s, the IRS launched an initiative designed to address noncompliance by fishermen in Alaska that resulted from confusion as well as community norms and attitudes. The IRS combined stepped-up enforcement activities with an extensive outreach and education campaign in remote fishing villages and on fishing vessels that included assisting with tax return preparation and training local volunteers to assist taxpayers. By the end of the initiative, the number of nonfilers among the target population declined by 30 percent. *Id*. at 177-178.

RECOMMENDATIONS

The National Taxpayer Advocate reiterates her recommendations that Congress consider the following actions:

1. Revise the budget rules so that the IRS is "fenced off" from otherwise applicable spending ceilings and is viewed more like an accounts receivable department. It should be funded at a level designed to maximize tax compliance, particularly voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden.
2. In allocating IRS resources, keep in mind that tax compliance requires a combination of high quality taxpayer service, outreach and education, and effective tax-law enforcement, and the IRS should continue to maintain a balanced approach toward that end. We are concerned that the program integrity cap adjustment procedures used in the past skew this important balance and should be avoided, but if cap adjustments continue to be used, we recommend they be written in a manner that applies to broadly defined compliance initiatives that include both taxpayer service (including outreach and education) and enforcement components.

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MSP #3 EMPLOYEE TRAINING: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill its Mission

RESPONSIBLE OFFICIAL

John Koskinen, Commissioner of Internal Revenue

DEFINITION OF PROBLEM

The IRS mission is to "provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."[1] With a complex and constantly changing tax law, it is essential that IRS employees receive prompt and appropriate training and education in order to provide taxpayers with complete and accurate service. However, budget cuts and sequestration have led the IRS to reduce its training budget by over 85 percent since fiscal year (FY) 2009.[2] Most of the IRS operating divisions that interact directly with taxpayers fared worse than the agency as a whole. Lacking appropriate training and education, IRS employees will be unable to fulfill their mission, and service to taxpayers will continue to erode.[3]

- In FY 2013, the IRS spent less than $250 per employee on training compared to $1,450 per employee in FY 2009, a reduction of over 83 percent.[4]
- The IRS created two review boards, the Training Review Board and the Video Review Board, in FY 2013 to review training requests for recommendation to the Deputy Commissioner for Operations Support.
- The Deputy Commissioner for Operations Support declined approval for over 35 percent of proposed courses between April and June of 2013.[5]
- Training hours delivered to employees in key job series have been reduced by as much as 89 percent since FY 2009.[6]

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1 Internal Revenue Manual (IRM) 1.1.1.1, *The IRS Mission* (Mar. 1, 2006).

2 IRS response to TAS research request (Nov. 22, 2013). In fiscal year (FY) 2009, the IRS spent $153,155,686 on training versus $22,574,539 in FY 2013, a reduction of 85.26 percent. The IRS training budget includes both training and conferences.

3 The IRS's training effort was determined as follows. In a research request, TAS asked the IRS to provide the training budget by operating division from FY 2009 through FY 2013. TAS identified 15 key taxpayer-facing job series in the five main IRS operating divisions (Wage & Investment (W&I), Small Business/Self-Employed (SB/SE), Tax Exempt and Government Entities (TE/GE), Appeals, and Large Business and International (LB&I)). We asked the IRS to provide, by job series, the training titles, number of students in each session, and number of hours per course for FYs 2009 and 2013. TAS also requested that the IRS break training hours down into two categories: in-person training (in person is defined as coached self-study, instructor-led classroom, on-the-job training and paper-based self-study) and virtual training (virtual training is defined as online, computer-based, CD or DVD, Electronic Knowledge Product, interactive video tele-training (IVT) studio produced). TAS acknowledges that the IRS may provide training in individual offices on an ad hoc basis that is not recorded in a formal manner in IRS training databases. This type of training has always occurred and we are treating it as a constant. In this piece, we have focused on formal training provided across the IRS.

4 IRS, Human Resources Reporting Center, *available at* https://persinfo.web.irs.gov/ (last visited Oct. 22, 2013). The IRS had 105,783 employees as of the last week of FY 2009 and spent $153,155,686 on training. In the last week of FY 2013, the IRS had 94,378 employees and spent $22,574,539 on training. Per employee, the IRS spent $1,447.83 in FY 2009 and only $239.19 in FY 2013. The IRS spent 83.48 percent less per employee on training in FY 2013 compared to FY 2009. IRS response to TAS Research Request (Nov. 22, 2013).

5 IRS response to TAS research request (Sept. 16, 2013). Training was proposed between April and June 2013.

6 IRS response to TAS research request (Nov. 22, 2013). For example, total training hours provided to Small Business/Self-Employed Revenue Officers in FY 2013 decreased by 89.29 percent, Large Business International Revenue Agents received 68.45 percent fewer hours of training in FY 2013, Tax Exempt Government Entity Tax Examiners received 80.63 percent fewer hours of training in FY 2013.

Delivering continuing education timely and in appropriate formats to employees is essential to the core function of the IRS. Faced with a declining budget, the IRS training and education programs have been reduced to bare minimums without consideration for the type of training employees need to perform basic job functions, protect taxpayer rights, and prevent harm and undue burden for taxpayers.[7]

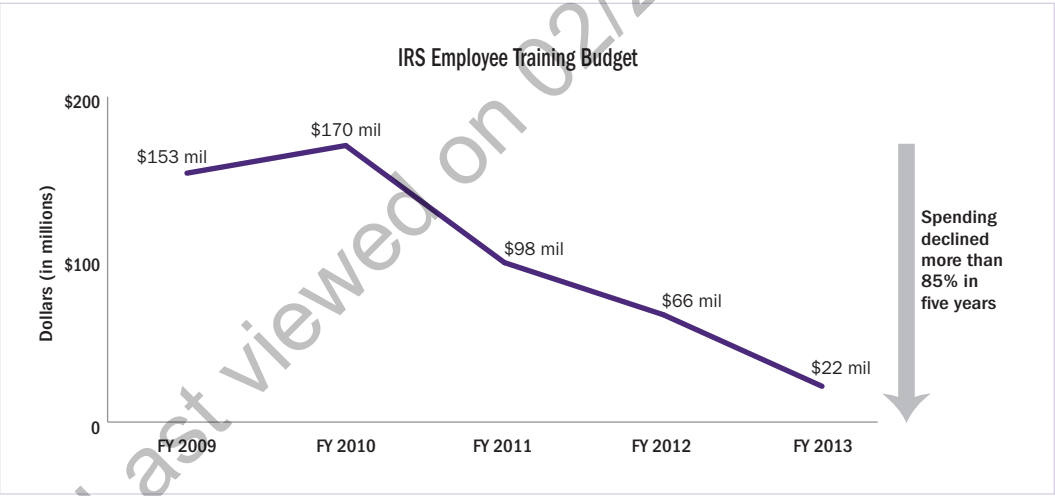
ANALYSIS OF PROBLEM

Background

Set into motion by the Budget Control Act of 2011 and beginning March 1, 2013, the sequester required federal agencies, including the IRS, to significantly cut their spending.[8] The IRS employee training budget experienced drastic cuts to ensure the IRS met its required overall reductions. Even before the sequester, however, the IRS had already sharply reduced dollars spent on training in response to a decrease or stagnation in its total operating budget since FY 2010.[9]

The IRS has drastically reduced spending on employee training.

FIGURE 1.3.1, IRS Training Budget, FY 2009–2013[10]



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Faced with funding constraints, the IRS training budget declined by over 85 percent between FY 2009 and FY 2013.[11] Per-employee spending dropped from nearly $1,450 per full time equivalent employee in

7 For a complete discussion of the National Taxpayer Advocate's concerns regarding IRS employee training in taxpayer rights, see Most Serious Problem: *Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights, infra/supra*. For a further discussion of the National Taxpayer Advocate's concerns about the impact of the failure to properly train IRS employees, see Most Serious Problem: *The Automated Collection System's Flawed Approach to Working Cases and the Types of Cases it Works Results in Low Collection Yields and Harms Taxpayers, infra/supra*; and Most Serious Problem: *Indian Tribal Taxpayers: Inadequate Consideration of Their Unique Needs Causes Burdens, infra/supra*.

8 Budget Control Act of 2011, Pub. L. No. 112-25.

9 See Department of the Treasury, FY 2014 *Budget in Brief, available at* http://www.treasury.gov/about/budget-performance/budget-in-brief/Pages/index_14.aspx (last visited Sept. 26, 2013) and Department of the Treasury, *FY 2012 Budget in Brief, available at* http://www.treasury.gov/about/budget-performance/budget-in-brief/Pages/index_12.aspx (last visited Sept. 26, 2013).

10 IRS response to TAS research request (Nov. 22, 2013).

11 IRS response to TAS research request (Sept. 16, 2013). In FY 2009, the IRS spent $153,155,686 on training versus $22,574,539 in FY 2013, a reduction of 85.26 percent.

2009 to less than $250 in 2013.[12] Most of the IRS operating divisions that interact directly with taxpayers fared worse than the agency as a whole. The IRS Appeals division reduced its training budget from nearly $6 million in FY 2009 to about $250,000 in FY 2013, or almost 96 percent.[13] During the same period:

- The Tax Exempt and Government Entities division slashed its training budget by almost 96 percent, or approximately $7 million;[14]
- The Small Business/Self-Employed division training budget declined by 93 percent;
- The Large Business and International division training budget fell by about 92 percent;
- The Taxpayer Advocate Service decreased its training budget by almost 78 percent; and
- Wage and Investment fared the best, weathering a nearly 74 percent decrease.[15]

The IRS is providing less training to employees.

Reductions in spending have resulted in fewer hours of training for employees. For those in several key professional IRS job series, training hours delivered have almost universally declined.[16] Among the job series reviewed by TAS, SB/SE Revenue Officers (ROs) experienced the heaviest cuts in training. In FY 2009, SB/SE ROs received over 700,000 hours of training compared to just 76,000 hours in FY 2013, a decrease of almost 90 percent.[17] Key duties of Revenue Officers include:

- Investigating and interviewing taxpayers (and those associated with their businesses);
- Fact finding;
- Examining business records to determine if tax liabilities have been accurately reported;
- Researching precedential court decisions; and
- Communicating complex audit findings to taxpayers and their representatives, including the RO's interpretation of the tax laws and regulations.[18]

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12 IRS, Human Resources Reporting Center, *available at* https://persinfo.web.irs.gov/ (last visited Oct. 22, 2013).

13 IRS response to TAS research request (Nov. 22, 2013). The Appeals division spent $5,803,332 on training in FY 2009 compared to $250,408 in FY 2013, a 95.68 percent decrease.

14 *Id*. TE/GE's training budget was reduced from $7,121,332 in FY 2009 to $316,263 in FY 2013, a 95.56 percent decrease.

15 IRS response to TAS research request (Nov. 22, 2013). SB/SE spent $52,391,207 in FY 2009 compared to $3,582,641 in FY 2013, a 93.16 percent decrease. LB&I's budget decreased from $11,738,428 in FY 2009 to $975,278, a 91.69 percent reduction. TAS spent $4,929,483 in FY 2009 and $1,091,310 in FY 2013, a 77.86 percent decrease. W&I spent $15,310,478 in FY 2009 compared to $3,987,023 in FY 2013, a 73.96 percent decrease.

16 IRS response to TAS research request (Nov. 22, 2013). TAS requested information from the IRS on 15 key taxpayer facing job series across the five main IRS operating divisions. In all but two job series examined, training hours delivered to employees decreased significantly since FY 2009. The W&I 0592 (Tax Examiner) and W&I 0962 (Contact Representative) job series employees received substantially similar hours of training in FY 2009 and FY 2013.

17 *Id*. In FY 2009, SB/SE provided 713,935 hours of training to its Revenue Officers, compared to 76,448 hours in FY 2013, an 89.29 percent decrease.

18 IRS, *Standard Position Description* GS-1169-12.

Budget cuts and sequestration have led the IRS to reduce its training budget by over 85 percent since fiscal year 2009.

Failing to train the ROs and other employees in the skills needed to do their jobs can have dire consequences for their ability to reach the right answer and provide quality service to taxpayers, as well as for protection of taxpayer rights.[19]

The IRS has reduced the number and variety of courses offered to employees.

Not only has the IRS reduced the funding and number of hours of training for employees, it has also cut the number of courses offered and eliminated entire subject areas. In FY 2009, SB/SE offered over 2,000 different in-person and virtual learning courses to its ROs, compared to just over 900 in FY 2013, a nearly 60 percent decrease.[20] Other job series saw even more drastic cuts. TE/GE Tax Examiners were offered 166 in-person training courses in FY 2009[21] but only three in FY 2013, a 98 percent decrease.[22]

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19 For a complete discussion of the National Taxpayer Advocate's concerns regarding IRS employee training in taxpayer rights, see Most Serious Problem: *Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights, infra/supra*. For a further discussion of the National Taxpayer Advocate's concerns about the impact of the failure to properly train IRS employees, see Most Serious Problem: *The Automated Collection System's Flawed Approach to Working Cases and the Types of Cases It Works Results in Low Collection Yields and Harms Taxpayers, infra/supra*; Most Serious Problem: *Indian Tribal Taxpayers: Inadequate Consideration of Their Unique Needs Causes Burdens, infra/supra*; and National Taxpayer Advocate's Report to the Acting Commissioner, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013).

20 IRS response to TAS research request (Nov. 22, 2013). In FY 2009, SB/SE offered 2,263 courses to employees in the Revenue Officer 1169 job series compared to 925 course offerings in FY 2013, a 59.12 percent reduction in course offerings.

21 *Id.*

22 *Id*.

FIGURE 1.3.2, Courses Offered In Person to TE/GE Tax Examiners in FY 2009[23]

1120 ES PENALTIES
1120 Refresher
11972 Module B Form 1120
2008 CUMULATIVE LIST ON EXAM ISSUES VIA CENTRA
2008 Cumulative Via CENTRA
2008 Form 990 Refresher
2009 IRM Updates
2009 New Hire AaGI & CP12 Phone Training
94x New Hire Training
94X-X ALERTS/FTDPN
990 CPE
990 N Training for E-Help Desk Accurint
ADVANCED BUSINESS MASTER FILE TRAINING PROGRAM
AGI IMF Default Screener Class #3
AM CPE - Tax Law Changes - Business Tax Returns
AM CPE 2008 - BALANCE DUE
AM KC FY09 NEW HIRE TRAINING
AM KC NEW HIRE TRAINING FY09
AM Ops1 New Hire FTP/FTF & DMI
AM Refresher: Tax Exempt/Government Entities
AM Refresher: Employment Taxes
AMO TE FTD Penalties Training
AMS 2.1 Updates
AMS DI REFRESHER TRAINING TEGE
ASFR Returns Refresher Training
ASFR Returns Training
ASFR RH & Refund Hold Training
AUR CPE 2009 - Case Analysis
BMF Modernized e-file: Lessons 1 – 8
BMF94X e-file: Lessons 1 - 4
BMF e-file Form 1041: Lessons 1 – 5
CAWR SESSION 2
CAWR, 6020B, DUPF
CI - EUP eFile Applications - Los Angeles Class
CI Media Writing
CLASSROOM INSTRUCTOR TRAINING COURSE
Clerical Mandatory CPE
COMMUNICATIONS TESTING
Complex Interest CPE
Course Development Graphics and Manipulation
CPE
CPE 2 PART A
CPE 2 Part B
CPE For TEGE
CPE II
CPE TEGE Enhanced Job Aid Training
CPE, Systemic and Other Updates
CPE/REFRESHER 2010 EXAMINATION TOPICS
E&G CPE for TE's
EBE
E-CASE DOCUMENTATION
e-help update training
E-HELP UPDATE-DISCLOSURE
Electronic Research for EP Via Centra
EMBEDDED QUALITY TRAINING CORE COURSE
EO Classification Database Referral Procedures
EO ENTITY UNPOSTABLES
EO Refresher
EP Training
e-Postcard
EPSS Individual Master File (IMF)
e-file-Recruit
e-services Training for Help Desk Assistors: Refresher Training
Exam Development Day
EXTRACTION & SORTING NEW HIRE CLASS
FDC Annual CPE Refresher Training
First Time Homebuyer/Acct.
Form 1041 (Item # 11972 Module C)
FORM 1065 (11972 MODULE A)
FORM 940 REFRESHER
FORM 941 Component 11964
FORM 944 REFRESHER
Form 94XX
Fraud CPE
FRONT LINE MANAGER COURSE (FLMC)
Front Line Manager Course (FLMC)
Front Line Manager Course (FLMC)
FTF/FTP/RCA 11964 L1
Fundamental Management Skills (FMS)
GovTrip Briefing
GovTrip Workshop
IDAP IA Tool Training
Identity Theft Training for AM Customer Service Representatives
IDRS - Basic TXMOD Comprehension (online course) Project Meeting
IMF INQUIRIES
Instructor Symposium
Intermediate/Advanced NQ Computation
Internal Control Workshop Via CENTRA
[illegible]
[illegible]
[illegible] Return UPDATE
LARGE CORP FORM 1065
MANDATORY CPE
MANDATORY CPE SESSION 2
Manual Refund Training
Manual Refunds
MR Refresher Training
NAME CONTROL CLASS
New Hire Orientation 2008 POSH & UNAX & ETHICS
Normal Retirement Age IRC 401(a) (26) & 1.401(a) Final Regs Via Centra
NRP Transcription
OAR TRAINING
Obsolete - BMF Modernized e-file: Forms 1065 and 1065 - B
Obsolete - BMF Modernized e-file: Forms 1120, 1120S, 1120F, and 7004
Obsolete - BMF Modernized e-file: Forms 990, 990EZ, 990N, 990PF, 1120PF, and Extensions
Obsolete - Lesson 3 - IMF e-file: EMS Communication Testing
Oct 08 IRS Revision CPE TEGE
ON-THE-JOB INSTRUCTOR (OJI) WORKSHOP
OVERVIEW OF WRERA 2008 VIA CENTRA
Pallet Jack/Tug Training
Paying Employement Tax CP 267s
Pre-Assessed IA CPE
PROCESSING BUSINESS MASTER FILE ENTITY UNPOSTABLES (RECRUIT)
PROCESSING BUSINESS MASTER FILE ENTITY UNPOSTABLES (RECRUIT)
PROCESSING BUSINESS MASTER FILE ENTITY UNPOSTABLES (REFRESHER)
Refresher: EIN
Restricted Interest CPE
Restricted Interest CPE
SB-CO-ICS Windows for SBSE Collection-Full Access Users
SB-CS-EXCOR: Correspondence Examination Program Procedures - Alimony
SB-EX-TS Technical Services Statutory Notice of Deficiency Training
SCAMPS ORIENTATION
SEIZING THE POWER & CUSTOMER SERVICE POWER
SOI FORM 8038
SOI FORM 8832
SOI FORM 990 EO
SOI FORM 990 PF
Suitability Training for e-help Desk Assistors: Recruit Training
TAP FY 2009 INTRODUCTION TO ACCOUNTING I
TAP FY09 - COLLEGE MATH I
TAP FY09 - COLLEGE MATH II
TAP-2009 HUMAN RESOURCE MANAGEMENT
TAPS 2008 - FINANCIAL ACCOUNTING I
TAPS FY2009 - FUND OF ACCTG I
Taxpayer and Third Party Authentication and Authorization
TCB MANDATORY CPE
TE/GE Enhanced Job Aid
TE/GE Enhanced Job Aid Orientation
Tefra CPE
TFRA TEIR TRAINING
TEGE EOCA TE TRNG
TEGE EP Refresher
TEGE JIT Refresher
TEGE REFRESHER
TG: TEGE Leadership CPE
TG: EMPLOYEE PLANS CPE
TG:EO Examinations Secretarial CPE
TG:EO EXEMPT ORGANIZATIONS EXAMINATIONS - BASIC
TG:EO Tax Exempt Determination Systems (TEDS)
TG:EP Determinations - Phase IA, Non-Pension Defined Contribution Plans
TG:EP Determinations - Phase IB, Plan Terminations
TG:EP SUPPORT STAFF CPE
TG:GE TEGE INDIAN TRIBAL GOVERNMENTS (ITG) CPE
TG:HQ Data Security
TG:LE TE/GE Functional Management Course
Third Party Sick Pay, Course 26596, Les 9 Tiers CPE
TOTAL EVALUATION PERFORMANCE SYSTEM (TEPS) EMPLOYEE JOB AID
TRAINING FOR HELP DESK ASSISTORS - E SERVICES
TRANSMISSIONS & ACKNOWLEDGEMENTS
Unpostable Follow-up Refresher Training #1
UNPOSTABLE PHONE TRAINING
WESTLAW ELECTRONIC RESEARCH TRAINING – CLASSROOM
XML Instructor Cadre Training

FY 2009: 166 courses
in-person for TE/GE Tax Examiners

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23 IRS response to TAS research request (Nov. 22, 2013). In FY 2009, SB/SE offered 2,263 courses to employees in the Revenue Officer 1169 job series compared to 925 course offerings in FY 2013, a 59.12 percent reduction in course offerings.

FIGURE 1.3.3, Courses offered in person to TE/GE Tax Examiners in FY 2013[24]

FY 2013: 3 courses
in-person for TE/GE Tax Examiners

TE/GE Penalties (FTF, FTP, Negligence, Accuracy, and IRC 6684)
SFR NON-FILER TRAINING CSB 217 5/1/13
New to ERS 2/25/2013 1.5 hours

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24 IRS response to TAS research request (Sept. 16, 2013).

TE/GE Tax Examiners are expected to make contact with taxpayers and representatives to clarify information or inform taxpayers of procedural or processing issues.[25] They must be able to

- Accurately and promptly determine assessment statute dates;
- Respond to complex statute-related questions from reviewers and management; and
- Determine if statute expiration dates could interfere with tax accounts.[26]

TE/GE Tax Examiners received a total of about 1,100 hours of training in FY 2013 compared to nearly 6,000 hours in FY 2009, a cutback of almost 81 percent.[27]

Failing to train employees, especially new hires with no previous IRS background, will harm both the taxpayers and the IRS's ability to fulfill its mission.

Of even greater concern are the courses that the operating divisions have substituted for substantive training on interviewing skills, interpretation of the law, and research. In FY 2013, Tax Examiners in Appeals were offered courses in topics such as furlough time-keeping, preparing for Windows 7 and Microsoft Office 2010, resume writing, and organizational change.[28] Courses offered to Tax Examiners in FY 2009, but eliminated in FY 2013, include Fundamental Tax Law, Processing Resolutions and Closing Collection Due Process Cases, and Communications Skills, all core functions of the Tax Examiner job series.[29] If the IRS fails to train employees in the substantive knowledge and skills they need to perform their jobs successfully, taxpayers cannot expect to receive assistance from employees with the knowledge and skills to help them.

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The multi-level training approval process delays training.

While reductions to the IRS training budget have severely impeded the ability of the IRS to effectively and appropriately train its employees, the new training approval process adds complications. In May 2012, the Office of Management and Budget (OMB) issued a memorandum to all heads of executive-level departments and agencies requiring that any proposed spending of over $100,000 on a single conference event be reviewed at the level of the agency Deputy Secretary or equivalent.[30] The Department of Treasury issued a subsequent directive outlining approval for spending on conferences, and requiring agencies in the Department to obtain approval for conferences as follows:[31]

- The authority to approve conferences with a total cost of under $3,000 remains with the agency;
- For the IRS, the Commissioner may approve costs of $3,000–$24,999;
- Spending of $25,000–$99,999 must be approved by the Assistant Secretary for Management of Treasury;
- Spending of $100,000–$249,999 requires the approval of the Deputy Treasury Secretary; and

25 IRS, *Standard Position Description GS-0592-072*.

26 *Id*.

27 IRS response to TAS research request (Sept. 16, 2013). TE/GE Tax Examiners received 5,711 hours of training total in FY 2009 compared to 1,106 hours in FY 2013, an 80.63 percent reduction.

28 IRS response to TAS research request (Nov. 22, 2013).

29 *Id*.

30 Office of Management and Budget, *Memorandum to the Heads of Executive Departments, and Agencies* (May 11, 2012).

31 Department of Treasury, *Treasury Directive 12-70* (May 6, 2013), *available at* http://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/td12-70.aspx (last visited Sept. 30, 2013).

- All amounts above $250,000 must be approved by the Treasury Secretary.[32]

The spending levels and required approvals outlined by the Department of Treasury are far more restrictive than those set forth by the OMB, further hindering the ability of the IRS to properly train its employees.

Following the directive, the IRS in July granted the authority to approve conference amounts of under $3,000 to the heads of the business divisions, such as the National Taxpayer Advocate, the Chief of Appeals, or the Commissioner of W&I.[33] However, the IRS added the requirement that any training event, even if it falls under the $3,000 threshold, must be recommended for approval by the IRS Training Review Board (TRB).[34] While final approval on any training lies with the Commissioner, the new TRB uses the following criteria to make recommendations to the Commissioner:[35]

- Is the training event mission critical?
- Can costs be reduced or eliminated, including travel, course materials, development costs, and/or vendor costs by use of alternative training methods?
- Can a less costly venue be used?
- Can the training event be conducted in a location where the majority of students are located or travel can be minimized?
- Can the training event be effectively converted to online learning and delivered virtually?
- Can participation in a vendor-taught event be maximized and thus reduce the number of classes?
- Can the number of attendees recommended be justified?

After the TRB makes recommendations for changes to, approval of, or cancellation of training events, training requests are forwarded to the Deputy Commissioner for Operations Support for review.

While the IRS needs to ensure that appropriate training is provided to employees, punishing an entire organization and the millions of taxpayers it serves as a result of the misguided actions of one IRS business unit is neither wise nor effective.[36] From April through June 2013, the operating divisions proposed over $15 million in spending for training.[37] The Deputy Commissioner for Operations Support recommended approval of only 25 percent of those dollars.[38] Courses not recommend for approval include:

- Training in Basic Offers In Compromise (OIC) for new Appeals Settlement Officers who had not previously been trained or had any experience in working OIC cases;

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32 Department of Treasury, *Treasury Directive 12-70* (May 6, 2013), *available at* http://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/td12-70.aspx (last visited Sept. 30, 2013).

33 IRS, *Interim Guidance Memorandum Interim Guidance on the Approval Process for Event Related Spending CFO-01-0713-05* (July 29, 2013).

34 IRS, *Treasury Directive 12-70 – FAQs* (June 24, 2013), *available at* http://hco.web.irs.gov/devtrain/PROGADMIN/TrDir12-70/TRDirFAQ.html (last visited Sept. 30, 2013).

35 IRS response to TAS research request (Sept. 16, 2013).

36 Treasury Inspector General for Tax Administration, Ref. No. 2013-10-037, *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California* (May 13, 2013). See also the concerns raised by the National Taxpayer Advocate in the National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress regarding the potential impact to all IRS training in light of the actions of employees at one conference.

37 IRS response to TAS research request (Sept. 16, 2013). The operating divisions proposed $15,407,690 in training from April through June 2013.

38 *Id*. The Deputy Commissioner for Operations Support recommended approval of $3,884,099.

- An in-person training for LB&I International Examiner new hires covering penalties, allocation and apportionment, branch profits tax, corporate mergers, and acquisitions in a case study and group discussion format;
- Basic employment tax training for new SB/SE Revenue Agents (auditors); and
- Core filing season training in basic tax law for new W&I Field Assistance employees.[39]

Between April and June 2013, the Deputy Commissioner for Operations Support received proposals for nearly 800 courses and recommended for approval almost 500, a reduction of over 35 percent.[40] The Deputy Commissioner for Operations Support did not recommend many courses designed to train employees new to their positions to perform the core functions of their jobs. Without such training, IRS employees may not be able to assist taxpayers in complex or even basic matters and thus cannot provide quality service. Failing to train employees, especially new hires with no previous IRS background, will harm both the taxpayers and the IRS's ability to fulfill its mission.

Failure to Train Employees will Harm Taxpayers

Taxpayers seeking assistance and relief from the IRS will find a workforce lacking the knowledge and ability to provide assistance if the IRS continues to meet budgetary obligations by simply not training its employees. While the National Taxpayer Advocate is well aware of the budgetary constraints, and is subject to a similar inability to provide certain core training to TAS employees, she believes the IRS cannot continue denying basic and essential training to employees. An untrained workforce is one that does not understand basic taxpayer rights, a problem underscored by an already limited training in that area.[41]

Beyond being ill-prepared to protect taxpayer rights, an employee untrained in the core functions of his or her job may provide limited assistance, reach the wrong conclusion for the taxpayer, or be unable to provide any assistance at all. The IRS is charged with administering the tax law – an ever-expanding, complex set of rules and requirements — which its employees cannot possibly do without adequate training. If taxpayers cannot turn to the IRS for assistance, they may have no option but to pay a tax professional or attempt to research a confusing law on their own. Some may simply choose to give up, causing even more problems for themselves and the IRS. Consequences to the taxpayers for non-compliance or errors in interpretation of the tax law include liens on homes, levies on paychecks or bank accounts, and destruction of credit records.[42]

An untrained workforce is one that does not understand basic taxpayer rights.

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39 IRS response to TAS research request (Sept. 16, 2013).

40 *Id*. The operating divisions proposed 767 courses between April 2013 and June 2013 and the Deputy Commissioner for Operations Support declined to approve 275 courses, a reduction of 35.85 percent.

41 For a full discussion of the National Taxpayer Advocate's concerns regarding the lack of training in taxpayer rights, see National Taxpayer Advocate's Report to the Acting Commissioner, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013) and Most Serious Problem: *Insufficient Education and Training about Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect their Rights, infra*.

42 For further discussion of the effects of noncompliance on taxpayers, see, *e.g.*, Most Serious Problem: *The Automated Collection System's Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers and the Public Fisc, infra.*, and Most Serious Problem: *Accuracy Related Penalties: The IRS Assessed Penalties Improperly, Refused to Abate Them, and Still Continues to Assess Them Automatically, infra*.

The IRS says that it recognizes the need for and importance of training its employees. The then-Principal Deputy Commissioner wrote in his initial assessment of the IRS:

> If we do not have funds to invest in our people in terms of recruiting new talent and sufficiently training our existing staff, as well as investing in the technology necessary to continue to build on the modernization efforts delivered over the last several years, there is no question that our service levels will suffer.[43]

It is clear from the current training provided to both experienced and new IRS employees that employees are not receiving sufficient training. While the then-Principal Deputy Commissioner stressed the need for training, he proceeded, in the same report, to laud the savings the IRS has achieved from the training budget, writing:

- The IRS limited employee travel and training to mission-critical projects beginning in FY 2011. Training travel alone has been reduced by $83 million from FY 2010 to FY 2012.
- The IRS has expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel. The IRS estimates that, by the end of FY 2013, training costs will have been reduced by about 83 percent and training-related travel costs by 87 percent when compared to FY 2010 levels.[44]

This report indicated that the IRS has expanded the use of alternative delivery methods for training. However, when the hours of training delivered to employees in key taxpayer-facing job series in FY 2013 are compared to the hours delivered in FY 2009, it is clear that training has not shifted to other methods, it has been eliminated.

CONCLUSION

IRS employees administer a complicated, ever-changing set of tax laws that are difficult to interpret and apply. A workforce lacking proper (or any) training in how to perform core job functions will be unable to provide service to taxpayers. Taxpayers will be harmed when they cannot contact the IRS and be assured that they will receive a prompt and correct answer to their inquiries or proper resolution of their account issues. The IRS cannot continue to meet budgetary obligations at the expense of training employees.

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43 IRS, *Charting a Path Forward at the IRS: Initial Assessment and Plan of Action* (June 24, 2013) at 41.

44 *Id.*

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Propose that Congress appropriate sufficient funding for the IRS to train its employees through the most effective means (in person, conference call, self-study, outside courses, etc.) for the subject matter in all aspects of their jobs including the protection of taxpayers' rights.
2. Prioritize funding for training employees in critical job skills.
3. Request and obtain from the Department of Treasury authority to approve training within the OMB stated guidelines.
4. Clearly define the criteria for TRB approval of training.

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MSP #4 TAXPAYER RIGHTS: Insufficient Education and Training About Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights

RESPONSIBLE OFFICIALS

John Koskinen, Commissioner of Internal Revenue
John M. Dalrymple, Deputy Commissioner, Services & Enforcement
Peggy Sherry, Deputy Commissioner for Operations Support
Karen Schiller, Commissioner, Small Business Self-Employed Division
Debra Holland, Commissioner, Wage & Investment Division
Heather C. Maloy, Commissioner, Large Business & International Division
Sunita B. Lough, Commissioner, Tax Exempt Government Entities Division
Kirsten B. Wielobob, Chief, Office of Appeals

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DEFINITION OF PROBLEM

While the Internal Revenue Code (IRC) guarantees certain rights to taxpayers, IRS employees do not always clearly communicate these rights to taxpayers at appropriate times. A recent nationwide survey found only 46 percent of U.S. taxpayers believed they have rights before the IRS, and only 11 percent knew what those rights were.[1] When employees inform taxpayers of their rights, they rely on Publication 1, *Your Rights as a Taxpayer*.[2] However, TAS focus groups indicate that taxpayers often do not read the publication.[3]

This lack of awareness of taxpayer rights is further compounded when IRS employees themselves do not sufficiently understand taxpayer rights. Only some employees receive initial training about taxpayer rights, and this information is not regularly reinforced during later periodic training, such as Continuing Professional Education (CPE). Information about taxpayer rights is scattered throughout the Internal Revenue Manual (IRM) and pertains to narrow circumstances or specific phases of taxpayers' dealings with the IRS. The IRS should provide employees with an overarching, comprehensive education about taxpayer rights, supplemented by training and guidance about how those rights adhere in specific situations.

1 Forrester Research Inc., *The TAS Omnibus Analysis*, from North American Technographics Omnibus Mail Survey, Q2/Q3 2012, 19-20 (Sept. 17, 2012).

2 The Technical and Miscellaneous Revenue Act of 1988 requires the IRS to distribute to taxpayers a statement of their rights and the obligations of the IRS during an audit when the IRS contacts the taxpayer regarding the determination or collection of tax. *See* Pub. L. No. 100-647, 102 Stat 3342 (1988). The IRS generally satisfies this requirement by providing taxpayers with Publication 1.

3 2011 IRS Nationwide Tax Forums TAS Focus Group Report, *Publication 1 - Taxpayer Rights* (Oct. 2011).

ANALYSIS OF PROBLEM

Background

The Code includes a number of taxpayer rights specific to certain situations, but it contains no organizing principles or formal acknowledgement of the fundamental taxpayer rights from which these statutory rights derive.[4] The information about taxpayer rights is scattered throughout the IRM and, as a result, IRS employees might be inclined only to uphold taxpayer rights in specific situations.

The National Taxpayer Advocate has recommended that a Taxpayer Bill of Rights (TBOR), a list of fundamental taxpayer rights and obligations, modeled after the United States Constitution's Bill of Rights, be formally codified.

The National Taxpayer Advocate has recommended that a Taxpayer Bill of Rights (TBOR), a list of fundamental taxpayer rights and obligations, modeled after the United States Constitution's Bill of Rights, be formally codified.[5] However, the IRS does not have to wait for legislative action. As recommended in this year's Annual Report to Congress, the IRS could follow the lead of other countries by adopting a TBOR through a taxpayer charter or other administrative statement of agency policy.[6] The TBOR would be a formal declaration of taxpayer rights and responsibilities written in plain language.[7] It would not provide additional rights not already statutorily or administratively granted. A TBOR is an essential platform for employee training, for taxpayer education, and, ultimately, for enabling taxpayers and employees to reach just and fair resolutions of tax liabilities."[8]

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Recent IRS Actions to Improve Taxpayer Rights Awareness

As a result of the IRS's review of its handling of exempt organization applications, Acting Commissioner Werfel committed the IRS to evaluate training for employees to ensure taxpayers know their rights.[9] In her report to the Acting Commissioner on November 4, 2013, the National Taxpayer Advocate urged the adoption of the TBOR and outlined mechanisms that raise taxpayer and employee awareness of taxpayer rights.[10] TAS is examining taxpayer rights training and has begun a comprehensive review of the Internal Revenue Manual (IRM) to identify places to insert:

- References to taxpayer rights;
- Guidance for employees to refer a taxpayer to a Low Income Taxpayer Clinic (LITC); and

4 For example, the right of a taxpayer to be informed is included in a number of different IRC provisions. IRC § 6213(a) requires the IRS to provide a notice of deficiency at least 90 days (150 days for taxpayers residing abroad) before it can take collection action. This notice informs taxpayers of the right to petition Tax Court and, as required by IRC § 7522(a), and must describe the basis for and the amount of tax, interest, and penalties due. IRC § 6330 requires the IRS to notify taxpayers 30 days before a levy and provide the amount of unpaid tax, the IRS's proposed action, the IRC provisions relating to levy, the procedures available to the IRS, the administrative appeals available to the taxpayer, and the alternatives available to prevent the levy. IRC § 6320(a) requires the IRS to notify a taxpayer of federal tax lien within five days of when the lien is filed.

5 *See* National Taxpayer Advocate 2011 Annual Report to Congress 493-518; National Taxpayer Advocate 2007 Annual Report to Congress 478-89.

6 *See* OECD Committee of Fiscal Affairs Forum on Tax Administration, Centre for Tax Policy and Administration, GAP002, *Taxpayers' Rights and Obligations* 3 (2003), *available at* http://www.oecd.org/ctp/taxadministration/14990856.pdf (analyzing survey results published in 1990).

7 *See* OECD Committee of Fiscal Affairs Forum on Tax Administration, Centre for Tax Policy and Administration, GAP002, *Taxpayers' Rights and Obligations* 6 (2003), *available at* http://www.oecd.org/ctp/taxadministration/14990856.pdf (analyzing survey results published in 1990).

8 *See* Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration, supra. See also* National Taxpayer Advocate's Report to the Acting Commissioner, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013).

9 *See* IRS, *Charting a Path Forward at the IRS: Initial Assessment and Plan of Action* 34 (June 24, 2013), *available at* http://www.irs.gov/uac/Newsroom/IRS-Charts-a-Path-Forward-with-Immediate-Actions.

10 National Taxpayer Advocate's Report to the Acting Commissioner, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), *available at* (insert link). *See* Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration, supra.*

- Instructions to provide Publication 1 where it is not currently required.

The Taxpayer Advocate Service recently collaborated with the IRS to develop language for the TBOR, and is planning to launch its own taxpayer rights website that includes the TBOR in 2014. TAS is drafting new versions of Publication 1 for the IRS to give to taxpayers at different points in the tax controversy process, including examination, appeals, and collection. TAS will conduct focus groups on the new publications in early 2014 and finalize them during the year. While these actions are encouraging, the lack of comprehensive training and education for employees on taxpayer rights remains a significant problem.

Employee training on taxpayer rights varies across the IRS.

The initial training for many new IRS employees contains only minimal instruction on taxpayer rights and varies greatly by employee position. A lack of continuing education on taxpayer rights negatively reflects on employees' ability to assist taxpayers and protect their rights because the basic knowledge acquired at initial training gradually fades over time without continuing education or reminders about how rights apply in specific contexts. TAS requested from the IRS detailed information about taxpayer rights training and education for new and current employees. Below are some of TAS's findings based on the IRS responses.

Examination[11]

- The Core Competency Training for newly hired Revenue Agents *(i.e.,* auditors or examiners) includes a 575-page participant guide, but only six paragraphs mention discussing taxpayer rights and the audit process with taxpayers.[12]
- For compliance employees[13] working examination cases, taxpayer rights are covered as parts of various processes, for example, review of installment agreements; but the actual rights are not explicitly explained. The IRS's response to TAS's information request includes six Automated Underreporter courses that discuss representation. However, the response merely states, "Tax examiners are trained when and how to accept 3rd party representation."[14] Issues relating to representation go beyond when and how to accept a power of attorney. The course should discuss informing taxpayers of their right to retain representation, as well as information on access to representation, including through Low Income Taxpayer Clinics that provide low to no-cost tax assistance.
- The Examination Toll-Free Telephone Assistor Training covers only selected taxpayer rights topics, such as taxpayer authentication and power of attorney.[15] While the scripts used in the training touch on a taxpayer's right to appeal by discussing Tax Court deadlines, they lack comprehensive information explaining taxpayers' appeal rights, the significance of the Tax Court as a pre-payment judicial forum, and the consequences of failing to act.

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11 This section pertains to examination employees in the Small Business/Self-Employed (SB/SE) Operating Division and the Wage and Investment (W&I) Operating Division.

12 SB/SE Core Competency Training 29689-102 (May 2011).

13 Compliance employees include examination and collection employees, primarily in centralized locations.

14 IRS response to TAS information request (Oct. 22, 2013).

15 Exam Toll-Free Telephone Assistor Training Course 12256-102 (Rev. June 2013).

- The fiscal year (FY) 2013 CPE schedule for Revenue Agents has six required and ten optional courses that focus primarily on technical topics, with no mention of taxpayer rights in the descriptions.[16]

Tax Exempt / Government Entities (TE/GE) Division

- TE/GE has multiple courses for Revenue Agents that cover taxpayer rights. Chapter 1 of the Employee Plans Examination Phase II course includes an entire section on taxpayer rights.[17] This training surpasses merely mentioning taxpayer rights. One section states: "Publication 1(EP) is mailed with the initial appointment letter and explains these rights and the examination process. **This, however, is merely the first step.**"[18] The course details how the employee must continue communicating taxpayer rights during the process. The Exempt Organizations Basic Law Course includes a roleplaying session where employees discuss Publication 1 with taxpayers and representatives.[19]
- Conversely, the TE/GE response showed Tax Examiners receive only one course on taxpayer rights, which is only for new hires and does not mention Publication 1. Taxpayer rights material includes two ten-minute mock interviews conducted by the instructors.[20]

Collection[21]

- The training module for newly hired Revenue Officers (ROs) provides a comprehensive introduction to taxpayer rights with two hours of lessons focusing on all aspects of rights related to collection.[22]
- Automated Collection System (ACS) employees, who work the majority of IRS lien and levy cases,[23] have two lessons on taxpayer rights as part of the ACS Basic New Hire Course.[24] One lesson explains communicating with the taxpayer about appeal rights, and the other provides training on appeal rights after an installment agreement is denied. Unlike the RO training, there is no stand-alone course that emphasizes overall rights.[25]
- ACS's e-guide is lacking when it comes to explaining and educating taxpayers on their rights as they go through the collection process.[26] For example, the "Refusal to Pay Situations" section of the e-guide advises the employee to tell the taxpayer that if he or she cannot pay, the IRS will

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16 IRS, FY 13 Exam CPE, Mandatory Lessons (June 28, 2013); FY 13 Exam CPE, Optional Lessons (July 18, 2013).

17 *See* IRS response to TAS information request (Sept. 19, 2013).

18 Employee Plans Examinations – Phase II course, Chapter 1 Pre-Contact Analysis/Pre-Audit, 11313-002, 1-37 (course delivered Jan. 31, 2013).

19 *See* IRS response to TAS information request (Sept. 19, 2013).

20 *See id.*

21 This section pertains to employees in Field Collection, part of the SB/SE Division and employees in the Automated Collection System, part of the Wage and Investment (W&I) Division.

22 IRS, Revenue Officer Training Unit 1, Module I Introduction to Taxpayer Rights Overview (Apr. 2012).

23 In fiscal year (FY) 2013, there were: 638,793 field levies versus 1,216,302 ACS levies; 63,944 field installment agreements versus 699,200 ACS installment agreements; and 228,318 currently not collectible field cases versus 346,576 currently not collectible ACS cases. Collection Activity Reports No. 5000-24 (Oct. 29, 2013), No. 5000-6 (Oct. 29, 2013), No. 5000-149 (Oct. 29, 2013). Currently not collectible numbers are hardship only.

24 *See* IRS response to TAS information request (Oct. 17, 2013) (discussing the ACS Basic-Taxpayer Appeal Rights and the ACS Basic-Independent Review).

25 *Id*.

26 The e-guide provides employees with an ongoing reference and source of education while on the job. *See* IRM 5.19.16.3.1 (Oct. 25, 2011).

take enforcement action.[27] There is no emphasis on explaining rights, specifically appeal rights or collection due process hearings.

Office of Appeals

- The Appeals Basic Training Course for new hires contains numerous references to appeal rights, including advising employees to explain these rights to the taxpayer at different points in the process. However, most of the course deals with procedures without emphasizing the taxpayer rights underlying those procedures. For example, the mediation training contains information about how a taxpayer can request mediation, the modification of *ex-parte* rules in mediation, and impartiality; but the course is mainly focused on how to conduct a mediation and reach a mutually acceptable agreement rather than on explaining and preserving foundational taxpayer rights in the process.
- The FY 2013 Appeals CPE schedule includes ten Customer Satisfaction courses, nine of which are from an outside vendor and focused on customer relationships in the private sector, along with one internal course on Cultural Competence and Effective Communication.[28] While the courses may encourage effective communication, they do not discuss taxpayer rights at all.

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The Internal Revenue Manual (IRM) frequently lacks comprehensive information about taxpayer rights and their importance for due process and fair tax administration.

The IRS frequently relies on the IRM to educate employees. IRM sections that cover specific situations may include reminders about taxpayer rights that apply in those situations, but do not provide comprehensive information about the rights and why they are important. For example, the Collection Appeals Rights section of the Collection IRM states broadly, "The CDP appeal provisions give taxpayers an opportunity for an independent review by Appeals, to ensure that the proposed levy or lien filing is warranted."[29] However, the description does not contain information about the fundamental elements of a Collection Due Process (CDP) hearing, including the statutorily mandated determination of "whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary."[30] As a result, employees may not fully understand the purpose of a CDP hearing, its role in ensuring the fairness of tax administration, and the scope of a taxpayer's right to appeal. Thus, some may view CDP hearings as a nuisance or a delaying tactic and discourage taxpayers from acting upon their rights, instead of encouraging them to take advantage of an important due process protection.

The initial training for many new IRS employees contains only minimal instruction on taxpayer rights and varies greatly by employee position.

Another example of the IRM failing to properly educate employees is the section regarding transferring taxpayer examinations to a field office.[31] The IRM cites Treas. Reg. 301.7605-1(e)(2), which provides that requests for transferring an

27 ACS E-guide, *Refusal to Pay* (July 23, 2013).

28 FY13CPE_TopicSchedule.xls posted on the IRS Office of Appeals internal website (last modified July 1, 2013).

29 IRM 5.19.8.4.1 (Aug. 27, 2010).

30 IRC § 6330(c)(3). Congress created CDP hearings not merely to ascertain whether the collection action was warranted, but, *inter alia*, to verify that the IRS had followed proper procedures in filing the lien or notice of levy and whether collection alternatives had been considered.

31 IRM 4.19.13.14.1 (Aug. 1, 2012).

exam are generally granted. However, the IRM fails to explain this procedure as an aspect of the taxpayer's right to be heard. Instead the IRM instructs employees to rely on a decision tree (If/Then) chart, which, in turn, directs the examiner to "provide assurance that the issue can be resolved at the campus" when a taxpayer requests a transfer to an area office.[32] Employees may simply rely on the chart without understanding how a taxpayer's request for a local transfer may be vital to that taxpayer being able to present his case in the format most conducive to his concerns being heard. If the request is viewed as simply an inventory and work assignment problem rather than the realization of a fundamental taxpayer right, the employee may discourage or improperly dissuade a taxpayer from making a legitimate request.

IRM sections sometimes instruct employees to take a specific action as a part of a process or procedure without explaining the underlying taxpayer right. In examination cases where the IRS issues a statutory notice of deficiency and the taxpayer requests additional time to respond, the IRM advises employees to inform the taxpayer that any extension to submit documents will not extend the time to petition the Tax Court.[33] However, employees may not understand why this is important for taxpayers, *i.e.,* if the taxpayer does not petition the Tax Court within a certain number of days, he or she will lose the ability to challenge the liability in Tax Court, which is the *only* federal judicial forum available to litigate a tax liability *before* paying the tax first.[34]

As these examples demonstrate, the lack of comprehensive information about taxpayer rights may be detrimental to employees' ability to assist taxpayers and protect their rights. The IRS could improve employees' understanding of fundamental taxpayer rights by incorporating the TBOR in the IRM and including examples of potential impact in key enforcement sections such as Lien and Levy actions in Collection, and Statutory Notices of Deficiency in Exam.

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Employees need a framework of taxpayer rights that shows them where fundamental taxpayer rights arise in their daily work and assists them in communicating these rights to taxpayers.

Because the Code does not list fundamental rights, an employee has no framework to reason how rights apply in a particular context. While the IRS has tried to come up with a statement of rights with Publication 1, this publication may be confusing to taxpayers. In addition, there are situations where taxpayers would benefit from information about their rights, but the IRS is not required to distribute Publication 1. Notably, the Acting Commissioner in his review of IRS exempt organizations practices found applicants for exempt status never received Publication 1 because the Code only requires the IRS to give Publication 1 to taxpayers who are selected for audit or are in collection.[35] Also, relying solely on Publication 1 to educate taxpayers runs the risk of furthering a "checkbox" mentality.[36]

32 IRM 4.19.13.14.1 (Aug. 1, 2012).

33 IRM 4.19.13.9.6 (Apr. 9, 2012).

34 *See* IRC § 6213(a).

35 *See* IRS, *Charting a Path Forward at the IRS: Initial Assessment and Plan of Action* 34 (June 24, 2013), *available at* http://www.irs.gov/file_source/PUP/newsroom/Initial%20Assessment%20and%20Plan%20of%20Action.pdf. The Technical and Miscellaneous Revenue Act of 1988 requires the IRS to distribute to taxpayers a statement of their rights and the obligations of the IRS during an audit when the IRS contacts the taxpayer regarding the determination or collection of tax. Pub. L. No. 100-647, § 6227, 102 Stat 3342, 3731 (1988).

36 An example is the Revenue Agent's classroom training, which teaches that employees can accomplish the task of informing taxpayers of their rights by providing Publication 1 and Privacy Act Notice 609. Revenue Agent Basic Classroom 1 Training, Trng. 31828-102, 9-20.

What the IRS needs is an improved Publication 1, and additional documents that explain the application of these rights in particular contexts, such as examination (Publication 1-E), collection (Publication 1-C), and appeals (Publication 1-A). This multi-step approach would enable taxpayers to:

1. Learn about their rights in general, so they know they have them and know to ask about them when a problem arises;
2. Learn about their specific rights as they need them within specific stages of the tax controversy process (Publication 1-E, Publication 1-A, Publication 1-C); and
3. Hear about these rights from IRS employees because the more contextual Publication 1 versions provide a vehicle for employees to explain the rights to taxpayers.

Although IRM sections direct employees to distribute Publication 1, they do not always instruct employees to engage the taxpayer regarding his or her rights.[37] The sections that do require the employee to explain rights to the taxpayer generally apply to only field collection and field examiners, who handle a minority of taxpayer cases.[38] Yet in FY 2013, ACS issued nearly double the number of levies, initiated nearly 11 times the number of Installment Agreements, and closed over half as many more (51.8 percent) cases as currently not collectible than the Collection Field function (CFf) .[39] In FY 2012, about 76 percent of all exams were correspondence exams.[40]

The majority of taxpayers with compliance issues, whose cases are worked by ACS or correspondence exam, will never receive a phone or in-person contact, and thus will never receive an explanation of their rights. Many of these taxpayers are unrepresented and thus unlikely to know their rights. Providing employees with expanded versions of Publication 1 that contain more detailed information about taxpayer rights would give employees a tool to use in explaining these rights to taxpayers and ensuring they understand them.

Employees' Lack of Understanding of Taxpayer Rights Leads to Poor Policy Decisions.

When employees are not adequately trained on taxpayer rights, they may make poor policy decisions, as evidenced by the IRS's recent revisions to one version of the Statutory Notice of Deficiency (SNOD).[41] The IRS attempted to put the SNOD in plain English, but removed some critical information that appeared in previous versions. Although the revised notice states that the taxpayer has the right to petition the United States Tax Court, nowhere does it explain that the Tax Court is the only judicial forum in which to contest the liability before paying it. The ability to appeal without pre-payment is a major

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37 *See, e.g.*, IRM 4.23.3.7.5 (July 19, 2013) (requiring examination employees to provide Publication 1 to taxpayers with initial contact letters regarding an employment tax exam); IRM 4.81.5.6.1 (Oct. 1, 2009) (requiring tax exempt bonds examination employees to include Publication 1 with all examination letters pursuant to IRC § 7521(b)(1)(A)).

38 As part of the initial contact, field collection employees must determine whether the taxpayer received Publication, ask the taxpayer if he or she has any questions about Publication 1, and answer those questions. IRM 5.1.10.3.2 (Oct. 28, 2011). Exam employees who make initial contact by phone or in person must explain the taxpayer's rights as outlined in Publication 1 and answer any questions the taxpayer may have. This generally only applies to field examiners because correspondence examiners generally contact the taxpayer by letter. IRM 4.10.2.7.3 (Aug. 1, 2007).

39 In fiscal year 2013, there were: 638,793 field levies versus 1,216,302 ACS levies; 63,944 field installment agreements versus 699,200 ACS installment agreements; and 228,318 currently not collectible field cases versus 346,576 currently not collectible ACS cases. Collection Activity Reports No. 5000-24 (Oct. 29, 2013), No. 5000-6 (Oct. 29, 2013), No. 5000-149 (Oct. 29, 2013). Currently not collectible numbers are hardship only.

40 IRS Data Book, Fiscal Year 2012, Table 9a, Examination Coverage: Recommended and Average Recommended Additional Tax After Examination, by Type and Size of Return. There were 1,122,216 correspondence exams in FY 2012 out of 1,481,966 total examinations.

41 *See* IRS, *Understanding Your CP3219A Notice*, http://www.irs.gov/Individuals/Understanding-Your-CP3219A-Notice for a sample CP 3219A notice (page last updated or reviewed Nov. 1, 2013).

component of the overall fairness and integrity of our tax system. Otherwise, only those who could afford to pay the tax would have the benefit of judicial review. Comments from practitioners participating in a Low Income Taxpayer Clinic listserv reflect the problems with this new notice:

- "This one looked just like another balance due notice."
- The new notice is "[b]ordering on deceptive and coercive for the less sophisticated."
- "I did a double take because it looked just like a collection notice. The previous client had the normal notice of deficiency. What a stark contrast!"[42]

It appears that the employees redesigning and reviewing the SNOD may not have been properly trained about the significance of the language on contesting the determination in a pre-payment judicial forum. They may also have been confused about the underlying purpose of the notice — *i.e.*, providing the taxpayer a "ticket to Tax Court." Without comprehensive training on taxpayer rights, employees may continue to make poor decisions, such as this one, that harm taxpayers.

IRS measures do not sufficiently take into account taxpayer rights.

The broad, overall guidelines for critical job elements (CJEs), which the IRS uses to assess employees' performance, do not include taxpayer rights.[43] The description for "Customer Satisfaction - Application" focuses on communicating with taxpayers, but makes no mention of communicating taxpayer rights to taxpayers.[44] CJEs for different positions vary greatly in their focus on taxpayer rights. For example, the Revenue Officer CJEs include an entire subsection devoted to taxpayer rights under the category of Customer Satisfaction - Knowledge.[45] To receive an "Exceeds" rating in this category, an employee must always:

- Educate the taxpayer on his or her rights throughout the collection process;
- Ensure the taxpayer's rights are observed and protected throughout the process;
- Protect the confidentiality of taxpayer return and case-related information; and
- Accurately explain the collection process throughout the case progression.[46]

In contrast, the CJEs for Customer Service Representatives (CSRs), who make up much of the ACS, only have one taxpayer rights measure, even though CSRs have contact with more taxpayers than other employees. This measure, "ensures that taxpayer rights are appropriately protected," is part of the broader subsection, Technical Knowledge/Research, and provides little specific guidance on how, precisely, the employee is to ensure such protection.[47] The contrast between CJEs for Revenue Officers and ACS

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42 Comments from ABA-Tax Low Income Taxpayer Clinic Discussion (Oct. 10, 2013).

43 IRS, Guidelines for Developing Critical Job Element (CJE) Performance Plans.

44 *Id*.

45 *See* Performance Plan for Revenue Officer Advisor / Reviewer and Revenue Officer / Independent Administrative Reviewer GS-1169 (Mar. 2006).

46 *Id*.

47 *See* Performance Plan for Customer Service Representative GS-0962 (Dec. 2004).

employees is troubling because ACS employees work far more collection cases and have contact with more taxpayers than Revenue Officers.[48]

In addition, case quality scores do not include taxpayer rights measurements, other than ascertaining whether the employee provided the taxpayer with the required written notice or Publication 1. For example, the Office of Appeals Case Quality standards include "Did Appeals Provide Appropriate Taxpayer Customer Service and Respect Taxpayer's Rights?"[49] To meet the standard of informing the taxpayer, employees only have to provide the Uniform Acknowledgement Letter timely (within 30 days of case receipt in Appeals) and communicate the status of the case within a reasonable time (generally every 90 days) until Appeals completes processing. Employees can demonstrate that the taxpayer was informed of his or her rights, including appeal rights, by providing the taxpayer with notices and publications. In contrast, TAS includes in its case quality attributes a measure for whether the employee educated the taxpayer and explained preventive actions to taxpayers. The IRS should adopt similar measures.

CONCLUSION

Many taxpayers have no knowledge of their rights, including specific rights that arise in certain situations or their fundamental rights as taxpayers. When employees also lack comprehensive knowledge of these rights, they may end up taking actions or establishing polices that violate these rights and harm taxpayers. At a time when the IRS budget is forcing difficult decisions across the agency, protecting taxpayer rights is more important than ever.

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RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Require all future updates of training modules to include a significant segment on taxpayer rights.
2. Require all training modules that will not be updated in the next year to include the independent taxpayer rights training module to be developed by TAS.
3. Require all IRS employees to take the TAS *Roadmap to a Tax Controversy* Level One training.
4. Require all operating divisions to include in their Business Performance Reviews an analysis of how employees were trained on taxpayer rights issues and what actions the operating divisions took to incorporate the TBOR into their programs.
5. Require operating divisions to update their case quality attributes to measure whether the employee informed the taxpayer of his or her rights beyond just requiring the mailing of a publication or notice.
6. Update the IRS's guidance for developing CJE's to include a focus on taxpayer rights.

48 In fiscal year 2013, there were: 638,793 field levies versus 1,216,302 ACS levies; 63,944 field installment agreements versus 699,200 ACS installment agreements; and 228,318 currently not collectible field cases versus 346,576 currently not collectible ACS cases. Collection Activity Reports No. 5000-24 (Oct. 29, 2013), No. 5000-6 (Oct. 29, 2013), No. 5000-149 (Oct. 29, 2013). Currently not collectible numbers are hardship only.

49 Appeals Quality Measurement System Reviewer's Guide for Non-Collection Cases Standard 1, Did Appeals Provide Appropriate Customer Service and Respect Taxpayers' Rights? 29-63 (Revised Oct. 1, 2012).

7. Distribute taxpayer rights posters to managers and require all employee offices to place them where the maximum number of employees will see them.
8. Update all IRM sections identified by TAS with language provided by TAS to incorporate the TBOR into the IRM.
9. Update all IRM sections identified by TAS to include requirements for employees to provide either Publication 1 or separate publications that explain the application of taxpayer rights in particular contexts, such as examination (Publication 1-E), collection (Publication 1-C), and appeals (Publication 1-A). Update all notices identified by TAS to include Publication 1, Publication 1-E, Publication 1-A, or Publication 1-C as a stuffer.

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MSP #5 REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing its Efforts to Effectively Regulate Unenrolled Preparers

RESPONSIBLE OFFICIAL

John Koskinen, Commissioner of Internal Revenue

DEFINITION OF PROBLEM

The IRS collects more than 90 percent of all federal revenue ($2.52 trillion in fiscal year 2012), with the largest portion coming from the individual income tax.[1] For tax year (TY) 2011, taxpayers filed about 142 million 1040-series individual returns,[2] with nearly 79 million taxpayers using paid preparers.[3] More than half (over 42 million) of these returns were prepared by preparers who are unregulated by the IRS.[4]

As preparers play a critical role in tax administration, it is essential that the IRS ensure that they are competent, visible, and accountable. In fact, the IRS was recently implementing a program to impose minimum competency requirements on the tax preparation profession. However, in *Loving v. Internal Revenue Service,* the District Court for the District of Columbia enjoined the IRS from further enforcing the testing and continuing education components of the program.[5] Thus, unless the District Court's ruling is overturned on appeal, U.S. taxpayers will continue to find themselves without meaningful IRS oversight of preparers, where anyone can hang out a shingle as a "tax return preparer" with no knowledge or experience required.

The case for IRS oversight over the return preparation industry is clear. Problems with return accuracy and ethical standards were substantiated by a series of "shopping visits" the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) conducted, where auditors posed as taxpayers and visited tax return preparation businesses.[6] Accordingly, the National

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1 2012 IRS Data Book, at 3 (Mar. 25, 2013) (Doc 2013-7103); Table 1, col 2; Department of Treasury, *Budget in Brief: Internal Revenue Service FY 2014* 1.

2 The TY 2011 returns were prepared in 2012. For TY 2011, the IRS received 142,424,022 individual income tax returns. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2011 (filed through Mar. 2013).

3 IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2011 (filed through Mar. 2013).

4 For a more detailed discussion of this data and its import, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31, Tax Analysts Tax Notes Today (May 13, 2013). IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2011 (filed through Mar. 2013). The category "unregulated preparer" reflects returns prepared by individuals with preparer tax identification numbers who did not list a profession when registering with the IRS. IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2011 (filed through Mar. 2013). IRS records show about one million returns as paid preparer returns that did not have a Preparer Tax Identification Number (PTIN) match in the Return Preparers and Providers Database.

5 111 A.F.T.R.2d (RIA) 589 (D.D.C. Jan. 18, 2013).

6 Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 2 (Apr. 4, 2006) (statement of Michael Brostek, Director - Strategic Issues, Before the Committee on Finance, U.S. Senate); Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

Taxpayer Advocate continues to recommend that the IRS establish minimum standards for return preparers as an essential consumer protection measure. Minimum standards would also improve professionalism and reduce preparer-facilitated noncompliance.[7]

While the question of regulatory authority is ultimately up to the courts to decide, the IRS has the responsibility to protect taxpayers by pursuing education and enforcement options that are undeniably within its purview. In the event that the courts decide that the IRS does not have authority to impose testing and continuing education requirements on preparers, the National Taxpayer Advocate urges the IRS to implement the following six-part strategy to protect taxpayers from preparer incompetence and misconduct:

1. Offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate.
2. Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn the voluntary examination and continuing education certificate.
3. Restrict the ability to name an unenrolled preparer as a Third Party Designee on Form 1040, *U.S. Individual Income Tax Return*.
4. Mount a consumer protection campaign to educate taxpayers about the need to select competent preparers who can demonstrate competency.
5. Develop a research-driven, Servicewide preparer compliance strategy similar in nature to the Earned Income Tax Credit (EITC) preparer compliance strategy.
6. Recommend that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate unenrolled preparers.

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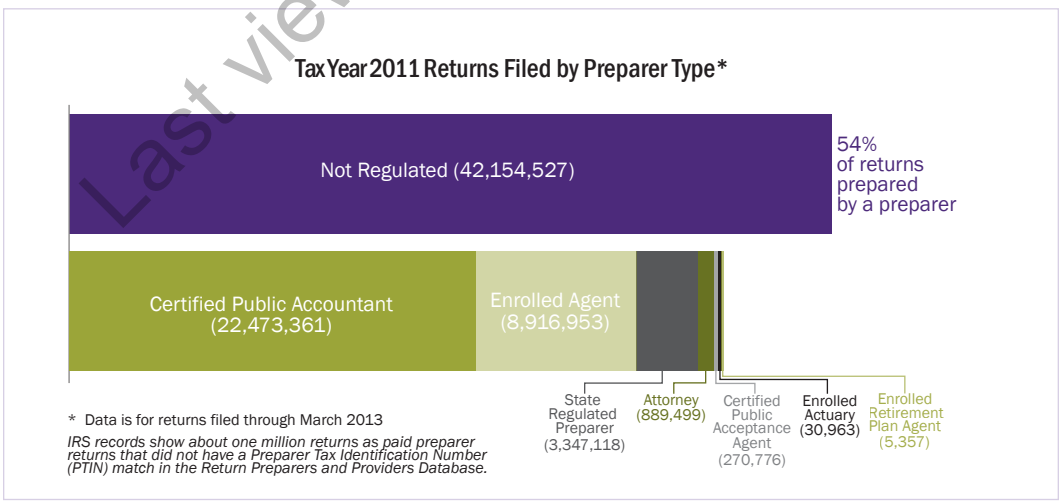

7 By statute, the IRS cannot require attorneys and accountants to pass the competency exam or satisfy continuing education requirements to prepare returns. 5 U.S.C §§ 500(b) & (c) grant attorneys and certified public accountants, respectively, the authority to represent clients before federal agencies (upon submitting a written declaration stating that he or she is currently qualified).

ANALYSIS OF PROBLEM

Background

The National Taxpayer Advocate Has Long Proposed a Program to Regulate Return Preparers

Since 2002, the National Taxpayer Advocate has advocated for a system to regulate return preparers. Her proposals included a program to register, test, and certify unenrolled preparers, as well as increased preparer penalties and improved due diligence requirements. The National Taxpayer Advocate has also recommended that the IRS mount a comprehensive education campaign to inform taxpayers how to choose a competent preparer and remind them to obtain a copy of the tax return with the preparer's signature.[8]

The National Taxpayer Advocate's recommendations to regulate the return preparer profession received widespread support. Most organizations representing established preparers supported her call for minimum industry standards. For example, in 2005 the House Ways and Means Subcommittee on Oversight held a hearing at which representatives of five outside organizations testified in support of regulating return preparers.[9] Preparer oversight has received similarly broad support from members of Congress. The Senate Finance Committee has twice approved legislation to regulate federal tax return preparers (once under Democratic and once under Republican control).[10] The full Senate also once approved similar legislation.[11] However, the House of Representatives never took up companion measures. More recently, several bills included proposals to regulate preparers — S.1219, the Taxpayer Protection and Assistance Act of 2007; H.R. 5716, the Taxpayer Bill of Rights Act of 2008; and S. 3215, the Taxpayer Bill of Rights of 2010.[12] All of these bills would have required preparers to have the knowledge and skills to prepare accurate returns.[13]

IRS Implements Return Preparer Strategy

In January 2010, the IRS published a study of federal tax return preparers that in most important aspects reflected the proposals made by the National Taxpayer Advocate.[14] As a result of the study, the IRS issued regulations requiring all preparers to register with the IRS by obtaining a preparer tax identification number (PTIN).[15] The IRS also required certain preparers to meet testing and continuing education standards.[16] Implementation began with the 2011 filing season, when the IRS required paid return preparers to obtain PTINs.[17] The IRS launched the registered tax return preparer competency test in November

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8 National Taxpayer Advocate 2009 Annual Report to Congress 41-69; National Taxpayer Advocate 2008 Annual Report to Congress 503-512; National Taxpayer Advocate 2006 Annual Report to Congress 197-221; National Taxpayer Advocate 2005 Annual Report to Congress 223-237; National Taxpayer Advocate 2004 Annual Report to Congress 67-88; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2002 Annual Report to Congress 216-230; *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

9 The organizations were the American Bar Association, the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, the National Society of Accountants, and the National Association of Tax Professionals. *See Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 109th Cong. (2005).

10 H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.).

11 H.R. 1528 (incorporating S. 882) (108th Cong.).

12 S. 1219, § 4, 110th Cong. (2007); H.R. 5716, § 4, 110th Cong. (2008); S. 3215, §202. 111th Cong. (2010).

13 *See also* GAO, GAO-08-781, *Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation* (Aug. 15, 2008).

14 IRS Publication 4832, Return Preparer Review (Dec. 2009).

15 Treas. Reg. § 1.6109-2(d).

16 31 C.F.R. §§ 10.4(c) (testing) and 10.6(e) (continuing education).

17 *See* IRS News Release, IR-2010-106, *IRS Begins Notifying Tax Return Preparers on PTIN Renewals* (Oct. 25, 2010).

2011 with a deadline to take the test by December 31, 2013. The continuing education requirement began during the 2012 calendar year.[18]

The District Court Enjoined IRS Preparer Initiatives

In January 2013, after the new return preparer program was substantially in place, a U.S. district court judge in *Loving v. Internal Revenue Service* enjoined the IRS from enforcing the testing and continuing education requirements. The outcome of *Loving* rests on the reviewing court's application of the *Chevron* analysis.[19]

Under *Chevron*, the court must first ask if Congress's intent in enacting the statute giving rise to the challenged government action — here, the regulation — is clear. If so, the court must give full effect to this expressed intent of Congress. Pursuant to 31 U.S.C. § 330(a)(1), Congress granted the Secretary of the Treasury authority to "regulate the practice of representatives of persons before the Department of the Treasury." The *Chevron* analysis turns on how "practice of representatives" is defined in the context of tax return preparation.

In *Loving*, the District Court reasoned that the statute equates "practice of representatives" to the presentation of a case before the IRS, and held that the mere preparation of a return for submission to the IRS does not amount to "practicing" before the IRS.[20] Thus, the District Court held that the statute unambiguously limits the IRS's authority to regulate the "practice of representatives." Therefore, under a *Chevron* analysis, 31 U.S.C. § 330(a)(1) does not authorize the Secretary of Treasury to regulate the practice of representatives who prepare federal tax returns on behalf of other persons for filing with, and review by, the IRS.[21] The Justice Department has appealed the District Court's decision.[22]

The District Court's Decision in *Loving* is Based on an Outdated Understanding.

The National Taxpayer Advocate believes that the District Court decision in *Loving* is based on an outdated understanding of the return preparation function.[23] For purposes of determining what constitutes "practice" before the IRS, the court excluded return preparation because, it reasoned, at the time of filing there is no dispute before the IRS and thus, no "case" to present, as required by 31 U.S.C. § 330(a)(2)

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18 IRS News Release, IR-2011-111, *IRS Moves to Next Phase of Return Preparer Initiative; New Competency Test to Begin* (Nov. 22, 2011).

19 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984). "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress" (step one). If, however, the reviewing court determines that the statute is ambiguous or silent regarding Congress's intent, the court must ask whether the agency position "is based on a permissible construction of the statute" (step two).

20 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013). The government filed a motion to suspend the injunction pending appeal. The U.S. District Court for the District of Columbia denied the motion but then modified the terms of the injunction to make clear that the IRS is not required to suspend the preparer tax identification number (PTIN) program, and not required to shut down all of its testing and continuing centers. *See Loving*, 111 A.F.T.R.2d (RIA) 702 (D.D.C. Feb. 1, 2013). On February 25, 2013, the government filed a motion for a stay pending appeal. On March 27, 2013, the U.S. District Court for the District of Columbia denied the motion for stay. *Loving*, 111 A.F.T.R.2d (RIA) 1384 (D.D.C. Mar. 27, 2013). Oral argument was held before the Court of Appeals for the D.C. Circuit on September 24, 2013.

21 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013).

22 *See Government Files Brief in D.C. Circuit Court in Return Preparer Oversight Case*, 2013 TNT 62-20, Tax Analysts Tax Notes Today (Apr. 3, 2013); *Loving v. IRS*, No. 1:12-cv-00385 (D.D.C. 2013) (USCA Case No. 13-5061). The oral arguments were held at the D.C. Circuit on September 24, 2013. *See* Matthew R. Madara, *Appeals Judges Turn Skeptical Eye Toward IRS Return Preparer Requirements,Tax Analysts* Tax Notes Today (Sept. 24, 2013).

23 For a more detailed discussion of the National Taxpayer Advocate's views, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31, Tax Analysts Tax Notes Today (May 13, 2013).

(D).[24] However, the filing of a tax return is not merely a ministerial act. The taxpayer is taking a position before the federal government regarding items of income, expenses, and eligibility for government benefits that are administered by the IRS. A preparer is not merely the taxpayer's scrivener. Taxpayers pay preparers for their knowledge and skills because they are uncomfortable navigating the complexity of the tax laws by themselves.[25]

Tax return filing is almost always "presenting a case" and return preparers are representatives before the IRS when they advise and assist taxpayers in making their claims to the IRS and Treasury.[26] More than 80 percent of individual income tax returns are actually claims for refund under IRC § 6402, and nearly 80 percent of those refund returns are prepared by preparers.[27]

The case for IRS oversight over the return preparation industry is clear.

In addition, IRC § 6695(g) imposes due diligence requirements for paid preparers of individual income tax returns claiming the EITC and a penalty of $500 for each failure to comply with the requirements. The regulations thereunder require the preparer to complete and submit Form 8867, *Paid Preparer's Earned Income Credit Checklist,* which includes a series of questions to determine the taxpayer's eligibility as well as the preparer's affirmative acknowledgement that he or she complied with the due diligence requirements. The preparer must also complete an EITC worksheet, and comply with recordkeeping and knowledge requirements.[28]

The due diligence requirements result in the preparer anticipating and preparing for an IRS challenge to the taxpayer's eligibility for EITC by answering certain questions, verifying to the IRS that the preparer asked certain questions and retained documentation probative of eligibility. In TY 2012, over 76 percent of preparers who prepared returns claiming EITC were unenrolled.[29] The chart below provides further information on EITC claims and the use of preparers in tax years 2010 through 2012:

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24 *Loving v. IRS*, 917 F. Supp. 2d 67, 74 (D.D.C. Jan. 18, 2013). The Secretary of the Treasury has the authority to require that a representative demonstrate:

(A) good character; (B) good reputation; (C) necessary qualifications to enable the representative to provide to persons valuable service; and (D) competency to advise and assist persons in presenting their cases.

31 U.S.C. § 330(a)(2)(A)-(D). In its reply brief, the government argues that the factors listed in § 330(a)(2) are discretionary and therefore not all required to constitute practice before the IRS. *See* Reply Brief for the Appellants, *Loving v. Internal Revenue Service*, No. 13-5061, page 18 (D.C. Cir. filed June 5, 2013).

25 *See also* Brief of Former Commissioners of Internal Revenue as amici curiae, supporting defendants-appellants, *Loving v. IRS*, No. 13-5061 (D.C. Cir. filed Apr. 5, 2013).

26 *See* Lawrence B. Gibbs, Loving v. IRS: *Treasury Has the Authority to Regulate Unregulated Commercial Preparers*, 2013 TNT 203-50, Tax Analysts Tax Notes Today (Oct. 21, 2013). In the article, the former IRS Commissioner argues in favor of the government's position and provides that the preparation of a return is the presentation of a case. Moreover, the article analogizes the preparation of return to the preparation of a will, which is undeniably considered representation, despite the absence of a principal-agent relationship.

27 For TY 2011, the IRS received 142,424,022 individual income tax returns, of which 114,511,777 (80.4 percent) claimed refunds. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2011 (filed through Mar. 2013). For TY 2011, preparers prepared 79,008,158 individual returns, of which 61,680,140 (78.1 percent) claimed refunds. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2011 (filed through Mar. 2013).

28 Treas. Reg. § 1.6695-2. For tax returns and claims for refund for tax years ending on or after December 31, 2011, preparers are required to submit Form 8867, with the taxpayer's return. T.D. 9570. This recent revision is consistent with recommendations made by the National Taxpayer Advocate in 2003. National Taxpayer Advocate 2003 Annual Report to Congress 270-302. The knowledge requirement provides that the preparer have no knowledge that any of the information used to determine if a taxpayer is eligible for the EITC is incorrect.

29 IRS, Returns Preparer and Provider Database.

TABLE 1.5.1, The Preparation of EITC Claims by Unenrolled Preparers in TY 2010-2012[30]

Tax Year	EITC Paid	Count	Total Preparers	Unenrolled Preparers	Percent Unenrolled
2010	$58,573,186,452	27,627,852	16,464,493	12,430,967	75.5%
2011	$61,109,934,146	27,816,576	16,549,166	12,198,085	73.7%
2012	$62,981,818,983	27,081,228	15,132,562	11,523,814	76.2%

In addition, the act of filing is also the first step for millions of U.S. taxpayers every year in what will become a formal tax controversy. For example, in the 2013 filing season, the IRS identified potential errors in approximately 18.9 million returns during processing, causing the IRS to send the returns to "error resolution," and requiring some of the taxpayers to present additional information.[31] Further, the IRS issued over 270,000 math error notices, disallowing dependency exemptions and tax credits tied to dependents for tax year 2012.[32] The following chart illustrates the use of paid preparers by taxpayers claiming refundable credits in tax years 2010 and 2011.

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TABLE 1.5.2, Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage: Tax Years 2010 and 2011[33]

Tax Credit	Tax Year	Number of Taxpayers	Average Claim (dollars)	Total Claims (dollars in thousands)	Preparer Returns (percentage)
Earned Income Tax Credit	2011	27,362,193	$2,270	$62,119,975	59.3%
Additional Child Tax Credit	2011	20,616,435	$1,347	$27,771,740	65.0%
First-Time Homebuyer Credit	2010	373,880	$6,893	$2,577,155	53.8%
Adoption Credit	2011	55,794	$13,474	$760,365	60.1%
Making Work Pay Credit	2010	106,381,764	$514	$54,784,234	53.6%
American Opportunity Tax Credit	2011	12,525,776	$899	$11,266,488	55.9%

The Availability of Tax Preparation Software Opened Opportunities for Untrained and Even Unscrupulous Return Preparers

Before reasonably priced return preparation software packages became widely available, knowledge of the tax laws was a barrier to entry into the return preparation industry. To gain the competence to prepare a return, preparers needed to read the tax laws, Treasury regulations, IRS publications, and the IRS form instructions, which required a significant investment of time, energy, skill, and knowledge. Once return preparation software became widely available and reasonably priced (as little as $119.95 for a package),

30 IRS, Compliance Data Warehouse Individual Returns Transaction File; IRS, Individual Master File (net of transactions 764, 765, and 768); IRS, Returns Preparer and Provider Database (through Nov. 2013) (Note that the amounts paid out by the IRS may have been subsequently disallowed in post-refund audits).

31 IRS, Submission Processing Miscellaneous Monitoring Report, Headquarters, ERS (IMF/BMF) 2013 vs. 2012 (week ending Sept. 27, 2013).

32 Individual Returns Transaction File (IRTF) tax module table from CDW tax year 2012 (transaction codes 604, 605,and 743) (Oct. 2013). For a detailed description of the path a return takes from submission to assessment and refund issuance, and all the possible controversies arising from that path, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31, Tax Analysts Tax Notes Today (May 13, 2013).

33 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File and Individual Master File, TY 2010 and 2011 (through Mar. 2013).

anyone could sit down and have the software walk them through the entire process without any previous knowledge or experience.[34]

The IRS sought to remedy this issue by imposing examination and continuing education requirements on preparers with no previously recognized credentials — unenrolled return preparers. Those preparers could satisfy the IRS's requirements and obtain the designation "registered tax return preparer" if they satisfied the program requirements. However, the current injunction imposed on the IRS by *Loving* prohibits the IRS from administering the testing and education components of the program. Therefore, after *Loving*, once again, anyone can hang up a shingle and be a return preparer.

Taxpayers Remain Vulnerable to Incompetent and Unscrupulous Preparers.

The need for regulation was evident long before the IRS implemented its return preparer program. In 2006 and 2008, GAO and TIGTA, respectively, conducted studies in which auditors posed as taxpayers and visited preparers for help in preparing returns. The results dramatically substantiated the National Taxpayer Advocate's longstanding concerns by suggesting that a high percentage of preparers prepare inaccurate returns, fail to perform sufficient due diligence, and even take positions that they know are not supportable.[35]

Without any regulation, we will continue to see a proliferation of return preparers showing up at check-cashing places, pawnshops, used car dealerships, furniture stores, etc. Anyone who doubts we have devolved into the Wild Wild West of tax return preparation should view two videos. The first is an advertisement for some type of services related to tax returns.[36] The second is a slideshow of photographs taken by Local Taxpayer Advocates in 2010 showing the variety of businesses touting tax preparation services.[37] In addition, the amicus brief of the National Consumer Law Center and the National Community Tax Coalition in *Loving* contains many examples of the virtual absence of professionalism and competency.[38]

Finally, over the past several years, the need for regulation of these preparers has become even more apparent at the Taxpayer Advocate Service. We recently have seen many misconduct cases in which the return preparers have altered return information without their clients' knowledge or consent in an attempt to obtain improperly inflated refunds or divert refunds for their personal benefit.[39]

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34 Results of Google search "Professional Tax Preparation Software Price" (Apr. 30, 2013).

35 Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 5, 23 (Apr. 4, 2006) (finding preparers made significant mistakes on 17 of the 19 returns prepared for GAO employees posing as taxpayers, including the omission of income on ten); TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* 2 (Sept. 3, 2008) (finding preparers made mistakes on 17 of the 28 returns prepared for TIGTA employees posing as taxpayers, including six willful or reckless errors).

36 http://www.youtube.com/watch?v=W00BmbrlvHk&sns=em (Southern King Taxes promotional video) (last viewed Dec. 10, 2013).

37 Taxpayer Advocate Service, *Tax Preparation Sites Across the United States: A Random Selection of Services Marketed to U.S. Taxpayers, available at* http://www.taxpayeradvocate.irs.gov/preparervideo (Dec. 10, 2013).

38 Brief of National Consumer Law Center and National Community Tax Coalition, as *amici curiae*, supporting defendants-appellants, *Loving v. IRS*, No. 13-5061 (D.C. Cir. filed Apr. 5, 2013) (Doc. #1429234). *See also* National Consumer Law Center, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (Nov. 2013), *available at* http://www.nclc.org/issues/riddled-returns.html (last visited Dec. 20, 2013).

39 For a more detailed description of return preparer misconduct and IRS procedures to assist victims of the misconduct, see Most Serious Problem: *The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Fraud, Despite Ample Guidance Allowing the Payment of Such Refunds, supra*; National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 1-4; National Taxpayer Advocate 2012 Annual Report to Congress 68-94 (Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully*).

Development of a Six-Part Return Preparer Strategy Would Protect Taxpayers in the Event the Courts Decide the IRS Does Not Have Regulatory Authority.

Given the demonstrated need for regulation of unenrolled preparers, and the uncertainty introduced by the *Loving* litigation, it is imperative that the IRS act to protect taxpayers from the harm that arises in the current unregulated environment. In the discussion below, we lay out an approach for ensuring that taxpayers receive competent and ethical preparation, regardless of the type of tax return preparer they choose. Accordingly, the National Taxpayer Advocate urges the IRS to develop a six-part strategy to protect taxpayers in the event that *Loving* is upheld on appeal. Specifically, the strategy should include the following components:

1. Offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate.
2. Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn the voluntary examination and continuing education certificate.
3. Restrict the ability to name an unenrolled preparer as a Third Party Designee on Form 1040.
4. Mount a consumer protection campaign that educates taxpayers about the need to select competent preparers who can demonstrate competency.
5. Develop a research driven and Servicewide preparer compliance strategy similar in nature to the EITC preparer compliance strategy.
6. Recommend that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate unenrolled preparers.

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Offer Unenrolled Preparers the Opportunity to Earn a Voluntary Examination and Continuing Education Certificate.

The IRS should offer paid unenrolled preparers the opportunity to *voluntarily* distinguish themselves from untrained preparers. This would involve providing a certificate to preparers who passed an IRS-developed examination and satisfy continuing education criteria similar to those previously implemented by the IRS. This may involve contracting with third parties to administer the examination and continuing education once the IRS follows the appropriate rulemaking processes.

Restrict the Ability of Unenrolled Preparers to Represent Taxpayers in Audits of Returns They Prepared Unless They Earn the Examination and Continuing Education Certificate.

Currently, unenrolled preparers are allowed to engage in limited practice before the IRS, representing taxpayers before revenue agents, customer service representatives, or similar officers and employees of the IRS (including the Taxpayer Advocate Service) during an examination if they signed the tax return or claim for refund for the tax period under examination.[40] These preparers cannot, however, represent taxpayers before Appeals or Collection.[41]

40 Section 10.7 of Circular 230 (31 C.F.R. § 10.7) was amended before *Loving* to remove the authorization for unenrolled, unlicensed individuals to represent before the agency on returns they signed. However, Notice 2011-6, 2011-3 I.R.B. 315 provided interim authority for these individuals to represent in this context during "the transition years" of the return preparer program. It is the opinion of the Office of Professional Responsibility (OPR) that this anticipated temporary authority should be amended to remove this privilege. OPR response to TAS information request 5 (Oct. 31, 2013).

41 31 C.F.R. § 10.3(f)(3).

Without any regulation, we will continue to see a proliferation of return preparers showing up at check-cashing places, pawnshops, used car dealerships, furniture stores, etc.

At the time when Treasury granted unenrolled preparers this limited practice authority, the role of a tax preparer required skill and knowledge of tax laws. Revenue Procedure 81-38 provides that the preparer of the return under audit could assist in the exam by explaining the positions taken.[42] However, as noted above, the advent of commercial preparation and filing software has radically changed the profession by enabling anyone to prepare a return without any training in the tax law. Thus, return preparation by an untrained individual with commercial software does not position that individual to competently assist the taxpayer in the examination.

Representing a taxpayer before Examination requires a certain level of knowledge, competence and skill, the absence of which can have a significant economic impact on the taxpayer. If the courts decide return preparation is not "presenting a case" before the IRS because it is mere preparation, it is in the best interest of taxpayers to restrict the authority granted to unenrolled return preparers to conduct limited practice before the IRS. Unenrolled preparers may not possess the requisite skill and knowledge to represent taxpayers at any level before the IRS.

To ensure that taxpayers have knowledgeable and skilled representation, the IRS should condition the authority for an unenrolled preparer to represent his or her preparation-clients in audits on his or her passing a competency test and satisfying annual continuing education requirements. This approach does not impinge on a preparer's ability to prepare a return. Even the plaintiffs in *Loving* raised no objection to the IRS regulating practitioners who wish to represent taxpayers during an examination.[43] If, as the *Loving* plaintiffs state, these unenrolled preparers are "merely" preparing returns — being scriveners — then, absent passing a test and satisfying continuing education requirements to demonstrate competency, they clearly should not be permitted to represent taxpayers in audits of returns.

Therefore, the National Taxpayer Advocate recommends revising all guidance to ensure that only competent unenrolled preparers have the authority to represent taxpayers under exam with respect to returns they have prepared. Accordingly, revisions are necessary to the current guidance provided by:

- Revenue Procedure 81-38;
- Circular 230[44] (any references relating to the authorization for unenrolled preparers to represent taxpayers in audits of returns they have prepared and signed); and
- 26 C.F.R. § 601.502(b)(5)(iii)).

Restrict the Ability to Name an Unenrolled Preparer as a Third Party Designee on Form 1040. Form 1040 includes a section for "Third Party Designee" in which the taxpayer can check a box to designate a person who has the authority to discuss the return with the IRS. The Office of Professional

42 *See* Rev. Proc. 81-38, 1981-2 C.B. 592.

43 *Loving v. IRS*, 917 F. Supp. 2d 67, 71 (D.D.C. Jan. 18, 2013).

44 31 C.F.R. Part 10.

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Responsibility (OPR) is contemplating prohibiting taxpayers from designating an unenrolled preparer as the Third Party Designee.[45] We support OPR in its efforts and believe this issue warrants consideration.[46]

OPR is considering excepting from such prohibition those preparers who are licensed by the IRS or a state licensing body.[47] The National Taxpayer Advocate believes OPR's position merits further investigation.

In addition, it is unclear whether restricting third party designees on Form 1040 would impact the authorization granted to an appointee in Form 8821, *Tax Information Authorization*. If the taxpayer appoints a preparer on Form 8821, the taxpayer does not authorize the appointee to advocate a position with respect to federal tax laws; to execute waivers, consents, or closing agreements; or to otherwise represent the taxpayer before the IRS.[48] In contrast to the Form 8821 designee, the Third Party Designee authorization on the Form 1040 authorizes the designee to both provide information and receive information, which is one step closer to acting as the taxpayer's agent. This issue requires further analysis.

Mount a Consumer Education Campaign Educating Taxpayers About the Need to Select Competent Preparers.

Consistent with the National Taxpayer Advocate's longstanding position that the IRS should mount a comprehensive taxpayer awareness campaign, we believe it is more important than ever that the IRS increase its outreach and education about choosing a preparer, with particular emphasis on the populations at most risk, such as low income, elderly and disabled taxpayers. Until the IRS is once again permitted to fully administer the return preparer regulations, the National Taxpayer Advocate believes taxpayers must proactively protect themselves when hiring preparers and the IRS should make every effort to provide them with the information they need to do so. In fact, the IRS will cease to provide return preparation services at Taxpayer Assistance Centers (TACs) during the 2014 filing season.[49] Therefore, low income, elderly and disabled taxpayers will have one less avenue to receive reliable tax preparation services at no cost, making this information campaign even more imperative to protect those most vulnerable taxpayers. TAS has already developed communications instructing taxpayers to do the following:

a. Ask the preparer directly about his or her qualifications and experience level in preparing tax returns. The preparer should convince the taxpayer that the preparer possesses sufficient knowledge of relevant tax law — not merely completion of return preparation software training or an "ability" to obtain large refunds for taxpayers. Further, the taxpayer should check with the Better Business Bureau or the state consumer protection website for any complaints or ongoing investigations against the preparer or the firm.[50]

b. Make sure the preparer signs the return and fills in his or her Preparer Tax Identification Number (PTIN) or Employer Identification Number where indicated on the tax forms.

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45 OPR response to TAS information request 5 (Oct. 31, 2013).

46 However, the prohibition should clearly exclude persons not in the business of preparing returns, such as parents preparing their child's return.

47 OPR response to TAS information request 5 (Oct. 31, 2013).

48 Instructions, Form 8821, *Tax Information Authorization*.

49 W&I response to TAS information request (Dec. 20, 2013). The IRS will refer taxpayers who visit the TACs for tax preparation to the nearest volunteer site for tax return preparation.

50 The communication should clearly provide that the taxpayer should not select a preparer based on the promised size of the refund.

c. Obtain a copy of the return signed by the preparer and keep the copy in the event there is a problem with the return.[51]

d. Ask the preparer for a business card or brochure and place it in the tax file with a copy of the invoice for the preparation services.

Develop a Research-Driven and Servicewide Return Preparer Compliance Strategy Similar in Nature to the FY 2014 EITC Preparer Compliance Strategy.

While it cannot impose testing and education requirements on preparers pending litigation, the IRS can increase competency and accountability among preparers by using tools that remain available. For example, the IRS holds annual Nationwide Tax Forums to provide preparers with the latest information on tax administration in general. More than half of those attending the forums are unenrolled preparers.[52] However, instead of increasing its presence at the forums, the IRS has drastically reduced the resources allocated to them.[53] For example, the IRS has cut the case resolution program and focus groups conducted at the forums, which represents lost opportunities for both practitioners and the IRS to interact in a mutually beneficial situation.[54]

Another cost-effective way to reach the unenrolled preparer population is through webinars, podcasts and other social media channels to deliver messages impacting vulnerable taxpayers, such as the EITC due diligence requirements in IRC § 6695(g).[55] The IRS currently focuses preparer education on EITC and other refundable credits. However, it has not changed its overall outreach and education strategy for preparers in response to *Loving*.[56]

In addition to education and outreach, the IRS has a wide array of enforcement tools to encourage compliance among return preparers. The IRS can assess Title 26 penalties as well as impose sanctions under Circular 230 (under Title 31), which is generally enforced by the Office of Professional Responsibility.[57] However, the IRS has not altered its compliance strategies in response to the *Loving* opinion.[58] While the National Taxpayer Advocate believes prevention in the form of taxpayer and preparer education and outreach is the most effective way to protect taxpayers, the IRS must enhance its compliance initiatives if it can no longer mandate minimum competency standards.

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51 The Taxpayer Advocate Service developed a poster (IRS Publication 5074, *Protect Your Refund*), and distributed copies to all W&I taxpayer assistance centers (TACs) and low income taxpayer clinic (LITC) offices. The communication should instruct the taxpayer to require the preparer to include the preparer's name and address on the return.

52 OPR response to TAS information request 3 (Oct. 31, 2013).

53 IRS National Public Liaison response to TAS information request. The IRS made presentations on EITC at the 2012 and 2013 Tax Forums. W&I response to TAS information request 3 (Oct. 28, 2013). In addition, OPR also presented three levels of training at the Tax Forums in 2013. OPR response to TAS information request (Oct. 31, 2013).

54 See National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 51-53.

55 The IRS held webinars on the topic of EITC due diligence in both English and Spanish in 2012. W&I response to TAS information request 3 (Oct. 28, 2013). The IRS website includes comprehensive information about EITC due diligence requirements for preparers. *See* http://www.eitc.irs.gov/rptoolkit/dd/. OPR has also held webinar broadcasts, phone forums, and various other types of broadcasts, press releases, and face-to-face speaking engagements. OPR response to TAS information request (Oct. 31, 2013). RPO also conducts live webinars, video presentations and uses various social media channels. RPO response to TAS information request (Nov. 12, 2013).

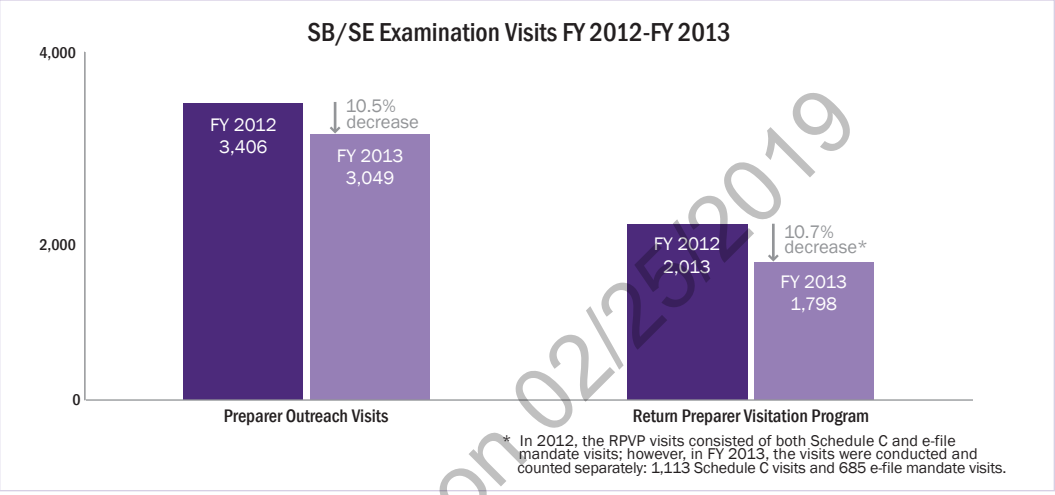
56 W&I response to TAS information request 2 (Oct. 28, 2013) (The IRS did notify examiners to limit education on its Knock and Talk Visits to just PTIN compliance after *Loving*). RPO has noted that its outreach and education has changed due to *Loving* in that there is a reduction in public speaking requests, and their education is directed more at individual preparers and related to program and tax compliance as well as complaints as opposed to more large preparer groups pre-*Loving*. RPO response to TAS information request (Nov. 12, 2013).

57 See IRC §§ 6694, 6695, 6713 and 31 C.F.R. § 10.50.

58 SB/SE response to TAS information request 2 (Nov. 5, 2013) ("SBSE Examination has not increased scrutiny and enforcement of return preparers in response to the injunction ordered by the District Court in *Loving v. IRS*. We have continued to identify, evaluate and conduct appropriate investigations of questionable return preparers referred to Examination or identified through compliance activity.").

SB/SE Examination conducts preparer outreach visits as directed by the IRS Return Preparer Office (RPO) and W&I's return preparer offices. Total outreach visits decreased by 10.5 percent from FY 2012 to FY 2013. In addition, visits conducted as part of the Return Preparer Visitation Program (RPVP), to address PTIN requirements, e-file requirements, and Schedule C preparation, declined from FY 2012 to FY 2013, by approximately 10.7 percent.[59]

FIGURE 1.5.3, SB/SE Exam Visits



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In addition to increasing the appropriate assessment and collection of preparer penalties under IRC §§ 6694 and 6695, repeat offenders must also deal with Circular 230 sanctions, which require coordination between various IRS functions. We have learned that the OPR and the Department of Justice have coordinated efforts to make return preparer injunctions a priority. OPR has also taken the position that its enhanced jurisdiction under sections 10.8(a) and (c) of Circular 230 is not impacted by *Loving*, and thus, all PTIN holders are still subject to the ethical standards under Subparts B and C of Circular 230.[60] OPR has also begun initiatives to crack down on preparers taking their fees directly out of taxpayer refunds by improperly setting up a split refund direct deposit using Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*, or directing the refund into a joint bank account in the name of the taxpayer and preparer.[61] These are positive developments that will benefit vulnerable taxpayers.

The National Taxpayer Advocate encourages the IRS to develop a Servicewide Return Preparer Strategy similar in nature to the FY 2014 EITC Return Preparer Strategy. The IRS developed this strategy over

59 SB/SE response to TAS information request (Nov. 5, 2013). SB/SE Exam conducted a total of 3,406 preparer outreach visits in FY 2012 and decreased to 3,049 total visits in FY 2013. The number of planned total return preparer visits in FY 2013 was originally 3,434; however, visitations were reduced due to Hurricane Sandy. SB/SE Exam conducted 2,013 RPVP visits in FY 2012 and then dropped to only 1,798 visits in FY 2013. RPVP visits declined by approximately 10.7 percent from FY 2012 to FY 2013. In 2012, the RPVP visits consisted of both Schedule C and e-file mandate visits; however, in FY 2013 the visits were conducted and counted separately — 1,113 Schedule C visits and 685 e-file mandate visits.

60 OPR response to TAS information request 3 (Oct. 31, 2013). Section 10.8(a) and (c) were added to Cir 230 in the 2011 amendments to insure that ethical oversight of the expanded universe of Circular 230 practitioners was available during the transition period without regard to whether a preparer had tested (or was required to test).

61 Kristin Parillo, *ABA Meeting: OPR and DOJ Coordinating Enforcement Against Return Preparers*, 2013 TNT 185-9, Tax Analysts Tax Notes Today (Sept. 24, 2013); OPR response to TAS information request (Oct. 31, 2013).

several years and based it on findings from a three-year EITC Real Time Return Preparer Test. The IRS has completed two years of the test during 2012 and 2013 and evaluated the effectiveness of several treatment streams both pre-filing season and post filing season, including various letters, phone calls, due diligence visits, knock-and-talk visits, and audits. According to the IRS, evaluation of the results showed that the test protected nearly $600 million in revenue during the 2013 filing season.[62] The IRS used the findings of the first two years of the test to design the FY 2014 Return Preparer Strategy, which utilizes improved and research-driven selection techniques and assigns progressive treatments based on the preparer's risk of segment.[63] The National Taxpayer Advocate believes that the IRS should build on the experience of this strategy to develop a servicewide return preparer compliance strategy.

Recommend that Congress Revise 31 U.S.C.§ 330(a)(2) to Make Clear That the IRS Has the Authority to Regulate Unenrolled Preparers.

If *Loving* is upheld on appeal, the National Taxpayer Advocate recommends that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate the unenrolled preparer population. Specifically, Congress should modify 31 U.S.C §§ 330(a)(2)(C) and (D) to clarify that the IRS can require a preparer to demonstrate the qualifications necessary to prepare and file returns, and that presenting a case to the IRS includes the preparation and filing of returns. The National Taxpayer Advocate also believes this is an opportunity to ensure that the statute clearly includes the submissions of other documents that determine tax liability, such as financial statements and offers in compromise.[64]

CONCLUSION

Until the IRS is allowed to resume the implementation of the testing and continuing education components of the return preparer program, taxpayers are vulnerable to incompetent and unscrupulous preparers. The IRS and the Taxpayer Advocate Service can assist taxpayers by educating them about the various precautions they can take to prevent becoming a victim. Without the ability to impose minimum standards on unenrolled return preparers, the IRS's only avenue to address competency issues is through targeted outreach and education to this population. However, the IRS is actually decreasing the amount of resources allocated to the tax forums, which has historically been an effective way to reach unenrolled return preparers. It has also significantly decreased preparer outreach visits. Finally, the IRS has not taken steps to enhance its return preparer compliance strategy in response to the *Loving* decision.

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62 IRS W&I Research Analysis, *Filing Season 2013 EITC Real Time Return Preparer Initial Findings / Recommendations* (Dec. 5, 2013).

63 FY 2014 EITC Return Preparer Strategy (Dec. 2013).

64 *See* National Taxpayer Advocate 2009 Annual Report to Congress 207 (recommending that the IRS require preparers of offers in compromise to sign the forms to enable the IRS to track such preparers).

RECOMMENDATIONS

Until the IRS is able to continue implementing the testing and continuing education requirements of the return preparer program, the National Taxpayer Advocate recommends that the IRS develop a six-part servicewide return preparer strategy with the following components:

1. Offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate.
2. Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn the voluntary examination and continuing education certificate.
3. Restrict the ability to name an unenrolled preparer as a Third Party Designee on Form 1040.
4. Mount a consumer protection campaign to educate taxpayers about the need to select competent preparers who can demonstrate competency.
5. Develop a research driven and Servicewide preparer compliance strategy similar in nature to the EITC preparer compliance strategy.
6. Recommend that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate unenrolled preparers.

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MSP #6 IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division
Mary Howard, Director, Office of Privacy, Governmental Liaison, and Disclosure

DEFINITION OF PROBLEM

Tax-related identity theft continues to impose significant burdens on taxpayers and the IRS. Since 2004, the National Taxpayer Advocate has identified this issue as one of the "Most Serious Problems" faced by taxpayers in nearly every annual report submitted to Congress.[1] In addition, the National Taxpayer Advocate has testified at numerous hearings on this subject, including seven since the start of 2012.[2]

Since 2004, the National Taxpayer Advocate has identified this issue as one of the "Most Serious Problems" faced by taxpayers in nearly every annual report submitted to Congress.

To its credit, the IRS has recognized identity theft as a major challenge and has devoted significant resources to addressing it. Yet the IRS still takes much too long to fully unwind the harm suffered by identity theft victims and issue refunds to the legitimate taxpayers. Moreover, the IRS has yet to implement an effective program for overseeing cases with multiple issues that require coordination among different IRS units, and is allowing too many victims to fall between the cracks of IRS bureaucracy. Thus, victim assistance overall, as well as the IRS's specialized but decentralized approach, continues to be inadequate.

To start, the IRS should rethink how it views identity theft. It must recognize that identity theft is a traumatic crime. A person's identity is core to his or her being — when someone steals and uses your identity, it is an invasion of your person. The IRS's approach to assisting the victims ignores this important fact, and in many ways treats the victim as someone experiencing a minor inconvenience instead of a frightening personal disaster. The National Taxpayer Advocate believes the IRS should set up a centralized identity theft unit similar to the centralized innocent spouse unit that assists taxpayers who may have been victims of domestic abuse. Moreover, the IRS should assign one person within the centralized identity theft unit to work with the victim until all actions are taken to resolve all related tax issues; this is the approach that TAS takes with taxpayers that come to our office.

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1 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*).

2 *See, e.g., Examining the Skyrocketing Problem of Identity Theft Related Tax Fraud at the IRS: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 112th Cong. (2013) (statement of Nina E. Olson, National Taxpayer Advocate); *Tax Fraud, Tax ID Theft, and Tax Reform: Moving Forward with Solutions: Hearing Before the S. Comm. on Finance*, 112th Cong. (2013) (statement of Nina E. Olson, National Taxpayer Advocate).

ANALYSIS OF PROBLEM

Identity Theft May Cause Significant Emotional Trauma.

Identity theft is an invasive crime that can have a traumatic emotional impact. While Post Traumatic Stress Disorder (PTSD) is usually associated with service members returning from war, or victims of violent crimes, some psychiatrists believe the symptoms experienced by victims of identity theft are quite similar.[3] The Identity Theft Resource Center found that victims of identity theft suffer from symptoms resembling those of PTSD.[4]

The IRS must recognize that victims of identity theft are not just experiencing minor tax issues, but are victims of a traumatic crime and re-evaluate its approach to identity theft victim assistance.

The IRS must recognize that victims of identity theft are not just experiencing minor tax issues, but are victims of a traumatic crime and re-evaluate its approach to identity theft victim assistance. The National Taxpayer Advocate suggests that the IRS adopt a design that mirrors its approach to aiding victims of domestic abuse who have filed for relief from joint and several liability, or "innocent spouse" relief and the Taxpayer Advocate Service's approach to taxpayers who experience significant hardship as a result of the IRS's actions or inaction.

In 1998, the IRS was given expanded authority for innocent spouse relief, following hearings that showed the IRS's handling of these cases was not only insensitive but often downright harmful to victims of psychological, physical, or financial abuse.[5] In response, the IRS set up a dedicated unit, the Cincinnati Centralized Innocent Spouse Operation (CCISO), that handles cases by assigning one person to interact with the taxpayer.[6] Employees in CCISO are trained in working with taxpayers in difficult and emotional situations.[7] This approach has enabled the IRS to deal with these taxpayers in a sensitive manner. The IRS needs to adopt a similar approach with identity theft victims.

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The IRS Should Assign a Single Employee to Be the Point of Contact with an Identity Theft Victim.

The identity theft victim, who may have experienced significant trauma, needs to have one person at the IRS to contact and rely upon. If the IRS believes the most efficient approach is to utilize a specialized structure with upwards of 20 different units[8] to resolve identity-theft related issues, this back-end process should be invisible to the taxpayer. As far as the victims are concerned, there should be *one* IRS employee who interacts with the taxpayer. That one employee should maintain control of the taxpayer's case,

3 *See* T. Sharp *et al.*, *Exploring the Psychological and Somatic Impact of Identity Theft*, J. of Forensic Sci., Vol. 49:131 (Jan. 2004); J. Monchuk, *Researcher Finds the Psychological Effects of Identity Theft Lingers with Victims*, (Apr. 20, 2011), *available at* http://medicalxpress.com/news/2011-04-psychological-effects-identity-theft-lingers.html.

4 *See* Identity Theft Resource Center, *ITRC Fact Sheet 108: Overcoming the Emotional Impact*, http://www.idtheftcenter.org/Fact-Sheets/fs-108.html (last visited Dec. 13, 2013); L. Carey, *Can PTSD Affect Victims of Identity Theft: Psychologists Say Yes* (July 29, 2009), *available at* http://voices.yahoo.com/can-ptsd-affect-victims-identity-theft-psychologists-3915926.html.

5 *See* IRC § 6015. "Innocent spouse relief" is frequently used to describe relief from joint and several liability under IRC § 6015(b). *See also* Joint Committee on Taxation, JCX-6-98, *Present Law and Background Relating to the Treatment of "Innocent Spouses"* (Feb. 9, 1998); *IRS Restructuring (Innocent Spouse Tax Rules): Hearing Before the S. Comm. on Finance*, 105th Cong. (1998).

6 *See* Internal Revenue Manual (IRM) 25.15.7.4, *First Read at the Cincinnati Centralized Innocent Spouse Operation (CCISO) Overview* (Feb. 19, 2013); IRM 25.15.8.2, *Innocent Spouse Relief* (Aug. 17, 2010); IRM 25.15.8.5.3.2, *CCISO Processing* (Aug. 17, 2010).

7 *See* http://win.web.irs.gov/innocentspouse/innocent_jobaids.htm (intranet site).

8 IRS responses to TAS information request (Oct. 30, 2013, and Nov. 13, 2013).

including ALL peripheral issues stemming from the identity theft. Otherwise, the IRS would be guilty of contributing to the problem and perpetuating the trauma to the victim.

The Taxpayer Advocate Service operates in a similar manner to the innocent spouse unit. Each taxpayer whose case is accepted into TAS is assigned a single case advocate whose toll-free phone number is given to the taxpayer, and every Local Taxpayer Advocate office has a toll-free fax number, eliminating barriers to communication. TAS case advocates speak with the taxpayer to gather relevant information and perform initial triage, route requests to the appropriate unit (often to multiple units), negotiate timeframes for response, and track the IRS responses. TAS case advocates follow up to make sure the IRS meets those deadlines, and keeps the taxpayer updated on the case. If a case advocate will be on leave or otherwise unavailable for an extended time, he or she will find another case advocate or supervisor to conduct the follow-up actions so the case will not stall.

The identity theft victim, who may have experienced significant trauma, needs to have one person at the IRS to contact and rely upon.

We believe the primary reason TAS can resolve identity theft cases in 87 days, while cases worked under normal IRS procedures can languish for more than a year,[9] is because our customers work with a single point of contact who is responsible for all aspects of their cases.[10] Although the cases are complex, TAS case advocates have achieved a relief rate of 87 percent in identity theft cases in FY 2013 (compared to 78 percent for TAS cases overall).[11] An overwhelming 94 percent of identity theft victims who come to TAS in fiscal year (FY) 2013 (through June) have expressed satisfaction (compared to a customer satisfaction score of 90 percent for TAS cases overall in that period).[12]

The IRS can and should operate in a similar manner when assisting identity theft victims. Such an approach may even save resources by cutting down on phone calls and correspondence from the victims. Taxpayers may have more patience if they are assigned a single caseworker who keeps them updated on their accounts. If the IRS wishes to conduct a pilot program, it could test whether these assumptions hold true.

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The IRS's Specialized Approach to Identity Theft Victim Assistance Has Proven to Be Inadequate.

As of the end of FY 2013, more than 3,000 IRS employees were working on identity theft — more than double the number at the start of the previous filing season.[13] Yet the IRS has consistently refused to adopt the single point of contact approach that would provide sensitive, holistic assistance to victims of a traumatic crime. The IRS seems to be throwing bodies at the problem, without addressing fundamental problems with its processes.

9 *See* TIGTA, Ref. No. 2012-040-050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Receive Quality Customer Service* (May 3, 2012); TIGTA, Ref. No. 2013-40-129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

10 Analysis conducted by TAS Technical Analysis and Guidance of data obtained from TAMIS (Oct. 1, 2013).

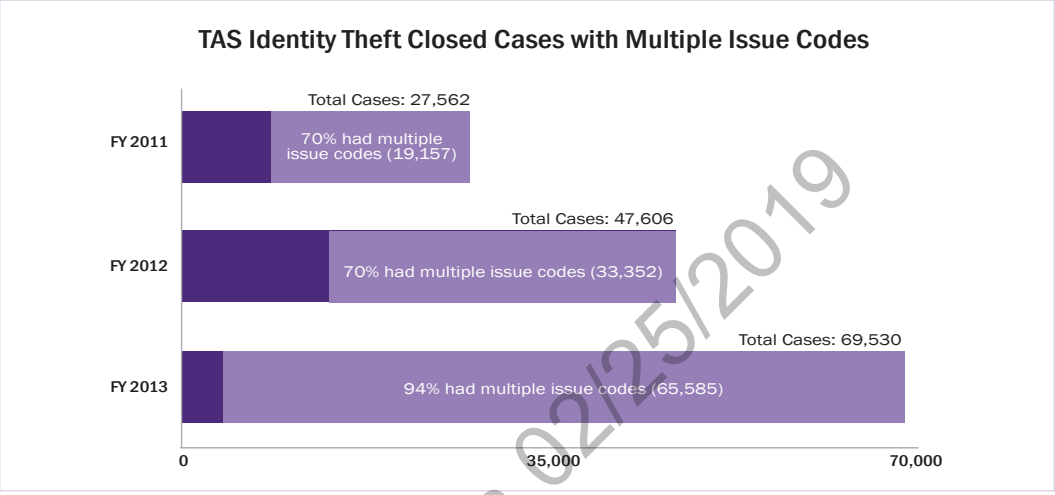
11 *Id*.

12 Analysis conducted by TAS Business Assessment of customer satisfaction scores reported for FY 2013 (through June 2013); data obtained from TAMIS (Oct. 1, 2013).

13 *See* IRS response to TAS information request (Nov. 13, 2013). However, these employees are spread among more than 20 different groups within the IRS. IRS response to TAS information request (Oct. 30, 2013, and Nov. 13, 2013).

In FY 2013, the IRS adopted a specialized approach under which each department (or "function") that deals with identity theft created a dedicated group of employees to work on those issues. Because identity theft cases can be complex, they sometimes require adjustments by multiple functions.[14]

FIGURE 1.6.1, Percent of TAS Identity Theft Cases with Multiple Issue Codes, FY 2011–FY 2013[15]



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Even where there is just one issue at hand, a case may still require multiple "touches" from various specialized units. Without a single person responsible for transferring cases from one function to another and for ensuring timely actions, the IRS creates greater risk that cases will become "stuck" or lost in the process.

Although IRS guidance instructs those working identity theft cases to identify all taxpayer issues, including possible multiple year involvement,[16] the current procedures under this specialized approach fall short of having this initial IRS employee be responsible for ensuring all issues are addressed. Under the current approach, the IRS employee working an identity theft case will look only at the one issue being worked by his or her particular function, and not assessing the taxpayer's problem holistically. Instead, because no single employee is responsible for the entirety of the case, the IRS is forcing the taxpayer to navigate an alphabet soup of departments, forms, and notices before the IRS can fully unwind the harm caused by the identity theft.[17]

The IRS has drafted a complex "transfer matrix" outlining situations in which a case must be routed from one specialized function to another. The National Taxpayer Advocate is concerned that routing cases

14 The IRS states that upwards of 20 different functions may touch an identity theft case. IRS responses to TAS information request (Oct. 30, 2013, and Nov. 13, 2013).

15 The IRS does not track the number of issues in a given identity theft case because, unlike TAS, it treats each module (year/tax/issue) as a different case. Accordingly, we can provide TAS data only. This chart is meant to illustrate that the vast majority of TAS identity theft cases involve multiple issue codes. The increase in the percentage of cases with multiple issue codes from FY 2011 to FY 2013 may be due to better coding by TAS case advocates to record secondary issue codes; it does not necessarily mean that TAS identity theft cases have become more complex in recent years.

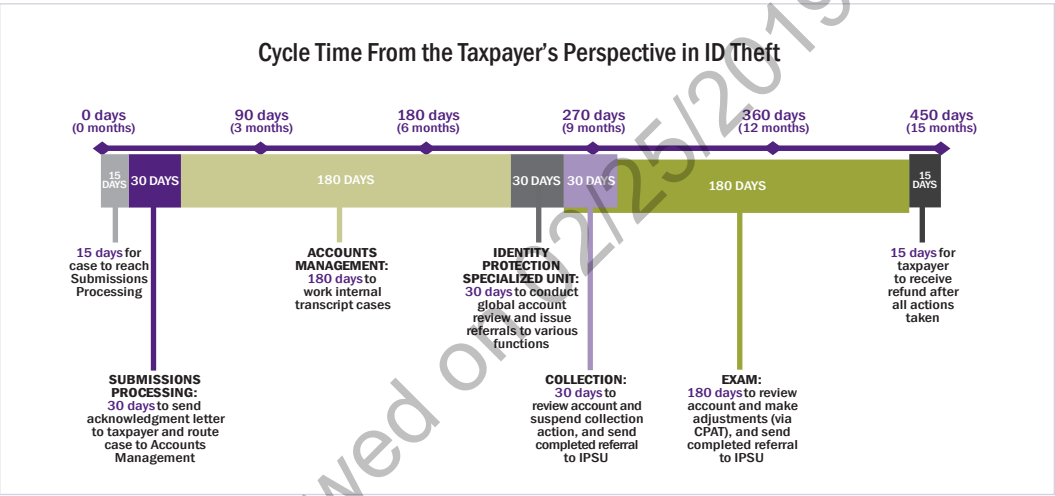
16 *See* IRM 10.5.3.2.1.2, *Assessing Scope of Taxpayer's Issues* (May 8, 2013).

17 *See Examining the Skyrocketing Problem of Identity Theft Related Tax Fraud at the IRS: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 112th Cong. (2013) (chart included in statement of Nina E. Olson, National Taxpayer Advocate).

among functions sequentially is inefficient, causing excessive delays. Based on TAS's experience with identity theft cases over the years, the National Taxpayer Advocate believes that transfers among functions will continue to be commonplace.

To illustrate the complexity of an identity theft case and how many "touches" the victim may have with various IRS functions, we have provided a detailed example in congressional testimony that shows how complex identity theft cases are and the multiple units and delays involved.[18] The timeline below illustrates the complex and convoluted process that taxpayers may need to navigate to receive full resolution of their identity theft issue.[19]

FIGURE 1.6.2, ID Theft Cycle Time for Taxpayers



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Victims routinely must deal with multiple IRS functions to resolve all of their account issues. Generally, most specialized units operate in a silo, treat the identity theft as a separate case, and work inventory on a FIFO (first-in, first-out) basis from the perspective of that specialized unit. Under such an approach, a taxpayer who reported the identity theft incident two weeks ago may be placed in the queue ahead of a victim who has been trying to obtain a refund for 20 months, if the latter taxpayer had the misfortune of dealing with other IRS departments to resolve related issues.[20] By having the IRS work identity theft cases as FIFO from the perspective of each silo, rather than holistically from the taxpayer perspective, we not only harm taxpayers (the victims) but also give a distorted picture of IRS efficiency and productivity.

The Treasury Inspector General for Tax Administration (TIGTA) has confirmed that identity theft cases are complex and easy for the IRS to lose in the shuffle. In its May 2012 report on IRS identity theft

18 *See Examining the Skyrocketing Problem of Identity Theft Related Tax Fraud at the IRS: Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Operations*, 112th Cong. (2013) (statement of Nina E. Olson, National Taxpayer Advocate), *available at* http://www.irs.gov/Advocate/National-Taxpayer-Advocate-Congressional-Testimony.

19 This example is not based on an actual or typical case; the timeline described is a hypothetical meant to show how many functions could be involved, and how much time could elapse, before an identity theft victim receives full relief. IRM 21.9.2.3, *Identity Theft – Telephone Overview* (Oct. 1, 2013); Letter 5073C; IRM 3.11.3-1, *Attachment Guide* (Jul. 25, 2013); IRM 10.5.3.2.4.1, *Multiple Function Criteria (MFC) Cases Requiring Referral to IPSU for Monitoring* (May 8, 2013); IRM 21.6.2.4.2.3, *Preliminary Research* (Oct. 1, 2013) IRM 4.19.13.25.11, *Referrals to CPAT/DITA* (Apr. 4, 2013); IRM 21.9.2.4.2, *Tax-Related Identity Theft - (Andover and Fresno IPSU only)* (Oct. 18, 2013).

20 IRS responses to TAS information request (Oct. 30, 2013, and Nov. 13, 2013).

victim assistance, TIGTA selected a sample of 17 identity theft cases and found the IRS had opened 58 separate cases to resolve the accounts of those 17 victims — an average of nearly three and a half cases for each person.[21] In a follow-up report released in September 2013, TIGTA found that the typical identity theft case was assigned to an average of 10 different assistors (some of whom were within the same function) prior to case resolution.[22]

The National Taxpayer Advocate continues to believe the IRS should follow TAS's approach to case resolution, and allow the IPSU to "own" identity theft cases rather than simply "monitor" them. Yet five years after establishment of the IPSU, it is clear that the IRS has gone in the opposite direction and has adopted a decentralized approach to identity theft victim assistance, one that imposes undue burden on the victims and creates procedures that would make Rube Goldberg proud.[23]

The IRS Should Track Cycle Time from the Perspective of the Victim.

Despite the commitment by former Commissioner Shulman in 2008 that the IRS would resolve identity theft victims' tax accounts "quickly and efficiently," the IRS does not know whether its processing time for identity theft cases has been increasing or decreasing.[24] While some IRS functions can track the length of time a case is in their inventory, the IRS still cannot provide an overall cycle time from the taxpayer's perspective. For example, specialized units generally measure cycle time solely from the date they receive the case; their cycle time measure does not reflect the time elapsed since the taxpayer filed his or her return or all of the interactions the victim had with the IRS prior to assignment to the function. Thus, the IRS cannot determine how well it has done in meeting this commitment to resolve identity theft cases "quickly and efficiently."

The fact that the IRS cannot accurately track the cycle time of an identity theft case from the perspective of the victim is astonishing, disappointing, and inexcusable.

We recognize that cycle time start dates may differ depending on the facts and circumstances of the cases, but the IRS should be able to count cycle time in a way that more closely reflects the taxpayer's experience and more accurately flags over-aged cases. Currently, as the above case example shows, an identity theft case might not be considered over-aged until the victim has been in the system for more than a year.

In a September 2013 audit, the Treasury Inspector General for Tax Administration (TIGTA) reported the average cycle time for the 100-case sample of identity theft cases it reviewed was 312 days, including 277 days of inactivity.[25] In other words, though the cases lingered in various IRS units for 312 days or approximately ten months, the average case was resolved with just 35 days of direct contact.

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21 *See* TIGTA, Ref. No. 2012-040-050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Receive Quality Customer Service* (May 3, 2012).

22 *See* TIGTA, Ref. No. 2013-40-129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

23 Merriam-Webster defines the adjective Rube Goldberg as "doing something simple in a very complicated way that is not necessary." *See* Merriam-Webster online dictionary, http://www.merriam-webster.com/dictionary/rube%20goldberg (last visited Nov. 21, 2013).

24 *Identity Theft: Who's Got Your Number, Hearing Before the S. Comm. on Finance*, 110th Cong. (2008) (response of IRS Commissioner Douglas H. Shulman to questions from Chairman Max Baucus), *available at* http://finance.senate.gov/hearings/hearing/download/?id=f989b16e-5da3-452d-9675-b75d796fe2b4.

25 *See* TIGTA, Ref. No. 2013-40-129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

The National Taxpayer Advocate is concerned that unless the IRS significantly changes its procedures to keep identity theft cases moving, cycle time will continue to increase in the coming year as the IRS struggles to keep up with its inventory. The fact that the IRS cannot accurately track the cycle time of an identity theft case from the perspective of the victim is astonishing, disappointing, and inexcusable.

The IRS Should Institute "Timeliness" Measures to Ensure Identity Theft Cases Do Not Languish.

TIGTA's 2013 report noted that the identity theft cases it reviewed showed an average of 277 days of inactivity.[26] The IRS should adopt an approach similar to TAS's "timeliness" goals that are intended to help our case advocates move cases along. For example, an IPSU employee could:

- Set a goal to contact the taxpayer within three to five days of case receipt, depending on the nature of the case;
- Develop a case action plan within three days of contact with the taxpayer;
- Issue a request to a function within three days of receiving all information from the taxpayer necessary to address the issue; and
- Follow up with the function within one day of a missed requested completion date.

The goal of these "timeliness" measures is to keep cases moving, which in turn will reduce cycle time in an organic way — not by meeting an artificial or arbitrary goal. Moreover, by centralizing cases in the IPSU, the IPSU's case cycle time measure will reflect the taxpayer's experience more closely, and the IPSU can designate certain taxpayer cases for expedited treatment in one function based on the overall cycle time of the case.

The IRS Should Develop an Identity Theft Database or System Accessible to All Functions Working on Identity Theft Cases.

As noted above, the IRS does not track cycle time from the identity theft victim's perspective; rather, each specialized function tracks the cycle time of the particular aspect of an identity theft case within its silo. With many cases requiring action by multiple functions, the IRS cannot track these cases accurately.

By creating a servicewide platform for tracking and monitoring its cases, the IRS could accurately assess the inventory at a given time and measure cycle time from the date the taxpayer identities himself or herself as a victim of identity theft. Such a system would also allow seamless transfers of cases from one function to another. Additionally, a single identity theft database would allow functions to share information. Any employee could see if the taxpayer submitted documentation and what actions the other functions have taken, thereby helping to reduce duplicative actions.

Proposed Enhancements to the Identity Protection Personal Identification Number (IP PIN) Process Make It Easier for Victims to Protect Their Accounts

In January 2011, the IRS initiated a pilot program to issue an Identity Protection Personal Identification Number (IP PIN) to a select group of taxpayers with an active identity theft indicator on their account.[27] An IP PIN is a unique code that the taxpayer must use, along with his or her taxpayer identification

26 See TIGTA, Ref. No. 2013-40-129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

27 IRM 10.5.3.2.16(1), *Identity Protection Personal Identifying Number (IP PIN)* (Jan. 11, 2013).

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number, to file electronically and bypass certain filters.[28] In prior years, taxpayers who lost, misplaced, or did not receive their IP PIN were required to contact the IRS to obtain a replacement IP PIN.[29] However, taxpayers who filed a return using a replacement IP PIN would be subject to delay in the processing of their return.

Effective in filing season 2014, the IRS is proposing to have taxpayers who have lost, misplaced, or never received their IP PIN retrieve their original IP PIN using an online application. This will allow the taxpayer's return to post to their account without additional delays. Under this proposal, only in instances where the taxpayer is unwilling or unable to use the online application will a replacement IP PIN be issued. We commend the IRS for considering this enhancement to the IP PIN program.

CONCLUSION

Identity theft causes significant problems for both the taxpayer and the IRS. IRS leadership has responded to this challenge not only by assigning more employees to work on identity theft but also by spending significant resources re-engineering its victim assistance processes over the years.[30] Certainly, some improvements have been made. Yet the IRS is not where it needs to be on this serious taxpayer problem.

The IRS must design its processes around the key fact that victims of identity theft have suffered serious trauma and need a specially trained group of employees working identity theft cases, much like victims of spousal abuse who are helped by employees in the IRS's innocent spouse unit. One key component of such an approach is to ensure that the victim deals with a single employee within the IRS during the duration of the case. That employee will serve as a buffer between the victim and the complex processes and multiple functions necessary to resolve the problem.

Given the multiple points of contact, lengthy inactive periods, and first-in, first-out processing for each unit, we believe the IRS will find, if it adopts our suggestions, that it would actually require **fewer** resources to do the same volume of work. The National Taxpayer Advocate proposes that the IRS conduct a pilot program to test this hypothesis. In such a pilot program, the IRS could detail some of its IPSU employees to TAS and have them work identity theft cases in the same manner that TAS works them — and then measure cycle time and extent of relief (addressing all issues) compared to a control sample of cases handled in the way IPSU currently does.

The National Taxpayer Advocate is confident that taxpayers — our customers — would be much more satisfied with their experience. Unless the IRS wants to continue to add to the victims' grief and trauma, it must do this. There is a clear choice here.

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28 IRM 10.5.3.2.16, *Identity Protection Personal Identifying Number (IP PIN)* (Jan. 11, 2013).

29 IRM 10.5.3.2.16(5), *Identity Protection Personal Identifying Number (IP PIN)* (Jan. 11, 2013).

30 The latest example involved the hiring of an external consulting firm to lead the Identity Theft Assessment and Action Group, which recommended the adoption of a specialized approach to identity theft victim assistance.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Designate the Identity Protection Specialized Unit (IPSU) as the centralized function that assigns a single employee to work with identity theft victims until all related issues are resolved.
2. Develop a method of tracking cycle time from the perspective of the victim.
3. Implement "timeliness" measures to ensure identity theft cases do not languish.
4. Develop an identity theft database or system accessible to all functions working on identity theft cases.

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MSP #7 HARDSHIP LEVIES: Four Years After the Tax Court's Holding in *Vinatieri V. Commissioner*, the IRS Continues to Levy on Taxpayers it Acknowledges are in Economic Hardship and then Fails to Release the Levies

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The IRS is required by law to release a levy that it knows is causing an economic hardship due to the financial condition of the taxpayer.[1] In the *Vinatieri* case, the U.S. Tax Court held that when the IRS sustains even a *proposed* levy on a taxpayer it knows is in economic hardship, it abuses its discretion.[2] In spite of this ruling, in 2011 the IRS levied on the Social Security Administration (SSA) and Railroad Retirement Board (RRB) benefits of nearly 67,000 taxpayers belonging to a group the IRS considers likely to be experiencing economic hardship — those whose incomes were less than 250 percent of the federal poverty level, or about $27,000 for a single person.[3] The median income of taxpayers subject to these levies was at most about $17,500.[4] The *least* amount of expenses the IRS would routinely allow, known as Allowable Living Expenses (ALE), added up to approximately $17,200 for a single person in 2011.[5] Therefore, it is likely that the expenses of many taxpayers whose benefits were levied exceeded their incomes. The federal poverty level for a single person in 2011 was $10,890, meaning that some of the 67,000 taxpayers whose benefits were levied were likely actually *living in poverty* and not just considered to be low income.

The court in *Vinatieri* held that the fact that the taxpayer has unfiled returns does not justify proceeding with a levy if the taxpayer has shown he or she is in economic hardship.[6] Of the nearly 67,000 low income (or possibly poverty-stricken) taxpayers whose federal payments the IRS levied, TAS determined

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1 IRC § 6343(a)(1)(D).

2 *Vinatieri v. Comm'r*, 133 T.C. 392 (2009).

3 Small Business / Self-Employed Division (SB/SE) Finance, Research and Strategy Project DEN0206 *Federal Payment Levy Program (FPLP) and Low Income Taxpayers* Appx. H, 4 Table H7 (May 2013). There were 66,926 taxpayers in this group. The levies were issued pursuant to the Federal Payment Levy Program (FPLP), discussed below. Appendix A of the study contains federal poverty levels.

4 The median income of taxpayers subject to levies on their SSA or RRB benefits was at most $17,439 depending on the source the IRS used to measure it. SB/SE Finance, Research and Strategy Project DEN0206 *Federal Payment Levy Program (FPLP) and Low Income Taxpayers* Appx. H, 3 Table H5 (May 2013).

5 As explained below, the IRS publishes allowable expense guidelines based on average, actual taxpayer expenditures. The allowable amounts vary by geographical location. The IRS uses these guidelines to determine a taxpayer's ability to pay delinquent tax liabilities. TAS used the lowest allowable housing expense and the lowest allowable vehicle operation cost to generate a conservative measure of ALE, even though these expenses correspond to different geographic areas and therefore could not have actually been sustained by the same taxpayer.

6 *Vinatieri v. Comm'r*, 133 T.C. 392 (2009).

that the IRS would have spared the accounts of nearly 41,000 — more than half — from the automatic levy program that triggered the levies, if not for these taxpayers' unfiled returns.[7]

Whether they are included in automated levy programs or subjected to levies on their wages or bank accounts, some taxpayers in economic hardship turn to TAS or low income taxpayer clinics (LITCs) for assistance in obtaining levy releases.[8] Clinic directors report, and TAS cases confirm, that even when the IRS agrees these taxpayers are experiencing economic hardship, it continues to insist on receiving their unfiled returns as a condition of releasing the levies.[9] When the IRS conditions levy release on securing delinquent returns from taxpayers who have shown they are in economic hardship, it burdens the taxpayers and creates unnecessary work for itself. Most importantly, the IRS in these cases acts in violation of the law, thereby subjecting itself to potential suit for negligent or reckless collection action.[10]

ANALYSIS OF PROBLEM

Background

In* Vinatieri v. Commissioner*, the Tax Court Clarified that Not Only is the IRS Required to Release Levies on Taxpayers who Have Shown they are in Economic Hardship, it Abuses its Discretion When it Sustains a Proposed Levy on These Taxpayers.

IRC § 6343(a)(1)(D) states that a levy shall be released if "the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer." Economic hardship "exists when a levy will cause an individual to be unable to pay his or her reasonable living expenses."[11] In the *Vinatieri* case, the IRS sent Ms. Vinatieri a notice of its intent to levy and of her right to a pre-levy collection due process (CDP) hearing. Ms. Vinatieri requested a hearing and demonstrated she was in economic hardship, but the Appeals Officer sustained the proposed levy. Relying on Internal Revenue Manual (IRM) provisions in effect at the time, the Appeals Officer cited Ms. Vinatieri's unfiled returns as justification for sustaining the proposed levy rather than placing the account into Currently Not Collectible (CNC) status.[12] The Tax Court held it was not appropriate to proceed with the levy given that IRC § 6343(a)(1)(D) requires the IRS to release a levy if it is causing economic hardship, and such economic hardship had already been shown. Sustaining a proposed levy that would have to be immediately released constituted an abuse of discretion.

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7 TAS analysis of taxpayer accounts that formed the basis of the SB/SE Finance, Research and Strategy Project DEN0206 *Federal Payment Levy Program (FPLP) and Low Income Taxpayers*. Of the 66,926 levies, TAS found 40,984 accounts (61 percent) that could have been filtered out of the FPLP program but were not, solely because of unfiled returns. TAS Research could not determine how many name mismatches there were, or whether a spouse had an invalid taxpayer identification number. To the extent either of these conditions were present, there may have been fewer than 40,984 such accounts.

8 In recognition of the need for low income taxpayers to have access to representation before the IRS and the courts, Congress in 1998 created the Low Income Taxpayer Clinic (LITC) program. IRC § 7526; Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), § 3601(a), Pub. L. No. 105-206, 112 Stat. 758 (1998). The clinics, which are independent from the IRS, represent low income taxpayers before the IRS and the Tax Court for free or no more than a nominal fee. IRC § 7526(b)(2). According to IRC § 7526(b)(1)(B), taxpayers with income of less than 250 percent of the poverty level are low income taxpayers for purposes of qualifying for LITC assistance.

9 August 7, 2013 conference call with directors of nine low income taxpayer clinics; Taxpayer Advocate Management Information System (TAMIS) cases 5511491, 5503338, and 5379810.

10 IRC § 7433(a) authorizes a taxpayer to bring a civil action for damages if an IRS employee "recklessly or intentionally, or by reason of negligence, disregards any provision of this title, or any regulation promulgated under this title" in connection with any collection of Federal tax with respect to that taxpayer.

11 Treas. Reg. § 301.6343-1(b)(4).

12 *Vinatieri v. Comm'r*, 133 T.C. 392, 395 (2009). IRS employees may remove an account from active inventory and place it into CNC status where "collection of the liability would create a hardship for taxpayers by leaving them unable to meet necessary living expenses." IRM 5.16.1.1 (May 22, 2012).

Following the Vinatieri *Decision, the IRS Changed Some Provisions of the IRM, but Training Materials, Electronic Job Aids, and Quality Standards Need Adjusting.*

In the light of the *Vinatieri* holding, TAS worked with the IRS and the Office of Chief Counsel to revise the IRM.[13] Various IRM provisions now make clear that unfiled returns are not an impediment to immediate levy release when a taxpayer is in economic hardship, and the account should be classified as CNC even if the taxpayer has unfiled returns.[14] The IRS has also clarified how collection employees should handle the issue of unfiled returns when they talk with taxpayers.[15] The National Taxpayer Advocate applauds the IRS for making these needed changes. They should be incorporated into IRS training materials and job aids, some of which are inadequate. For example, the materials the IRS used to train Automated Collection System (ACS) employees in 2011, 2012, and 2013 did not cover the holding in *Vinatieri*.[16] Moreover, ACS employees and Compliance Services Collection Operation employees rely on automated decision trees, called e-guides, that have not been cleared through the appropriate IRS review process, including vetting by TAS.[17] The IRS should update and vet these materials. More importantly, as the National Taxpayer Advocate has urged, the IRS should evaluate collection employees specifically on whether they recognized, considered, and addressed a taxpayer's economic hardship.[18]

The IRS Adopted a Filter Intended to Prevent Automatic Levies on Social Security Payments to Low Income Taxpayers, but Excluded Accounts of Taxpayers with Unfiled Returns from the Filter.

The IRS has the authority to issue a continuous levy on a variety of federal sources of income, including Social Security and Railroad Retirement Board benefits, and since 2000 has carried out automatic levies on these sources pursuant to the Federal Payment Levy Program (FPLP).[19] The IRS has long recognized that most FPLP levies are on taxpayers' Social Security payments, and has sought to avoid levying on

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13 National Taxpayer Advocate 2010 Annual Report to Congress 85 (Most Serious Problem: *IRS Collection Policies and Procedures Fail to Adequately Protect Taxpayers Suffering an Economic Hardship*).

14 *See, e.g.*, IRM 5.19.4.4.10.5(j) (Sept. 10, 2013) (for release of levy); IRM 5.16.1.2.9(9) (May 22, 2012) (for CNC status). IRM 5.16.1.1 (May 22, 2012).

15 IRM 5.19.4.4.10.5(j) (Sept. 10, 2013), which ACS employees consult, now provides: "When the Service determines that the levy is creating an economic hardship, do not refuse, delay or understate the release amount as a means to secure other compliance, *e.g.*, missing tax returns. When there are also open delinquent returns, do not condition relief of the economic hardship upon receiving the delinquent returns. Inform the taxpayer of the financial information needed to make a collection determination and provide relief of the economic hardship if appropriate. You may, as a separate issue, inform the taxpayer of the unfiled tax returns and pursue appropriate actions to resolve them separate from the economic hardship relief issue. You may also inform the taxpayer before an installment agreement can be established delinquent returns must be filed." The IRS agreed to revise IRM 5.11.2.3.1.4(5), directed to Field Revenue Officers, to provide: "When contacted by a taxpayer claiming an inability to meet basic living expenses due to the levy and there are also open Del Rets [delinquent returns], do not condition relief of the economic hardship upon receiving the delinquent returns. These are separate collection issues. Inform the taxpayer of the financial information needed to make a collection determination and provide relief of the hardship if appropriate. You may, as a separate issue, inform the taxpayer of the unfiled tax returns and pursue appropriate actions to resolve them separate from the hardship relief issue. You may also inform the taxpayer before an installment agreement can be established delinquent returns must be filed." TAS Systemic Advocacy Management System Internal Management Document IRM review 27283 (July 30, 2013).

16 IRS response to TAS information request (Sept. 16, 2013).

17 The e-Guides are available at http://serp.enterprise.irs.gov/databases/irm-sup.dr/compliance_eguides.htm For a discussion on how IRS materials are vetted, see National Taxpayer Advocate, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013; National Taxpayer Advocate's Report in Response to the Acting Commissioner's 30-day Report: *Analysis and Recommendations to Raise Taxpayer and Employee Awareness of the Taxpayer Advocate Service and Taxpayer Rights* (Aug. 23, 2013).

18 See National Taxpayer Advocate 2010 Annual Report to Congress 85 (Most Serious Problem: *IRS Collection Policies and Procedures Fail to Adequately Protect Taxpayers Suffering an Economic Hardship*) which includes a discussion of collection case quality measurement and the recommendation that the IRS "[e]stablish quality review procedures that measure whether employees considered the possibility that a taxpayer was in economic hardship and managed the account appropriately." The IRS recently revised some quality standards, see IRM 21.10.1-6 (Oct. 1, 2013), *available at* http://serp.enterprise.irs.gov/databases/irm.dr/current/21.dr/21.10.dr/21.10.1.dr/21.10.1-6.htm, but they still do not measure whether the employee considered whether a taxpayer is in economic hardship before taking enforced collection action.

19 IRC § 6331(h)(2). IRM 5.11.7.2.1.1 (2) (Aug. 28, 2012).

Social Security payments to low income taxpayers.[20] In 2002, the IRS developed a filter to exclude from the FPLP program the accounts of low income taxpayers, relying on the total positive income (TPI) reported on the taxpayer's last filed return as its sole measure of the taxpayer's financial situation.[21] The IRS filter did not recognize that taxpayers may not have recently filed a return, making available data potentially dated and unreliable, and did not consider the possibility the taxpayer could have assets from which the tax liability could be paid. For these reasons, the General Accounting Office (GAO, now the Government Accountability Office) in 2003 questioned the effectiveness of the filter, and the IRS removed it in 2005.[22] TAS cases with FPLP levies immediately increased sharply.[23]

In 2008, TAS Research began to design, develop, and test an improved filtering or screening model.[24] The purpose of the low income filter was to identify and remove low income taxpayers that the model demonstrated would experience economic hardship and thus be entitled to immediate levy release under IRC § 6343(a)(1)(D). The new TAS model, in addition to using taxpayers' income information from filed individual income tax returns, used third-party payor documents supplied to the IRS to estimate the taxpayers' incomes.[25] The TAS model then used other tax return data to estimate ALE (living expenses the IRS routinely allows when determining a taxpayer's ability to pay).[26] If the most recent year's tax return was not filed, allowable expenses were based on a household size of one, since the number of dependents could not be determined.[27] The TAS model was designed to offer a conservative estimate of taxpayer expenses, while also using multiple sources to ascertain all taxpayer income, even if unreported. TAS then performed additional analyses to explore the availability of other taxpayer assets to satisfy the liability and investigated whether IRS databases are sufficient to detect such available assets. The study findings suggested that a significant number of taxpayers are subject to a levy on their SSA income even though they cannot afford the levy.[28]

It is likely that the expenses of many taxpayers whose benefits were levied exceeded their incomes.

Subsequent to the publication of TAS's study findings, the National Taxpayer Advocate engaged in ongoing discussions with the IRS Director of Compliance, Wage & Investment Division, to discuss the development of a new low income filter for taxpayers otherwise subject to FPLP levies. The IRS accepted the results of the TAS study, but expressed concern about the difficulties of automating the algorithm TAS

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20 For example, in 2008, the IRS received more than two million FPLP levy payments from taxpayers, with more than 83 percent of those payments coming from Social Security benefits. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

21 TPI is simply the sum of the values shown in various income fields on a return (wages; interest; dividends; distributions 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 a zero.).

22 GAO, GAO 03-356, *Tax Administration, Federal Payment Levy Payment Program Measures, Performance and Equity Can Be Improved* 13-15 (Mar. 6, 2003). The General Accounting Office was renamed the Government Accountability Office in July 2004.

23 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 48 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

24 *Id*.

25 *Id*.

26 Allowable expenses for some items (*e.g.*, food, clothing, and health care) are based on national standards, while allowable expenses for other items (*e.g.*, housing and transportation) are based on local standards. See IRM 5.15.1.7 *Allowable Expense Overview* (Oct. 2, 2012). The IRS ALEs are available at http://mysbse.web.irs.gov/Collection/toolsprocesses/AllowExp/Standards/default.aspx.

27 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 54 n. 31 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

28 *Id*. at 57.

used in its research study to determine economic hardship.[29] A more administrable measure, such as a minimum dollar amount of income, or income as a percentage of the federal poverty level, was needed as a proxy for economic hardship. The discussions culminated in a meeting on October 6, 2009, at which the IRS proposed a filter that, among other things, would exclude the accounts of taxpayers with unfiled returns, leaving them subject to FPLP levies even though they were low income.[30] Although the National Taxpayer Advocate was uncomfortable with this approach, the IRS assured her that it would exclude these taxpayers from the filter only if they appeared to have a filing requirement.[31] The Deputy Commissioner for Services and Enforcement and the Commissioner of the Wage and Investment Division had collectively determined that the low income filter would be set at 250 percent of the federal poverty level.[32]

This low income filter, which failed to protect the accounts of taxpayers with unfiled returns, was adopted prior to the Tax Court's decision in *Vinatieri*. As discussed above, the court in *Vinatieri* found that IRC § 6343(a)(1)(D) requires the IRS to release a levy that would cause the taxpayer economic hardship, with no exception to that mandate for taxpayers who have unfiled returns. After the *Vinatieri* decision, despite urging by the National Taxpayer Advocate, the IRS refused to adjust the filter to cover accounts with unfiled returns.[33] The National Taxpayer Advocate responded on January 12, 2012 by issuing Taxpayer Advocate Directive 2012-2, "Taxpayers Whose Incomes Are Below 250 percent of the Federal Poverty Level Set by the Department of Health and Human Services and who receive Social Security or Railroad Retirement Board Benefits Should Be Screened Out of the Federal Payment Levy Program, regardless of unfiled returns or outstanding business debts."[34]

The IRS studied the effect that the mandate in the Taxpayer Advocate Directive would have and prepared a report in May of 2013.[35] It stated that about 151,000 low income taxpayers received Social Security or Railroad Retirement Board benefits in 2010, had an outstanding tax liability in 2011, and had unfiled returns or business debt.[36] They were consequently subject to levy under the FPLP program in 2011 rather than excluded through the low income filter. Of these approximately 151,000 taxpayers, the IRS actually

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29 It would be difficult for the IRS to create a program that could manually draw data from multiple databases, as the TAS study did, to identify taxpayer income, household size, and allowable expense information.

30 IRS PowerPoint presentation, *Federal Payment Levy Program: Proposed Process to Implement Low Income Filter for Social Security and Railroad Retirement* (Sept. 29, 2009), presented to the National Taxpayer Advocate on Oct. 6, 2009.

31 Notes of Oct. 6, 2009 meeting, on file with National Taxpayer Advocate.

32 *Id*.

33 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 350, 365 (Most Serious Problem: *The New Income Filter for the Federal Payment Levy Program Does Not Fully Protect Low Income Taxpayers from Levies on Social Security Benefits*).

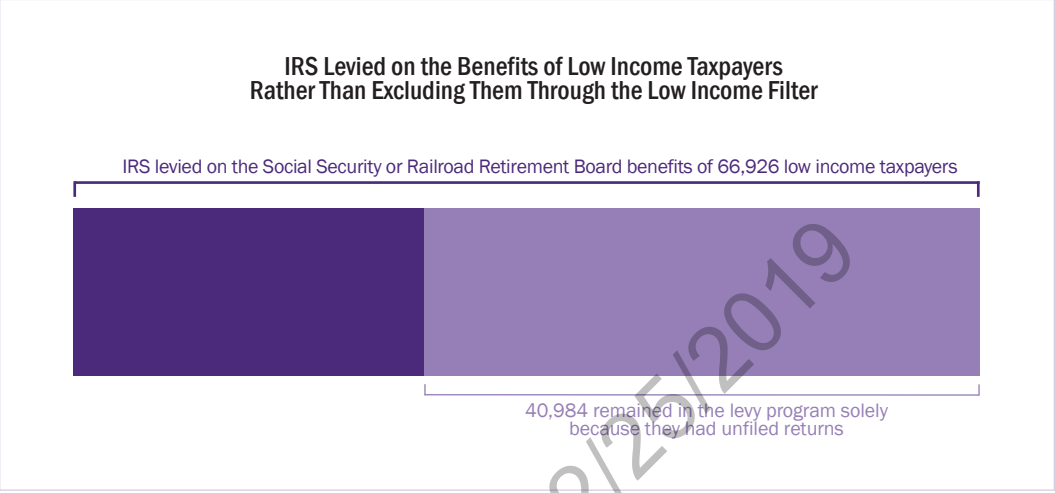
34 Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a TAD to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers. IRM 1.2.50.4, Delegation Order 0-3 (formerly DO-250, Rev. 1), Authority to Issue Taxpayer Assistance Directives, (Jan. 17, 2001). *See also* IRM 13.2.1.6, Taxpayer Advocate Directives (July 16,2009). Almost two years after the National Taxpayer issued the TAD, the Deputy Commissioner for Services and Enforcement sustained the appeal of the portion of the TAD pertaining to unfiled returns, refusing to adopt the National Taxpayer Advocate's position that the low income filter should cover these accounts. His memo notes: "Nonfilers are not compliant with their filing requirements and, thus, the IRS does not have the information to be able to determine if their income is less than 250% of the poverty level. Failing to comply with filing requirements is a threshold requirement that disqualifies taxpayers from consideration in other collection programs, such as installment agreement or offers in compromise." Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, TAD 2012-2, Low Income Filter in the Federal Payment Levy Program (Dec. 20, 2013). The Deputy Commissioner sustained the TAD on the issue of whether outstanding business debt should disqualify an account from the filter, and agreed to change the current policy as soon as practical.

35 SB/SE Finance, Research and Strategy Project DEN0206 *Federal Payment Levy Program (FPLP) and Low Income Taxpayers* (May 2013).

36 *Id*. at 6, identifying 150,963 of these taxpayers.

levied on the Social Security or RRB benefits of 66,926.[37] Of these 66,926 taxpayers, 40,984 (61 percent) remained in the levy program solely because they had unfiled returns.[38]

FIGURE 1.7.1, IRS Levies on Benefits



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Had any of these taxpayers, prior to the levy, demonstrated their economic hardship (which, but for the unfiled returns, the IRS would have already presumed by running them through the low income filter), the IRS would have been prohibited from proceeding with the levy, according to the holding in *Vinatieri*.[39] Post levy, if any of these taxpayers requested a levy release and showed that he or she was experiencing economic hardship because of the levy, the IRS would be required to release it under IRC § 6343. Many taxpayers probably were experiencing economic hardship. For 2011, the *lowest* amount of ALE for a hypothetical single person who lived in the part of the country with the least expensive housing and also lived in the part of the country with the least expensive vehicle operating cost was $17,200.[40] As discussed above, the median income of the taxpayers whose SSA or RRB benefits were levied was at most about $17,500.[41]

37 *Id*.

38 TAS analysis of taxpayer accounts that formed the basis of the SB/SE Finance, Research and Strategy Project DEN0206 *Federal Payment Levy Program (FPLP) and Low Income Taxpayers*. Throughout the study, SB/SE overstated the number of accounts with unfiled returns. Although the status code that indicates an unfiled return for purposes of the filter is 3, the SB/SE study also included, as accounts with unfiled returns for purposes of the filter, accounts with other status codes. TAS Research could not determine how many name mismatches there were, or whether a spouse had an invalid taxpayer identification number. To the extent either of these conditions were present, there may have been fewer than 40,984 such accounts.

39 As discussed above, the IRS determined that 250 percent of the federal poverty level fairly approximates the regulatory definition of economic hardship and that determination operates as a presumption, at least for purposes of the FPLP levy filter.

40 The lowest amount allowed for housing and utilities was $645 per month, which is the amount allowed for taxpayers who live in Arthur County, Nebraska. The lowest amount of operating costs for one vehicle (not including ownership costs) was $192 per month, the amount allowed for taxpayers who live in Seattle, Washington. The national standard for food and clothing was $534 per month and for health care was $60 per month. Thus, the least amount of ALE for a hypothetical taxpayer who lived in Arthur County, Nebraska but used the vehicle operating cost for Seattle, Washington was $1,431. Total annual expenses for this hypothetical taxpayer would be $1,431 X 12 = $17,172. The October 2011 version of the IRS ALEs is *available at* http://mysbse.web.irs.gov/Collection/toolsprocesses/AllowExp/Standards/default.aspx.

41 The median income of taxpayers subject to levies on their SSA or RRB benefits was at most $17,439 depending on the source the IRS used to measure it. SB/SE Finance, Research and Strategy Project DEN0206 Federal Payment Levy Program (FPLP) and Low Income Taxpayers Appx. H, 3 Table H5 (May 2013). The study does not provide the range of these taxpayers' incomes.

Moreover, Appendix A of the IRS study shows that the federal poverty level in 2011 was:

- $10,890 for one person;
- $14,710 for a couple;
- $18,530 for a family of three; and
- $22,350 for a family of four.[42]

The median annual income of taxpayers whose SSA and RRB benefits were levied was at most about $17,500.[43] Thus, the taxpayers whose payments were levied were not only low income in the sense that their incomes were less than 250 percent of the poverty guidelines, but there is a very real possibility they were actually living in poverty.[44] Taxpayers in these circumstances may not have protested the levies because they were incompetent, infirm, or intimidated by the IRS. Their Social Security benefits may have been payable, but for the levy, directly to nursing homes or other caregivers. That the IRS was able to actually collect money from these vulnerable taxpayers is not a justification for leaving the levies in place.

The characteristics of taxpayers whose SSA payments were levied in FY 2012 demonstrate the needless burden placed on taxpayers who, but for unfiled returns, would have been excluded from levy. A TAS Research analysis found about 53,000 taxpayers were subject to FPLP levies in 2012, and they collectively failed to file about 95,000 returns.[45] By July 2013, only slightly more than 16,000 returns had been secured.[46]

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42 SB/SE Finance, Research and Strategy Project DEN0206 *Federal Payment Levy Program (FPLP) and Low Income Taxpayers* Appx. A, Table 9 (May 2013).

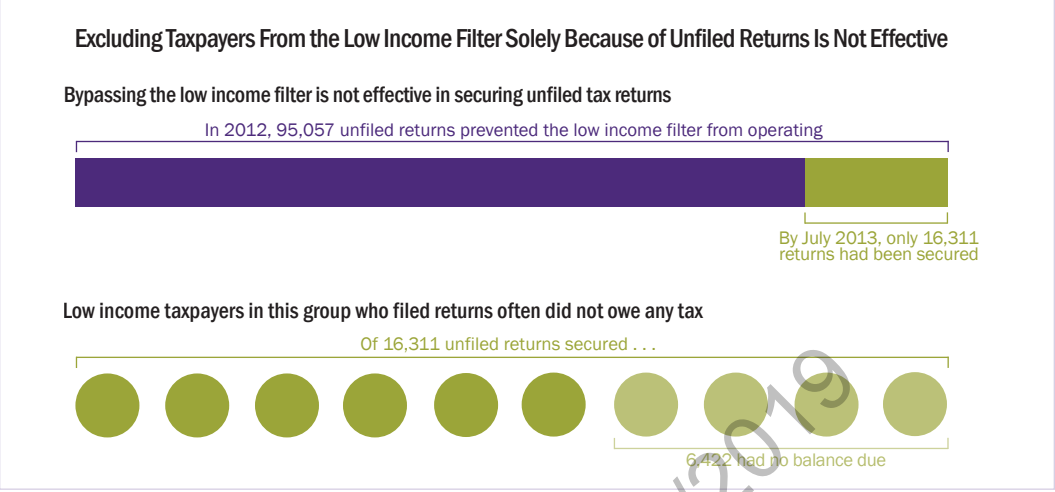
43 The median income of taxpayers subject to levies on their SSA or RRB benefits was at most $17,439 depending on the source the IRS used to measure it. SB/SE Finance, Research and Strategy Project DEN0206 Federal Payment Levy Program (FPLP) and Low Income Taxpayers Appx. H, 3 Table H5 (May 2013), The study does not provide the range of these taxpayers' incomes.

44 Rather than posing to itself the question of whether it proceeded appropriately in automatically levying on these taxpayers who may have been living at or near the poverty level, the IRS appears to congratulate itself on the additional revenue it raised, noting that it collected an average of $793 from each of the 66,926 taxpayers it levied and observing, "[t]he IRS could have lost $53 million revenue if the NTA recommendation had been in place in CY 2011." SB/SE Finance, Research and Strategy Project DEN0206 *Federal Payment Levy Program (FPLP) and Low Income Taxpayers* 12 (May 2013). Moreover, as noted above, SB/SE overstated the number of accounts that had unfiled returns and consequently the "lost revenue" that could have resulted from adopting the National Taxpayer Advocate's recommendation.

45 We found that 52,857 low income taxpayers with 95,057 different unfiled returns received a levy in FY 2012. Individual Master File from IRS Compliance Data Warehouse.

46 Taxpayers filed 16,311 returns. Individual Master File from IRS Compliance Data Warehouse. The IRS filed an additional 4,566 substitutes for return but could have taken this action even without the FPLP levy.

FIGURE 1.7.2, Return Filing by Taxpayers Excluded from Low Income Filter



Of these 16,000 returns, over a third showed no balance due.[47] The total tax reported on the returns was $30.8 million, of which 80 percent remained uncollected as of October 2013.[48] Thus, the insistence on securing returns resulted in returns actually being filed only about 20 percent of the time, and only 20 percent of the tax shown on those returns was collected by October of 2013.[49]

Taxpayers in Economic Hardship Continue to Come to TAS and LITCs Because IRS Employees Persist in Conditioning Levy Release on Filing Delinquent Returns.

Directors of Low Income Taxpayer Clinics across the country have told TAS that about 75 percent of their levy release cases follow a similar fact pattern.[50] Typically, the taxpayer contacts the clinic because the IRS is levying on his or her wages, bank account, or Social Security payments. The taxpayer demonstrates that he or she is in economic hardship, so the LITC representative contacts the IRS and requests release of the levy. The IRS employee does not usually reject the assertion that the taxpayer is in economic hardship, but tells the clinic employee the IRS will not release the levy because the taxpayer has unfiled returns – that "until the returns are filed, I can't help you."[51] Only if the clinic employee specifically cites the *Vinatieri* case, or the IRM requirements for CNC status, or otherwise insists that levy release and CNC status is appropriate does the IRS agree to release the levy without first receiving unfiled returns. TAS cases reflect the same fact pattern.[52] As the LITC directors observed, an unassisted taxpayer would probably find these obstacles insurmountable.

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47 Taxpayers filed 16,311 returns, 6,422 of which (39 percent) showed no balance due. Individual Return Transaction file, IRS Compliance Data Warehouse.

48 Of the $30.8 million total tax shown on the returns, $24.6 million remained uncollected as of October 2013. Accounts Receivable Dollar Inventory, IRS Compliance Data Warehouse.

49 Only 17.2 percent (16,311) of the 95,057 returns were secured and 79.9 percent of the $30.8 million of total taxes was still due.

50 August 7, 2013 conference call with directors of nine LITCs in nine different states.

51 As discussed below, the IRS is not required to obtain documentation of the economic hardship before releasing a levy when the assessed amount is below a certain amount and other conditions are present. See IRM 5.11.2.2.1.4 (Aug. 24, 2010), cross referencing IRM 5.16.1.2.9(3) (May 22, 2012).

52 *See, e.g.*, TAMIS cases 5511491, 5503338, and 5379810.

The IRS Can Determine from its Own and Third-Party Databases Whether a Taxpayer is Likely in Economic Hardship Before it Issues a Levy.

The Treasury regulation pertaining to levy release contemplates a taxpayer acting in good faith when requesting a levy release, and providing documentation to support the claim that the levy is causing economic hardship.[53] As discussed above, the IRS identified a proxy for establishing economic hardship within the meaning of IRC § 6343 for one class of taxpayers (those subject to levies on their Social Security payments), and adopted the FPLP low income filter to avoid levying on those taxpayers in the first place. This approach reduces the burden on taxpayers and on the IRS by obviating the need for taxpayers to request the release and substantiate the hardship the IRS already presumes, and for the IRS to release the levies.

Most importantly, the IRS in these cases acts in violation of the law, thereby subjecting itself to potential suit for negligent or reckless collection action.

The IRS could systemically exclude accounts from levies other than FPLP levies (such as wage and bank levies), if not based on a proxy, then on actual data that shows the taxpayer is in economic hardship. Revenue officers are already authorized to release a levy or place an account into CNC status *solely* on the basis of information on returns and in databases (both internal to the IRS and those maintained by third parties) that contain financial information about the taxpayer.[54] As an alternative to simply expanding the existing FPLP filter to include taxpayers who have unfiled returns, the IRS could develop a computer program that identifies taxpayers who, based on IRS records and other databases, are likely in economic hardship. It could deploy the program annually, and adjust it as necessary to identify taxpayers who, if levied, would be entitled to immediate levy release; conversely, annual review would identify taxpayers whose financial circumstances have improved to the point that collection action might be warranted. The National Taxpayer Advocate and TAS Research intend to explore the viability of this approach in the coming calendar year.

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CONCLUSION

When taxpayers in demonstrated economic hardship contact the IRS to request levy release, the IRS continues to insist on securing unfiled returns as a condition to releasing the levy, a violation of IRC § 6343(a)(1)(D). Even sustaining a *proposed* levy under these circumstances is unlawful, according to the holding in *Vinatieri*. In addition to failing to appropriately deal with taxpayers when they contact the IRS, the IRS does not consistently ascertain *before levying* whether a taxpayer is likely facing economic hardship, even though information in its own and third-party databases permit it to make this determination. On the contrary, the IRS purposely excludes from a pre-levy filter some taxpayers it would otherwise presume to be in economic hardship solely because they have unfiled returns.

53 See Treas. Reg. 301.6343-1.

54 IRM 5.16.1.2.9(3) (May 22, 2012) provides that where the assessed amount is below a certain amount and other conditions are present, a collection information statement (CIS) is not required. IRM 5.11.2.2.1.4 (Aug. 24, 2010), pertaining to levy release, provides, "[w]hen the taxpayer cannot pay, assuming the levy is released, a CIS is required unless the exceptions listed in IRM 5.16.1.2.9(3), *Hardship*, (CNC exceptions) are met."

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Establish quality review procedures that measure whether employees identified and considered the possibility that a taxpayer was in economic hardship before levying.
2. Establish quality review procedures that measure whether, in cases in which the employee identified economic hardship, the employee adhered to the *Vinatieri* decision by placing the account in Currently Not Collectible status rather than levying.
3. Develop and publish IRM guidelines for how collection employees, on the basis of information in IRS and third-party databases, should consider the possibility a taxpayer is in economic hardship before issuing a levy.
4. Adjust the FPLP low income filter to include accounts with unfiled returns.
5. Inform collection employees of procedural changes described above by issuing a separate alert and a memorandum.
6. Update training materials and job aids to reflect the *Vinatieri* decision and the 2013 changes to IRM 5.19 and 5.11.

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MSP #8 RETURN PREPARER FRAUD: The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds

RESPONSIBLE OFFICIAL

John Koskinen, Commissioner of Internal Revenue

DEFINITION OF PROBLEM

While most tax return preparers treat their clients with honesty and integrity, some unscrupulous preparers prey on unsuspecting taxpayers by altering return information without their clients' knowledge or divert refunds for their personal benefit. This type of fraud creates significant challenges for the IRS, harms innocent taxpayers, and undermines trust in our tax system.

In 2012, the IRS developed interim guidance[1] that addresses in a taxpayer-favorable manner the type of fraud where the preparer inflates the refund without the taxpayer's knowledge, provides the taxpayer with the accurate refund amount, and pockets the difference.[2] Yet in cases where the preparer alters return information without the taxpayer's consent and directs the entire refund to an account under his or her control, the IRS has refused to make these victims whole — namely, by issuing the refunds claimed on their legitimate returns.

On October 17, 2012, the National Taxpayer Advocate issued a proposed Taxpayer Advocate Directive (TAD) directing the Commissioner of Wage and Investment (W&I) to, among other things, develop procedures to issue refunds to victims of return preparer fraud who are due a refund after they file a correct original return. After receiving an unsatisfactory response, the National Taxpayer Advocate included return preparer fraud as a most serious problem faced by taxpayers in her 2012 Annual Report to Congress.

The National Taxpayer Advocate has elevated 25 preparer fraud Taxpayer Assistance Orders (TAOs) to the Acting Commissioner. *These taxpayers have been waiting an average of more than two years to receive their refunds.* Some of these victims have been waiting for refunds ever since they filed 2008 tax returns.[3] These victims are typically low income taxpayers, with a median adjusted gross income of $17,548; the median refund amount is $2,511. In at least 14 cases, the taxpayer reported the refund fraud to the local police.

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1 *See* Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012), superseded by Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013).

2 In such cases, the taxpayer has a copy of the legitimate return, receives the refund he or she was expecting, and has no reason to suspect fraud. Only when the IRS ultimately discovers the taxpayer's return is incorrect and attempts to recover the excess refund through levies, liens, and other enforcement actions does the taxpayer learn of the preparer's fraud.

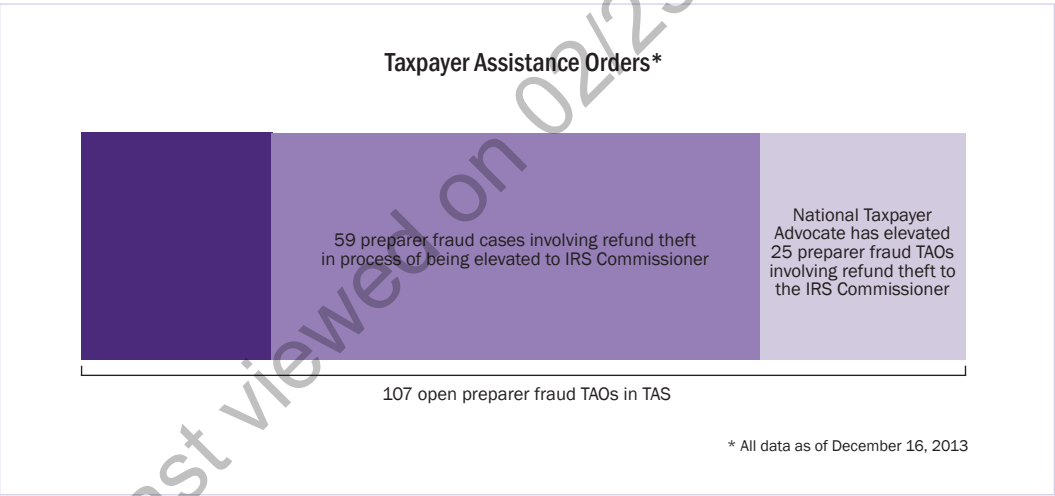
3 *See, e.g.*, Taxpayer Advocate Management Information System (TAMIS) case numbers 4757753, 5269873, and 5361465.

ANALYSIS OF PROBLEM

Background

The IRS has developed interim guidance and procedures to address situations where a victim of return preparer fraud has received the full refund that he or she expected.[4] However, the IRS response is insufficient in cases where the victim of the preparer has not received the full refund to which he or she is entitled because the preparer has stolen it. The guidance falls short of instructing IRS employees to issue refunds to victims of preparer fraud, which from the victim's perspective is likely the most important aspect of the case. Instead, the procedures instruct employees to suspend action on such cases pending further guidance.

TAS began keeping track of preparer fraud TAOs in fiscal year 2012; there are 107 open preparer fraud TAOs within TAS as of December 16, 2013.[5] Of these, the National Taxpayer Advocate has elevated 25 preparer fraud TAOs involving refund theft to the Acting Commissioner of Internal Revenue, with another 59 in the process of being elevated to that level.



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Some of the victims who have come to TAS for help have been waiting for refunds ever since they filed 2008 tax returns.[6] In the 25 preparer fraud TAOs elevated to the Acting Commissioner, *the taxpayers have been waiting an average of more than two years to receive their refunds!* These victims are typically low income taxpayers, with a median adjusted gross income of $17,548. In at least 14 cases, the taxpayer reported the refund fraud to the local police, resulting in at least five arrests.

4 See Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013); Director, Collection Policy, *Interim Guidance Memorandum on Return Preparer Fraud or Misconduct*, SBSE-05-0613-0034 (June 3, 2013).

5 See email from Director, TAS Technical Analysis & Guidance (Dec. 19, 2013).

6 *See, e.g.*, TAMIS case numbers 4757753, 5269873, and 5361465.

FIGURE 1.8.1, Statistical Snapshot of the 25 Preparer Fraud TAOs elevated to the Acting Commissioner

Median AGI	Median Refund	Average Days Waiting [7]
$17,548	$2,511	745

On December 20, 2013, the Deputy Commissioner for Services and Enforcement responded to the 25 TAOs that had been elevated to the Acting Commissioner level. For victims who did not receive the full amount of refund he or she was expecting, the IRS will not issue any further refunds. The rationale given was that it would be difficult for the IRS to detect collusion between the preparer and the victim.[8]

The National Taxpayer Advocate is not naïve and recognizes that collusion is a legitimate area of concern. However, there are ways to deal with that possibility without harming a whole class of taxpayers. Some taxpayers that have come to TAS have filed police reports (taxpayers did so in 14 of the 25 TAO cases) and even assisted law enforcement personnel in having the preparer arrested for fraud. In such cases, any suspicion of collusion should be allayed. Instead of trying to develop workable documentation requirements to address this concern of collusion, the IRS made a blanket decision to deny payment to all victims of preparer fraud who have not received the full amount of their refund (unless they can show that the return filed was completely unauthorized; the IRS may try to resolve those cases using identity theft procedures).[9]

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It Is Permissible for the IRS to Reissue Refunds to Victims of Preparer Fraud, When the Return Preparer Has Absconded with the First Refund.

Since 2000, the IRS has received the benefit of several Chief Counsel opinions that address preparer fraud.[10] These opinions, when read together, authorize the IRS to:

1. Deem the first, falsified return a "nullity;"
2. Accept and process the second, true return submitted by the taxpayer after discovering the preparer fraud; and
3. Issue any refund due to the taxpayer under the second, true return (including any amounts previously paid to and stolen by the preparer), plus interest.

Particularly insightful is the Chief Counsel position in Field Service Advice (FSA) 200038005 from June 6, 2000. While FSA are not precedential, they do offer a glimpse into how the IRS may analyze a similar situation. This FSA involved a taxpayer who visited a Volunteer Income Tax Assistance (VITA) site staffed by military volunteers to have her return prepared electronically. The taxpayer received a copy of the return she authorized and was expecting a refund to be direct deposited. When she did not receive the

7 Measured from the date the taxpayer came to TAS for assistance through December 2013.

8 *See* Deputy Commissioner for Services and Enforcement response to the National Taxpayer Advocate re: Return Preparer Fraud TAOs (Dec. 20, 2013) (stating "It would be extremely difficult to ensure that the taxpayer and the return preparer are not in collusion in order to obtain an additional refund. If collusion is not present in the current cases, establishing a process whereby IRS issues a second refund could certainly create an incentive for taxpayers and preparers to abuse in order to obtain additional Federal monies.").

9 *See* Deputy Commissioner for Services and Enforcement response to the National Taxpayer Advocate re: Return Preparer Fraud TAOs (Dec. 20, 2013).

10 *See* Field Service Advice 200038005 (June 6, 2000); IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

refund at the expected date, she contacted the VITA site, which discovered that someone affiliated with the site altered the taxpayer's return information and directed the refund into another account. The FSA concluded that if the taxpayer can show that the direct deposit was stolen, the IRS may reissue a second refund to the taxpayer since it is clear the taxpayer never received the first one. In other words, there is no legal impediment to the IRS reissuing a refund to make the taxpayer whole in situations of return preparer fraud.

An Unauthorized Tax Return Should Not Be Treated as a Legitimate Return of the Taxpayer.

In *Beard v. Commissioner*,[11] involving a taxpayer who altered a Form 1040, *U.S. Individual Income Tax Return*, the Tax Court applied a four-part test to determine whether a document filed with the IRS qualifies as a "return" for tax purposes. Those requirements are that the document:

1. Purport to be a return;
2. Be signed under penalties of perjury;
3. Contain sufficient data to permit a tax to be calculated; and
4. Evince an honest and genuine endeavor to satisfy the requirements of tax law.

The IRS Office of Chief Counsel has routinely referred to the *Beard* analysis in its opinions on preparer fraud as the generally accepted test for determining the validity of a tax return.[12]

Return preparer misconduct occurs when a tax preparer alters return information without their clients' knowledge or consent in an attempt to obtain improperly inflated refunds, or to divert refunds for their personal benefit.

In a typical preparer fraud case scenario, the preparer alters some information on the return after the taxpayer has authorized a prior version. Accordingly, the return submitted by the return preparer was not reviewed, authorized, or signed by the taxpayer under penalties of perjury. It is not a valid return, as it fails the signature requirement of the *Beard* test, and should not be treated as a return of the taxpayer.

Thus, the decision faced by IRS leadership in whether it will pay refunds to victims of preparer fraud is largely one of public policy, rather than a legal question.

Public Policy Concerns Dictate that the IRS Make Victims of Preparer Fraud Whole.

In 2012, the National Taxpayer Advocate has designated the complexity of the Internal Revenue Code (IRC) as one of the most serious problems facing taxpayers.[13] The existing code, by our count, has reached nearly four million words and imposes unconscionable burden on taxpayers.[14] Our analysis of IRS data indicates

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11 82 T.C. 766, 777-78 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

12 *See* IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011). In discussions with IRS Executives, the Office of Chief Counsel recently advised that the IRS, as an innocent third party, would not be required to pay out these refunds under agency law. Specifically, the IRS could rely on the fraudulent representation of the return preparer (the agent) who filed a return he or she fraudulently altered; thus, any refunds issued by the IRS to the return preparer would satisfy the IRS's obligation to pay a refund to the taxpayer (the principal). The Office of Chief Counsel has not adopted or advanced this position in any of its opinions pertaining to return preparer fraud. Indeed, this theory contradicts all prior opinions on the matter and would result in treating taxpayers who are similarly situated, but for the issuance of a refund, being treated disparately.

13 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 3-23 (Most Serious Problem: *The Complexity of the Tax Code*).

14 *See Id*. at 6.

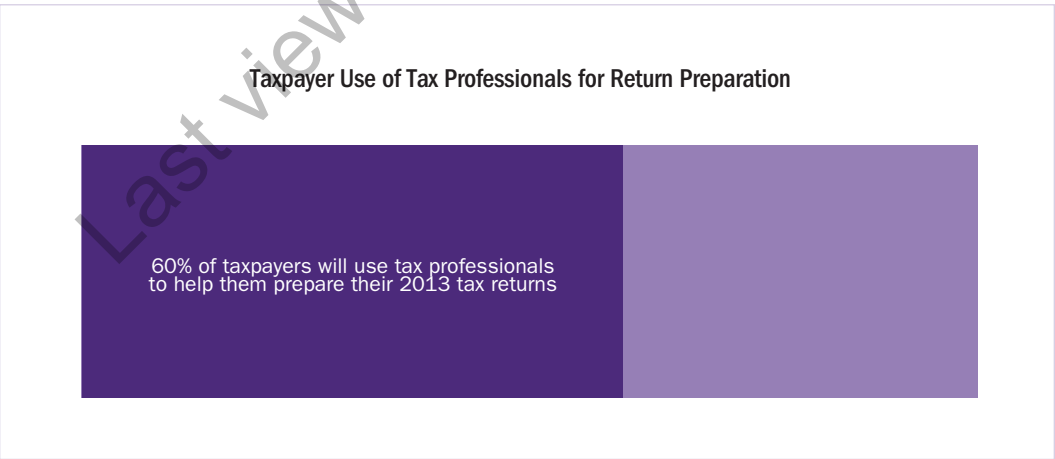
that individuals and businesses spend about 6.1 billion hours a year complying with tax-filing requirements.[15]

Even as tax compliance becomes more complex, the IRS provides fewer resources to help taxpayers file their returns. For example, IRS Taxpayer Assistance Center staff will no longer help customers with return preparation.[16] Many taxpayers, particularly low-income ones who are eligible for various refundable credits, feel pressure to hire a preparer to meet their statutorily-mandated tax filing requirement.

FIGURE 1.8.2, Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage: Tax Years 2010 and 2011[17]

Tax Credit	Tax Year	Number of Taxpayers	Average Claim (dollars)	Total Claims (dollars in thousands)	Preparer Returns (percentage)
EITC	2011	27,362,193	$2,270	$62,119,975	59.3%
Additional child tax credit	2011	20,616,435	$1,347	$27,771,740	65.0%
First-time home buyer credit	2010	373,880	$6,893	$2,577,155	53.8%
Adoption credit	2011	55,794	$13,474	$760,365	60.1%
Making work pay credit	2010	106,381,764	$514	$54,784,234	53.6%
American opportunity tax credit	2011	12,525,776	$899	$11,266,488	55.9%

Overall, approximately 60 percent of taxpayers will use tax professionals to help them navigate the maze of the tax code and prepare their 2013 tax returns.[18]



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15 *See Id*. at 5.

16 *See Id*. at 302 (Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*); IRS, W&I Business Performance Review (Nov. 20, 2013); IRS, Wage & Investment Division, Response to TAS information request (email dated Dec. 20, 2013). The IRS will refer taxpayers who visit Taxpayer Assistance Centers for tax preparation to the nearest volunteer site for tax return preparation.

17 IRS Compliance Data Warehouse, Individual Returns Transaction File and Individual Master File, tax year 2010 and 2011 (through Mar. 2013).

18 *See* IRS, IR-2013-33, IRS Releases the Dirty Dozen Tax Scams for 2013, *available at* http://www.irs.gov/uac/Newsroom/IRS-Releases-the-Dirty-Dozen-Tax-Scams-for-2013; IRS, IR-2008-2, *Treasury and IRS Give Taxpayers Greater Control over Information Held by Tax Preparers, Propose Marketing Restrictions on RALs, available at* http://www.irs.gov/uac/Treasury-and-IRS-Give-Taxpayers-Greater-Control-over-Information-Held-by-Tax-Preparers;-Propose-Marketing-Restrictions-on-RALs.

Although the IRS has attempted to test, certify, and regulate return preparers, it has not yet been able to implement such a system.[19] In the absence of a certification program that would differentiate qualified tax return preparers from other individuals or businesses offering the same services, taxpayers may find themselves handing over sensitive tax information to an opportunistic preparer who alters the taxpayer's return without authorization.

When this happens, the IRS response has been underwhelming. While the IRS may eventually untangle the victim's account issues, the IRS's position has been that the taxpayer's sole recourse for any stolen refunds lies with the preparer, not the IRS. Victims of preparer fraud, particularly low income and unsophisticated taxpayers who may not be well-versed in the civil litigation options theoretically available to them, would be right in feeling that the IRS has failed them.

A Victim of Preparer Fraud Is Similar to an Innocent Spouse

Generally, married taxpayers who file jointly are jointly and severally liable for any tax, interest, and penalties due as shown on the return.[20] However, innocent spouses may file for relief from joint and several liability under IRC § 6015. In 1998, the IRS was given expanded authority for innocent spouse relief.[21] Congress wanted the IRS, when it had evidence of misdoing through no fault of the victim, to refund the money to the innocent spouse — even when the other party (the "non-innocent" spouse) was unable to pay.

In the case of preparer fraud, no statutory fix is needed to make the victim whole. A series of Chief Counsel opinions make it clear that the IRS has the legal right to issue refunds to victims of preparer fraud — even in instances where the other party (the preparer) is unable to return the proceeds from the first refund. The Office of Chief Counsel recently reaffirmed that position to the National Taxpayer Advocate and the IRS Commissioner.

Although Preparer Fraud Is Similar to Identity Theft, the IRS Treats Victims Substantially Differently.

Return preparer fraud is similar to identity theft in that both crimes delay refunds and cause account problems, but the IRS deals with the victims in substantially different ways. Over the years, the IRS has developed victim assistance procedures that ultimately unwind the harm to a victim of identity theft. Although it may take much longer than an identity theft victim prefers, the IRS has procedures to "back

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19 *See* Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS is Enjoined from Continuing Its Efforts to Effectively Regulate Unenrolled Preparers, supra*. In November 2011, the IRS launched a return preparer competency test with a deadline for completion by December 31, 2013. *See* IRS News Release, IR-2011-111, *IRS Moves to Next Phase of Return Preparer Initiative; New Competency Test to Begin* (Nov. 22, 2011). However, in January 2013, a U.S. District Court judge in *Loving v. Internal Revenue Service* disagreed with the IRS's view that it has the authority to implement these requirements on its own, and invalidated the testing and continuing education requirements. *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013). The government filed a motion to suspend the injunction pending appeal. The U.S. District Court for the District of Columbia denied the motion but then modified the terms of the injunction. *See Loving v. IRS*, 920 F. Supp. 2d 108 (D.D.C. Feb. 1, 2013). The Justice Department has appealed the District Court's decision. *Loving v. IRS*, No. 1:12-cv-00385 (D.D.C. 2013) (USCA Case No. 13-5061).

20 *See* IRC § 6013(d)(3).

21 *See* IRC § 6015. "Innocent spouse relief" is frequently used to describe relief from joint and several liability under IRC § 6015(b). Refunds are also available under IRC 6015(f), called "equitable relief." *See also* Joint Committee on Taxation, JCX-6-98, *Present Law and Background Relating to the Treatment of "Innocent Spouses"* (Feb. 9, 1998); *IRS Restructuring (Innocent Spouse Tax Rules): Hearing Before the S. Comm. on Finance*, 105th Cong. (1998).

out" the return filed by the perpetrator, process the true return, and pay out the associated refund claim, if applicable.[22]

In contrast, the IRS has not developed procedures that would fully unwind the harm suffered by victims of preparer fraud. For instance, although the IRS is willing to process the correct original return from the taxpayer, the IRS will not provide full relief by issuing a refund to these victims in cases where the preparer absconded with the initial refund that the IRS issued after receiving the falsified return.[23]

The IRS has the legal authority to issue such refunds to victims of preparer fraud. The National Taxpayer Advocate urges IRS leadership to make these vulnerable taxpayers whole once it is established that they were not complicit in the crime, just as the IRS works to make identity theft victims whole.

The IRS Should Consider Multiple Factors — Including Mitigation, Restitution, and Substantiation — Before Deciding Whether to Release a Refund to a Victim of Preparer Fraud.

In the absence of any regulation of return preparers, taxpayers have many options when choosing someone to prepare and file their tax returns. Return preparers run the gamut from attorneys and certified public accountants to large, national tax preparation firms to nonprofessionals who have purchased off-the-shelf software and volunteer to prepare a neighbor's return. Undoubtedly, some taxpayers are swayed by claims made by certain preparers to obtain a refund amount that may seem too good to be true. The IRS, rightfully, must be cognizant of the possibility of collusion between the preparer and the "victim" in an attempt to defraud the government. Moreover, the IRS does not want to serve as the *de facto* insurer of taxpayers who choose a preparer solely based on the size of the refund they were promised. Doing so would create a moral hazard by encouraging taxpayers to engage in high-risk behavior.

With these concerns in mind, the National Taxpayer Advocate proposes a framework of analysis the IRS can undertake when deciding whether to issue refunds to purported victims of preparer fraud. This framework includes mitigation, restitution, and substantiation.

Mitigation

The IRS should ask the victim what actions were taken to prevent the preparer fraud or to minimize the loss. For example, did the victim request a copy of the return that he or she authorized for filing? If the refund was not received by the expected date, did the victim promptly follow up with the preparer to check on the status? Did the victim contact the IRS to request a refund trace?

If the fraud was committed by an employee of a national, franchised tax preparation firm, did the victim request a settlement from the firm? To take the onus off the victim, the National Taxpayer Advocate suggests that the IRS establish a liaison with the nation's largest tax preparation firms to present these cases and request that they make the victims whole. TAS could spearhead coordination with the Wage & Investment division, the Criminal Investigation division, Chief Counsel, the Return Preparer Office, and the Office of Professional Responsibility.

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22 *See generally* IRM 21.6.2, *Individual Tax Returns, Adjusting TIN-Related Problems* (Oct. 1, 2013).

23 See Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013).

These taxpayers who have been victimized by return preparers are being harmed again by the IRS inaction.

Restitution

The IRS should not be obligated to pay out the full amount of the refund when restitution is available and recovered. If the preparer, whether out of guilt or under a court order, paid the victim a portion of the refund after being confronted or convicted, the IRS should subtract the amount of any money recovered by the victim. In these cases, emphasis should be on restitution *received*. Some preparers may be indigent or incarcerated. Thus, they may be unable to comply with a court order to pay restitution.

Substantiation

Victims of preparer fraud should be encouraged to provide the IRS with as much documentary evidence of the claim as possible. In addition to the required forms,[24] victims may wish to submit:

- A copy of the unaltered return (if provided by the preparer);
- A business card, flyer, or other advertisement with the preparer's contact information;
- A copy of any refund traces requested;
- A copy of bank statements showing the expected refund was not deposited into the victim's account; and
- Taxpayer statement (signed under penalties of perjury).

The IRS should encourage victims of preparer fraud to contact local law enforcement and file a report or complaint against the preparer. Doing so would ease the IRS's concern that the preparer and taxpayer may have been acting collaboratively to defraud the government. Victims should provide a copy of the police report (and conviction, if applicable). However, some jurisdictions may not be willing to receive a victim's complaint or issue a police report. Thus, the absence of one or more of these documents should not count against the taxpayer's claim. Moreover, none of the factors discussed above need be dispositive of the matter.

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CONCLUSION

In many return preparer fraud cases, refunds are directed to an account under the preparer's control, leaving the taxpayer with no monetary benefit from the fraudulent filing and having to deal with the IRS in the aftermath. Although there is no legal impediment to the IRS reissuing refunds to victims of preparer fraud, IRS leadership has refused to make the policy call to do so. These taxpayers, who have been victimized by return preparers, are being harmed again by IRS inaction.

In the case of a return altered by a preparer, the IRS should have even more reason to assist the taxpayer than in refund fraud cases not involving a preparer. While a non-preparer third party who alters a return may be a mere thief, an errant preparer is not only a thief but is violating his or her fiduciary duty to the taxpayer and the tax system.

24 The IRS requires victims of preparer fraud to submit Forms 14157, *Return Preparer Complaint*, and 14157-A, *Tax Return Preparer Fraud or Misconduct Affidavit*, to the Memphis Accounts Management office. *See* Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013).

Not long ago, an IRS report stated that, "tax return preparers and the associated industry play a pivotal role in our system of tax administration and they must be a part of any strategy to strengthen the integrity of the tax system."[25] To protect the integrity of tax administration, the IRS must develop procedures that address the 21st-century version of return preparers' misappropriation of their clients' federal tax refunds.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop comprehensive guidance providing full relief to victims of return preparer fraud, including the issuance of a refund.
2. Direct TAS, W&I, Criminal Investigation, Chief Counsel, the Return Preparer Office, and the Office of Professional Responsibility to develop referral procedures for and establish a liaison to national tax preparation firms, to seek recovery of refunds for taxpayers defrauded by their employees or agents.

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25 IRS Pub. 4832, *Return Preparer Review*, at 32 (Dec. 2009).

MSP #9 EARNED INCOME TAX CREDIT: The IRS Inappropriately Bans Many Taxpayers from Claiming EITC

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division
William J. Wilkins, Chief Counsel

DEFINITION OF PROBLEM

Section 32(k) of the Internal Revenue Code (IRC) authorizes the IRS to ban taxpayers from claiming the earned income tax credit (EITC) for two years if the IRS determines they claimed the credit improperly due to reckless or intentional disregard of rules and regulations.[1] This standard requires more than mere negligence on the part of the taxpayer.[2] According to IRS Chief Counsel guidance, a taxpayer's failure to participate in an EITC audit does not justify imposing the ban.[3] Once the IRS imposes the ban, any EITC claimed in the next two years will be disallowed even if the taxpayer is otherwise eligible for the credit.

IRS data shows:

- The IRS imposed the ban improperly almost 40 percent of the time in 2011;[4]
- Taxpayers who were (but for the 2011 ban) eligible for the credit in the following two years were deprived of a tax benefit that averaged more than $4,600 for the two years combined.[5]

In a representative sample of two-year ban cases, the Taxpayer Advocate Service (TAS) found:

- In 19 percent of the cases, the IRS imposed the ban solely because EITC had been disallowed in a previous year;[6]
- In only ten percent of the cases did a taxpayer's response to the audit raise the *possibility* that he or she had the requisite state of mind to justify the two-year ban;[7]

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1 IRC § 32(k)(1)(B)(ii) provides for a two-year "disallowance period" of "2 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to reckless or intentional disregard of rules and regulations."

2 For example, as discussed below, for purposes of the accuracy-related penalty under IRC § 6662, "negligence" includes "any failure to make a reasonable attempt to comply with the provisions of this title" and is distinguished from a "disregard" which is "reckless" or "intentional." IRC § 6662(c).

3 IRS Service Center Advisory SCA 200245051 (Nov. 8, 2002). As discussed below, IRS procedures permitted *automatic* imposition of the ban in some in which the taxpayer did not respond to IRS audit notices.

4 Of the 5,438 taxpayers on whom the IRS imposed the ban in 2011, the accounts of 2,121 are designated on IRS records as "no show/no response" or carry the notation that mail sent to them was returned as undelivered. 2,121 out of 5,438 is 39 percent. IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File (Tax Year 2011).

5 The average amount of EITC for eligible taxpayers was $2,274 in 2012 and $2,358 in 2013. The combined average was $4,632. IRS response to TAS fact check (Dec. 20, 2013).

6 In 62 cases out of 333, the *only* explanation for imposing the ban was the prior year's disallowance. Sixty two out of 333 is 19 percent. As described below, the IRS assigned project codes to some audits that resulted in *automatic* imposition of the two-year ban because of a previous disallowance of the credit.

7 Of the 330 cases in which the IRS requested substantiation of claimed EITC, the taxpayer responded by submitting documents that were clearly insufficient in 32 cases. Thirty two out of 330 is ten percent.

- In 69 percent of the cases, the ban was imposed without required managerial approval;[8]
- In almost 90 percent of the cases, neither IRS work papers nor communications to the taxpayer contained the required explanation of why the ban was imposed;[9] and
- Taxpayers' average income was about $15,500.[10]

Low income taxpayers face unique obstacles in learning EITC rules and substantiating their entitlement to the credit, but IRS procedures do not take this into account. Instead, the IRS applies the two-year ban on the basis of unexamined assumptions about the taxpayer's state of mind or even *presupposes* reckless or intentional disregard of the rules and regulations, potentially causing significant harm to taxpayers who may be entitled to EITC in a subsequent year.

Addressing the inaccurate and unsupported application of the two-year bans is even more urgent and necessary if the Administration's proposal to permit the IRS to use math error authority in the context of these bans is adopted by Congress.[11] The National Taxpayer Advocate does not support such a proposal unless and until the IRS improves its procedures to ensure its auditors make affirmative and reasonable determinations that a taxpayer acted with reckless or intentional disregard of rules or regulations before imposing the two-year ban. Moreover, Congress should clarify that IRS bears the burden of proving the taxpayer acted intentionally or recklessly with respect to his or her EITC claim.

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ANALYSIS OF PROBLEM

Background

IRC § 32(k) Authorizes a Two-Year Ban on Claiming EITC, But Only If the IRS Determines the Taxpayer's Actions or Intent Meets Statutory Criteria.

IRC § 32(k)(1)(B)(ii) disallows EITC claims for two taxable years if there has been "a *final determination* that the taxpayer's claim of credit was due to *reckless or intentional disregard of rules and regulations*."[12] Neither section 32 nor its regulations define the terms "reckless or intentional disregard," nor is there any judicial interpretation of the subsection.[13] However, IRS Chief Counsel guidance provides that if EITC

8 Internal Revenue Manual (IRM) 4.19.14.6.1 (Jan. 1, 2013). Of the 333 cases in the sample, there was no evidence of managerial approval of the ban in 229 cases. Two hundred twenty nine out of 333 is 69 percent.

9 IRM 4.19.14.6.1 (Jan. 1, 2013). Of the 333 cases in the sample, there was no explanation (or there was only a conclusory or cursory statement that the ban applied, or the "explanation" for imposing the ban was that EITC had been disallowed in a previous year) in 295 cases. Two hundred ninety five out of 333 is 89 percent.

10 The average adjusted gross income for the 333 taxpayers in the sample was $15,478. TAS Research, CDW, Individual Returns Transaction File.

11 Budget of the United States Government, Fiscal Year 2014 212, 219, *available at* http://www.whitehouse.gov/omb/budget/Overview. Under IRC § 6213(b), the IRS may correct mathematical or clerical errors on returns and send notices to taxpayers explaining the changes. Taxpayers who do not request an abatement of the resulting tax within 60 days after the notice is issued are assessed the additional tax and they do not have the right to petition the Tax Court on the basis of the notice.

12 IRC § 32(k)(1)((B)(ii) (emphasis added). IRC § 32(k) was enacted as part of the Tax Reform Act of 1997, Pub. L. No. 105-34, § 1085(a)(1), 111 Stat. 788, 956. IRC § 32(k(1)(B)(i) authorizes the IRS to impose a ten-year ban on taxpayers who fraudulently claim EITC, but the IRS imposes the ten-year ban infrequently (13 times, 27 times, and 17 times in 2009, 2010, and 2011 respectively). IRS CDW, *Individual Returns Transaction File* (Tax Years 2009, 2010, 2011).

13 Neither the statute nor the regulations cross reference any other Code section (such as IRC § 6662) or regulations that contain similar language. Under IRC § 6662(b)(1), an accuracy-related penalty may be imposed on certain underpayments due to "negligence or disregard of rules or regulations." IRC § 6662(c) provides: "For purposes of this section, the term 'negligence' includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard." Treas. Reg. § 1.6662-3(b)(2) provides: "A disregard is 'reckless' if the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe. A disregard is 'intentional' if the taxpayer knows of the rule or regulation that is disregarded.

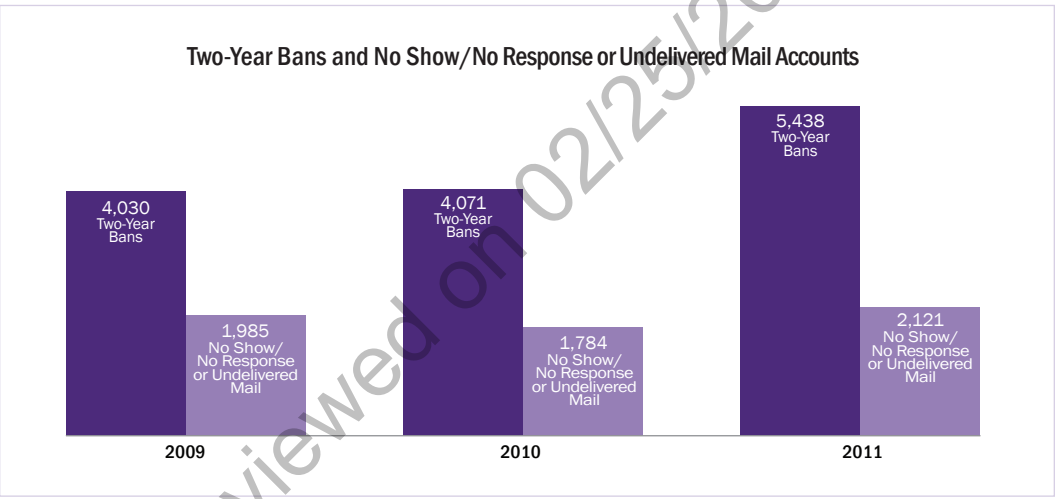
was disallowed because the taxpayer did not respond (or did not respond adequately) to a request for substantiation of claimed EITC, the ban should not be imposed.[14]

Recognizing that "each case may have a different reason for asserting the penalty/ban," the IRM requires examiners who propose the two-year ban to note in their work papers the reason for the decision.[15] A manager must approve all two-year bans.[16]

IRS Data Shows the IRS Frequently Imposes the Two-Year Ban Inappropriately.

TAS research of IRS databases shows that the IRS imposed the two-year EITC ban in tax years 2009-2011 as follows:

FIGURE 1.9.1, Total Number of Two-Year Bans and Number of Accounts Designated as No Show/No Response or Undelivered Mail[17]



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With startling frequency, the IRS imposed the ban on taxpayers with whom it had had no interaction 49 percent of the time in 2009, 44 percent of the time in 2010, and 39 percent in 2011. There was no occasion on which the IRS could ascertain anything about these taxpayers' states of mind. As discussed below, IRS procedures permitted *automatic* imposition of the ban in some cases because the taxpayer did not respond to IRS audit notices, despite Chief Counsel guidance to the contrary.

Analysis of a Random Sample of EITC Ban Cases Also Shows the IRS Frequently Imposes the Two-Year Ban Inappropriately.

To learn more about how the IRS handles the two-year ban, TAS Research extracted a random, statistically valid sample of 333 instances of the 5,438 cases in which the IRS imposed the two-year ban in

14 IRS SCA 200245051 (Nov. 8, 2002).

15 IRM 4.19.14.6.1 (Jan. 1, 2013).

16 *Id*. The 2013 version of this IRM cross references to IRM 20.1.5.1.6, which describes managerial approval as mandated by IRC § 6751(b).

17 TAS Research, CDW, Audit Information Management System (AIMS) Closed Case Database (Tax Year 2011). As described below, for tax year 2011, the TAS sample only found 28 percent (with margin of +/- about 5 percent) of accounts were designated as "no show/ no response" or "undelivered mail."

2011.[18] The TAS team reviewed records stored on IRS databases and ordered hardcopy files from IRS storage facilities as necessary.[19] Among the study's principal findings:

- Of the 333 two-year ban cases in the sample, almost 80 percent stemmed from audits of tax year 2011.[20]
- The average adjusted gross income of taxpayers in the sample was $15,478.[21]
- The average amount of denied EITC was $3,731, or 24 percent of adjusted gross income on average.[22]
- In almost 30 percent of the sample cases, the taxpayer did not participate in the audit (*i.e.*, did not respond to notices or requests for information).[23]
- In almost 90 percent of the cases, there was no clear explanation of why the ban was imposed or the "explanation" was that EITC had been disallowed in a prior year.[24]

Part of the reason satisfactory explanations were so infrequent may be because some bans were imposed *systemically*. When the IRS disallows claimed EITC for a particular tax year, it places an indicator on the taxpayer's account and if the taxpayer claims EITC in a later year, the IRS requests the taxpayer to recertify eligibility for the credit.[25] If the recertification is not submitted and the case is selected for audit, the case is assigned a project code. Two project codes are:

- PC 0027 - Full scope EITC with 2 year ban proposed
- PC 0028 - Schedule C and full scope EITC with 2 year ban proposed.

A separate IRM provision explains how the IRS handles cases assigned project codes 27 or 28:

> These cases will be worked as EITC Recertification cases; using existing aging and purging time frames, however both the initial contact letter and report will propose a 2 year EITC ban. If the taxpayer does not reply the 2 year EITC ban will post to Master File along with the EITC disallowance. If the taxpayer replies, evaluate the documentation and determine if

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18 A TAS Examination Senior Technical Analyst, together with a team of TAS employees consisting mainly of three experienced Internal Revenue Agent Technical Advisors, developed a data collection instrument to analyze cases in the sample. The sample is statistically valid at the 95 percent confidence level with a margin of error of about five percent, which allows study findings to be projected to the population. TAS originally intended to review 365 cases but succeeded in getting all relevant information for 333.

19 Among other databases, the TAS team consulted the IRS Correspondence Examination Automation Support (CEAS) database that includes copies of correspondence with taxpayers. Where CEAS records did not contain an explanation of why the ban was imposed, the team ordered the paper case file and reviewed it for the missing information.

20 In the sample cases, 261 of the bans stemmed from audits of tax year 2011, 63 stemmed from audits of tax year 2010, eight stemmed from audits of tax year 2009, and one stemmed from a 2008 audit. 261 out of 333 is 78 percent. Most of the audits (206 or 62 percent), were handled by the Wage and Investment division (W&I), while 127 or 38 percent were handled by the Small Business/Self Employed divisions (SB/SE). TAS Research, CDW, AIMS Closed Case Database.

21 TAS Research, CDW, Individual Returns Transaction File.

22 TAS Research, CDW, Individual Master File.

23 Out of 333 cases in the sample, 92 or 28 percent were no-response cases — there was no interaction between the IRS and the taxpayer.

24 There were 233 cases in which there was no clear explanation for imposing the ban other than the prior year's disallowance. There were 62 cases in which the *only* explanation for imposing the ban was the prior year's disallowance. Two hundred thirty-three + 62 is 295, and 295 out of 333 is 89 percent. A typical statement in a communication to a taxpayer was simply: "Based upon the information we have available, we propose that you should be restricted from receiving the EITC for the following 2 years. This 2-year ban is asserted for the reckless or intentional disregard of the rules and regulations regarding the EITC under IRC Section 32(k)(1)(B)(ii)." Moreover, the TAS team reviewing the cases in the sample reported that IRS examiners sometimes indicated they were imposing the ban because they believed the taxpayer acted *negligently* (as opposed to *recklessly* or with *intentional* disregard of the EITC rules). The team did not quantify the number of cases in which the examiner gave this explanation for imposing the ban and therefore we cannot project the frequency with which it occurs. However, this terminology certainly suggests inappropriate application of the ban.

25 IRM 4.19.14.6, *Recertifications* (Jan.1, 2013).

> circumstances exist not to assert the 2 year EITC ban. If taxpayers request a Reconsideration of PC 0027 or 0028 cases, use existing Reconsideration guidelines for taxpayers with a 2 year EITC ban.[26]

This IRM provision means the IRS will *automatically* impose the two-year ban on certain taxpayers who do not respond to audit notifications: taxpayers who were required to recertify eligibility for EITC and whose audits are assigned project codes 27 or 28. There is no attempt to ascertain whether the reason for the previous disallowance is different from the reason for the current year's disallowance (*e.g.*, whether the same children were claimed as qualifying children), or whether there was ever any contact with the taxpayer from which to surmise he or she understood the reason for either disallowance. According to this provision, if these taxpayers do respond to audit notifications, it is their burden to show that two-year ban should not apply, rather than the IRS's burden to show that it does apply.[27]

IRS data show that the IRS imposed the ban improperly almost 40 percent of the time in 2011.

As Figure 1.9.2 shows, of the 333 cases in the sample, taxpayers' audits were designated with project code 27 or 28, and the taxpayer did not participate in the audit, in 50 cases, or in 15 percent of the cases in the sample. This resulted in *automatic* imposition of the two-year ban. In some cases, mail to the taxpayer had been returned as undeliverable — the taxpayer may have never realized he or she was being audited.

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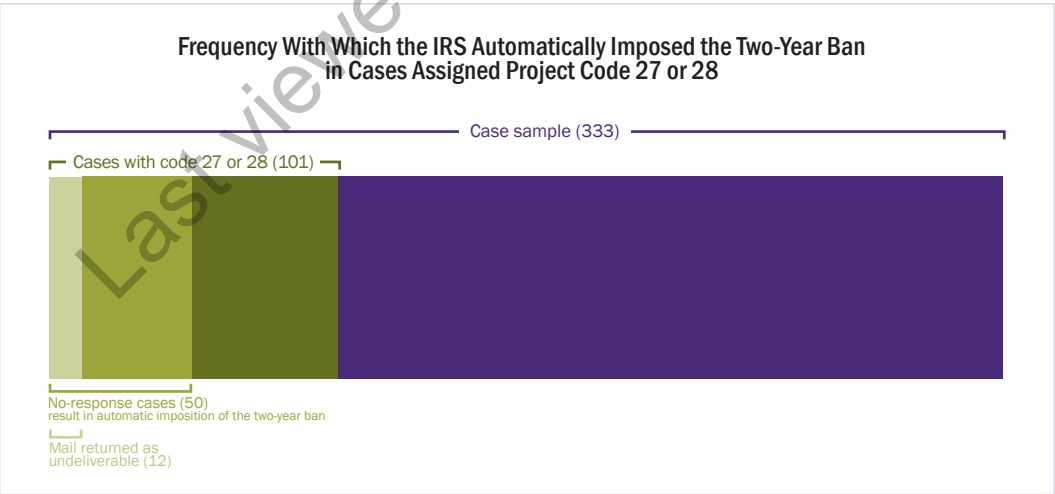
FIGURE 1.9.2, Frequency with Which the IRS Imposed the Two-Year Ban in Cases Assigned Project Code 27 or 28[28]



26 IRM 4.19.14.6.1.5 *Project Codes 0027 and 0028 – EITC Recertification with a Proposed 2 Year EITC Ban* (Jan. 1, 2013).

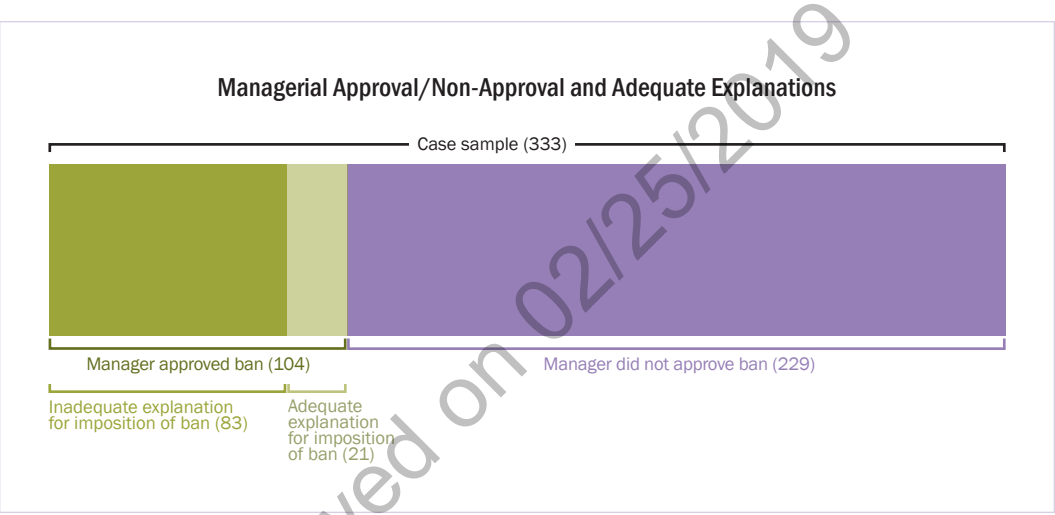
27 The National Taxpayer Advocate recommends that Congress amend IRC § 32 to clarify that the burden is on the IRS to show the ban should apply. *See* Legislative Recommendation: *Allocate to the IRS the Burden of Proving it Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit, infra.*

28 In the TAS sample of cases, 101 cases had been assigned project code 27 or 28. Of these 101 cases, 50 were no-response cases, 12 of them with undelivered mail. Fifty out of 333 is 15 percent.

The IRS rarely follows its own procedures for imposing the two-year ban. Specifically, the TAS study found:

- In more than two-thirds of the sample cases, the required managerial approval of the ban was not secured.[29]
- When a manager approved the ban, the explanation was insufficient 80 percent of the time.[30]
- *In only six percent of the cases did the IRS follow its own procedures by adequately explaining why the ban was imposed and obtaining managerial approval.*[31]

FIGURE 1.9.3, Managerial Approval/Non-Approval and Adequate Explanations



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In terms of IRS requests for substantiation, analysis of the sample cases showed that the IRS almost always (in 330 out of 333 cases) requested documentation from the taxpayer to substantiate the claimed EITC. In these 330 cases:

- In 122 cases, or almost 40 percent of the time, it appeared from the documents submitted that the taxpayer actually believed he or she qualified for the EITC.[32] An example of a case in this category is one in which a taxpayer claimed the credit with respect to her children and provided birth certificates to show the qualifying relationship. The documentation the taxpayer initially submitted to satisfy the residency was for a year other than the year under exam. The taxpayer then provided a letter from the children's school that showed where the children resided for the year under exam, but did not show the children lived with the taxpayer.

29 Of the 333 cases in the sample, there was no evidence of managerial approval of the ban in 229 cases, or 69 percent.

30 In the 104 cases in which a manager approved the ban, in 83 cases the explanation was not clear explanation or the only explanation was that EITC had been disallowed in a prior year. Eighty three out of 104 is 80 percent.

31 Only 21 cases contained an adequate explanation of why the ban was imposed (other than because EITC had been disallowed in a prior year) and had the required managerial approval. Twenty one out of 333 is six percent.

32 Of the 330 cases in which the IRS requested substantiation, the taxpayer responded by submitting documents that were reasonable attempts to substantiate the claimed credit in 122 cases, or 37 percent of the time.

- About 50 percent of the time, it was unclear whether the taxpayer understood whether he or she qualified for the credit.[33] For example, in an audit that encompassed 2009-2011, the taxpayer submitted birth certificates for two children and his marriage certificate, which substantiated a qualifying relationship for only one child. The taxpayer also submitted school records and receipts for rent and after-school care for both children, but only for 2010. In this instance, the taxpayer made an effort to provide some substantiating documentation, but not for both children and not for all audit years, although it is not clear whether he understood the law or the procedural requirements.
- In only ten percent of the cases were the documents clearly insufficient to support the claimed EITC, raising the *possibility* that the taxpayer had the requisite state of mind to justify the two-year ban.[34] For example, a taxpayer submitted copies of school records that did not reflect the taxpayer's address, paperwork from a doctor's office showing the other parent's address, and a birth certificate that appeared to have been typed.[35]

IRS Procedures Do Not Take Into Account That the Unique Challenges Low Income Taxpayers Face in Substantiating Claimed EITC May Shed Light on these Taxpayers' State of Mind or Actions.

The National Taxpayer Advocate has repeatedly described the unique difficulties low income taxpayers face in attempting to comply with IRS requests for substantiation of claimed EITC.[36] Each year, the composition of the EITC population changes by about a third.[37] A chart prepared by the Treasury Inspector General for Tax Administration (TIGTA), reproduced below as Figure 1.9.4, shows how taxpayers move in and out of EITC.[38] Thirty-seven percent are intermittent or first-time filers, meaning they do not have any experience in claiming the credit or they have no recent experience.[39] Only 20 percent of taxpayers are termed "continual filers" who might be expected to have learned from their experience.[40]

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33 Of the 330 cases in which the IRS requested substantiation, in 176 cases, or 53 percent, it was unclear whether the taxpayer believed he or she was entitled to the claimed EITC.

34 Of the 330 cases in which the IRS requested substantiation, the taxpayer responded by submitting documents that were clearly insufficient in 32 cases, or ten percent of the time.

35 When questioned, the taxpayer admitted the children lived with their other parent five days a week.

36 *See, e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 296, 304 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance and Take Steps to Improve Both Service and Compliance*) ("IRS letters are legalistic, not tailored to the taxpayer's particular situation, and do not discuss alternate sources of documentation. Low income persons may live without written leases or may not have school records for their children because of their living situation or patterns of moving. Migratory living patterns, lack of education, lack of time (*e.g.* holding multiple jobs), lack of transportation, and limited access to technology (internet, faxes, etc.) add to the difficulty of finding and submitting documents."); National Taxpayer Advocate 2009 Annual Report to Congress 110 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*) ("Although a diverse population, low income taxpayers do share common characteristics. Low income taxpayers are found more frequently among the elderly, the disabled, Native Americans, and taxpayers who may have limited English proficiency (LEP) relative to the general Wage and Investment (W&I) taxpayer population. Many require extra assistance to understand tax law changes, as demonstrated by the widespread confusion about the 2008 Economic Stimulus Payment (ESP) and the resulting flood of calls to the IRS toll-free line. Low income taxpayers tend to be more transitory than the general population, with 27.5 percent of those below the poverty level moving in 2007 while only 15 percent of the general population moved during the same time.").

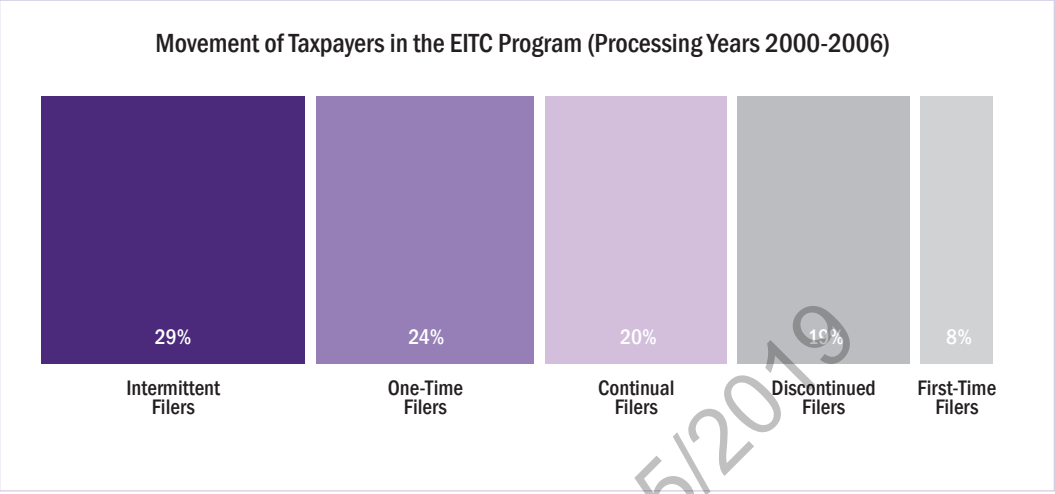
37 Kathleen M. Carley, *Simulating EITC Filing Behaviors: Validating Agent Based Simulation for IRS Analyses: The 2004 Hartford Case Study*, prepared for the National Taxpayer Advocate. National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2.137.

38 Treasury Inspector General for Tax Administration (TIGTA) Ref. No. 2009-40-024, *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments* 2 (2008), *available at* http://www.treas.gov/tigta/auditreports/2009reports/200940024fr.pdf. The report refers to taxpayers who claim EITC as being "in the EITC program."

39 Intermittent Filers are taxpayers who claim the EITC in one year but not the next, then file and claim the credit again at a later time.

40 Discontinued Filers are taxpayers who had consistently claimed the EITC but who stopped filing a tax return or no longer qualified for the EITC.

FIGURE 1.9.4, Movement of Taxpayers in the EITC Program (Processing Years 2000–2006)



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These taxpayers' circumstances would be relevant to a determination under other Code sections, such as the innocent spouse provisions of IRC § 6015 or with respect to certain penalty provisions.[41] In other areas of the law, these circumstances might establish the absence of negligence (and necessarily the absence of recklessness or intentional disregard).[42] For purposes of the two-year ban, however, IRS procedures do not take these factors into account or adequately consider that taxpayers claiming EITC may be in "learning mode." In fact, the applicable IRM provisions result in the IRS punishing EITC taxpayers while they are learning these complex rules.[43] A better approach, in view of the shifting population of EITC claimants and the consequent need to continuously educate taxpayers about the rules for EITC eligibility, would be for the IRS to regard the EITC audit as an opportunity. If the education is effective, taxpayers not only understand whether they are eligible to claim EITC in the audit year, but they can also remain compliant or avoid future noncompliance as their circumstances change.

41 IRC § 6015(f), for example, allows for relief from liability for a taxpayer who did not know or have reason to know, of an understatement of tax shown on a joint return, or of an underpayment of the tax. Rev. Proc. 2013-34, 2013-43 I.R.B. 397, § 4.03(2)(c)(iii) provides "[t]he facts and circumstances that are considered in determining whether the requesting spouse had reason to know of an understatement, or reason to know whether the nonrequesting spouse could or would pay the reported tax liability, include, but are not limited to, the requesting spouse's level of education, any deceit or evasiveness of the nonrequesting spouse, the requesting spouse's degree of involvement in the activity generating the income tax liability, the requesting spouse's involvement in business or household financial matters, the requesting spouse's business or financial expertise, and any lavish or unusual expenditures compared with past spending levels." IRC § 6664 provides that reasonable cause for an underpayment and the taxpayer acting in good faith with respect to the underpayment may constitute a defense to imposition of the IRC § 6662 accuracy related penalty. Treas. Reg. § 1.6664-4(b) provides that "[c]ircumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer." The regulation also provides that reliance on the advice of a professional tax advisor may constitute reasonable cause and good faith. As discussed below, most of the returns in our sample of cases were prepared by paid tax preparers.

42 *See ,e.g.*, Restatement 2d of Torts § 283, which provides "[u]nless the actor is a child, the standard of conduct to which he must conform to avoid being negligent is that of a reasonable man under like circumstances." Comment d notes that "[i]n determining whether the actor should realize the risk which his conduct involves, the qualities which are of importance are those which are necessary for the perception of the circumstances existing at the time of his act or omission and such intelligence, knowledge, and experience as are necessary to enable him to recognize the chance of harm to others involved therein."

43 IRS employees, who apply these complex rules by relying on IRM lists of "acceptable documentation" to substantiate claimed EITC, may not evaluate the claim accurately and completely. *See* National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 71, *Study of Tax Court Cases in Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 77 *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*. Historically, taxpayers often recover substantially all of the credit when the IRS takes a "second look" at denied EITC claims. In the 2004 EITC Audit Reconsideration study, TAS Research found that in audit reconsiderations, 40 percent of EITC claimants working with IRS Exam employees, and 45 percent of those working with TAS, recovered EITC payments. The 2010 TAS *EITC No Relief, No Response Review* showed that on average, TAS obtains full or partial relief in approximately 48 percent of EITC cases. *See* TAS Business Performance Review, 2nd Qtr. 2011, 15 (Mar. 2011).

IRM Provisions May be Leading IRS Employees to Impose Bans Inappropriately.

The main IRM provision that explains when to impose the two-year ban clarifies that first-time disallowance of EITC should not generally trigger the ban and, in an "if/then" formulation, gives eight scenarios in which the examiner *should* impose it.[44] Two of these scenarios are reasonable formulations — they presume the examiner actually spoke with the taxpayer and gathered enough information to ascertain the taxpayer's state of mind.[45] Two other scenarios at least remind the examiner that the decision to impose the ban depends on the facts and circumstances of the case.[46] Three of the scenarios, however, contain unexamined assumptions about the taxpayer's state of mind or even *presuppose* reckless or intentional disregard of the rules and regulations.[47]

One scenario in the IRM table merges the substantive requirements for claiming EITC with the requirements for imposing the ban, and reflects a misconception of the law. It provides:

> "**IF** The taxpayer filed MFJ [married filing a joint return] in prior tax years, is now filing as HOH [head of household], and our records show the taxpayers still live at the same address and/*or are still married* (emphasis added), **AND** Is unable to establish he/she is divorced or legally separated (They may be splitting the children to maximize the EITC) **THEN** The two year ban should be imposed."

Actually, divorce or legal separation is not required for a taxpayer living apart from his or her spouse to be considered as not married, so a taxpayer described by this "if/then" sequence could still be entitled to claim EITC as a head of household.[48] An examiner who disallows EITC in this scenario without ascertaining more about the taxpayer's situation may very well be misapplying the law. When this error occurs, it disproportionately affects racial and ethnic minorities, who predominate in the group of

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44 IRM 4.19.14.6.1(7) (Jan. 1, 2013). The scenarios are shown in a table, referred to as a nonexclusive "starting point to help determine if the two-year ban is appropriate," but no additional analytical framework is provided.

45 IRM 4.19.14.6.1(7) (Jan. 1, 2013). The first example, which would justify imposing the ban even on a first-time disallowance, is: "During a conversation, the taxpayer admits he/she knew they did not meet the eligibility requirements but decided to 'try it anyway.' In this instance, the ban would be justified because the taxpayer intentionally disregarded the rules and regulations." TAS found that this occurred in seven of the 333 sample cases. The second example is: "If the taxpayer is claiming different qualifying children each year and when asked to identify the qualifying children, the taxpayer does not know who they are claiming," then "[t]he two year ban should be imposed."

46 The first scenario is: if "[t]his is a Recertification case [*i.e.*, the taxpayer's claimed EITC was previously denied and the taxpayer is now required, per Treas. Reg. § 1.32-3(c), to file Form 8862, *Information To Claim Earned Income Credit After Disallowance*], and "[i]nadequate documentation is received from the taxpayer and the case results in the EITC being disallowed again," then '[b]ased on facts and circumstances presented apply the two-year ban." The example also says, however, "The taxpayer was previously informed of the requirements and the specific rules and regulations pertaining to EITC." This may or may not be true — the taxpayer may not have received any explanation for the previous disallowance, or may not have understood an explanation that was received. Moreover, the reason for the second disallowance may differ from the reason for the first disallowance. The second scenario is: if "[a] decedent's SSN is used for a qualifying child" and "[t]he person died before the year under examination," then "[b]ased on facts and circumstances presented apply the two-year ban."

47 They are: if "[t]he technician can determine the taxpayer's claim was due to reckless or intentional disregard rather than misunderstanding or confusion of the rules" then the two year ban should be imposed; if "[t]here is a lack of acceptable records" and "[t]he taxpayer understood what types of documentation could be accepted" the ban should be imposed; if "[t]he taxpayer agreed with the assessment and denial of EITC in the previous tax year(s)" and '[i]s again unable to verify eligibility for claiming the EITC and qualifying children" the ban should be imposed.

48 A married taxpayer need only be "treated as" not married within the meaning of IRC § 7703(b) to file a separate return using a filing status of Head of Household, if the other requirements of IRC § 2(b) are also met. IRC § 2(c), *Certain married individuals living apart*, provides: "For purposes of this part, an individual shall be treated as not married at the close of the taxable year if such individual is so treated under the provisions of section 7703(b)." IRC § 7703(b)(3) provides that married taxpayers who are not members of the same household for the last six months of the year may be considered as not married if the requirements of IRC § 7703(b)(1) and (2) (pertaining to maintaining a household) are also met.

married-but-indefinitely-separated taxpayers.[49] This single IRM provision invites examiners to first disallow EITC by misapplying the law, and to then compound the error by imposing the two-year ban.[50]

The Avenues Available to a Taxpayer to Challenge an IRS Application of the Two-year Ban Are Procedurally Complex.

When the IRS audits a taxpayer's return and determines to disallow claimed EITC and impose the ban, it issues a statutory notice of deficiency which includes notice of the IRS's determination to impose the two-year ban.[51] The taxpayer may petition the Tax Court for review of the disallowed EITC as well as the determination to impose the ban.[52] If the taxpayer petitions the Tax Court, he or she may bear the burden of proving the IRS erred in imposing the ban.[53] If the taxpayer does not timely file a Tax Court petition, the additional tax, if any, will be assessed and the two-year ban will remain uncontested. IRS records will reflect the two-year ban, and if the taxpayer claims EITC the following year, the credit will be automatically disallowed even if the taxpayer otherwise qualifies for it.[54] The same deficiency procedures also apply to a later year's disallowance.[55] If the taxpayer files a Tax Court petition for review of a later disallowance due to the ban, the court may consider whether the ban was properly imposed in the earlier year because this is relevant to determining the tax for the later year, but the court would not have jurisdiction to redetermine the tax for the earlier year when the ban was imposed.[56]

We note that the Treasury Department's fiscal year (FY) 2014 revenue proposals would allow the IRS to use math error authority to disallow EITC if the taxpayer claimed the credit while subject to the two-year ban.[57] Math error authority permits the IRS to assess a tax deficiency without issuing a statutory notice

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49 *See, e.g.*, The Ohio State University Research and Innovation Communications, *Marital Separations an Alternative to Divorce for Poor Couples* (Aug.13, 2012), *available at* http://researchnews.osu.edu/archive/maritalsep.htm (last visited Sept,12, 2013). The research, carried out by Dmitry Tumin and Zhenchao Qian showed that 15 percent of separations did not end in either divorce or reconciliation within ten years and that couples in these prolonged separations tended to be racial and ethnic minorities. These couples also tended to have young children. and low family income — the very population EITC is intended to reach.

50 The error is perpetuated in the IRM audit reconsideration provisions. IRM 4.13.3.18 (Sept. 30, 2010) describes the audit reconsideration procedures and makes clear that the IRS can remove the ban and reverse disallowance of the EITC. However, it provides that "[i]f the taxpayer failed to substantiate EITC entitlement for the year that triggered the ban, the audit reconsideration will be disallowed." The provision seems illogical because if the taxpayer initially substantiated entitlement to EITC the IRS would have allowed the EITC and not imposed the ban. Moreover, the provision would appear to prevent audit reconsideration of bans imposed on taxpayers who simply did not respond to IRS requests for information or whose mail was returned as undelivered.

51 The statutory notice of deficiency, authorized by IRC § 6212, informs the taxpayer of the additional amount of tax the IRS believes he or she owes and advises of the right to petition the Tax Court for review of that determination. IRM 4.19.14.6.1.1 (6), (11) (Jan. 1, 2013); IRM 4.13.3.18 (Sept. 30, 2010).

52 *See, e.g., Garcia v. Comm'r*, T.C. Summ. Op. 2013-28 (Apr. 3, 2013) for the facts contained therein; under IRC § 7463(b), the opinion is not precedent for any other case.

53 Tax Court Rule of Practice and Procedure 142(a); *Welch v. Helvering*, 290 U.S. 111, 115 (1933). The National Taxpayer Advocate recommends that Congress amend IRC § 32 to clarify that the burden of showing the appropriateness of the ban is on the IRS. *See* Legislative Recommendation: *Allocate to the IRS the Burden of Proving it Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit, infra*.

54 IRM 4.19.14.6.1.1 (6), (11) (Jan. 1, 2013).

55 IRM 4.19.14.6.1.1 (11) (Jan. 1, 2013).

56 IRC § 6214(b) provides that the Tax Court "in redetermining a deficiency of income tax for any taxable year or of gift tax for any calendar year or calendar quarter shall consider such facts with relation to the taxes for other years or calendar quarters as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other year or calendar quarter has been overpaid or underpaid." IRM 4.19.14.6.1.3 (Jan. 1, 2007) instructs employees that if the taxpayer petitions the Tax Court, they should provide Chief Counsel attorneys with the complete case file for the year that is the subject of the Tax Court petition as well as the year in which the ban was imposed.

57 Budget of the United States Government, Fiscal Year 2014 212, 219, *available at* http://www.whitehouse.gov/omb/budget/Overview; Perspectives, Budget of the United States Government, Fiscal Year 2014 205, *available at* http://www.whitehouse.gov/omb/budget/Analytical_Perspectives.

of deficiency with the attendant right to petition the Tax Court for review.[58] The National Taxpayer Advocate does not support the Treasury Department's proposal to extend the use of math error authority in this manner unless and until: 1) the IRS adopts procedures that ensure IRS auditors make a considered (as opposed to automated or presumed) determination that reckless or intentional disregard of rules or regulations occurred; and 2) Congress clarifies that the IRS bears the burden of proving the taxpayer acted intentionally or recklessly with respect to his or her EITC claim.[59]

The IRS Has Imposed More Stringent Due Diligence Requirements on Paid Preparers who Prepare Returns that Claim EITC, and These Requirements May Increase Compliance.

Paid return preparers were involved in about 71 percent of the returns in the TAS sample of two-year ban cases.[60] In more than half (27) of the 50 cases in which the IRS automatically imposed the ban because EITC had been disallowed in a previous year and the taxpayer did not respond to audit notices, the tax return was prepared by a paid preparer. IRC § 6695(g) provides that:

> [a]ny person who is a tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary by regulations with respect to determining eligibility for, or the amount of, the credit allowable by section 32 shall pay a penalty of $500 for each such failure.[61]

Under the regulations, for returns filed after December 31, 2011, preparers must demonstrate they exercised due diligence in determining earned income eligibility by submitting Form 8867, *Paid Preparer's Earned Income Credit Checklist*, or "Alternative Eligibility Record" and file it with the return or claim for refund.[62] The IRS imposed the section 6695(g) penalty on almost 900 individuals in fiscal year 2012 and the average amount of penalty assessed in each case exceeded $10,000.[63] Unsurprisingly, it appears that preparers subject to the penalty prepared multiple returns.

By not articulating the reason for imposing the ban and securing managerial approval, the IRS does not adhere to its own procedures.

The 2012 version of Form 8867, in Part IV, "Due Diligence Requirements," poses two new questions that relate to relationship and residency of any qualifying

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58 IRC § 6213(b)(1). The analysis that accompanies the President's budget proposal explains, "[t]he IRS may correct certain mathematical or clerical errors made on tax returns to reflect the taxpayer's correct tax liability (this authority is generally referred to as 'math error authority')." Perspectives, Budget of the United States Government, Fiscal Year 2014 205, *available at* http://www.whitehouse.gov/omb/budget/Analytical_Perspectives.

59 *See* Legislative Recommendation: *Allocate to the IRS the Burden of Proving it Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit, infra*.

60 In 237 out of 333 cases, a paid preparer signed the return or there are other indications, such as a refund anticipation loan, that indicate a paid preparer was involved.

61 The United States-Korea Free Trade Agreement Implementation Act, Pub. L. No. 112–41, § 501, 125 Stat 428, amended IRC § 6695(g) by increasing the amount of the penalty from $100 to $500 for returns filed after December 31, 2011. See Treas. Reg. § 1.6695–2(a). The National Taxpayer Advocate recommended increasing the amount of the preparer penalty in 2003. See National Taxpayer Advocate 2003 Annual Report to Congress 272 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*).

62 Treas. Reg. § 1.6695–2(b)(1). Most of the returns in the TAS sample cases were filed after Dec. 31, 2011. Although a 2009 version of Form 8867 was available, preparers of returns filed before Dec. 31, 2011, were not required to file Form 8867 with the returns they prepared.

63 The penalty was imposed against 881 individuals in FY 2012. IRS response to TAS fact check (Dec. 20, 2013).

children with respect to whom the credit is being claimed.[64] The same portion of the form now asks the preparer to identify, from a list of documents, which one(s) he or she relied on to determine the residence or disability of a qualifying child and which documents supported any claimed Schedule C income or expenses. The preparer can also indicate, by checking a box, that he or she relied on "other" unspecified documents, "did not rely on any documents, but made notes in file," or simply "did not rely on any documents."[65] The preparer is instructed that due diligence requires that he or she keep for three years:

- Form 8867, *Paid Preparer's Earned Income Credit Checklist*;
- The EIC worksheet(s) or the preparer's own worksheet(s);
- Copies of any taxpayer documents the preparer relied on to determine eligibility for or amount of EIC;
- A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained; and
- A record of any additional questions the preparer asked and the client's answers.[66]

The National Taxpayer Advocate applauds the IRS for finalizing the regulation that requires preparers to submit Form 8867 with returns they prepare and for revising Form 8867 to not only reflect the new regulation but also facilitate preparer due diligence.[67]

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64 One question is: "If any qualifying child was not the taxpayer's son or daughter, did you ask why the parents were not claiming the child and document the answer?"' Another question is "If the answer to question 13a is 'Yes' (indicating that the child lived for more than half the year with someone else who could claim the child for the EIC), did you explain the tiebreaker rules and possible consequences of another person claiming your client's qualifying child?" A "qualifying child" is a person who among other things meets age requirements, bears a specified relationship to the taxpayer, and has the same principal residence as the taxpayer for more than half the year. IRC §§ 32(c)(3), 152(c). The last two components of EITC eligibility — relationship and residency — can be particularly difficult to substantiate. National Taxpayer Advocate 2011 Annual Report to Congress 296, 304 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance and Take Steps to Improve Both Service and Compliance*).

65 This format, which serves as a prompt for the preparer by suggesting documents that might be appropriate substantiation, appeared for the first time on the 2012 version of the form.

66 These directions correspond to the requirements of Treas. Reg. 1.6695-2(b)(4) that the preparer submit with the return "A) A copy of the completed Form 8867 (or successor form); (B) A copy of the completed Earned Income Credit Worksheet (or other record of the tax return preparer's EIC computation permitted under paragraph (b)(2)(i)(B) of this section); and (C) A record of how and when the information used to complete Form 8867 (or successor form) and the Earned Income Credit Worksheet (or other record of the tax return preparer's EIC computation permitted under paragraph (b)(2)(i)(B) of this section) was obtained by the tax return preparer, including the identity of any person furnishing the information, as well as a copy of any document that was provided by the taxpayer and on which the tax return preparer relied to complete Form 8867 (or successor form) or the Earned Income Credit Worksheet (or other record of the tax return preparer's EIC computation permitted under paragraph (b)(2)(i)(B) of this section)."

67 The National Taxpayer Advocate first recommended that the IRS impose broader due diligence requirements on EITC return preparers in 2003 (see National Taxpayer Advocate 2003 Annual Report to Congress 36 (Most Serious Problem: *Earned Income Tax Credit Compliance Strategy*). She also in 2003 recommended that Congress amend IRC § 6695(g) to impose the same requirements the Treasury regulation now imposes. National Taxpayer Advocate 2003 Annual Report to Congress 272 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*). The National Taxpayer Advocate renewed these recommendations over the years. *See, e.g*, National Taxpayer Advocate 2009 Annual Report to Congress 56 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*). We note, however, that attorneys, certified public accountants, enrolled agents, or enrolled actuaries, all of whom are regulated by the IRS, may not be willing to prepare returns that claim EITC because of the additional burden Treas. Reg. 1.6695-2(b)(4) and the revised Form 8867 imposes on them. To the extent regulated return preparers are unwilling to prepare returns claiming EITC, the returns may be prepared by unenrolled return preparers (*i.e.*, preparers with no recognized credentials to prepare returns and over whom the IRS does not have regulatory authority). *See Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. 2013); Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS is Enjoined from Continuing Its Efforts to Effectively Regulate Return Preparers, supra*.

CONCLUSION

IRC § 32(k) is a unique penalty provision because it permits the IRS to sanction taxpayers not only for the year they improperly claim EITC, but also for two subsequent tax years, whether or not the taxpayers become eligible for EITC in those later years. Because of its reach, the statute applies only where the taxpayer noncompliance was egregious or is attributable to a particular state of mind, *i.e.*, due to reckless or intentional disregard of the EITC rules. The IRS, by imposing — sometimes automatically — the ban on taxpayers who did not participate in the audit or who submitted documents demonstrating they believed they were entitled to the claimed EITC, does not act within the statutory confines. By not articulating the reason for imposing the ban and securing managerial approval, the IRS does not adhere to its own IRM and acts arbitrarily and capriciously.

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RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Immediately suspend the application of IRM provisions (*e.g.*, IRM 4.19.14.6.1.5) that permit automatic imposition of the two-year EITC ban or require the taxpayer to show why the ban should not be imposed.
2. In collaboration and consultation with the National Taxpayer Advocate, include on the Treasury Guidance Priority List regulations that explain when the IRS should impose EITC bans.[68]
3. Revise, in consultation with the National Taxpayer Advocate, the IRM provisions on the two-year ban to take into account what is reasonable to expect of taxpayers who claim EITC. At a minimum, before imposing the two-year ban, examiners should be required to:
   a. Attempt to speak with the taxpayer;
   b. Determine whether the substantiation the taxpayer submitted is probative of the EITC claim or shows a sincere effort to prove the elements of EITC, even if the documentation is not listed in the IRM as acceptable substantiation or the documentation is insufficient, and
   c. Consider the role, if any, of a paid preparer in claiming disallowed EITC.
4. Conduct quality reviews of every case in which the IRS proposes to impose the two-year ban. One hundred percent quality reviews should continue for at least three years and until the IRS's failure to adhere to the terms of the statute and the IRM is corrected.

68 The Treasury Department's Office of Tax Policy and the IRS use the Annual Guidance Priority List each year to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance. See IRM 32.1, Chief Counsel Regulation Handbook. The National Taxpayer Advocate's proposal that guidance to determine whether EITC was claimed in "reckless or intentional disregard of rules and regulations" for purposes of IRC § 32(k)(1)(B)(ii) be included in the 2013-2014 Guidance Priority Plan was not adopted. *See* 2013-2014 Priority Guidance Plan, *available at* http://www.irs.gov/uac/Priority-Guidance-Plan (Aug. 9, 2013).

MSP #10 INDIAN TRIBAL TAXPAYERS: Inadequate Consideration of Their Unique Needs Causes Burdens

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage & Investment Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Sunita B. Lough, Commissioner, Tax-Exempt & Government Entities Division
William J. Wilkins, Chief Counsel

DEFINITION OF PROBLEM

In filing season 2013, an IRS filter wrongly flagged Indian tribal member returns as fraudulent due to common filing characteristics that the IRS has identified as indicators of fraud. This error in tax administration is symptomatic of the IRS's failure to recognize legitimate geographic, economic, and cultural circumstances of a unique taxpayer population. Although the National Taxpayer Advocate's 2008 Annual Report to Congress applauded IRS outreach to Indian Nations as exemplary, it is unclear if all IRS functions are responsive to their needs. In certain cases, IRS operating divisions (ODs) remain unaware of the particular characteristics and needs of Indian taxpayers, potentially resulting in unnecessary contact with the IRS and unwarranted audits, taxes, or penalties. Particular concerns relate to the IRS's:

- Improper treatment of tribal distributions;
- Misunderstanding of Native American family structure;
- Ignorance of tribal sovereignty;
- Delays in processing of certain settlement awards; and
- Failure to publish legal guidance for tribes.

In guidance posted on an internal web page, the IRS Indian Tribal Government (ITG) function advises employees to seek help from a TAS Local Taxpayer Advocate (LTA) when an OD fails to respond to an issue within ITG's jurisdiction or expertise. While LTAs welcome referrals, when one function routinely seeks assistance in relaying taxpayer needs to another function, the issue extends beyond case-by-case resolution.

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ANALYSIS OF PROBLEM

Indian Tribal Taxpayers Have Unique Status.

Indian tribes have a unique status in federal tax law.[1] In some respects, tribes have a level of sovereignty similar to that of the 50 states, which are not subject to tax on their income.[2] Historically, the Supreme Court classified tribes as domestic dependent nations.[3] The Internal Revenue Manual (IRM) sets forth the following overview of tribal sovereignty.[4]

The Internal Revenue Manual Gives an Overview of Tribal Sovereignty.

The U.S. government has a unique legal relationship with Indian tribal governments as set forth in the Constitution, treaties, statutes, and court decisions. Congress may limit the authority of Indian tribes, but within those limits the tribes retain "attributes of sovereignty over both their members and their territory."[5] Tribal government powers include the authority to choose the form of government, determine tribal membership, regulate tribal and individual property, levy taxes, establish courts, and maintain law and order. Generally, Indian tribes provide governmental services, such as transportation, education, and medical care to tribal members.

Although Congress can limit tribal powers of sovereignty, the states cannot. The general rule in the field of Indian law is that unless there is specific delegation of authority provided by Congress, laws do not apply to Indians on reservations. Thus, Indian tribes are "semi-sovereign" entities, or "distinct, independent political communities" within the borders of the states in which they reside. Their sovereign powers can be limited or defined by an act of Congress or, in some cases, those powers may have been implicitly lost when tribes became subject to overriding federal sovereignty. On the other hand, the laws of any state can have but limited effect on Indian residents of reservations, or on the exercise of tribal sovereign power within reservations.[6]

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1 According to expert sources, both American Indian and Native American are acceptable terms, although the latter tends to encompass Native Alaskans and Hawaiians as well as Indians *per se*. While each term may connote subtle nuances, authors may use them interchangeably. *See* Kathryn Walbert, American Indian vs. Native American: A Note on Terminology (Univ. of N.C. – Chapel Hill), http://www.learnnc.org/lp/editions/nc-american-indians/5526 (last visited May 6, 2013); Peter d'Errico, Native American Indian Studies: A Note on Names (Univ. of Mass. – Amherst), http://www.umass.edu/legal/derrico/name.html (last visited May 6, 2013); Nat'l Museum of the Amer. Indian, What Is the Correct Terminology: American Indian, Indian, Native American, or Native? (Smithsonian Inst.), http://nmai.si.edu/explore/forfamilies/resources/didyouknow/#2 (last visited May 6, 2013); Native Amer. Rights Fund, Why Are Indians Sometimes Referred to as Native Americans?, http://www.narf.org/pubs/misc/faqs.html (last visited May 6, 2013); Utah Div'n of Indian Affairs, American Indian vs. Native American: Which Is The Proper Term?, http://indian.utah.gov/faq/indian_heritage.html (last visited May 6, 2013).

2 *See* 10th Amend. to U.S. Const.; IRS Pub. 963, Federal-State Reference Guide.

3 *See Cherokee Nation v. Georgia*, 30 U.S. 1 (1831). Further, lands reserved by tribes are defined by statute as Indian Country. *See* 18 U.S.C. § 1151; IRM 4.86.1.1.1(2), *Who We Are* (June 1, 2006); IRM 4.86.1.3(2), *Other Tribal Contacts* (June 1, 2006). "**Indian Country** is a multifaceted term that historically has been used as a geographical designation, as a legal term, and as a cultural concept that encompasses the past, present, and future of American Indian people. It embodies the idea that there is 'a place' for Indians. The existence of Indian Country, through the many evolutions of that term, represents an acknowledgment and agreement that Indian people will survive. It is a concession to the notion that the melting pot is not everyone's idea of the American dream, and that many Indian people desire to live in that place they call Indian Country." *Gale Encyclopedia of U.S. History*, *available at* http://www.answers.com/topic/indian-country#ixzz2TCAIJZCq (last visited July 31, 2013). *See also* Stephen W. Silliman, *The 'Old West' in the Middle East: U.S. Military Metaphors in Real and Imagined Indian Country*, 110 American Anthropologist 237 (2008), *available at* http://www.faculty.umb.edu/stephen_silliman/articles/oldwestinmiddleeast.pdf (last visited July 31, 2013); Rob't Imrie, *Tribes Angered by General's Reference to Enemy Land as Indian Country*, Associated Press (Feb. 21, 1991), *available at* http://www.apnewsarchive.com/1991/Tribes-Angered-By-General-s-Reference-to-Enemy-Land-as-Indian-Country-/id-ce150feb55e4a9058c307295efc07f4a (last visited July 31, 2013).

4 The following passage is taken from IRM 4.86.1.5, *Tribal Sovereignty Overview* (Jan. 1, 2003).

5 IRM 4.86.1.5, *Tribal Sovereignty Overview* (Jan. 1, 2003) (quoting *U.S. v. Mazurie*, 419 U.S. 544, 557 (1975)).

6 IRM 4.86.1.5, *Tribal Sovereignty Overview* (Jan. 1, 2003) (citing Mary B. Magnuson, *Indian Legal Issues*, Minn. Inst. of Legal Educ'n (1995)).

Over the years, presidents have issued executive orders that directed federal agencies, to the extent permitted by law, to "respect Indian tribal self-government and sovereignty, honor tribal treaty and other rights, and strive to meet the responsibilities that arise from the unique legal relationship between the Federal Government and Indian tribal governments."[7]

The IRS Should Follow the Indian Tribal Government Function (ITG) in Exercising Cultural Sensitivity.

The ITG function, which operates within the Tax-Exempt/Government Entities Operating Division (TE/GE), addresses tribal employment, programs, trusts, businesses, and distributions to individual members. While the 2008 Annual Report to Congress praised the exemplary outreach conducted by ITG toward its customers, it is unclear if the function has received cooperation within the IRS.[8] On the contrary, ITG and TAS staff have heard IRS employees utter culturally insensitive remarks to tribal people. An IRM provision that directs IRS employees to follow ITG protocol when contacting tribes could establish a model for consultation of the ITG function within the IRS.[9] While the ITG function focuses on tribal entities:

> There may be times when it is unclear who should be controlling a situation, such as in the examination of a tribal leader's personal income tax return or the examination of a large number of tribal members. When coordination efforts between divisions do not resolve a tribal issue, Taxpayer Advocate Service referrals should be considered as a potential avenue of resolution when certain criteria are met.[10]

Accordingly, the IRS, led by TAS and ITG, should train campus and field compliance employees about tribal issues. Jointly, federal agencies have produced an online course containing a "Cultural Orientation" module that could counteract reported insensitivity.[11]

Tribal Members Confront Issues Different from Those of the Overall Taxpayer Population.

Indian taxpayers may confront IRS misunderstandings and delays relating to issues such as tribal distributions, presumed fraud or frivolous positions, family relations, settlement awards, and health coverage. As these issues are reflected on individual returns, they would be processed by ODs rather than the ITG function which focuses on Native American issues. Consequently, individual Indians may have to reinvent the wheel to resolve systemic problems on a case-by-case basis. It would be more efficient for the IRS to establish a cross-functional working group on issues of Indian individuals, parallel to the ITG function that focuses on tribal entities.

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7 *Id*. (quoting Exec. Ord. No. 13175, 65 Fed. Reg. 67249 (Nov. 6, 2000)).

8 National Taxpayer Advocate 2008 Annual Report to Congress 99-100 (footnotes omitted): "Another example of outstanding service is the IRS's Office of Indian Tribal Governments outreach to Indian Nations. During 2008, the office conducted 85 events with a total attendance of more than 3,600 customers. The office also offered large-scale workshops for 227 Alaskan tribal villages and 112 Navajo villages. Services include educational workshops on Title 31, employment tax forms, tip reporting, employment taxes, the Earned Income Tax Credit (EITC), information reporting, and gaming issues. VITA also held sessions at seven events. The IRS should follow the Office of Indian Tribal Governments' model in targeting and bringing programs to other taxpayer populations."

9 *See* IRM 4.86.1.2, *Protocol for Contacting Tribes* (Jan. 1, 2003).

10 *See* IRM 4.86.1.1.3, *Coordination Between Divisions* (July 28, 2008).

11 *Working Effectively with Tribal Governments*, *available at* http://tribal.golearnportal.org/return.php (last visited July 31, 2013).

While the IRS recently issued various pieces of guidance helpful to Indian individuals, major projects remain outstanding, especially those applicable to tribal entities. The resulting uncertainty can sustain a chilling effect on tribal enterprise, distorting economic opportunities.

The IRS Has Treated Tribal Distributions Improperly.

Tribes may distribute funds, such as tax-exempt revenue of the tribe, to individual members. IRS compliance functions consistently subject tribal distributions, that are not from work, to self-employment tax apparently due to misinterpretation of Form 1099, *U.S. Information Return*. For federal tax purposes, these amounts may constitute income, but it is unclear why they would be treated as self-employment earnings. The TE/GE intranet includes a form instructing ITG staff to advise IRS campuses that such distributions are not an individual's self-employment earnings, and to file Form 911, *Application for Taxpayer Assistance Order*, with the LTA if a campus does not comply.[12]

While TAS is pleased that the ITG function shows concern by referring problems for resolution, this approach all but concedes that Automated Underreporter (AUR, the IRS program that processes information returns) may have a harmful effect, and at worst, may discriminate against a particular taxpayer population. For tax year 2011, TAS has identified in LTA inventory at least 42 cases where the IRS inaccurately assumed that a tribal member's Form 1099 was incorrect, either because the withholding amount apparently did not meet expected parameters or otherwise. The data reveal an underlying systemic issue that the IRS should be trying to resolve.

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The IRS Has Filtered Returns Inaccurately.

In the 2013 filing season, an IRS filter wrongly flagged returns of tribal members as fraudulent presumably because their characteristics, such as certain mail delivery patterns, happened to resemble those in a fraudulent scheme.[13] This error in tax administration is symptomatic of IRS failure to recognize legitimate geographic, economic, and cultural circumstances of a unique taxpayer population, and to program IRS systems to avoid false positives that have a disparate impact on that population. Given that the IRS routinely changes filters to reflect characteristics of the filing population, this experience should afford an opportunity for greater accuracy in the future. To avoid repeating past mistakes, IRS functions (such as Wage & Investment Pre-Refund, AUR, Automatic Substitute for Return (ASFR), Correspondence Exam, and Field Exam) should consult ITG before implementing filters or similar programs that could erroneously target Indian taxpayers.

The IRS May Misunderstand Native American Family Structure.

Eligibility for various tax benefits may depend on family relations as documented by the taxpayer. However, some Native American families do not fit the standard family structure. Last year, the National Taxpayer Advocate proposed a Legislative Recommendation to recognize children with special needs adopted under tribal law, as the tax law recognizes only those adopted under state law.[14] Generally, the Internal Revenue Code (IRC) allows a credit to parents who adopt children, with a larger amount for

12 See http://tege.web.irs.gov/article.asp?category=tege&title=mytege-ge-itg-government-functions&path=/my-tege/4_govt-entities (last visited Apr. 26, 2013).

13 The IRS uses statistical and other criteria, commonly known as filters, to segregate returns into treatment streams. *See generally* IRM 4.1.3, *Sources of Returns-Priority Programs-DIF and Ordering* (Aug. 10, 2012).

14 See National Taxpayer Advocate 2012 Annual Report to Congress 520 (Legislative Recommendation: *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes*).

a child who has special needs relating to ethnic background, age, membership in a minority or sibling group, or a medical condition.[15] However, the tax law allows only a state to certify special needs.[16] In specified circumstances, the tax law treats a tribe as a state, but unfortunately the adoption credit is not a specified provision.[17]

Similar legislative or administrative misapprehensions of Indian households, which can consist of multiple generations living together, may arise in the context of filing status, the child tax credit, Earned Income Tax Credit, dependency deduction, or otherwise.[18] The IRS has recognized unique circumstances of tribal members in informal guidance on "Alternative Documentation for Native Americans," which lists tribal — rather than state — documents acceptable for identifying qualifying children.[19] Such informal guidance deserves to be codified in the IRM.

The IRS May Display Ignorance of Tribal Sovereignty.

TAS is aware of cases in which tribal members who may have misunderstood federal tax requirements tell the IRS that they are members of sovereign nations. In response, the IRS asserts a penalty for a frivolous position.[20] While certain allegations of sovereignty may be frivolous, Indian tribes are sovereign entities.[21] In good faith, the taxpayer may have made a true statement that was simply inapplicable to an individual return. Thus, a tribal member's statement about sovereignty may not reflect a desire to delay or impede the administration of federal tax laws within the meaning of the penalty provision. The IRS should clarify that not all statements about sovereignty deserve a frivolous penalty.

The IRS May Delay Processing of Keepseagle Awards.

In 2011, the U.S. Department of Agriculture (USDA) settled a class action lawsuit, known as *Keepseagle,* for discrimination against Indian borrowers in the Farm Loan Program.[22] Under the settlement, 4,200 "Track A" individuals received up to $50,000 each in 2012; 170 "Track B" individuals received up to $250,000 each.[23] In addition, USDA forgave outstanding debt and remitted to the IRS amounts to cover the taxes on the awards, including the forgiveness. In general, forgiven debt constitutes income, with exceptions for insolvent taxpayers, among other cases.[24] TAS is aware of *Keepseagle* cases in which the IRS has not credited USDA remittances to taxpayers' accounts. In addition, taxpayers who claim the insolvency exception may face refund delays pending IRS verification of insolvency.[25] In this case, taxpayers

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15 *See* IRC § 23(d)(3).

16 *See id*.

17 *See* IRC § 7871.

18 *See* IRC §§ 2, 24, 32, 151.

19 *See* Service-wide Electronic Research Program (SERP) Alert W 04158 (Mar. 4, 2004).

20 *See* IRC § 6702.

21 *Compare* Rev. Rul. 2007-22, 2007-1 C.B. 866, with IRM 4.86.1.5, *Tribal Sovereignty Overview* (Jan. 1, 2003).

22 *See Keepseagle v. Vilsack*, No. 1:99CV03119 (D.D.C. 2011).

23 *See* Nat'l Cong. of Amer. Indians, *Protect Native Money Update* (Jan. 30, 2013), *available at* http://www.ncai.org/protectnativemoney (last visited July 31, 2013).

24 *See* IRC § 108.

25 *See* IRS Pub. 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments*.

While the ITG function conducts exemplary outreach, other IRS organizations remain unaware of particular characteristics and needs of Indian individual and tribal taxpayers. This lack of awareness could result in unnecessary contact with the IRS and unwarranted auditing, taxation, or penalties.

may need assistance in submitting the required information.[26] The IRS should render assistance as required, after consultation and collaboration with TAS.

Patients of the Indian Health Service Should Be Exempt from the Affordable Care Act.

The Affordable Care Act (ACA) requires individuals to obtain health insurance or pay a tax.[27] This individual requirement excepts various people, such as those experiencing hardship — as determined by the Department of Health & Human Services (HHS) — as well as Indians, who may receive tribal health care.[28] Technically, the latter exemption covers members of federally-recognized tribes, a category that covers only a portion of the Native American and Alaska Native population, excluding some patients of the federal health care providers such as the Indian Health Service (IHS), which is available to those of Indian descent, even if not enrolled in a recognized tribe.[29] Commentators have complained that penalties should not apply to patients of the IHS or similar services.[30] In response, HHS expanded the hardship exemption to cover those patients, explaining that "HHS does not have the legal authority to modify through regulation the statutory definitions of 'Indian' as referenced in the Affordable Care Act… Any changes to the definition must be legislative."[31]

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Tribes Need Legal Guidance.

While the IRS recently issued various pieces of guidance helpful to Indian individuals, major projects remain outstanding, especially those applicable to tribal entities. The resulting uncertainty can sustain a chilling effect on tribal enterprise, distorting economic opportunities.

In particular, integral part regulations, which would offer guidance to tribal entities, have been pending for six years. Historically, a series of IRS rulings has exempted from tax certain entities that are integral parts of governments, which as such are themselves tax-exempt.[32] This patchwork of rulings could affect a variety of entities, including recent forms such as charter schools, as well as enterprises of tribes. In view of the uncertainty of this law with potential economic impact, the Priority Guidance Plan (PGP) annually co-signed by the Commissioner of Internal Revenue, IRS Chief Counsel, and Treasury Assistant Secretary (Tax Policy) has promised, every year since 2007, regulations setting forth criteria for treating an entity as an integral part of a state, local or tribal government.[33] Yet the IRS has issued no such guidance.

26 *Cf.* National Taxpayer Advocate 2008 Annual Report to Congress 39 (Most Serious Problem: *Understanding and Reporting the Tax Consequences of Cancellation of Debt Income*), 391 (Legislative Recommendation: *Simplify the Tax Treatment of Cancellation of Debt Income*); 2007 Annual Report to Congress 13 (Most Serious Problem: *Tax Consequences of Cancellation of Debt Income*).

27 IRS, Affordable Care Act (ACA) Tax Provisions, *at* http://www.irs.gov/uac/Affordable-Care-Act-Tax-Provisions-Home.

28 *See* IRC § 5000A(e).

29 *See* Indian Health Serv., *Indian Health Man*. 2-1.2, *available at* http://www.ihs.gov/IHM/index.cfm?module=dsp_ihm_pc_p2c1#2-1.2 (last visited Aug. 1, 2013).

30 *See* Assoc. Press, *Some Native Americans May Be Penalized Under ACA* (May 15, 2013), *available at* http://www.cbsnews.com/8301-204_162-57584676/ap-some-native-americans-may-be-penalized-under-affordable-care-act/ (last visited Aug. 1, 2013).

31 78 Fed. Reg. 39,501 (July 1, 2013); *see also* IHS Press Release, Administration Renews Commitment to American Indians and Alaska Natives (June 26, 2013), *available at* http://www.ihs.gov/newsroom/pressreleases/2013pressreleases/renewcommitment/ (last visited Aug. 8, 2013); *cf. infra* Legislative Recommendation: *Premium Tax Credit: Lower the Affordability Threshold*.

32 *See* Ellen Aprill, *The Integral, the Essential, and the Instrumental*, 23 J. Corp. L. 803 (1998).

33 *See* IRS Priority Guidance Plans, *available at* http://www.irs.gov/uac/Priority-Guidance-Plan (last visited Aug. 2, 2013).

On a related topic, the IRS declined to issue guidance on corporations chartered under tribal law. For federal tax purposes, corporations chartered under state law are corporations, but the status of those chartered under tribal law is unclear.[34] From 2001 to 2007, a PGP commitment to guidance on this topic turned into another broken promise. By way of explanation, tribal corporations could be subsumed under integral part regulations if the IRS completes those regulations.

Nevertheless, the IRS recently issued guidance helpful to tribal members, responding in part to a long-standing executive order that memorializes a U.S. government commitment to consultation with tribes.[35] Significant publications include:

- *General Welfare Exclusion*. Under an administrative doctrine harking back at least to the New Deal era, the IRS has excluded from income government payments to needy individuals. Notice 2012-75 proposes guidance on applying this general welfare exclusion to tribal programs, specifically creating a safe harbor where individual need may be unclear (*e.g.* payments to attend pow-wows).[36] Upon consideration of public comments, the IRS should finalize this guidance.
- *Indian Gaming Regulatory Act (IGRA) Trusts.* Under IGRA, tribes may set aside *per capita* payments derived from tribal-owned enterprises (such as casinos) for children (and other legal incompetents) in trust. In general, trust deposits are income when the beneficiary obtains control of the money.[37] As set forth in prior guidance, judicial (and regulatory) doctrines of constructive receipt (or economic benefit) may allow deferral of inclusion in income when the beneficiary's control is subject to substantial limitations or restrictions, such as claims of the tribe's creditors.[38] Recent guidance maintains deferral while clarifying that trustees may make staggered distributions to beneficiaries at different ages or upon the occurrence of specific events rather than distributing all the trust assets when the beneficiary attains a specified age, broadening the class of survivors who may inherit a beneficiary's trust interest, and modifying trustees' discretion to make health and welfare distributions.[39]
- *Tribal Trust Settlements.* In 2012, the U.S. settled major litigation in which tribes complained that federal agencies had historically mismanaged property that the government holds in trust for tribes. Consequently, the U.S. agreed to pay more than $1 billion to tribes, which may in turn make *per capita* payments to members. Recent IRS guidance clarifies that *per capita* payments are excluded from members' income to the extent attributable to the settlement, while interest earned after transfer to the tribe would be included.[40]

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34 *See* Karen Atkinson & Kathleen Nilles, *Tribal Business Structure Handbook* (Dep't of the Interior, 2008), Ch. III, http://www.irs.gov/pub/irs-tege/tribal_business_structure_handbook.pdf.

35 *See* Exec. Ord. 13,175, 65 Fed. Reg. 67,249 (Nov. 9, 2000); supplemented by Pres. Memo. 74 Fed. Reg. 57,879 (Nov. 5, 2009); implemented by O.M.B. Memo. M-10-33 (July 30, 2010).

36 2012-2 C.B. 715 (Dec. 5, 2012).

37 *See* Treas. Reg. § 1.451-2.

38 *See* Rev. Proc. 2003-14, 2003-1 C.B. 319.

39 *See* Rev. Proc. 2011-56, 2011-2 C.B. 834.

40 *See* Notice 2013-55, 2013-38 I.R.B. 207; Notice 2013-1, 2013-3 I.R.B. 281; Notice 2012-60, 2012-41 I.R.B. 445.

CONCLUSION

While the ITG function conducts exemplary outreach, other IRS organizations remain unaware of particular characteristics and needs of Indian individual and tribal taxpayers. This lack of awareness could result in unnecessary contact with the IRS and unwarranted auditing, taxation, or penalties. Informal and published guidance could direct IRS employees to consult the ITG function or otherwise account for special considerations surrounding Native American individuals and tribal governments.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

- Train all compliance employees about the culture and needs of Native American taxpayers, rendering assistance as required by this population, after consulting with and referring taxpayers to TAS when necessary.[41]
- Establish a cross-functional working group on issues of Indian individuals, parallel to the ITG function which focuses on tribal entities.
- Consult with the ITG function before implementing filters or similar programs (such as those operated by Wage & Investment Pre-Refund, AUR, ASFR, Correspondence Exam; Field Exam) that could have the effect of erroneously targeting Indian taxpayers.
- Correct procedures that result in routine failure to comply with ITG directives.
- Finalize guidance on tribal documentation of qualifying children, frivolous claim penalties, integral parts of governments including tribal corporations, general welfare exclusion of tribal distributions, and other questions as they arise.

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41 *Cf.* National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*); 2009 Annual Report to Congress, vol. 2, § 4, 75 (Research Study: *Running Social Programs Through the Tax System*).

MSP #11 COLLECTION STRATEGY: The Automated Collection System's Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division

DEFINITION OF PROBLEM

The Automated Collection System (ACS) is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies.[1] ACS collects tax largely by offsetting taxpayers' refunds, and eliminates much of its inventory by passing cases to other parts of the IRS:

- In fiscal year (FY) 2013, ACS collected approximately $5.4 billion on open Taxpayer Delinquent Accounts (TDA).[2] However, $2.5 billion (about 47 percent) of this amount came through automatic refund offsets, which are generally not attributable to ACS employees' direct efforts.[3]
- While collections on open TDA accounts totaled $5.4 billion, ACS transferred approximately three times as much — $16.1 billion — in unresolved tax liabilities to other IRS collection inventory, *i.e.,* the Queue, the Collection Field function (CFf), or Shelved Inventory.[4]

ACS's failure to resolve cases is due in part to approach to working cases and the types of cases it is assigned.[5] More specifically:

- Rather than applying the appropriate type of contact for each type of taxpayer, ACS generally relies on notices of intent to levy or systemically generated levies, which are often not effective. For instance, in FY 2013 the ACS received 2,889,971 new taxpayer cases and issued 1,216,302 levies, averaging almost one levy for every two cases received.[6] Although this is still a high number of levies, it is about 46 percent lower than in FY 2012.[7] Despite this substantial reduction, ACS's overall collections actually increased for the latter period. This result is not surprising, based on a TAS

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1 The ACS call center assigns incoming calls to contact representatives or tax examiners who work with taxpayers. ACS's telephone call center is designed to get taxpayers into the phone-based system as quickly as possible by sending them to the first available contact representative or tax examiner who can assist them, regardless of where the assistor is located geographically.

2 TDAs are collection accounts that remain unresolved at the conclusion of the collection notice process and have been designated for additional collection activity, *e.g.*, ACS or the Collection Field function (CFf). A taxpayer may have multiple TDAs (*e.g.*, one for each delinquent tax period).

3 IRS Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013). In FY 2013, the IRS collected $2.8 billion of the $5.4 billion through taxpayers making full or partial payments on their delinquent accounts.

4 *Id.* The Queue is a holding inventory where collection cases sit, usually after being in ACS, and before being assigned to the CFf or reassignment to ACS. Cases sit in the Queue based on business rules and available resources. Shelved Inventory means accounts that are not being worked due to resource limitations. The CFf is predominantly staffed by revenue officers who make field contact with taxpayers, secure delinquent returns and financial information, initiate installment agreements, and take enforcement action including liens, levies, and seizures of property.

5 National Taxpayer Advocate 2012 Annual Report to Congress 381.

6 IRS Collection Activity Report, NO-5000-24, *Levy & Seizure Report* (Sept. 2013).

7 In FY 2012, ACS received 2,758,926 new taxpayer cases and issued 2,247,168 levies. The decrease from FY 2012 to FY 2013 likely results from the IRS's decision to dedicate three ACS call sites to Accounts Management call center duties this past filing season.

review of ACS cases that found about 75 percent of levies were unproductive (*i.e.,* did not attach to a payment source).[8]

- Several studies show that letters and phone calls are superior to levies in generating a response and collecting outstanding tax.[9] In one IRS study, the rate of response from taxpayers after receiving letters was nearly three times greater than the rate for those who received levies.[10] A recent study showed that an expanded use of predictive dialer calls that were connected to live assistors generated a 45 percent contact rate.[11]
- Some types of cases are more suitable to ACS treatment than others. For instance, in FY 2013, only four percent of the cases processed through the Wage and Investment (W&I) division's ACS were sent to the Queue, while Small Business/Self-Employed division (SB/SE) ACS, which receives many employment tax cases, transferred 31 percent.[12]

An ACS collection strategy that places less emphasis on levies and instead identifies which taxpayers would best respond to other collection approaches, and initiates that approach early in the life of the debt, would yield effective contacts and better case resolutions. Further, an early intervention strategy in which the IRS first attempts to talk to the taxpayer by making an outgoing call or sending a notice, and then considers whether a levy is appropriate, would reduce the risk of placing the taxpayer in economic hardship, which could endanger the taxpayer's health or a business's viability. In addition, this approach would prevent the liability from growing to an amount that cannot be resolved and reduce the need for more extreme collection measures.

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ANALYSIS OF PROBLEM

Background

ACS Is the IRS's Collection Call Center.

When a delinquent account is not resolved through the normal notice process, the IRS typically assigns it to the ACS.[13] Cases are assigned to contact representatives or tax examiners. If the accounts remain unpaid or unresolved in ACS, they are transferred to the Collection Queue or to the Collection Field function. If a case moves to the Queue, the IRS makes little attempt to stay in contact with the taxpayer, unlike other creditors such as credit card companies that send regular notices.

When in ACS, taxpayers will often find themselves subject to a lien or levy. In cases where a levy source is available, one of ACS's first actions is usually to send out a *Final Notice of Intent to Levy and Your Notice of*

8 TAS reviewed 579 taxpayers in ACS.

9 ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000).

10 *Id*. This only included levies and Letters 16 that were presumed to reach the taxpayer (*i.e.*, did not come back as undelivered).

11 Predictive Dialer Test – ACS Accounts, Wage and Investment, Research and Analysis (May 2013). The 45 percent response rate is for accounts where a call was made and a letter sent. However, when just a call was made on the account the response rate was 37 percent. A predictive dialer is a telephone control system that automatically calls a list of telephone numbers in sequence, screening out no-answers, busy signals, answering machines and disconnected numbers and predicting when a live person will answer the call.

12 IRS Collection Activity Report NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013).

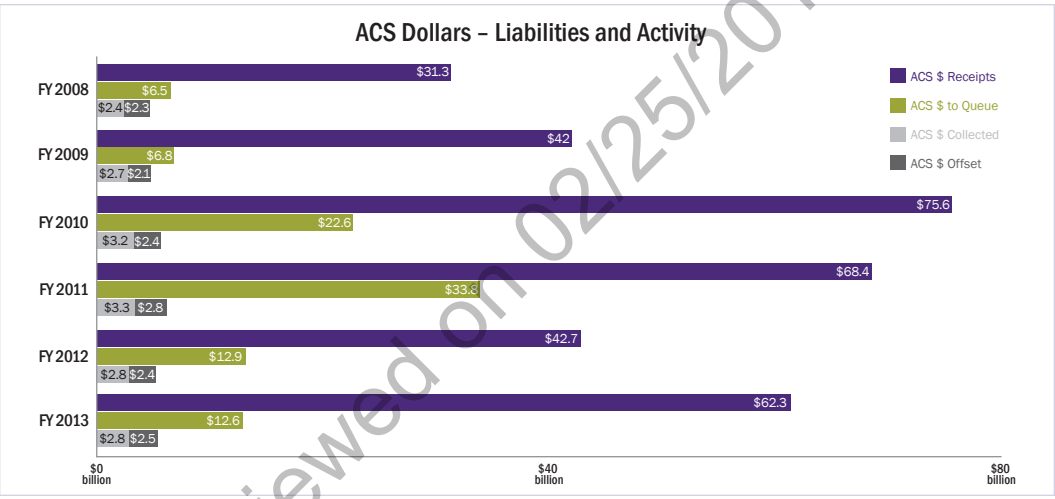
13 Internal Revenue Manual (IRM) 5.19.5.1 (Mar. 6, 2009); IRM 5.19.5.2 (Dec. 1, 2007). When a case is assigned to ACS it may take steps to issue a lien or levy against the taxpayer or send the taxpayer one of the following letters: Letter 16, *Please Call us About Your Overdue Taxes or Tax Return*; Letter 99, *Please Call Us About Your Overdue Taxes or Tax Returns*; Letter 40, *Advisory Notice to Taxpayer of Need to Contact Third Parties*; Letter 11, *Final Notice, Notice of Intent to Levy and Your Notice of a Right to a Hearing*.

a Right to a Hearing, rather than trying to contact the taxpayer through an outgoing call. ACS employees spend only about two percent of all their direct time making outbound calls.[14]

ACS Performance

ACS is not using the most effective methods for resolving cases and collecting liabilities. Over the past six years, ACS has consistently collected a modest percentage of dollars placed in its inventory, and almost half of those dollars came through computer-generated refund offsets, which are not part of ACS employees' direct efforts. Rather than collecting the outstanding liabilities, ACS has routinely transferred a large percentage of its inventory to the Queue or Shelved Inventory where penalties and interest continue to accrue. The chart below details ACS's performance.

FIGURE 1.11.1, ACS Activity by Fiscal Year



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The IRS should reassess its ACS collection strategy, which relies almost exclusively on its enforcement power (*i.e.*, issuing a lien or levy) to establish contacts with delinquent taxpayers. The IRS's own studies show a more conscientious and intentional (as opposed to automatic) use of liens and levies, outgoing phone calls, regular reminders of payment due, and "soft" notices to specific segments of taxpayers would be more effective.

ACS's Overreliance on its Levy Authority Is Counterproductive.

A recent study indicates ACS's current practice of relying primarily on its levy authority to generate taxpayer contacts may not maximize case closures. The SB/SE Denver ACS study reviewed 72,770 TDA cases that were in SB/SE ACS, and were closed during May of 2011 either as:

1) Fully Satisfied;

2) Taxpayer entered into an installment agreement (IA); or

14 IRS response to TAS research request (Oct. 24, 2012). In FY 2012, the percentages of ACS employees' direct time spent making outgoing calls on cases were 2.4 percent for SB/SE and 2.0 percent for W&I. A Treasury Inspector General for Tax Administration (TIGTA) report showed SB/SE ACS as spending 62 percent of its time answering incoming calls, 35 percent of its time working correspondence and research on accounts, and three percent of its time making outbound calls. For W&I ACS, 74 percent of its time was spent answering incoming calls, 24 percent of its time was spent working correspondence inventory and research accounts, and two percent making outbound calls. TIGTA, Ref. No. 2010-30-046, *More Management Information Is Needed to Improve Oversight of Automated Collection System Outbound Calls* 6 (Apr. 28, 2010).

3) The liability was currently not collectible (CNC).[15]

To determine what actions led to these case closures, the study reviewed actions taken during the 180 days prior to closure. The study showed that out of the 72,770 TDA cases closed in May of 2011, 25,657 (or 35 percent) had a levy action taken 180 days prior to closure.[16] In other words, the levy action contributed directly to closure in only those 25,657 cases. Despite the fact that levies were only responsible for closing 35 percent of the cases, a primary recommendation of the report was for ACS to issue even more levies to close cases.

A significant omission of the SB/SE Denver ACS study was that it did not consider levies issued during the 180-day period that did not result in a case closure (*i.e.*, unproductive levies). However, TAS did conduct such an analysis in a separate review of a statistically representative sample of 579 ACS cases that were in ACS inventory from about mid-2012 to mid-2013, and found most ACS levies are unproductive. In the analysis of the 579 ACS cases, 227 were issued a levy, but only 56 of these levies (or about 25 percent) were productive (*i.e.*, attached to a revenue source).[17] The remaining 75 percent of levies were unproductive, and possibly discouraged the taxpayer from contacting ACS.

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Reliance on ACS Enforcement Powers Can Cause Economic Hardship to Taxpayers and Unnecessarily Tie Up IRS Resources.

ACS's tendency to rely heavily on its levy authority can produce severe consequences for the taxpayer and the IRS alike. For instance, when ACS issues a levy without first attempting to contact the taxpayer, it risks causing economic hardship. Once a taxpayer has shown hardship, the IRS is required by law to release that levy, creating unnecessary work for the IRS.[18] Not only do these levies unnecessarily harm the taxpayer, but the release process unnecessarily ties up IRS resources in resolving problems that could have been avoided altogether. Both the taxpayer and the IRS would be better served if the IRS designed its collection action to be "no more intrusive than necessary."[19] It can do this by attempting to ensure upfront that the levy is the best way to collect the tax and that all other methods of collection, including outgoing calls, are ineffective.

ACS Can Limit its Use of Levies, Reducing Harm to Taxpayers without Reducing Dollars Collected.

ACS's most recent performance supports the premise that more levies do not necessarily translate into more dollars collected. For example, in FY 2013, ACS issued approximately 1.2 million levies, a

15 ACS Closed Case Actions Project DEN0181, SB/SE Research (Aug. 2012). Fully Satisfied applies to cases that were resolved by payment or abatement of assessed amounts. Installment agreements are not fully satisfied at time of closure and the case may reopen if the taxpayer does not keep the terms of the agreement. Cases closed as CNC have a balance due that is not being pursued.

16 Within 180 days of the levy being issued 25,657 cases were closed. Further, 12,455 of these cases were fully satisfied, 9,241 were put into IAs, and 3,961 were placed in CNC status.

17 TAS reviewed 600 taxpayers in ACS. The ACS sample was selected by extracting Individual Master File (IMF) and Business Master File (BMF) taxpayers assigned to ACS at some time from cycle 201230 forward (from mid-2012 to mid-2013). Taxpayers were determined to be assigned to ACS from the Accounts Receivable Dollar Inventory entity table. After identifying this population, a sample of 600 taxpayers was randomly selected. TAS was able to obtain information to complete 579 data collection instruments (DCI). The other 21 DCIs could not be completed. The random sample of 579 taxpayers has a 90 percent confidence level with about a five percent plus or minus margin.

18 IRC § 6343(a)(1)(D).

19 IRC § 6330(c)(3)(C). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 478 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*); National Taxpayer Advocate's Report to Acting Commissioner Daniel Werfel, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013) at 2, 3; National Taxpayer Advocate 2011 Annual Report to Congress 493 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*).

When ACS issues a levy without first attempting to contact the taxpayer, it risks causing economic hardship.

reduction of about 46 percent from FY 2012.[20] This decrease likely results from the IRS's decision to dedicate three ACS call sites to Accounts Management call center duties this past filing season. Despite this substantial reduction in levy action, dollars collected on TDAs actually increased for the latter period.[21] Specifically, through FY 2013, the IRS reported collection revenue generated by ACS on TDAs as approximately $2.8 billion, an increase of about $25.5 million compared to 2012.[22] The fact that revenue secured through ACS operations did not suffer in light of the substantial decline in ACS levies indicates that levies are not the principal drivers of ACS collections, and that other, proactive collection treatments may prove more effective, and reduce unnecessary harm inflicted on taxpayers.

ACS Could Improve Its Case Resolution Rate by Increasing the Use of Notices and Phone Calls.

Although levies are an important tool for the IRS in addressing uncooperative, "won't pay" taxpayers, systemically generated levies will unnecessarily harm many taxpayers, while failing to collect the optimal amount of revenue. By relying on one collection method over others, ACS is ignoring one of its own studies that shows certain letters generate a higher response rate when compared to levies. Ignoring this study, and maintaining a collection strategy that relies heavily on levies, fails to achieve the highest possible response or resolution rate.

Kansas City Customer Service Site Study Conducted in 2000

In a 2000 study by the Kansas City customer service site, the IRS compared the effectiveness of letters and levy actions in generating a telephone response from the taxpayer.[23] The study was conducted by randomly pulling and analyzing 2,000 delinquent accounts that had one of the following actions:

1) Letter 11, *Final Notice, Notice of Intent to Levy and Your Notice of a Right to a Hearing*;[24]
2) Letter 16, *Please Call us About Your Overdue Taxes or Tax Return*;[25]
3) Letter 40, *Advisory Notice to Taxpayer of Need to Contact Third Parties*;[26]
4) Letter 99, *Please Call Us About Your Overdue Taxes or Tax Returns*;[27] and

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20 IRS Collection Activity Report NO-5000-24, *Levy & Seizure Report* (Sept. 2013). In FY 2013, the field also issued fewer levies when compared to FY 2012, albeit it was not as significant of a decline as ACS's. Specifically, the CFf issued 11 percent fewer levies in FY 2013 when compared to 2012. IRS Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013).

21 This revenue is collected by the use of Collection resources. It includes levies, IAs, payments on collection notices, etc. It does not include refund offsets.

22 IRS Collection Activity Report No. 5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013). The $2.8 billion collected on TDAs for FY 2013 does not include dollars collected through offsets. When offsets are included for FY 2013, $5.4 billion was collected. About $5.2 billion was collected for FY 2012 when including offsets, which means that ACS actually collected about $200 million more in FY 2013 than it did in FY 2012, despite the reduction in the issuance of levies.

23 *See* ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000). While not specified in the study, the sample size would generally yield results with a margin of plus or minus five percent at the 95 percent confidence level.

24 This letter is sent by certified mail with a return receipt and is required before the IRS can take any enforcement action.

25 This letter asks the taxpayer to call the IRS regarding overdue taxes or tax returns.

26 This letter advises the taxpayer that the IRS could be contacting a third party regarding a balance due and does not require a response. Even though it requires no response by taxpayers, the study found it was the most effective tool in prompting telephonic customer contact, because taxpayers were concerned that their neighbors or employers would become aware of their affairs. (This form letter is no longer in use.)

27 This letter is the same as Letter 16, but mailed out when a new case comes to ACS.

5) Levy.[28]

The 2,000 TDAs were broken up into five groups of 400 (one group of 400 for each of the letters and levies).[29] The sample consisted of TDAs for which the letter or levy had been outstanding for at least 45 days.[30]

This study concluded, "[a]ny of the four letters sent prompted a higher rate of telephone response from the taxpayer than levy action." More specifically, the response rate for levies was about 13 percent, while the response rate for Letter 16, *Please Call Us About Your Overdue Taxes or Tax Return*, was nearly 37 percent, and all letters had a response rate over 30 percent.[31] Further, the study concluded that ACS could increase the effectiveness of its letters by securing better addresses, which could be done by enhancing its efforts to search for a last known address.[32] This step could have a significant impact as the study found about 29 percent of ACS letters were returned as undelivered.[33]

Although the finding that a levy notice was not the most effective way to generate a response from the taxpayer was significant, this was probably not the most important conclusion from the report. The key point was the significance of determining what type of action best generates a resolution. The study found that a case is twice as likely to close when a taxpayer responds to a letter.[34] This finding is consistent with TAS's review of ACS cases described above, which showed a case was resolved in 50 percent of cases where an ACS letter or phone call resulted in a contact with the taxpayer.[35]

The Kansas City study also found certain actions that generated a response led to case resolution more often than others. For instance, the study showed not only that taxpayers are less likely to respond to a levy action than letters, but that when taxpayers do respond to these actions, levy actions were less likely to lead to closed cases. When taxpayers responded by telephone to a levy, the IRS closed only 24 percent of their cases. Conversely, when taxpayers responded by telephone to a letter titled *Please Call Us About Your Overdue Taxes or Tax Returns,* 35 percent of the cases ended in closure. Moreover, only eight percent of the taxpayers who responded by telephone to a levy fully paid their accounts and only six percent entered into installment agreements. By comparison, 17 percent of taxpayers who responded by telephone to a letter paid in full and 12 percent entered into an IA.[36] Therefore, when crafting the best collection strategy, ACS's study shows that considering what action will most likely generate a response and a resolution to the case is critical.

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28 After a Letter 11, *Final Notice, Notice of Intent to Levy and Your Notice of a Right to a Hearing*, has been sent, a levy is sent to both the levy source and the taxpayer. The levy sources may have been contacted on some of the cases in order to verify financial relationship with the taxpayer.

29 The sample was further divided to 200 of each for W&I and 200 each for SB/SE.

30 The data was captured in date increments to show the impact of letter mailing over the 30 days.

31 *See* ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000). This only included levies and Letters 16 that were presumed to reach the taxpayer (*i.e.*, did not come back as undelivered).

32 National Taxpayer Advocate 2009 Annual Report to Congress 221 (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

33 *See* ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000).

34 ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000). Case closure actions include: full payment of the liability, the taxpayer has entered into an IA, case is CNC, case is in bankruptcy status, or the case has been sent to the Queue or CFf.

35 TAS reviewed a sample of 579 taxpayers who were assigned to ACS at some time from cycle 201230 forward (from mid-2012 to mid-2013).

36 ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000). Taxpayers were responding to Letter 99, *Please Call Us About Your Overdue Taxes or Tax Returns*.

A Predictive Dialer Study Showed that a Number of Taxpayers Are Best Reached by an Outgoing Call.

A recent study provides more evidence that methods more effective than levies are at ACS's disposal. In 2013, W&I Research and Analysis tested the effectiveness of the W&I ACS predictive dialer system.[37] The study showed that when a live person answers predictive dialer calls, and the number of attempted calls is not limited, the system generated a contact rate of up to 45 percent.[38] This far exceeded the response rate when only Letter 16, *Please Call us About Your Overdue Taxes or Tax Return*, was sent out to taxpayers, which was at most 17 percent. Further, the contact rate for the predictive dialer calls exceeds the results of ACS levies in the SB/SE Denver ACS study, discussed above, which showed a 25 percent productive contact rate.[39] The predictive dialer study also observed that predictive dialer calls where the number of attempts was not limited and live assistors operated the line generated a "significantly higher proportion of contacts," and a "significantly higher proportion of IAs" than predictive dialer calls using a recorded voice.[40]

ACS Is Not Very Successful at Working Business Cases.

In addition to using the right method to generate a contact with the taxpayer, and ultimately resolving the case, another part of making ACS more effective is assigning it the appropriate types of cases to work. An examination of ACS indicates that SB/SE ACS is being assigned cases that would be better worked in the field. More specifically, compared to W&I, SB/SE ACS is significantly less successful at resolving cases and placing taxpayers in installment agreements. For instance, in FY 2013, W&I ACS resolved (as a percentage) twice as many TDA cases with installment IAs as SB/SE ACS.[41]

However, the most significant difference between SB/SE and W&I ACS is the number of cases transferred to the Queue. In FY 2013, only four percent of the cases processed through W&I ACS went to the Queue, while SB/SE ACS transferred 31 percent.[42]

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37 Predictive Dialer Test – ACS Accounts, Wage and Investment, Research and Analysis (May 2013).

38 The study conducted a review of the effectiveness of the W&I ACS predictive dialer system by conducting a predictive dialer test with two different groups. In large part, the two test groups were conducted in the same manner. Test group one had a response rate of 37 percent. This test group included 12,497 taxpayers and was conducted in December of 2012, but only made outgoing calls. The 45 percent response rate was for test group two, which included 11,951 taxpayers and was conducted in February of 2013 but made outgoing calls and sent letters.

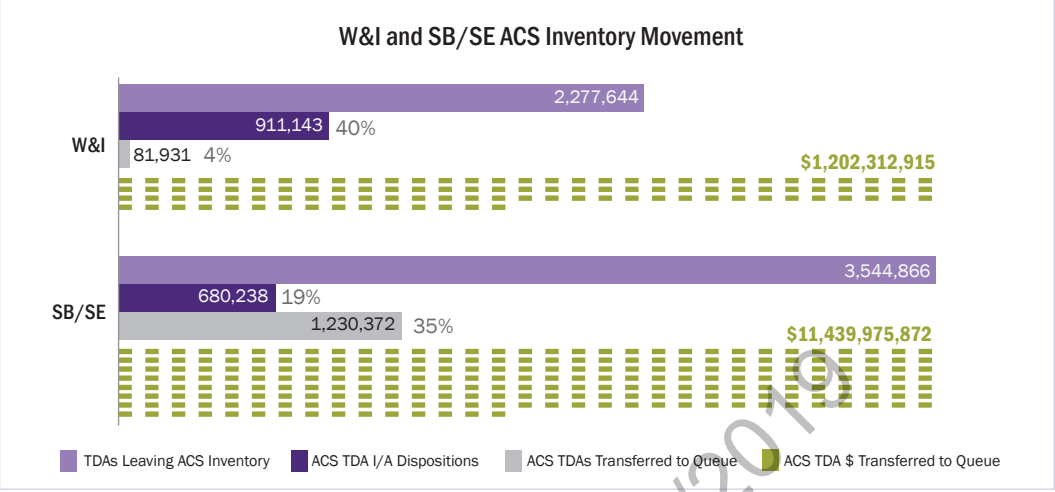
39 ACS Closed Case Actions Project DEN0181, SB/SE Research (Aug. 2012).

40 Predictive Dialer Test – ACS Accounts, Wage and Investment, Research and Analysis (May 2013).

41 IRS Collection Activity Report NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013).

42 *Id*.

FIGURE 1.11.2, ACS Inventory Movement



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A large number of these unresolved cases are small business cases involving trust fund taxes.[43] ACS received $2.9 billion in business trust fund cases, but $1.6 billion — or 55 percent — left ACS as unresolved. Further, in regards to cases that were processed through SB/SE ACS, only $310 million were collected (including refund offsets) while the accounts were in ACS's inventory.[44] The low rate of collection for delinquent business taxes and the delay in resolution results in more accrued debt and increases overall uncollectible debt.[45]

This comparison reveals that ACS can be effective in resolving TDAs of certain segments of the population, notably wage earners, but strikingly ineffective in collecting on other TDAs, namely, business trust fund cases.[46] It is unclear why the IRS places these cases in SB/SE ACS, especially when they are more likely to be resolved in the field. The field closed 57 percent of trust fund modules with a balance between $1,500 and $5,000 as full paid, while SB/SE ACS only closed 42 percent as full paid.[47] Of greater concern is the fact that SB/SE ACS transferred 42 percent of modules that have a liability within the $1,500-$5,000 range to the Queue, while the CFf transferred only four percent. This is yet another indicator that business trust fund cases are not being assigned appropriately, causing them to go unresolved, penalties and interest to accrue, and revenue to be lost. If the field is not available to work business trust

43 IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. These taxes are often referred to as the "trust fund" taxes. Trust fund taxes include employment taxes, income tax withheld from employees' wages, and certain types of excise taxes. IRC § 6672 provides for the assessment of a Trust Fund Recovery Penalty (TFRP) against those deemed responsible persons when these monies are not paid as required.

44 About $1 billion of the $2.9 billion in business trust fund cases received by ACS are uncollected dollars that remain in its inventory

45 IRS Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2012). As discussed further in Most Serious Problem: *Collection Process: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue, infra*, SB/SE ACS employees are not authorized to consider a business taxpayer's complex financial statements, such as cash flow and profit and loss statements, nor are they trained to complete a financial analysis of BMF cases. Further, ACS employees are limited to granting in-business trust fund express installment agreements (IBTFE) for business accounts with a balance due of $25,000 or less. This means that business taxpayers who call ACS after receiving a notice (potentially a levy notice) will speak with an ACS assistor who has limited authority to agree to an IA.

46 National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 (*A Comparison of Revenue Officers and the Automated Collection System in Addressing Similar Employment Tax Delinquencies*), *infra*.

47 *Id.* These are rates of cases directly assigned to the CFf. In this Vol. 2 study, TAS focused on newly-delinquent taxpayers with one or two employment tax delinquencies TDA modules in 2003, and those with three delinquencies in 2003, provided they were not pyramiding (*i.e.*, there was a gap between the last two delinquencies).

fund cases at a particular time, the IRS should place those cases with a core ACS unit trained to work them effectively, rather than allowing them to sit in the queue unaddressed.[48]

A Recent Change to the Internal Revenue Manual (IRM) Will Expand the Case Resolution Discussion Between the Taxpayer and ACS and Increase the Likelihood that Certain Cases Will Be Resolved.

Although ACS's overall collection strategy remains counterproductive, positive changes have occurred. A recent revision to IRM 5.19.1, *Liability Collection, Balance Due,* and proper training on the change for ACS assistors will expand collection alternatives to more taxpayers and remove barriers to resolving cases. Under the new provisions, the IRS will not require liquidation of assets or equity in an asset even when such liquidation would result in full or substantial partial payment of the liability, if:

- Factors such as advanced age, ill health, or other special circumstances would prevent the liquidation of the assets; or
- The taxpayer qualifies for guaranteed, streamlined, or in-business trust fund express agreements.[49]

Further, under the IRM revisions, ACS assistors will no longer ask a taxpayer to liquidate or borrow against an asset if doing so will create an economic hardship.

The low rate of collection for delinquent business taxes and the delay in resolution results in more accrued debt and increases overall uncollectible debt.

Past IRS practice has been to push for full payment of the liability through liquidation of assets, and if the taxpayer was unable to make a full payment, the case was likely to land in the Queue. These changes should expand the conversation between ACS assistors and taxpayers. In the circumstances discussed above, assistors will be able to discuss collection options, such as IAs. To be effective, however, the IRS must train ACS assistors on this significant change.[50] Moreover, the IRS should expand these provisions to other taxpayer circumstances. Merely insisting on the taxpayer paying in full is not a realistic position in many situations, and, as the ACS data illustrate, doing so has not yielded and will not yield effective tax collection.

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48 See Most Serious Problem: *Collection Process: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue*, *infra*.

49 IRM 5.19.1.5.4.2 (Oct. 18, 2013). In Business Trust Fund Express Agreements can be granted for liabilities up to the aggregate assessed balance (CC SUMRY) of $25,000. The entire liability, including accruals, must be paid within 24 months or before the Collection Statute Expiration Date (CSED), whichever is earlier. In order to qualify, the taxpayer must be in full filing compliance and current on tax deposits.

50 See Most Serious Problem: *The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission*, *supra*; Most Serious Problem: *Taxpayer Rights Training: Insufficient Education and Training about Taxpayer Rights Impairs IRS Employees' Ability to Assist Taxpayers and Protect Their Rights*, *supra*.

CONCLUSION

The ACS plays a vital part in collecting outstanding tax liabilities. However, the National Taxpayer Advocate believes a re-orientation of ACS practices could increase productive case resolutions, while reducing unnecessary harm to the taxpayer. This new approach should place more emphasis on better segmentation of taxpayer debtors and effective initial contacts. It should embody less immediate reliance on levy authority, which harms taxpayers, is not highly productive, and creates IRS re-work. Further, the IRS should immediately assign small business cases to a revenue officer to be worked, or place them with a core ACS unit that is trained and has the necessary skills to work cases when the field is unavailable.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that ACS:

1. Better identify groups of taxpayers that would more likely respond best to a particular collection action or communication.
2. In an attempt to establish contact with the taxpayer, include a soft notice in its systemic procedures that would discuss payment options up front.
3. Send out a monthly (or no less than quarterly) notice to taxpayers whose cases are in the Queue that informs them of the tax owed and penalty and interest accruals as well as payment options.
4. Create and properly train a core ACS unit that can work and resolve small business cases when the field cannot take on more assignments.
5. Expand the guidance under IRM 5.19.1, *Liability Collection, Balance Due,* to require ACS assistors to present all collection alternatives to the taxpayer upfront in all cases.

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MSP #12 COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers And Contribute To Substantial Amounts Of Lost Revenue

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

The existing IRS collection strategy fails to recognize and meet the needs of business taxpayers in resolving collection issues.[1] The majority of business taxpayers working with the IRS are initially routed through collection units that have neither the authority nor the expertise to fully resolve their problems. Consequently, in fiscal year (FY) 2013, approximately 60 percent of the collection "final" notices involving business-related "trust fund" taxes were not resolved through the notice process.[2] In FY 2013, approximately 3.7 times more delinquent trust fund dollars passed through the Automated Collection System (ACS) with unresolved cases than the ACS actually collected (including refund offsets and installment agreements).[3] As a result, the resolution of these collection accounts is unnecessarily delayed, which contributes to additional tax delinquencies and the rapid accumulation of penalties and interest — factors that increase the risk these taxpayers may never pay the taxes or get back into compliance.

Alternative collection solutions for business taxpayers, *e.g.*, installment agreements (IAs) and offers in compromise (OICs), are exceptionally rare. The IRS's reluctance or failure to proactively consider these options for in-business, trust fund (IBTF) taxpayers contributes to unnecessary delays in resolving their accounts. As a result, at the conclusion of FY 2013:

- Approximately three quarters of the open inventory of trust fund tax cases involved multiple tax delinquencies;[4]
- Almost half involved four or more delinquent tax periods;[5] and

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1 In this report, the term "business taxpayers" refers to taxpayers with tax obligations that are tracked by the IRS on the Business Master File (BMF), *e.g.*, employment taxes, corporate income taxes, and partnership returns. The majority of IRS collection cases that pertain to BMF liabilities are associated with small business taxpayers, defined by the IRS as businesses reporting assets of less than $10 million. For example, in FY 2013, 94 percent of the "final" notices issued on Form 941/944 delinquencies involved small business entities. IRS, Collection Activity Report, NO-5000-2/242, *Taxpayer Delinquent Account Receivable Notices* (Sept. 2013).

2 IRS, Collection Activity Report, NO-5000-2/242, *Taxpayer Delinquent Accounts Report, Part 2 Account Receivable Notices* (Sept. 2013). A "trust fund" tax is money withheld from an employee's wages (income tax, social security, and Medicare taxes) by an employer and held in trust until paid to the Treasury. Definition found at IRS, Businesses-&-Self-Employed/Trust-Fund-Taxes, www.irs.gov/Businesses/Small (last visited Aug. 9, 2013.).

3 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013). In FY 2013, ACS transferred $1.202 billion in trust fund delinquencies to the Queue (the Queue is an inventory of Taxpayer Delinquent Accounts (TDAs) that are active, but unassigned), $396 million to the Collection Field function (CFf), and reported $20 million as "shelved" (currently not collectible). ACS reported $243 million as collected on open trust fund accounts, $67 million collected through offsets, and $128 million collected on installment agreements established by ACS on BMF accounts.

4 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013). As of Sept. 2013, 75 percent of the trust fund cases in inventory involved more than one TDA.

5 *Id*. As of Sept. 2013, 44 percent of the trust fund cases in inventory involved four or more TDAs.

- Over 70 percent of the delinquent trust fund inventory involved debts for tax years at least three years old.[6]

Therefore, it should come as no surprise that from FY 2010 to FY 2013, the IRS has reported as uncollectible an average of $4.2 billion per year in trust fund tax debts — or roughly 1 ½ times the amount the IRS managed to collect on these accounts, including refund offsets and installment agreements.[7]

The National Taxpayer Advocate is troubled by the high percentage of business taxpayers who are unable to resolve their tax problems in response to IRS collection notices or contacts with ACS, noting that:

- The withholding and payment of trust fund taxes are vital components of the voluntary tax system;
- Trust fund tax delinquencies can quickly become unmanageable for business taxpayers;
- The IRS provides inadequate attention and service for emerging trust fund collection cases;
- The IRS insists on assigning trust fund tax cases to employees who are not fully equipped to provide the services needed to resolve them; and
- The full range of collection options are often not available to business taxpayers until the tax debts have become uncollectible.

The IRS could be much more successful in resolving many of these accounts by taking a more proactive, service-oriented approach to these cases. By not providing reasonable, timely solutions for business taxpayers, the IRS is losing opportunities to improve compliance, collect more revenue, and support the nation's economy.

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6 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013). In FY 2013, the IRS reported in inventory 1,197,082 TDAs involving trust fund taxes associated with tax years 2010 and prior, or 71.2 percent of the total.

7 *Id*; see also IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013). The IRS reported $4.158 billion, $5.091 billion, $4.149 billion, and $3.586 billion in trust fund taxes as currently not collectible in FYs 2010, 2011, 2012, and 2013, respectively. The IRS reported dollars collected/offset on trust fund TDA accounts as $2.192 billion, $2.344 billion, $1.925 billion, and $1.808 billion for FYs 2010, 2011, 2012, and 2013, respectively. The IRS reported $625 million, $728 million, $857 million, and $875 million collected from installment agreements on BMF accounts during FYs 2010, 2011, 2012, and 2013, respectively. Note: the installment agreement figures include all payments on all BMF accounts — not only those involving trust fund taxes.

ANALYSIS OF PROBLEM

The withholding of employment taxes by business taxpayers is a vital component of the voluntary compliance tax system.

Taxpayer businesses contribute to the administration of the nation's voluntary tax system through the withholding and payment of employment-related "trust fund" taxes. IRS studies have confirmed that taxpayers subject to trust fund tax withholding maintain the highest levels of voluntary compliance.[8] In FY 2012, trust fund taxes comprised approximately 70 percent of the total tax revenues collected by the IRS.[9] In a very real sense, trust fund taxes collected by employers help form the "backbone" of the nation's tax system.

By not providing reasonable, timely solutions for business taxpayers, the IRS is losing opportunities to improve compliance, collect more revenue, and support the nation's economy.

Trust fund tax delinquencies are "high risk" debts, which can quickly become unmanageable for business taxpayers.

Bureau of Labor Statistics data reveal that over half of newly established businesses fail within the first five years of operation,[10] and only about a third survive ten years or more.[11] It is not uncommon for a financially struggling business to fail to meet its trust fund tax obligations. Without adequate attention, these debts can multiply rapidly and quickly become very difficult for the taxpayer to resolve. In FY 2013, the IRS reported in inventory over 450,000 taxpayer cases involving delinquent trust fund taxes.[12] As shown in Figure X, of these accounts, 75 percent involved more than one delinquent tax period, and 44 percent involved four or more.[13] These cases accounted for over $14 billion in delinquent trust fund taxes.[14] Consequently, the IRS has traditionally categorized trust fund tax delinquencies as "high risk" debts.[15]

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8 IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study* (Jan. 6, 2012). The IRS reports that compliance is highest where there is third-party information reporting and/or withholding. For example, most wages and salaries are reported by employers to the IRS on Forms W-2 and are subject to withholding. As a result, a net of only one percent of wage and salary income was misreported in 2006. In contrast, amounts subject to little or no information reporting had a 56 percent net misreporting rate.

9 IRS, Internal Revenue Service Data Book (October 1, 2011, to September 30, 2012).

10 U.S. Bureau of Labor Statistics, Business Employment Dynamics, www.bls.gov/bdm/entrepreneurship/bdm_chart 3.htm (last visited Aug. 7, 2013).

11 *Id*.

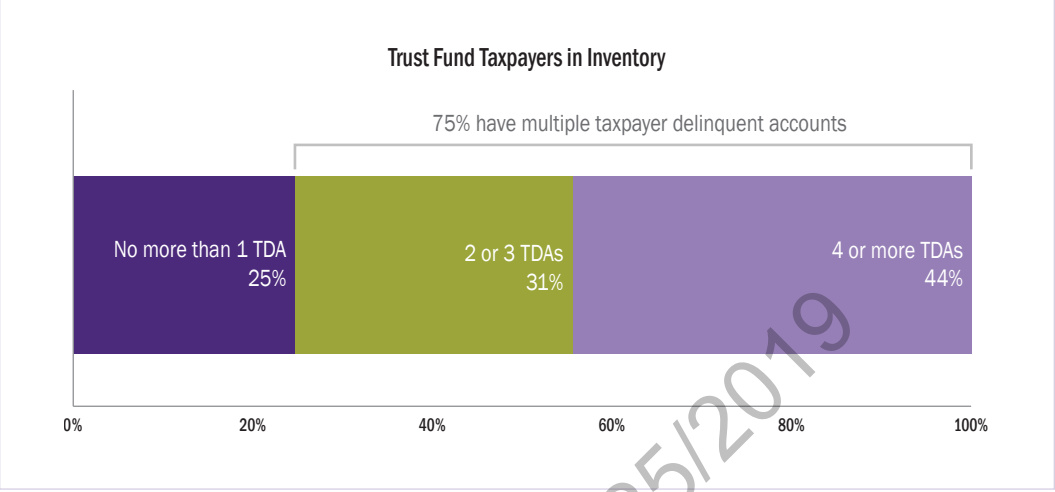
12 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Sept. 2013). The IRS reported 451,861 taxpayer cases in inventory that included trust fund taxes.

13 *Id*. The IRS reported 338,431 taxpayer cases involving more than one delinquent trust fund period, and 198,529 involving four or more such periods.

14 *Id*. The IRS reported in inventory $14,018,345,606 in delinquent trust fund taxes at the conclusion of FY 2013.

15 Internal Revenue Manual (IRM) 5.3.1.2.3, *Case Codes and Subcodes* (Feb. 22, 2012).

FIGURE 1.12.1, Trust Fund Taxpayers in Inventory – 75 Percent Have Multiple Taxpayer Delinquent Accounts[16]



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The IRS collection strategy does not adequately recognize and address "high risk" trust fund tax cases in a timely, effective manner.

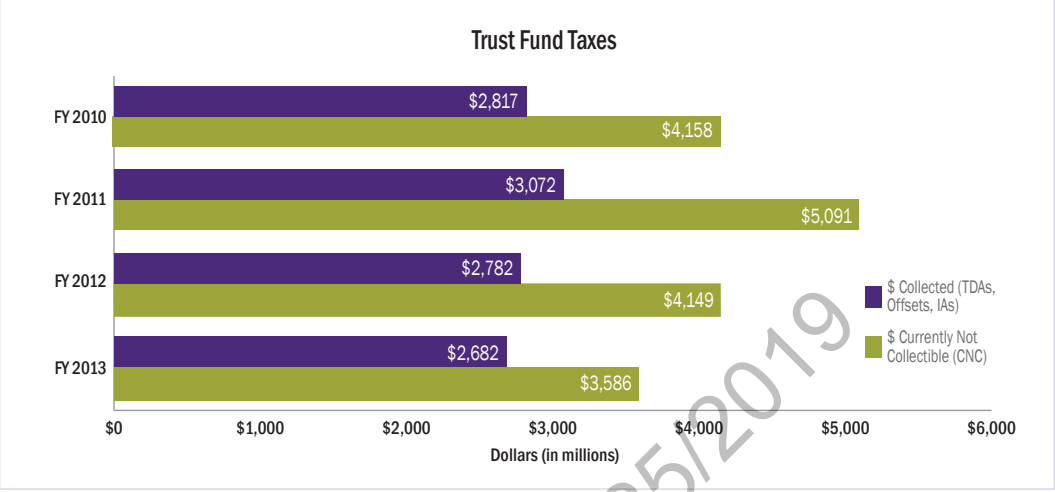
In recent years, the National Taxpayer Advocate has expressed concerns that despite the high-risk nature of cases involving trust fund taxes, the IRS has consistently failed to interact with these taxpayers with a proper sense of immediacy.[17] The IRS continues to view emerging trust fund tax problems as relatively simple cases that do not warrant early intervention by field-based revenue officers. Almost all trust fund tax cases are initially addressed through collection notices and IRS call centers, even though employees in these areas are not trained or empowered to resolve many of these accounts. Consequently, the IRS has lost billions in tax revenues by failing to employ an effective collection strategy for this important taxpayer segment. *From FY 2010 through FY 2013, the IRS reported as uncollectible an average of approximately $4.2 billion per year in trust fund tax debts — or roughly 1 ½ times the amount the IRS collected on these TDA accounts, including refund offsets and installment agreements.*[18]

16 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Sept. 2013).

17 For an in-depth discussion of these issues, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*) and National Taxpayer Advocate 2012 Annual Report to Congress 358-380 (Most Serious Problem: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations*).

18 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Sept. 2013); IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013). The IRS reported $4.158 billion, $5.091 billion, $4.149 billion, and $3.586 billion in trust fund taxes as currently not collectible in FYs 2010, 2011, 2012, and 2013, respectively. The IRS reported dollars collected/offset on trust fund TDA accounts as $2.192 billion, $2.344 billion, $1.925 billion, and $1.807 billion for FYs 2010, 2011, 2012, and 2013, respectively. The IRS reported $625 million, $728 million, $857 million, and $875 million collected from installment agreements on BMF accounts during FYs 2010, 2011, 2012, and 2013, respectively. Note: the installment agreement figures include all payments on all BMF accounts — not only those involving trust fund taxes.

FIGURE 1.12.2, Substantial Amounts of Trust Fund Taxes are Reported as Currently Not Collectible (CNC) Each Year[19]



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The IRS provides inadequate service and attention to emerging trust fund tax cases, especially when the debts are new and easier to resolve.

In virtually all IRS tax delinquency cases, the collection activity starts with the IRS sending notices to the taxpayer. Generally, delinquencies involving trust fund taxes receive two collection notices. While a significant number of taxpayers resolve debts in response to these notices, the majority of this population does not.

In FY 2013, the IRS issued approximately 1.5 million "final notices" (CP 504B) to small business taxpayers, representing approximately $7.2 billion in unpaid trust fund taxes.[20] About 38.8 percent of these notices were resolved by full payments (37.2 percent) or IAs (1.6 percent).[21] The IRS collected $740 million in response to these notices, or 10.3 percent of the balances due.[22] On the other hand, approximately $5.7 billion in employment tax debts — over 60 percent of the "final" notice accounts went forward in the collecting process as TDAs because the taxpayers did not successfully resolve the balances due after the IRS issued the "final" collection notice.[23]

19 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Account Cumulative Report* (Sept. 2013); IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013).

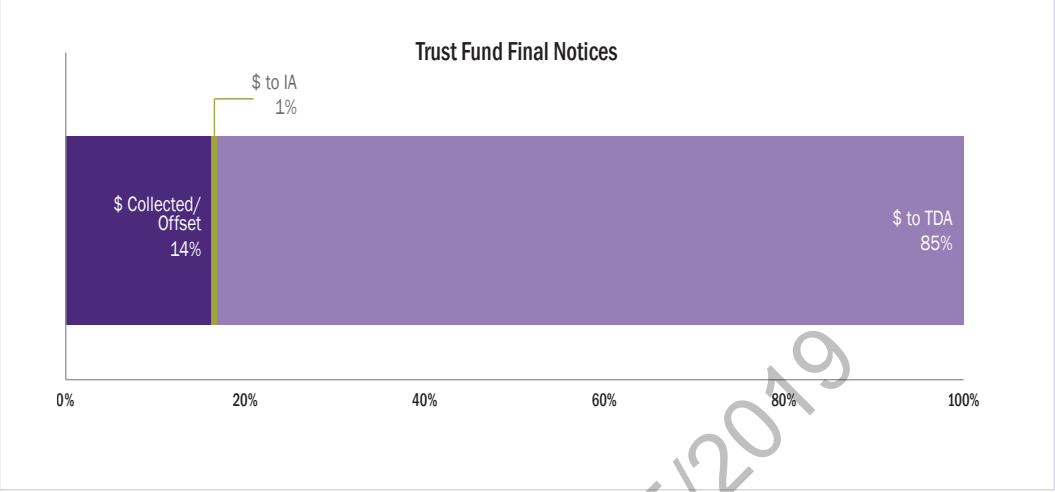
20 IRS, Collection Activity Report, NO-5000-2/242, *Taxpayer Delinquent Accounts Report, Part 2 Account Receivable Notices* (Sept. 2013).

21 *Id*.

22 *Id*.

23 *Id*.

FIGURE 1.12.3, Most Delinquent Trust Fund Taxes are Not Collected Via Final Notices[24]



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Collection notices to business taxpayers convey a blunt message that may discourage some from even attempting contact with the IRS.

The first notice (CP 14) issued to delinquent taxpayers employs a curt, matter-of-fact tone, which informs the taxpayer of unpaid taxes, and emphasizes that the taxpayer needs to pay the full amount immediately (in big bold letters). While the second page of the notice does provide information about contacting the IRS to discuss payment arrangements, the front page clearly stresses the message of "full pay now!"

However, if the taxpayer does not respond within five weeks, the final notice (CP 504B) is issued, and the tone is even more harsh.

Notice of intent to levy

Intent to seize your property or rights to property
Amount due immediately: $3,999.86

As we notified you before, our records show you have unpaid taxes for the tax year ending December 31, 2005 (Form 1120). If you don't call us immediately or pay the amount due by March 12, 2009, we will seize ("levy") your property or rights to property and apply it to the $3,999.86 you owe.

Billing summary

Amount you owed	$2,902.68
Failure-to-pay penalty	284.26
Interest charges	812.92
Amount due immediately	**$3,999.86**

What you need to do immediately

Pay immediately
- Send us the amount due of $3,999.86, or we will seize ("levy") your property or rights to property on or after March 12, 2009.

Continued on back...

24 IRS, Collection Activity Report, NO-5000-2/242, *Taxpayer Delinquent Accounts Report, Part 2 Account Receivable Notices* (Sept. 2013). See also IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013). In FY 2013, the IRS reported approximately $935 million as collected or offset from final notices involving business trust fund taxes. Another $84 million in delinquencies were included in installment agreements, and $5.659 billion moved on in the collecting process as TDAs.

Once again, information regarding alternative payment options can be found in the fine print of the second page. Clearly, this notice was designed to encourage taxpayers to take action. However, the front page does little to encourage a financially struggling taxpayer to contact the IRS, especially if he or she cannot "pay immediately." The notice does not even acknowledge the possibility that the business may want to comply but is facing some financial difficulties. In the section "What you need to do immediately," the only option is to pay in full.

Taxpayer responses to collection notices are handled by IRS employees who are not fully equipped to resolve trust fund tax cases.

Business taxpayers responding to collection notices are directed to call an IRS toll-free number, serviced by customer service representatives (CSRs) in the Accounts Management (AM) operation of the Wage and Investment (W&I) operating division. Written responses are worked by tax examiners (TEs) in the Compliance Services Collection Operation (CSCO) of the Small Business/Self-Employed (SB/SE) operating division. However, the IRS imposes significant limitations on the abilities of these employees to provide full service to taxpayers with trust fund tax debts.

Punting a noncompliant taxpayer downstream, when that taxpayer has reached out to the IRS, is foolhardy and costly.

Accounts Management and CSCO employees receive no formal training in performing financial analysis on business cases and have very limited authorities to place taxpayers with trust fund tax debts into installment agreements.[25] For example, AM employees are only authorized to enter into an IA that meets the "streamlined" IA criteria established for AM, limited to cases with balances due of $10,000 or less and payment terms of no more than 24 months.[26] AM employees may not allow any short-term payment extensions to IBTF taxpayers.[27] If the taxpayer owes more than $25,000, or cannot pay in full within 24 months, AM will advise the taxpayer the account is being assigned for a field contact by a revenue officer.[28] If the taxpayer is not in full filing compliance, AM advises the taxpayer to file the delinquent return and call back within 30 days.[29]

Although virtually all collection notices instruct taxpayers to call AM for assistance in resolving delinquent accounts, IBTF taxpayers who do not meet AM's strict criteria for streamlined IAs will generally not succeed in their attempts to resolve their tax liability at the first point of contact, and will be passed on to the next step of the collecting process.[30] The abysmal collection statistics cited above show the consequences of the IRS's failure to work with the taxpayer at the first point of contact. Punting a noncompliant taxpayer downstream, when that taxpayer has reached out to the IRS, is foolhardy and costly.

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25 IRS response to TAS information request (Sept. 13, 2012).

26 IRM 21.3.12.4.7, *In-Business Trust Fund (IBTF) Express Agreement Criteria* (Oct. 1, 2012). AM employees are authorized to establish IBTF Express Agreements up to the aggregate assessed balance (CC SUMRY) of $10,000. The entire liability, including accruals, must be paid within 24 months, or before the collection statute expiration date, whichever is earlier. In order to qualify, the taxpayer must be in full filing compliance and current on federal tax deposits (FTDs). If the taxpayer owes more than $10,000 but less than $25,000, the IA request is forwarded to CSCO.

27 IRM 21.3.12.4.2, *Taxpayer Can Full Pay Within 11 to 59 Days - IMF, BMF Out-of-Business or BMF In-Business Non-Trust Fund Accounts* (Oct. 1, 2012) and IRM 21.3.12.4.3, *Taxpayer Can Full Pay Within 60 to 120 Days - IMF, BMF Out-of-Business or BMF In-Business Non-Trust Fund Accounts* (Mar. 27, 2013).

28 IRM 21.3.12.4.7, *In-Business Trust Fund (IBTF) Express Agreement Criteria* (Oct. 1, 2012).

29 *Id*.

30 Note: Written responses from taxpayers are worked in the SB/SE CSCO operation. CSCO has similar restrictions in providing service on IBTF accounts, but works with expanded criteria for considering IBTF Express IAs, *i.e.*, tax balances of $25,000 or less.

The Automated Collection System (ACS) frequently fails to resolve trust fund tax delinquency problems; yet the IRS still assigns almost all business cases to ACS.

When not resolved by notices, almost all business cases involving trust fund taxes are initially assigned to ACS. However, in their efforts to assist these taxpayers, ACS employees are hampered by the same training limitations and procedural restrictions as employees working collection notices. For example, ACS employees do not have the authority to grant extensions to pay on IBTF accounts,[31] will not discuss alternative payment options if the taxpayer has an unfiled return,[32] and are not trained or authorized to enter into non-streamlined IAs for accounts involving business taxes.[33]

In light of these restrictions, ACS has limited success in resolving business cases involving trust fund taxes.

- Of the trust fund cases processed through ACS, approximately 65 percent left ACS as unresolved cases, *i.e.*, transfers to the Queue[34] (52 percent), transfers to the Field (eight percent), or cases that were deferred or shelved (five percent).[35]
- ACS received approximately $2.9 billion in trust fund accounts, but reported only $310 million — or 11 percent — as collected or offset while the accounts were in ACS.[36]
- Of the trust fund dollars that passed through ACS, $1.6 billion left ACS with unresolved accounts, including $1.2 billion transferred to the Queue.[37]
- Including revenue collected through installment agreements and offsets, approximately 3.7 times as many delinquent trust fund dollars left ACS with unresolved cases as were collected by ACS.[38]

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31 IRM 5.19.1.5.3, *Full Pay Within 60 or 120 Day Agreement* (Oct. 18, 2013) ("This type of agreement **cannot** be granted for **any** In-Business Trust Fund (IBTF) taxpayer. Any taxpayer with an open employment tax filing requirement is considered in-business and is **not** eligible for this type of agreement.").

32 IRM 5.19.1.5.4.2, *IA Requirements, IBTF Express Agreement* (Oct. 18, 2013) ("Taxpayers must be in filing compliance. If not, the IA will not be granted.").

33 IRS response to TAS information request (Sept. 13, 2012).

34 The Collection Queue is an inventory of TDA accounts that are active, but unassigned to the ACS or CFf functions. *See* IRM 5.1.20.2, *Collection Inventory Management* (May 27, 2008). IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013). At the conclusion of FY 2013, 230,550 trust fund taxpayer cases, including 928,472 trust fund TDA modules were assigned to the Queue inventory.

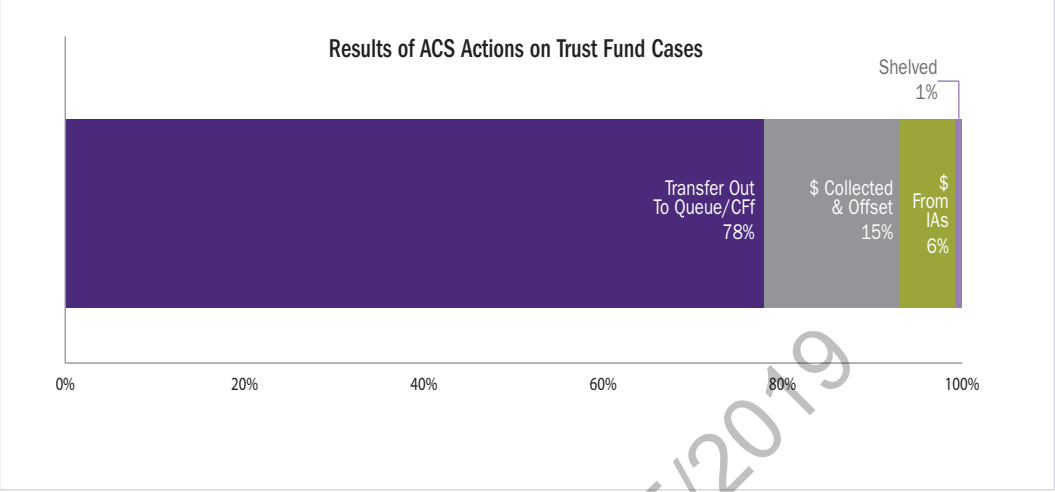
35 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013).

36 *Id*.

37 *Id*.

38 *Id*.

FIGURE 1.12.4, ACS is Usually Not Successful in Collecting Trust Fund Dollars[39]



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"Full service" collection options are often not available until the tax has become uncollectible.

Despite the high risk nature of trust fund tax debts, the IRS collecting process does not allow taxpayers timely access to the services and payment options that can only be provided by revenue officers in the Collection Field operation. IRS focus group participants have indicated that the main reason business taxpayers do not pay their payroll taxes is because "they do not see the immediate consequences of noncompliance."[40] When asked how the IRS could help these taxpayers, the number one strategy participants recommended was "the need for the IRS to react faster."[41] They stated, "The main problem is that many taxpayers are buried too deep by the time the IRS gets involved."[42]

Unfortunately, "reacting faster" from the taxpayer's perspective is not a key component of the IRS collection strategy and "getting involved" is too often limited to issuing collection notices, and restricting the subsequent taxpayer contacts to untrained and unempowered employees. Delays in service delivery are further exacerbated by the IRS's practice of assigning most trust fund cases that are not resolved through the notice process or ACS into the Collection Queue. These questionable assignment practices promote the pyramiding of additional trust fund tax liabilities, and the aging of IRS accounts receivable. At the end of FY 2013, 55 percent of these high risk cases were assigned to the Queue.[43] *Not surprisingly, approximately 71 percent of the current trust fund TDA inventory involved debts for tax years at least three years old.*[44] Studies conducted by the IRS recognize the "collectibility curve" that becomes apparent as delinquent accounts age. This "curve" indicates that after three years of becoming overdue, these accounts

39 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report (Sept. 2013).* See also IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013).

40 IRS, SB/SE Research, *Your Clients and the Economy – How Can the IRS Help*, 4 (Jan. 2010).

41 *Id*.

42 *Id*.

43 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013).

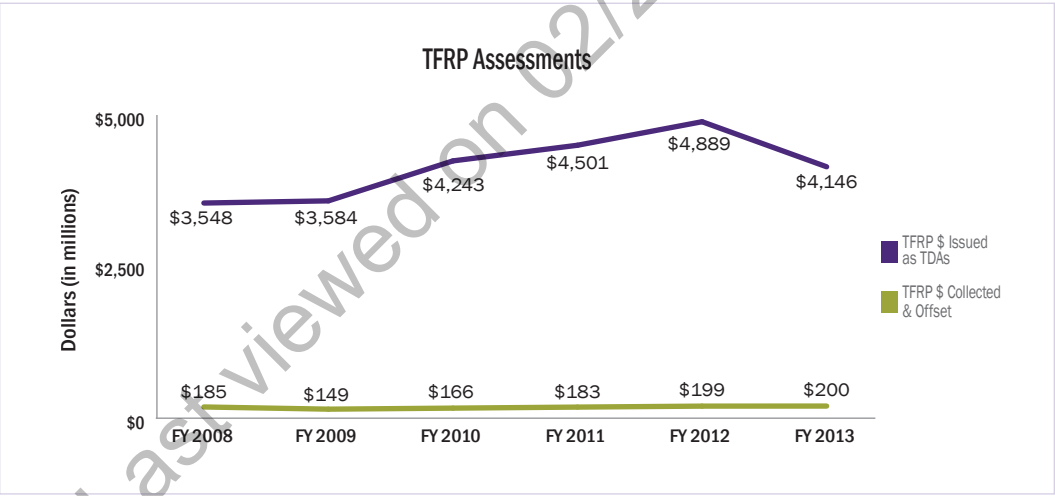
44 *Id*. At the conclusion of FY 2013, the IRS reported in inventory 1,197,082 trust fund TDA accounts related to tax years 2010 and prior.

produce minimal collections.[45] Yet clearly, the assignment practices employed by the IRS for IBTF cases ignore this critically important collecting principle.

The current use of the Collection Field operation does little to improve revenue collection or taxpayer compliance.

The IRS's strategy for dealing with the large, aged inventory of high risk trust fund cases emphasizes the use of the Trust Fund Recovery Penalty (TFRP).[46] However, IRS data indicates the escalating use of TFRP investigations and assessments has been an unproductive use of valuable collection resources. From FY 2007 to FY 2012, the dollar value of TFRP assessments issued as TDAs increased by 61 percent, but TFRP dollars collected actually *decreased* by seven percent.[47] Although $4.9 billion in TFRP assessments were issued as TDAs in FY 2012, only $199 million was collected (including offsets) — about four percent of the dollars issued.[48] Moreover, the IRS's increasing emphasis on the use of the TFRP indicates the IRS is aware that many trust fund tax cases assigned to the CFf are likely to be uncollectible. Nevertheless, the IRS continues to resist changing its collection strategy for servicing these accounts.

FIGURE 1.12.5, Only A Small Portion of TFRP Assessments Is Actually Collected[49]



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45 IRS, TACT: *Collection Team VSM Decision Paper* I (July 8, 2009).

46 IRM 5.7.3.1, *Introduction* (Nov. 12, 2010). The TFRP is a penalty provided by Internal Revenue Code § 6672 against any person required to collect, account for, and pay over taxes held in trust who willfully fails to perform any of these activities. The penalty is equal to the total amount of tax evaded, not collected, or not accounted for and paid over.

47 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2012).

48 *Id*. Note: in FY 2013, the IRS issued $4.146 billion in TFRP TDA assessments — a significant decrease from FY 2012, and reported $200 million collected on TFRP accounts. While a trend is not yet evident, the decrease in TFRP dollars issued is noteworthy. However, the dollars collected on TFRP accounts remains a very small percentage of TFRP dollars issued — five percent in FY 2013.

49 IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2012).

Further, the IRS places very little emphasis on pre-delinquency education, early intervention on emerging delinquencies, or post-delinquency prevention on recidivists. The use of Federal Tax Deposit (FTD) Alerts and other field contacts on relatively small balance due employment tax accounts is rare.[50] Further, the IRS already has procedures in place that facilitate early intervention by revenue officers in cases where the taxpayers have had prior accounts in TDA status, *i.e.*, very high risk, repeat delinquents. The issuance and delivery of the Letter 903, *You Haven't Deposited Federal Employment Taxes,* systemically generates coding to the IRS computer system, which provides for systemic control and subsequent follow-up on these accounts. If a subsequent TDA, return delinquency, or FTD Alert is issued, it will be accelerated to the field for an early intervention by a revenue officer. However, these procedures are not commonly used.[51]

Improved use of collection payment options, including installment agreements and offers in compromise, employed earlier in the collecting process, would improve revenue collected, reduce revenue loss, and promote compliance within the business community.

The use of IAs and OICs to assist in the collection of trust fund tax delinquencies is astonishingly rare.[52] While the IRS does not track the number of IAs or OICs granted to IBTF taxpayers, it does report the overall numbers of IAs involving taxes reported on the business master file (BMF). The IRS issued 87,875 BMF IAs through September 2013, a 17 percent decline from the same period in FY 2011,[53] the year in which the IRS "Fresh Start" initiative brought more flexibility into the "IBTF Express" IA criteria.[54] Of particular concern is that in FY 2013, only 24,415 trust fund accounts receiving the CP 504B "final notice" were resolved with IAs — only 1.6 percent of the final notices issued — even though 97 percent of these notices met the new "IBTF Express" criteria.[55] Likewise, once cases left the notice stream and moved on in the collecting process, ACS issued only 29,246 BMF installment agreements, representing only 5.5 percent of the BMF taxpayer cases received by ACS during FY 2013.[56]

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50 IRM 5.7.1.1, *Federal Tax Deposit FTD Alerts* (May 15, 2012). The FTD Alert process identifies, at an early stage (*i.e.*, before the return is due), taxpayers who have fallen behind in their deposits. FTD Alerts determine an employer's compliance with employment tax deposit requirements for the quarter of Alert issuance, and for subsequent quarters until the taxpayer is brought into full compliance. In FY 2012, the IRS issued 5,217 FTD Alerts to revenue officers in the CFf, a 37 percent reduction from FY 2009. IRS response to information request (Sept. 9, 2013).

51 IRM 5.7.2.2, *Issuance of Letter 903* (Sept. 28, 2012). Issuance of the Letter 903, *You Haven't Deposited Federal Employment Taxes*, systemically generates TC 148-09 to the IDRS database. If a subsequent balance due, return delinquency, or FTD Alert is issued, it will be coded with an "L" and it will be accelerated to the field. IRS data reveals that as of July 2013, the IRS had only 717 taxpayer cases in inventory where issuance of the L-903 had generated the TC 148-09 coding. IRS, Business Return Transaction File (July 2013).

52 IRS response to information request (Sept. 9, 2013). The IRS acknowledges that the number of IAs, SLIAs, and OICs granted to IBTF taxpayers is not systemically tracked. In FY 2012, the IRS reports that 1,376 offers were accepted that included any type of BMF tax delinquency, including those from business taxpayers who were no longer operating at the time the offers were accepted.

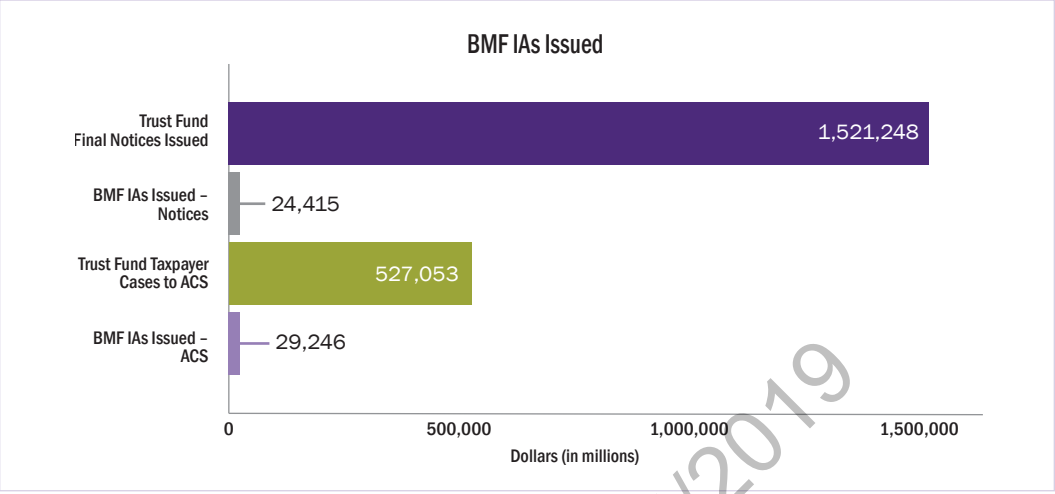
53 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013).

54 IBTF Express IAs may be granted if the entire liability, including accruals total $25,000 or less, and the taxes will be fully paid within 24 months. (Note: AM employees working notice responses on the toll-free phone lines may only issue IBTF Express IAs on liabilities of $10,000 or less.)

55 IRS, Collection Activity Report, NO-5000-2/242, *Taxpayer Delinquent Accounts Report, Part 2 Account Receivable Notices* (Sept. 2013).

56 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013).

FIGURE 1.12.6, BMF IAS Issued By AM, CSCO and ACS Are Rare[57]



A significant contributing factor to the astonishingly low number of BMF IAs issued for collection notice and ACS accounts is the IRS's hard policy of not even discussing the possibility of payment options with a taxpayer who has an unfiled return at the time contact is made with the IRS. The policy guidance provided to AM, CSCO and ACS employees places a great deal of emphasis on taxpayers being "in compliance" before the employees can consider payment options.[58] From the taxpayer's perspective, this IRS position can be confusing, and frustrating. *All collection cases*, by definition, involve taxpayers who are not "in compliance." The unfiled returns are simply part of the problem that these taxpayers need to resolve. However, turning away taxpayers in this manner, while they are attempting to come forward and work out reasonable payment solutions, is remarkably bad taxpayer service. Doing so in high risk trust fund compliance cases is simply irresponsible tax administration.

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57 IRS, Collection Activity Report, NO-5000-6, *Installment Agreement Report* (Sept. 2013); IRS, Collection Activity Report, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2013); IRS, Collection Activity Report, NO-5000-2/242, *Taxpayer Delinquent Accounts Report*, *Part 2 Account Receivable Notices* (Sept. 2013).

58 Throughout IRM 21 and IRM 5.19, the IRS prohibits the issuance of an IA to any taxpayer with unfiled returns.

CONCLUSION

For case assignment purposes, the IRS collection strategy categorizes collection cases involving business taxpayers with trust fund tax debts as relatively simple delinquencies that do not warrant immediate assignment to revenue officers. Yet, the IRS also views these cases as "high risk," and significantly restricts the ability of employees to provide the services needed to resolve the majority of these accounts. For many business taxpayers, the result is the IRS version of the proverbial "runaround." The delays in providing adequate service for these taxpayers result in not only poor service for business taxpayers, but also billions of dollars of lost revenue.

RECOMMENDATIONS

To improve service delivery for business taxpayers with tax debts, the National Taxpayer Advocate recommends that the IRS:

1. Must reconcile its case assignment practices involving IBTF tax delinquencies with the authorities delegated to employees assigned to work these accounts. Trust fund tax delinquencies should not be assigned to employees who are not fully empowered to resolve them. Current IRS practices create undue burden on taxpayers and contribute to significant delays in case resolution.
2. Should develop and test a new "second" notice for business taxpayers with trust fund tax debts, with an expanded focus on the availability of collection payment options. The notice should proactively invite taxpayers who have not acted since receiving the first notice or who are experiencing financial difficulties to contact the IRS to discuss payment options and should provide more information about the options that may be available. This information should be on the front page of the notice.
3. Should develop and implement an initiative to test the benefits that may be obtained through continued efforts to reach out to IBTF taxpayers whose accounts have been assigned to the Collection Queue. Through regularly issued "reminder" notices, similar to the new notice described in Recommendation 2 above, the IRS may encourage taxpayers to self-correct delinquencies on accounts that would otherwise sit inactive in the Queue.
4. Should allow "conditional IAs" for business taxpayers with trust fund tax debts. These IA procedures would allow ACS, CSCO, and AM to set up IAs for taxpayers' unfiled returns, with a requirement to file the returns included as a condition of finalizing the agreement within a reasonable period.
5. Should revise the collection procedures detailed in IRM 5.7.2.2, *Issuance of Letter 903*, and expand the use of the L-903 process to serve as a delinquency prevention tool. This practice would allow the IRS to clearly identify high-risk, repeat delinquents, and expedite these cases to Revenue Officers for appropriate attention.

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MSP #13 COLLECTION STATUTE EXPIRATION DATES: The IRS Lacks a Plan to Resolve Taxpayer Accounts with Extensions Exceeding its Current Policy Limits

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

As of December 31, 2013, 2,371 taxpayers remain subject to IRS collection action because of waivers of the applicable statutory period for collection, which violate the IRS policy limit of five years.[1] Before 2000, IRS collection personnel solicited waivers to extend the collection period when it did not appear the taxpayer could pay the tax owed prior to the collection statute expiration date (CSED).[2] Congress limited this practice as part of the IRS Restructuring and Reform Act of 1998 (RRA 98), which generally ended CSED waivers, other than for extensions entered in connection with installment agreements (IAs).[3] In response to Taxpayer Advocate Directive (TAD) 2010-3, the IRS Small Business/Self-Employed Division (SB/SE) and TAS formed a workgroup to investigate and resolve CSED extensions that exceeded five years.[4]

The IRS has placed almost 82 percent (1,939) of these accounts in currently not collectible (CNC) status or in the collection queue, and has no plan to collect these amounts.[5] A TAS analysis of these accounts reveals that 309 of these taxpayers are deceased.[6] Further, more than half of the taxpayers subject to these CSED extensions owe more than $50,000, of which almost 76 percent is attributable to accrued penalties and interest.[7]

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1 IRS, Compliance Data Warehouse (CDW), Integrated Data Retrieval System (IDRS), analysis of IDRS transaction code (TC) 550, definer code (DC) 0 and 1 for Individual Master File (IMF) accounts for tax periods ended on or before December 31, 1998 (April 20, 2013).

2 National Taxpayer Advocate 2006 Annual Report to Congress 428.

3 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3461, 112 Stat. 685, 764 (1998). The legislation also provided for collection statute extensions in connection with the release of levies after the collection statute expiration date (CSED) expired. However, the IRS has not implemented this provision.

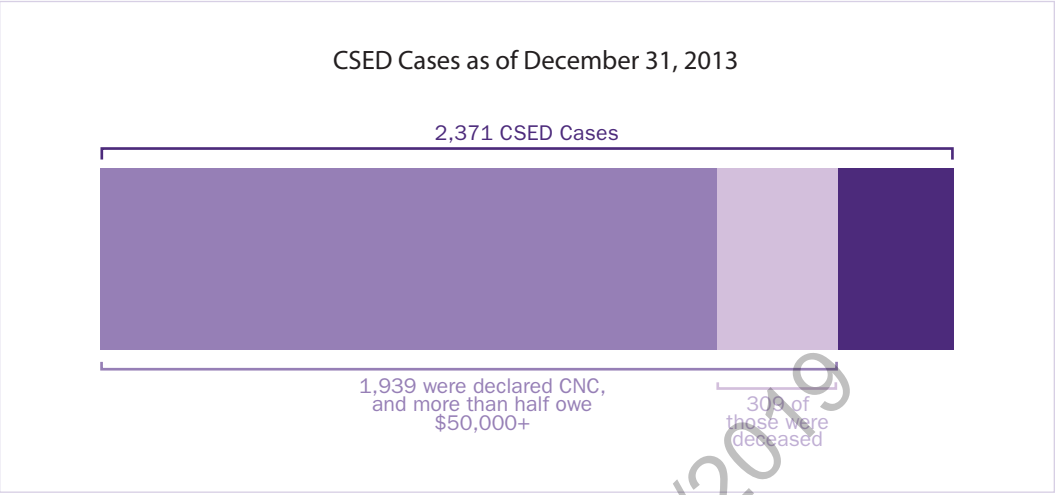
4 Taxpayer Advocate Directive (TAD) 2010-3 and responses to the TAD, *available at*: http://www.irs.gov/Advocate/Taxpayer-Advocate-Directives-and-Related-Documents.

5 IRS CDW, analysis of IDRS TC 550, DC 0 and 1, TC 470, and Status Code 24 (Queue) for Individual Master File (IMF) (April 20, 2013). The IRS deems accounts currently not collectible (CNC) or places them in the collection queue where it does not have the resources to collect or identifies a noncollectible account. *See, e.g.*, Internal Revenue Manual (IRM) 5.11.1.2.2.2(7)(d) (Feb. 3, 2012), IRM 5.19.5.5.8(3) (Sept. 21, 2011), and IRM 5.16.1.1 (May 22, 2012).

6 IRS CDW, analysis of IDRS TC 550, DC 0 and 1, TC 470 for Individual Master File (IMF) (Apr. 20, 2013).

7 IRS CDW, analysis of IDRS TC 550, DC 0 and 1, Tax Module Balances (TMODBAL) by Taxpayer Identification Number (TIN) for the IMF (Apr. 20, 2013).

FIGURE 1.13.1, CSED Cases as of December 31, 2013[8]



The majority of these lengthy CSED cases burden taxpayers, who do not appear able to pay or resolve their debts through collection alternatives. Legal and administrative impediments have unnecessarily complicated the resolution of these accounts. In all but one Annual Report to Congress since 2009, the National Taxpayer Advocate identified accounts with lengthy CSEDs as a most serious problem or provided a status update about the problem. The National Taxpayer Advocate's chief concern is the IRS's failure to cancel these unreasonable CSED extensions that do not comply with current policies. The IRS has already spent over four years trying to fix this problem, and no resolution is in sight. The IRS's lack of urgency with respect to this issue — which involves undoing agreements that in many instances were violations of policy or law — is shocking.

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ANALYSIS OF PROBLEM

Background

The IRS generally has ten years to collect a tax liability from a taxpayer.[9] The CSED is the date the IRS must cease taking collection actions on a taxpayer's account. By statute, various conditions suspend the period and extend the CSED.[10]

RRA 98 Changed the Rules for Seeking Collection Statute Waivers.

Before January 1, 2000 (the effective date of section 3461 of RRA 98), the IRS would solicit waivers to extend the CSED to a time when taxpayers could pay their full liabilities or pay in connection with IAs. The IRS initially solicited these waivers on accounts with an open CSED and for periods as long as

8 IRS, Compliance Data Warehouse (CDW), Integrated Data Retrieval System (IDRS), analysis of IDRS transaction code (TC) 550, definer code (DC) 0 and 1 for Individual Master File (IMF) accounts for tax periods ended on or before December 31, 1998 (April 20, 2013).

9 Internal Revenue Code (IRC) § 6502(a).

10 A number of code sections provide that the statute may be suspended by operation of law. *See, e.g.*, IRC § 6330(e) (after a timely request for a Collection Due Process (CDP) hearing); IRC § 6331(i) & (k) (during the pendency of an installment agreement (IA) or offer in compromise (OIC) investigation, or refund suit for a divisible tax; 30 days after the rejection or termination of an IA, or rejection of an OIC; and for any appeals of a rejected IA or OIC, or a terminated IA); IRC § 6503 (during a deficiency proceeding, and for 60 days thereafter; any period for which a taxpayer is outside the United States for six months or longer; any period for which the IRS holds property wrongfully seized until it returns the property; during the pendency of a substitution of value lien discharge proceeding).

10, 20, 30, 40 or even 50 years.[11] Despite adopting the policy on October 30, 1991 of limiting CSED waivers to five years in connection with IAs, the IRS continued soliciting waivers of longer than five years in certain cases until the law changed in 2000.[12] The American Jobs Creation Act of 2004 amended IRC § 6159 to provide for partial payment installment agreements (PPIAs).[13] The IRS responded by limiting its five-year extension policy to PPIAs.[14]

Collection statute extensions concerned Congress in 1998 because the IRS often did not inform taxpayers about their legal rights or consequences of extending statutory periods:

> … The Committee is concerned that in some cases taxpayers have not been fully aware of their rights to refuse to extend the statute of limitations, and have felt that they had no choice but to agree to extend the statute of limitations upon the request of the IRS. Moreover, the Committee believes that the IRS should collect all taxes within 10 years, and that such statute of limitation should not be extended.[15]

As part of RRA 98, Congress amended Internal Revenue Code § 6502(a)(2) to restrict the terms under which the IRS and taxpayers could agree to extend the statutory period for collection beyond ten years. Congress provided that the IRS could collect after the statutory period only if the IRS and the taxpayer agreed to extend the statutory period for collection *in connection with* an original installment agreement or before releasing a levy after the ten-year period.[16] Section 3461(c)(2) of RRA 98, which controls most lengthy CSED accounts, states:

> — If, in any request to extend the period of limitations made on or before December 31, 1999, a taxpayer agreed to extend such period beyond the 10-year period referred to in section 6502(a) of the Internal Revenue Code of 1986, such extension shall expire on the latest of —
>
> (A) the last day of such 10-year period,
>
> (B) December 31, 2002, or
>
> (C) in the case of an extension in connection with an installment agreement, the 90th day after the end of the period of such extension.[17]

Taxpayers use Form 900, *Tax Collection Waiver*, to extend the period for collections on accounts beyond the ten-year statutory period for collection. Counsel has concluded, "A tax collection waiver executed pursuant to IRC § 6502(a)(2) is not a contract [that the parties could agree to amend]. *See Florsheim*

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11 *See* Internal Revenue Manual (IRM) 53(11)(1) (Oct. 28, 1993) (stating, "The ten year collection period may, at any time prior to its expiration, be extended for any period of time agreed upon by the taxpayer and the district director.").

12 IRM 5331.1(12)(b)2 (Oct. 30, 1991).

13 American Jobs Creation Act of 2004 (AJCA), Pub. L. No. 108-357, § 843(a) and (b), 118 Stat. 1600 (Oct. 22, 2004). Prior to 1998, IRS employees sometimes entered into monthly payment agreements that would not fully pay the tax liability over the term of the agreement. In 1998, IRS Counsel concluded that these partial payment agreements were not permitted. In 2004, Congress enacted the AJCA to legally provide for partial payment IAs. H.R. Conf. Rpt. 108-755, at 649-650 (Oct. 7, 2004).

14 IRM 5.14.2.1 (July 12, 2005). The procedure permits waivers of five years plus one year may be added for administrative actions.

15 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, S. Rept. No. 105-174 at 87 (June 24, 1998).

16 IRC § 6502(a)(2); Treas. Reg. § 301.6502-1(b)(2). Even though the IRS currently has no procedures regarding when seeking an extension of the CSED in connection with a levy release might be appropriate, the statute and regulations provide that the IRS may secure a CSED waiver in connection with a release of a levy where the CSED on the underlying tax liability has expired. The agreement to extend the collection statute must be entered into prior to the levy being released.

17 RRA 98, Pub. L. No. 105-206, § 3461(c)(2), 112 Stat. 685, 764 (1998).

Bros. Drygoods Co. v. United States, 280 U.S. 453. 468 (1930). Rather, it is a voluntary, unilateral waiver of a defense by the taxpayer."[18]

The National Taxpayer Advocate Proposes Legislation and Orders IRS Review and Resolution of Lengthy CSED Accounts.

In 2006, the National Taxpayer Advocate proposed legislation to eliminate the IRS's inventory of over 32,000 accounts affecting approximately 14,000 taxpayers with lengthy CSED extensions.[19] In 2009, the National Taxpayer Advocate recommended that the IRS resolve excessively long CSEDs by writing off accounts with CSEDs greater than the original CSED plus five years (absent other lawful extensions).[20]

On January 20, 2010, the National Taxpayer Advocate issued TAD 2010-3, directing the SB/SE Commissioner to, among other things, provide employees for an SB/SE-TAS workgroup for review, resolution, adjustment, or correction of all accounts with CSEDs extended beyond 15 years after assessment (plus any statutory suspensions).[21] On June 10, 2010, the Deputy Commissioner for Services and Enforcement modified the TAD to require SB/SE (as part of the SB/SE-TAS workgroup, and in coordination with the Office of Chief Counsel) to review these accounts on a case-by-case basis and determine whether alternative resolutions could be reached.

The National Taxpayer Advocate's chief concern is the IRS's failure to cancel these unreasonable CSED extensions that do not comply with current policies. The IRS has already spent over four years trying to fix this problem, and no resolution is in sight.

The Resolution of All Lengthy CSED Accounts Hinges on Accurate Research of Accounts and Remedies that Comport with the Law.

In response to the TAD, the TAS-SB/SE CSED Workgroup investigated CSEDs extended by taxpayers longer than five years. The group initially determined that 4,466 taxpayers held accounts with extensions exceeding policy limits.[22]

The TAS - SB/SE CSED Workgroup Reviews Taxpayer Accounts.

The workgroup is investigating whether it can resolve accounts systemically, rather than case by case.[23] As of December 31, 2013, 2,371 individual taxpayers, who waived the collection statute for more than five years on tax periods before 1999, have open CSEDs.[24] Figure 1.13.2 shows the number of taxpayers by length of the waiver, whether the IRS has placed their accounts in currently not collectible (CNC) status, and the percentage of taxpayers in CNC status.

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18 IRS Office of Chief Counsel, Program Manager Technical Advice (PMTA) 2010-10, Memorandum to Director, Collection Policy, Small Business/Self-Employed Division (SB/SE) (Feb. 12, 2010).

19 National Taxpayer Advocate 2006 Annual Report to Congress 428.

20 National Taxpayer Advocate 2009 Annual Report to Congress 227.

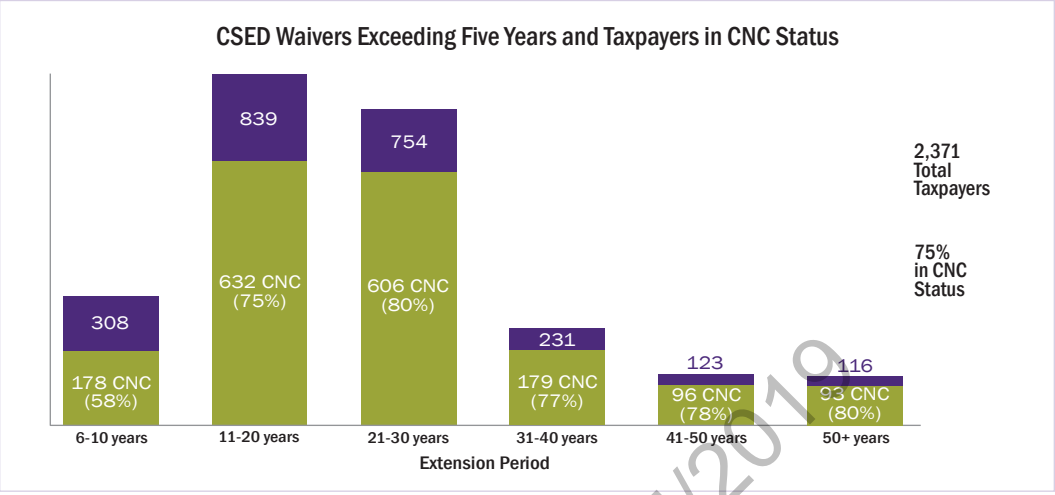
21 National Taxpayer Advocate, Taxpayer Advocate Directive 2010-3 (Jan. 20, 2010).

22 National Taxpayer Advocate 2012 Annual Report to Congress 470.

23 TAS-SB/SE CSED Workgroup, *Memorandum re: Effective Tax Administration Offers In Compromise for Certain Taxpayers Under a Lengthy CSED Extension* (June 21, 2012).

24 *Id*.

FIGURE 1.13.2, CSED Waivers Exceeding Five Years and Taxpayers in CNC Status[25]



SB/SE Research data on these accounts also show:

- 1,628 or almost 69 percent of these taxpayers signed waivers exceeding five years on or after October 30, 1991 in violation of IRS policy in effect at that time.[26]
- Over 87 percent only owe income tax liabilities.[27]
- 295, approximately 12 percent, owe trust fund taxes.[28]
- 2,209, over 93 percent, defaulted on the IA entered in connection with his or her lengthy CSED waiver.[29]
- 117, less than five percent, incurred additional tax liabilities after 1998.[30]

The following chart shows the breakout of taxpayers by active, CNC status (bankruptcy, decedent cases, unable to contact or locate, and economic hardship), and shelved (in the queue or no resources to work) accounts.

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25 TAS-SB/SE CSED Workgroup, *Memorandum re: Effective Tax Administration Offers In Compromise for Certain Taxpayers Under a Lengthy CSED Extension* (June 21, 2012).

26 *Id*.

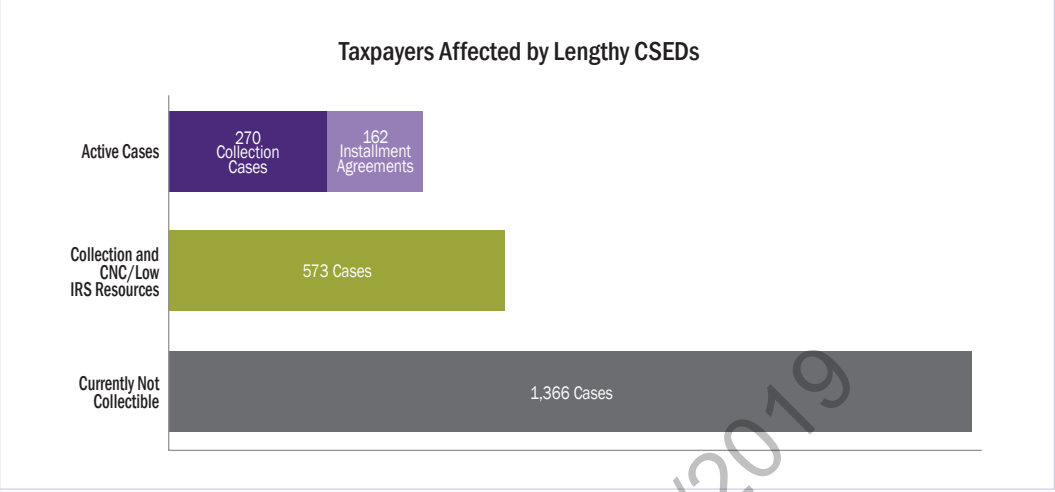
27 *Id*.

28 *Id*. Trust fund taxes refer to taxes collected or withheld under a trust imposed under IRC § 7501. The Trust Fund Recovery Penalty (TFRP) is a penalty that is assessed under IRC § 6672 against the individual or individuals who are responsible for paying the trust fund taxes but willfully did not do so. The amount of the penalty is equal to the amount of the unpaid trust fund taxes.

29 IRS CDW, analysis of IDRS TC 550, DC 0 and 1 for IMF accounts and Masterfile Status code (MF status) (June 25, 2013).

30 IRS CDW, analysis of IDRS TC 550, DC 0 and 1 for IMF accounts (June 25, 2013).

FIGURE 1.13.3, Taxpayers Affected by Lengthy CSEDs[31]



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The IRS has not filed or refiled a notice of federal tax lien on almost 14 percent of the taxpayers' tax modules subject to the lengthy CSEDs.[32] The majority of these lengthy CSED cases burden taxpayers, who do not appear able to pay or resolve their debts through collection alternatives, and who would not be subject to collection on these IRS debts under current policy and law.

The IRS's Unacceptable Delay in Resolving These Lengthy CSED Accounts Is Due in Part to Chief Counsel's Concerns About The Commissioner's Authority to Undo These Extensions.

In connection with the TAD, the Office of Chief Counsel issued an opinion addressing whether the Commissioner could revoke, modify, or cancel the taxpayers' waivers for lengthy CSEDs, or whether the Commissioner could abate such liabilities as excessive in amount. Counsel concluded that while the Commissioner lacked the authority to modify or rescind a CSED waiver, the Commissioner could place these accounts into a separate noncollectible status "as to which refund offset and state-income tax levy would also be suspended."[33] However, placing the account in this special separate noncollectible status would not entirely solve the matter.

Liens filed against taxpayers facing lengthy CSEDs would continue to attach to their property and continue to harm these taxpayers by negatively impacting their credit score and economic viability.[34]

31 IRS CDW, analysis of IDRS TC 550, DC 0 and 1 for IMF accounts (June 25, 2013).

32 *Id*.

33 IRS Office of Chief Counsel, Program Manager Technical Advice (PMTA) 2010-10, Memorandum to Director, Collection Policy, Small Business/Self-Employed Division (SB/SE) (Feb. 12, 2010).

34 The Counsel Memo did indicate that the IRS might be able, on a case-by-case basis, to withdraw the lien under the best interest test found in section 6323(j)(1)(D) which would remove the lien from the taxpayer's credit history. On average, a lien filing reduces a taxpayer's credit score by 100 points. The impact of the lien filing is greatest upon the initial filing and diminishes over time. See written response from Vantage Score® (Sept. 17, 2009); National Taxpayer Advocate 2009 Annual Report to Congress 20 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*).

Unpaid tax liens may remain on a taxpayer's credit history, leaving a derogatory mark on the credit history indefinitely.[35]

Counsel further concluded, "The Commissioner's authority under section 6404(c) to abate tax "under uniform rules" when "the administrative and collection costs involved would not warrant collection of the amount due" would not authorize blanket abatements directed by the National Taxpayer Advocate. These abatements are typically made on a case-by-case basis, as the financial situations of taxpayers vary."[36] The National Taxpayer Advocate's position is that the abatement authorization under IRC § 6404(c) contains no explicit exception or prohibition for applying "uniform rules" for abatement to a group or class of taxpayers. Here, we have clearly defined groups of taxpayers with clearly described similar circumstances. Some of these circumstances fit squarely within the 6404(c) abatement language. The language of 6404(c) does not ignore the needs of administrative efficiency — indeed, the statutory language, together with principles of efficient tax administration, clearly contemplates a blanket abatement in these situations.

The majority of these lengthy CSED cases burden taxpayers, who do not appear able to pay or resolve their debts through collection alternatives, and who would not be subject to collection on these IRS debts under current policy and law.

In 2012, IRS Chief Counsel concluded that the IRS can only solicit offers in compromise from these taxpayers if it makes determinations of equity or hardship based on the facts and circumstances of each case.[37] Most recently, the workgroup requested assistance from Counsel to see whether there was a way to resolve these accounts under the existing statutory scheme. Counsel is in the process of writing a legal memo that we hope will provide a way or ways to resolve these cases. The National Taxpayer Advocate, however, is running out of patience.

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CONCLUSION

Lengthy CSED accounts are a remnant of the era preceding RRA 98. The IRS continues to burden taxpayers who waived a collection statute for more than five years in connection with an IA. While RRA 98 limited other CSED waivers, the IRS has not yet implemented a plan to resolve lengthy CSED waivers, even though many were solicited in violation of IRS policy. Further, IRS data show little or no collection activity on these accounts. The National Taxpayer Advocate is greatly concerned that the IRS will do nothing and hold these uncollectible debts over taxpayers' heads, rather than resolve all lengthy CSED accounts once and for all as agreed to in response to TAD 2010-3.

35 As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years and Equifax for ten years, while Transunion credit reports reflect them indefinitely. Released liens, including those paid off by the taxpayer, are not generally removed from the credit history until seven years from the date of release. *See* The Fair Credit Reporting Act (FCRA), § 605(a)(3), 15 USC 1681c(a)(3); IRC § 6325(a)(1) (lien will be released if the liability is satisfied or becomes unenforceable). However, California requires that all liens, released and open, be removed from credit histories ten years after the filing date. *See* Cal. Civ. Code, § 1785.13(d).

36 IRS Office of Chief Counsel, Program Manager Technical Advice (PMTA) 2010-10, Memorandum to Director, Collection Policy, Small Business/Self Employed Division (SB/SE) (Feb. 12, 2013).

37 *Id.*

RECOMMENDATIONS

The National Taxpayer Advocate offers the following recommendations to finally resolve all lengthy CSED accounts:

1. By April 15, 2014, cease collection of payments on all accounts where the collection period was extended in violation of the IRS 1991 waiver policy.
2. By June 30, 2014, abate all such extended CSED accounts under the authority vested in the Commissioner under the Internal Revenue Code.

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MSP #14 COLLECTION DUE PROCESS HEARINGS: Current Procedures Allow Undue Deference to the Collection Function and Do Not Provide the Taxpayer a Fair and Impartial Hearing

RESPONSIBLE OFFICIALS

Kirsten B. Wielobob, Chief, Office of Appeals
Debra Holland, Commissioner, Wage and Investment Division
Karen Schiller, Commissioner, Small Business/ Self-Employed Division

DEFINITION OF PROBLEM

The IRS's current procedures for Collection Due Process (CDP) hearings do not always result in a fair, impartial, and independent review. The IRS Restructuring and Reform Act of 1998 (RRA 98) established a taxpayer's right to an independent review of IRS lien and levy actions by the Office of Appeals, known as a CDP hearing.[1] Unlike other creditors, the IRS can file a lien against or levy a taxpayer's assets without first obtaining a court order. Providing due process rights for collection actions forces the IRS to consider the taxpayer's circumstances before (or immediately after, in the case of lien filing) exercising these powers.[2]

As conducted by the IRS today, CDP hearings do not provide most taxpayers with a meaningful hearing. In many cases, the IRS issues a CDP notice before making any other contact with the taxpayer and before he or she has a chance to meaningfully engage with Collection. As a result, taxpayers may feel pressured into requesting a CDP hearing, and Appeals may receive cases that are not fully developed. When Collection receives a CDP request, it has discretion as to when to send the case to Appeals. In situations where the taxpayer works with Collection and does reach an agreement, Collection will ask the taxpayer to withdraw the CDP request, taking away his or her opportunity for an independent review.

One of the most significant problems with CDP hearings is that Appeals may not give proper attention to a core taxpayer rights aspect of the hearing, namely, the balancing test that requires the Hearing Officer to weigh the need for collection against the taxpayer's interest that the action be no more intrusive than necessary.[3] Moreover, Hearing Officers do not exercise settlement authority used by other Appeals Officers and thus may not fully carry out the balancing test.

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1 *See* IRC § 6330(b). *See also* Pub. L. No. 105-206, § 3401. A lien is "a legal right or interest that a creditor has in another's property, lasting usually until a debt or duty that it secures is satisfied." *Black's Law Dictionary* (9th ed. 2009). *See also* IRC § 6321. Levy refers to the IRS's ability to collect amounts owed by taking the property or rights to the property of the taxpayer. *See* IRC § 6331.

2 The taxpayer must file a CDP request within 30 days of receiving the CDP notice. The IRS sends the CDP notice within five days of the filing of the lien or the Notice of Intent to Levy. IRC §§ 6330(b)(1) and 6330(b)(3). In limited circumstances described in IRC § 6330(f) the taxpayer does not have CDP rights until after the levy.

3 "Hearing Officer" describes " a group of employees who deal with taxpayers and resolve disputes. An Appeals hearing officer is any Settlement Officer, Appeals Officer, Appeals Account Resolution Specialist or other employee holding hearings, conferences or who otherwise resolves open case issues in Appeals." IRS, AJAC FAQs, http://appeals.web.irs.gov/about/ajac-faq.htm (updated Sept. 30, 2013).

ANALYSIS OF PROBLEM

RRA 98 established a taxpayer's right to a CDP hearing to give taxpayers who are dealing with the IRS the same protections they have when dealing with other creditors.[4] Congressional testimony explained, "Many people were shocked to learn that a number of the due process protections Americans take for granted in other legal proceedings do not apply to actions involving the IRS."[5] As a result, Congress sought increased protection for taxpayers.[6] The Senate committee report emphasized, "a proposed collection action should not be approved solely because the IRS shows that it has followed appropriate procedures."[7]

CDP hearings have three major elements:

1. To provide an independent review of IRS collection action by an Appeals employee;
2. To verify that Collection has followed any applicable law or administrative procedure; and
3. To ensure "any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary."[8]

During a CDP hearing, a taxpayer may raise appropriate spousal defenses, challenge the appropriateness of the collection actions, and offer collection alternatives.[9] A taxpayer can challenge the underlying liability if he or she did not receive a statutory notice of deficiency or otherwise have an opportunity to dispute the tax liability.[10]

Of the taxpayers who receive CDP notices, few request CDP hearings. In FY 2012, the IRS issued over 3.6 million CDP notices and received only about 47,500 CDP hearing requests, approximately 1.31 percent of hearings offered.[11] CDP cases represented 37.9 percent of Appeals receipts in 2012 and 35.9 percent through June 30, 2013, the largest single receipt source.[12]

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4 S. Rep. No. 105-174, at 68 (1998).

5 144 Cong. Rec. 4,190 (1998).

6 144 Cong. Rec. 4,184 (1998). "Currently there is a woeful lack of protection in this area, particularly during collection activity, where the IRS is the judge and jury, and where some agency employees take a cavalier approach to issuing a notice of lien, levy, or seizure of a taxpayer's home, personal belongings, or business property."

7 S. Rep. No. 105-174, at 68 (1998).

8 IRC § 6330(c).

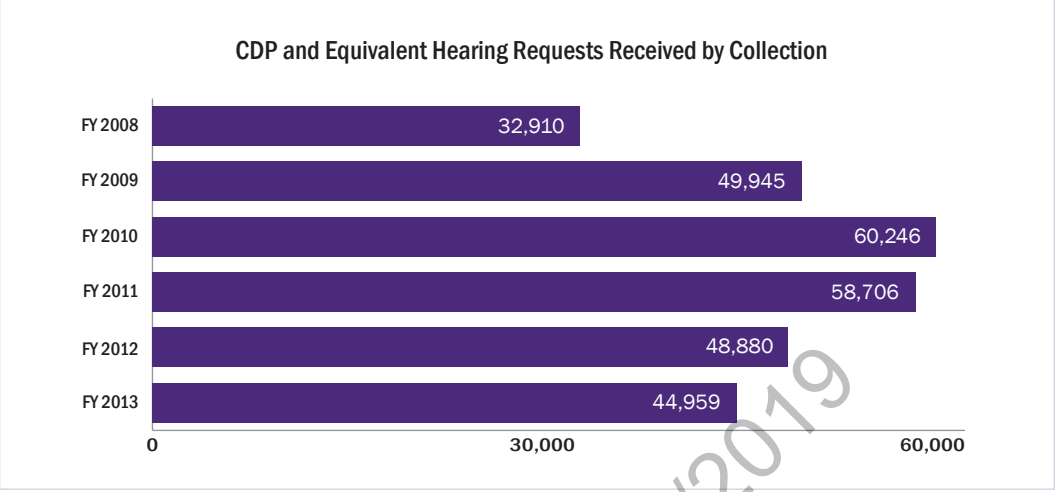
9 IRC § 6330(c)(2)(A).

10 IRC § 6330(c)(2)(B).

11 IRS response to TAS information request (Nov. 15, 2013). Fiscal year is based on when the CDP hearing was requested. In the first half of 2013, the IRS issued over 2.4 million CDP notices, but received only 35,780 CDP requests, approximately 1.48 percent.

12 IRS response to TAS information request (Sept. 17, 2013). Appeals receipts include other issues taxpayers commonly appeal, such as issues in examination. Compare to Examination/TEGE appeals, comprising 31.4 percent in fiscal year (FY) 2012 and 31.4 percent through June 30, 2013.

FIGURE 1.14.1, CDP and Equivalent Hearing (EH) Requests, Fiscal Years 2008–2013[13]



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Taxpayers may not have the chance to work with Collection before receiving a CDP notice and may feel forced into a CDP hearing.

The IRS must issue a CDP notice within five days of filing a notice of federal tax lien (NFTL), and at least 30 days before it can levy with respect to the unpaid tax.[14] Although the statute ties the timing of the CDP notice to the NFTL and notice of intent to levy ("NIL"), issuing the CDP notice too early undercuts the entire CDP process.[15] In many cases, Collection employees do not attempt to contact the taxpayer before sending the CDP notice. The Internal Revenue Manual (IRM) requires employees to make reasonable efforts to contact the taxpayer (by visiting, calling, or mailing a notice to the last known address) before issuing the NFTL.[16] However, the IRS undermines this protection by requiring the NFTL filing determination ten days after the initial contact attempt or when the contact was due (before any undeliverable mail would be returned and processed).[17] For levies, there is no requirement that the IRS contact the taxpayer before issuing the NIL, which the IRS can issue as early as ten days after issuing the notice of assessment and demand for payment.[18] Neither the Automated Collection System (ACS) nor Field Collection tracks how often employees contact taxpayers by phone or mail prior to sending CDP notices.[19] Given that ACS employees only spend about two or three percent of their time on outbound calls, it is unlikely ACS contacts most taxpayers before issuing the CDP notice.[20] For Field Collection,

13 TAS Research Individual Master File transaction code 971 action code 275 or 278 (Nov. 17, 2013). Fiscal year is based on when the CDP notice was mailed to the taxpayer, as opposed to the date when the CDP hearing was requested, as used in the text above.

14 IRC §§ 6320(a)(2), 6330(a)(2). In limited situations, the IRS can levy before providing the right to a CDP hearing. IRC § 6330(f). IRC § 6320(a)(2) requires the IRS to issue a notice of the taxpayer's right to a CDP hearing within five days of filing the notice of tax lien.

15 IRC § 6331(d)(2) requires the IRS to provide notice of intent to levy at least 30 days before the day of the levy, except where the collection of tax is in jeopardy.

16 IRM 5.12.2.2(1) (Oct 14, 2013). If the taxpayer does not send in a payment, the IRS must advise the taxpayer of his or her right to appeal under the Collection Appeals Program, which is the only pre-lien administrative appeal process. It is limited to procedural arguments. *See* IRM 5.12.6.4 (2) (Oct. 14, 2013).

17 IRM 5.12.2.3.2(1) (Oct 14, 2013).

18 *See* IRM 5.11.1 (Feb. 3, 2012). The IRS usually issues the Notice of Intent to Levy and Notice of Your Right to a Hearing (L1058) on initial contact with a business taxpayer or combination business/individual taxpayer when a deadline is set for the taxpayer to take specific action. For individual taxpayers, the IRM advises using discretion as to whether to issue the L1058 on initial contact. IRM 5.11.1.2.2 (Dec. 11, 2009).

19 IRS Response to TAS Information Request (Sept. 3, 2013).

20 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2010-30-046, *More Management Information is Needed to Improve Oversight of Automated Collection System Outbound Calls* 3 (Apr. 28, 2010).

Revenue Officers (ROs) issue the CDP notice at the same time as the initial contact when the RO asks for the financial analysis.[21]

A taxpayer has only 30 days to file a CDP request after receiving a CDP notice, and may feel pressured to request a hearing even if he or she is still putting together documentation and trying to work with Collection.[22] If a taxpayer does not provide the requested information before Collection's deadline, it may deny the taxpayer's position as unsubstantiated and transfer the case file to Appeals without reviewing the documents later provided.[23] In some cases, ROs may perceive the filing of a CDP request as an action solely to delay collection and refer the taxpayer's representative to the Office of Professional Responsibility, despite the fact that filing a CDP request is a reasonable and legal action to take.[24]

Taxpayers may sacrifice their rights if they come to an agreement with Collection after filing the CDP request.

A taxpayer who files a CDP request to preserve the right to a hearing may end up sacrificing this right if he or she reaches an agreement with Collection. If the taxpayer and the IRS come to a proposed settlement, the IRS asks the taxpayer to withdraw the CDP request.[25] While Collection has told TAS that a taxpayer is *not required* to withdraw a CDP request upon reaching a resolution, the IRM states "the RO should solicit a withdrawal of the hearing request."[26] If a taxpayer withdraws a CDP request, the taxpayer loses the opportunity for Appeals to verify independently that the IRS has followed the law and procedures and conduct the balancing test.[27]

The IRS should change these procedures so that Appeals enters into the agreement with the taxpayer, meaning Appeals will still be required to make the CDP determination.[28] When a taxpayer reaches an agreement with Appeals, he or she must sign a form that waives the right to judicial review of Appeals' determination.[29] Under the current system, where a taxpayer signs an agreement with Collection, the result is the worst of both worlds – the taxpayer loses the opportunity for a future Appeals determination that is subject to judicial review, while at the same time giving up the current opportunity for Appeals to review Collection's actions and conduct the balancing test.

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21 "While the notices sent in the notice stream are sufficient for filing an NFTL, generally when an NFTL has not been previously filed the revenue officer's determination with respect to the filing of the NFTL will be done in conjunction with the initial actual contact or initial attempted contact." While it is preferable to contact the taxpayer in person, the initial contact can also be done by phone or by mailing a notice or letter to the last known address. IRM 5.12.2.2 (Oct. 14, 2013). *See also* IRM 5.1.30.2 (July 8, 2011), 5.1.30.3 (July 8, 2011), 5.1.30.5 (July 8, 2011).

22 IRC § 6330(a)(3); IRC § 6320(a)(3).

23 In some cases, a taxpayer may not receive the NIL or NFTL letter. In FY 2012, 33.9 percent of the NIL letters and 6.5 percent of the NFTL letters were unclaimed, refused, or undeliverable. TAS Research Individual Master File, ratio of taxpayers with transaction code 971 action code 67 or 68 to number of taxpayers with transaction code 971 action code 69. (Nov. 16, 2013). *See* IRM 5.12.6.3.17 (Oct. 14, 2013).

24 The Director of the IRS Office of Professional Responsibility (OPR) has warned practitioners that assisting with a CDP claim involving collection alternatives could lead to practitioner discipline if the taxpayer is not compliant with payment and filing obligations. *See* 137 Tax Notes 742 (Nov. 12, 2012).

25 IRM 5.1.9.3.4 (Feb. 23, 2012).

26 IRS response to TAS information request (Sept. 3, 2013). The regulations provide that withdrawal is allowed but not required. Treas. Reg. 301.6330-1(c), A-C9 provides that when a taxpayer resolves the matter with Collection after filing a CDP request, "the taxpayer *may* withdraw in writing the request that a CDP hearing be conducted by Appeals" (emphasis added). See IRM 5.1.9.3.3 (3) (Feb. 23, 2012).

27 IRM 8.22.5.2.5(5) (Nov. 8, 2013) states, "The Legal and Administrative review is not required when a taxpayer withdraws his/her hearing request," but the IRM is silent as to whether Appeals must conduct the balancing test. The taxpayer also loses the ability to challenge the underlying liability, if allowed in the CDP hearing. *See* IRC § 6330(c)(2)(B).

28 IRC § 6330(c)(3) provides that the CDP determination shall take into consideration: the verification that the law and applicable procedures were followed, any issues raised relating to the unpaid tax or the proposed levy allowed to be raised under IRC § 6330(b)(2), and the balancing test.

29 IRM 8.22.7.1.2 (Nov. 5, 2013). This is similar to what takes place when a taxpayer settles a case in Tax Court and must agree not to appeal the decision.

The process of requesting a hearing raises impartiality concerns.

A taxpayer who requests a CDP hearing may doubt whether the review will be independent because the taxpayer must send the request to Collection, the same office demanding payment.[30] Collection has discretion as to when to send the CDP case to Appeals, and can delay a hearing by not sending the case to Appeals for up to 90 days if it determines the taxpayer is willing to work with Collection.[31] Collection can also send the case immediately if it determines the taxpayer does not want to work with collection or raises frivolous arguments.[32] Thus, the timing of when Appeals receives a case comes with an implication that the taxpayer is a "good taxpayer" willing to work with Collection, or a "bad taxpayer" acting unreasonably. The Appeals Customer Satisfaction Survey reflects the disparity in the time it takes a case to reach Appeals, and found that taxpayers whose cases took 30 days or less to assign to an Appeals Officer were significantly less satisfied overall than those whose cases took longer."[33] Taxpayers may have been dissatisfied because they felt rushed into the Appeals proceedings without the opportunity to have their information and specific facts considered.[34] However, other Appeals customers who were dissatisfied with the amount of time it took to hear from Appeals thought Appeals should schedule an initial conference within 30 days of a request.[35]

Current procedures may prevent taxpayers from effectively challenging the underlying liability.

Some taxpayers may disagree with the underlying liability even though they do not meet the statutory requirements for challenging it.[36] If eligible, taxpayers can raise the liability through other channels.[37] Currently, when a taxpayer raises liability issues such as Innocent Spouse, penalties, or interest abatement, or the taxpayer submits a Doubt as to Liability (DATL) OIC, Appeals assigns the case to an Appeals Officer or Settlement Officer for consideration.[38] If a taxpayer files an amended return or disputes an automated substitute for return (ASFR), the CDP hearing is suspended while

Unlike other creditors, the IRS can file a lien against or levy a taxpayer's assets without first obtaining a court order.

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30 *See* IRS Form 12153 (Mar. 2012).

31 During the first three quarters of 2013, the average time from the filing of a CDP request to Appeals receiving the CDP case was 69 days. IRS Response to TAS Information Request (Sept. 5, 2013). *See also* IRM 5.1.9.3.3 (Feb. 23, 2012).

32 See IRM 5.1.9.3.3 (Feb. 23, 2012).

33 Appeals Customer Satisfaction Survey, National Report, Fiscal Year 2012 Results, Time to Hear from Appeals 9. Appeals Customer Satisfaction Survey, National Report, Fiscal Year 2012 Results, Overall Satisfaction by Time from Appeal Request to Case Assignment 15.

34 Two of the strongest drivers of satisfaction for Appeals customers were "Consideration of Information You Presented" and "Application of the Law to the Facts in Your Case." *Id*. at 23.

35 This seemingly contradictory finding may be the result of some Appeals customers experiencing extreme wait times for their conferences to be scheduled. A recent TIGTA report found 58 CDP or Equivalent Hearing cases from a sample of 132 that exceeded the target time of 90 days to resolve or forward to Appeals. Twenty-nine of these cases took more than 180 days to resolve or forward to Appeals. *See* TIGTA, Ref. No. 2013-10-103, *The Office of Appeals Continues to Experience Difficulties in the Handling of Collection Due Process Cases* 7 (Sept. 17, 2013). The sample was taken from 2011 and 2012. *Id*. at 31.

36 The taxpayer can contest a liability during a CDP hearing if he or she did not receive a notice of deficiency, never signed a consent for assessment, and did not have a prior opportunity to dispute the tax liability with Appeals. IRC § 6320(c) and IRC § 6330(c)(2)(B). A taxpayer may not have received a statutory notice of deficiency where the notice was undeliverable and the IRS had the taxpayer's last known address, but the IRS failed to send the notice the taxpayer's last known address.

37 These channels include audit reconsiderations, amended returns, and doubt as to liability (DATL) offer in compromise (OIC). A taxpayer is eligible for audit reconsideration if he or she meets four criteria: the taxpayer must have filed a tax return, the assessment must be unpaid or the IRS has reversed tax credits that the taxpayer is disputing, the taxpayer must identify which adjustments he/she is disputing, and the taxpayer must provide additional information not considered during the original examination. IRM 4.13.1.4 (Oct. 1, 2006). IRC § 7122 provides the authority to enter in OICs, including offers relating only to liability issues.

38 IRM 8.22.8.5.1 (Nov. 8, 2013).

the return is sent to Exam or the ASFR Reconsideration team.[39] As part of the Appeals Judicial Approach and Culture (AJAC) project, Appeals is considering which function should make the initial determination on DATL OICs settled by Appeals.[40] Compliance will determine whether to abate any of the liability, while the CDP hearing itself will remain in Appeals' jurisdiction.[41] These forthcoming changes are positive if they allow Compliance to first consider the DATL offer (subject to the right to an administrative appeal of a rejection) and then allow Appeals to consider other issues as part of the CDP hearing. Unless the appropriate IRS function first resolves the liability issue, Appeals could end up sustaining a levy action even though resolving the liability may extinguish the levy entirely or qualify the taxpayer for a guaranteed or streamlined installment agreement (IA).[42]

Another issue is that taxpayers cannot contest prior-year liabilities in CDP hearings. The regulations refer to a taxpayer's ability to contest liabilities "for any tax period shown on the CDP notice."[43] Appeals does not hear challenges to prior-year liabilities if they are not included on the CDP notice. This does not allow the taxpayer to resolve the collection matter in the most efficient way because most collection alternatives — IAs, OICs, and currently not collectible status — need to cover all years with a liability. One solution to this problem would be for Appeals to suspend the CDP hearing when non-CDP liability issues would be included in collection alternatives covered by the CDP hearing, to allow the taxpayer to resolve these related liability issues with the appropriate IRS function.

Taxpayers face roadblocks to receiving equivalent hearings.

If a taxpayer does not request a CDP hearing within the 30-day period, the taxpayer may still qualify for an equivalent hearing.[44] However, the IRS does not make it simple — the taxpayer will only receive an equivalent hearing if specifically requested.[45] Collection will not automatically process late-filed CDP requests as equivalent hearing requests.[46] Because equivalent hearings generally follow the same procedures as CDP hearings, taxpayers miss an important opportunity for Appeals to conduct the balancing test and review the collection action.[47]

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39 IRM 8.22.8.7.1.1 (Nov. 8, 2013). The National Taxpayer Advocate recommended a legislative change codifying the audit reconsideration process and providing, *inter alia*, that the Office of Appeals shall not issue a Notice of Determination in said case until such reconsideration and administrative appeal of the underlying liability have been concluded and the results are taken into consideration in making the CDP determination. National Taxpayer Advocate 2005 Annual Report to Congress 463.

40 The AJAC project has the goal of "enhancing internal and external customer perceptions of fair, impartial, and independent Office of Appeals." *See* Memorandum for Appeals Employees, Implementation of the Appeals Judicial Approach and Culture (AJAC) Project, Control No. Ap-08-0713-03 (July 18, 2013).

41 IRS, AJAC FAQS, Offers in Compromise Q6, http://appeals.web.irs.gov/about/ajac-faq.htm#Offers_in_Compromise (updated Nov. 17, 2013).

42 See IRM 5.19.1.5.4 (Oct. 18, 2013).

43 IRC§ 6330(c)(2)(B) allows the taxpayer to raise at the CDP hearing "challenges to the existence or amount of the underlying tax liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability." Treas. Reg. 301.6330-1(e)(1) provides, "The taxpayer also may raise challenges to the existence or amount of the tax liability specified on the CDP Notice *for any tax period shown on the CDP Notice* if the taxpayer did not receive a statutory notice of deficiency for that tax liability or did not otherwise have an opportunity to dispute that tax liability." (emphasis added).

44 IRM 5.19.8.4.3 (Nov. 1, 2007).

45 A taxpayer can request an equivalent hearing by checking a box on Form 12153, *Request for Collection Due Process or Equivalent Hearing* (which the taxpayer may not have checked because he or she thought the CDP request was timely), by making a written request, or by confirming that he or she wants the untimely CDP hearing request to be treated as an Equivalent Hearing when notified by Collection of an untimely CDP hearing request. The taxpayer must request the hearing within the one year period beginning the day after the date of the CDP levy notice or the day after the end of the five-day period following an NFTL filing. IRM 8.22.4.3 (Mar. 29, 2012).

46 IRM 5.19.8.4.3 (Nov. 1, 2007).

47 IRM 8.22.4.3 (Mar. 29, 2012). The Collection Statute Expiration date is not suspended for an equivalent hearing. The taxpayer cannot receive judicial review of the equivalent hearing, except for innocent spouse issues, abatement of interest issues, and the timeliness of the CDP hearing request. *Id. See* Treas. Reg. 301.6330-1(i).

AJAC procedures are promising, but need further development.

When a taxpayer requests a CDP hearing, Appeals may receive a partial case file or the case may have no development at all.[48] Under the AJAC interim guidance, CDP Hearing Officers have three options for cases that are not fully developed.[49] They can:

- Request information from the taxpayer;
- Issue an Appeals Referral Investigation (ARI) to Collection to secure information;[50] or
- Make a determination based on the information they have.[51]

The AJAC guidance needs further detail to guide Hearing Officers about when to exercise each option. Hearing Officers should only request information from Collection in limited circumstances, which need to be spelled out. For example, if the case file indicates a financial statement was prepared, but it is not in the file, it would be appropriate for the Hearing Officer to issue an ARI. Or, if the taxpayer requests a collection alternative for the first time while the case is in Appeals, an ARI to have Collection review and research is appropriate. However, if the taxpayer has updated financial information to submit, this is squarely in Appeals' jurisdiction, and it should conduct the analysis.[52] The Appeals response to TAS's research request states, "If the taxpayer submits additional information to Appeals that requires further analysis or more complex development, Appeals may issue an Appeals Referral Investigation (ARI) to the originating function as needed." This response raises concerns because Appeals should analyze the additional or supplemental facts as part of its independent review.

Under AJAC procedures, if the taxpayer submits an OIC, the Centralized Offer in Compromise (COIC) unit will review it and share the results with the taxpayer. If COIC's recommendation is anything other than acceptance, Appeals will make the final determination.[53] This approach is positive in that it allows Appeals to retain jurisdiction, ensure the IRS followed proper procedures, and conduct the balancing test.

Concerns remain regarding Appeals' independence from Collection.

Despite the AJAC changes, concerns remain regarding Appeals' independence because it lacks IRM guidance of its own regarding CDP cases.[54] The AJAC interim guidance advises Settlement Officers to use the Collection IRM to:

- Verify whether administrative procedures were followed in issuing the NFTL or NIL;
- Review Collection case actions and decisions; and

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48 IRM 8.22.4.6(3) a-g (Mar. 29, 2012). *See also* IRM 5.1.9.3.3 (Feb. 23, 2012).

49 See footnote 45 *supra*.

50 Appeals can use an ARI to request a Collection officer research the taxpayer's assets and income, or evaluate their proposed Collection Alternative. Collection provides this information or analysis to the hearing officer.

51 *See* Memorandum for Appeals Employees, Control No. Ap-08-0713-03, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project* (July 18, 2013) (revising IRM 8.22.4.2.1). IRM 8.22.4.2.1 was revised on November 5, 2013 and provides only two options in these situations: request the information from the taxpayer or issue an ARI to Collection.

52 "Appeals exercises independent judgment concerning disputed valuations and business decisions made by Collection." IRM 8.23.1.1 (8) (Nov. 20, 2013). "A cadre of Appeals hearing officers will provide the additional review of real property valuations for Appeals." IRM 8.23.3.3.2.5 (Nov. 21, 2013).

53 *See* Memorandum for Appeals Employees, Control No. Ap-08-0713-03, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project* (July 18, 2013) (revising IRM 8.22.7.10.6.5). IRM 8.22.7.10.6.5 was revised on November 5, 2013 and incorporates this change.

54 Complaints regarding Appeals' lack of independence have been common since Congress created CDP hearings. In 2012, the IRS published Rev. Proc. 2012-18, which prohibits certain communications between Appeals and the IRS function where the case originated (originating function). *See* Rev. Proc. 2012-18, 2012-10 I.R.B. 455.

- Evaluate alternatives to collection action.[55]

While the Collection IRM may be helpful in determining whether Collection followed the proper administrative procedures, Appeals needs its own guidelines for evaluating Collection's actions and decisions. One of the primary components of a CDP hearing is the balancing test, in which Appeals must weigh the IRS's need for efficient collection with the taxpayer's concern that the collection action be no more intrusive than necessary.[56] This balancing test is a fundamental taxpayer right, preventing the government from collecting tax without considering the taxpayer's legitimate interest.[57] It is unique in that Congress has specifically and statutorily required Appeals to weigh the taxpayer's interest against the IRS's need for collection. When Appeals Officers working CDP cases have to use the Collection IRM, which does not provide guidance on the balancing test, they may not provide a truly independent review or give proper attention to the test.

Without receiving an independent hearing from Appeals, taxpayers will continue to face emotional distress and economic hardship without the protections Congress intended.

Another issue is the practice of sustaining Collection's interpretation without independent verification, especially where Collection determines the taxpayer raised frivolous issues or requested a CDP hearing to delay or impede collection.[58] The Collection official can assert in the transmittal document that the taxpayer is making a frivolous argument or one intended to delay collection. If Collection believes the CDP request is frivolous, the taxpayer receives a special Appeals letter, giving him or her 30 days to amend the request.[59] The taxpayer loses the right to a face-to-face hearing if he or she does not amend the request to remove all "frivolous" arguments, including one that reflects a desire to delay.[60]

Appeals does not exercise its settlement authority in CDP cases.

Revenue Procedure 2012-18 and the Appeals IRM make it clear that Appeals has the authority to settle cases.[61] However, Appeals only considers the hazards of litigation in CDP cases in limited situations.[62] Since the advent of CDP in RRA 98, a significant body of law has developed around what constitutes abuse of discretion on the part of the IRS in collection actions. Where case law is unfavorable to the IRS position or practice in a case, Appeals' failure to take these conditions into account may mean that the

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55 *See* Memorandum for Appeals Employees, Control No. Ap-08-0713-03 *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project* (July 18, 2013) (revising IRM 8.22.4.2.1).

56 IRC § 6330(c)(3).

57 The National Taxpayer Advocate has recommended that fundamental taxpayer rights, such as the right to be heard and the right to a fair and just tax system, be incorporated into ongoing Collection and Appeals training. National Taxpayer Advocate's Report to the Acting Commissioner, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* 26-27 (Nov. 4, 2013).

58 *See* IRM 5.19.8.4.7.7 (Sept. 2, 2009). Appeals still receives CDP requests that Collection has deemed to delay or impede collection. Conversely, offers in compromise or installment agreement requests that Collection deems "Solely to Delay" may not go to Appeals. *See* IRM 5.14.3.2 (3)(e) (Jun. 12, 2009); IRM 5.8.3.13.1 (May 14, 2013).

59 "If I do not hear from you or if you submit another issue that is frivolous, or reflects a desire to delay or impede the administration of federal tax laws, I will disregard your hearing request and return your case to the IRS Collection office that referred it to Appeals." Letter 4380 (July 2008).

60 Letter 4380 (July 2008).

61 "Appeals employees remain ultimately responsible for independently evaluating the strengths and weaknesses of the issues in cases assigned to them and making independent judgments concerning the overall strengths and weakness of the cases and the hazards of litigation." Rev. Proc. 2012-18, § 2.02(3)(b). "The judicial attitude is one which reasonably appraises the facts, law, and litigating prospects; uses sound judgment and ability to see both sides of a question; and is objective and impartial. Any approach which contemplates a maximum possible result in favor of the Government or a deficiency in every case is incompatible with a judicial attitude and the Appeals mission." IRM 8.6.4.1.4 (Oct. 26, 2007).

62 "Settlement Officers use hazards of litigation when working Trust Fund Recovery Penalties. Hazards of Litigation are germane to TFRP cases because the determination of the exact amount of the proposed penalty can be tried in court. Collection Due Process cases can be reviewed by the Tax Court, but only for an abuse of discretion, not on the actual case resolution." IRS response to TAS information request (Sept. 5, 2013).

IRS is misapplying the balancing test. If the IRS has a high risk of losing the issue in litigation, then the collection action may not be "no more intrusive than necessary." In its response to TAS's research request regarding the hazards of litigation, Appeals stated, "Collection Due Process cases can be reviewed by the Tax Court, but only for an abuse of discretion, not on the actual case resolution."[63] However, the Tax Court's application of an abuse of discretion standard does not mean that Appeals should not exercise its settlement authority and take the hazards of litigation into account. The rationale for judicial review of collection actions is to provide guidance for when IRS actions constitute abuse of discretion. If the IRS ignores that guidance, it will harm taxpayers.

CONCLUSION

The National Taxpayer Advocate has written about CDP-related issues in numerous Annual Reports to Congress and has offered several legislative recommendations.[64] Without receiving an independent hearing from Appeals, taxpayers will continue to face emotional and economic hardship without the protections Congress intended. Taxpayers have a right to an independent review of collection actions by an impartial Hearing Officer, who must verify that the IRS followed the law and administrative procedures and conduct the balancing test. To make these protections real, the IRS needs to take the recommended actions.

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RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Require Collection to attempt to contact the taxpayer, preferably by phone, before issuing a CDP notice.
2. Direct the taxpayer to send his or her CDP request to Appeals instead of Collection. If this is not done, require Collection to send cases to Appeals immediately upon receipt of the CDP request.
3. Consider untimely CDP requests as requests for an equivalent hearing if they qualify. Notify the taxpayer by letter and attach a list of questions and answers about equivalent hearings.
4. If a taxpayer reaches an agreement with Collection, do not ask the taxpayer to waive the right to a CDP hearing. Require Appeals to retain jurisdiction of the hearing when a taxpayer reaches an agreement with Collection, meaning Appeals and not Collection enters into the agreement with the taxpayer and conducts the other tasks required in CDP hearings.
5. Require Appeals to suspend a CDP hearing when a taxpayer raises a liability issue for a non-CDP year that would be included in collection alternatives covered by the CDP hearing. Allow the taxpayer to resolve these related liability issues with the appropriate IRS function.

63 IRS response to TAS information request (Sept. 5, 2013).

64 See National Taxpayer Advocate 2002 Annual Report to Congress 110-15, 2003 Annual Report to Congress 38-59, 2004 Annual Report to Congress 264-89, 2006 Annual Report to Congress 266–88, 2009 Annual Report to Congress 70-84, 2010 Annual Report to Congress 128-48 (Most Serious Problem: *Inadequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered*); National Taxpayer Advocate 2011 Annual Report to Congress (Most Litigated Issue: *Appeals from Collection Due Process (CDP) Hearings Under Internal Revenue Code Sections 6320 and 6330 619*); National Taxpayer Advocate 2012 Annual Report to Congress 6 (Legislative Recommendation: *Amend IRC §§ 6320 and 6330 to Provide Collection Due Process Rights to Third Parties (Known as Nominees, Alter Egos, and Transferees) Holding Legal Title to Property Subject to IRS Collection Actions).*

6. Provide further guidance and examples of when the issuance of an Appeals Referral Investigation is appropriate, and limit the use of ARIs to obtaining additional documentation or facts, not analysis.
7. Update the Appeals IRM to provide significant guidance on CDP hearings, including reviewing the collection action, conducting the balancing test, and considering collection alternatives.
8. Require all Appeals Officers, Settlement Officers, and Appeals Account Resolution Specialists to take updated training on conducting the balancing test and applying the hazards of litigation.

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MSP #15 EXEMPT ORGANIZATIONS: The IRS Continues to Struggle with Revocation Processes and Erroneous Revocations of Exempt Status

RESPONSIBLE OFFICIAL

Sunita B. Lough, Commissioner, Tax Exempt & Government Entities Division

DEFNITION OF PROBLEM

The IRS's Exempt Organization (EO) unit receives about 60,000 applications for exempt status each year.[1] In addition, EO receives applications for reinstatement from organizations whose exempt status was automatically revoked. These applications added more than 50,000 cases to EO's workload over the past three years.[2] Already understaffed, EO did not allocate more resources to its Determinations Unit, which processes both initial and reinstatement applications. Its inventory backlog now stands at about 66,000 cases, more than the number of initial applications it usually receives in an entire year, four times the 2010 level, and more than triple the 2011 level.[3] Organizations consulting the "Where is My Exemption Application?" page on IRS.gov are informed that applications requiring review by an EO specialist take a year and a half just to be assigned.[4]

There is no procedure for administrative review of automatic revocations, yet EO uses automated systems that erroneously identify thousands of organizations as no longer exempt.[5] Planned programming changes will not avert future erroneous revocations. By erroneously listing an organization as having lost its tax exempt status, the IRS may cause the organization to lose funding it needs to survive and the effect may be community-wide.

In today's difficult economy and in light of long-term cuts in projected spending known as sequestration, exempt organizations are faced with a gap between an increasing need for their assistance and diminishing

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1 *Public Charity Organizational Issues, Unrelated Business Income Tax, and the Revised Form 990*, Hearing before the H. Comm. on Ways and Means, Subcomm. on Oversight, 112th Cong. 2nd Sess. (July 25, 2012) 2 (testimony of Steven T. Miller, Deputy Commissioner of Services and Enforcement, Internal Revenue Service), *available at* http://waysandmeans.house.gov/UploadedFiles/Miller_Testimony_7.25.pdf (noting that "We consistently receive about 60,000 applications for tax-exempt status each year. Most are requesting status under section 501(c)(3).").

2 Total EO determinations case receipts were 66,038 for fiscal year (FY) 2011; 79,362 for FY 2012; and 79,740 for FY 2013. IRS response to TAS fact check, referencing TE/GE's fourth quarter 2013 Business Performance Review (BPR) (Dec. 16, 2013).

3 TE/GE response to TAS information request (Nov. 12, 2013). FY 2010 open inventory consisted of 15,570 determinations cases. For FY 2011, the level was 20,603 cases. IRS response to TAS fact check, referencing TE/GE's fourth quarter 2013 Business BPR (Dec. 16, 2013). TE/GE's most recent BPR posted on its webpage is for the second quarter of FY 2012. *See* TE/GE BPR FY 2012: Second Quarter (May 23, 2012), *available at* http://tege.web.irs.gov/support/planning/planning.asp.

4 Where Is My Exemption Application?, *available at* http://www.irs.gov/Charities-&-Non-Profits/Where-Is-My-Exemption-Application (informing tax-pay as of Nov. 14, 2013, that EO was assigning applications it received in May of 2012). The web page was last updated on Sept. 23, 2013. Organizations consulting the more recently updated "Where's My Application?" page on IRS.gov are informed that the IRS might take up to six months after acknowledgthe application to either inform the applicant that the application has been approved or to request additional information. *See Where's My Application, available at* http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Where's-My-Application%3F (last vis-Dec. 17, 2013, showing the page had been updated Dec. 11, 2013). This new webpage was first available around Nov. 1, 2013. See Systemic Advocacy Management System submission 28938. Because six months have not yet elapsed since then, TAS cannot verify the reliability of the six-month estimate.

5 TE/GE estimates it erroneously treated about 9,000 organizations as having had their exempt status automatically revoked. TE/GE response to TAS information request (Nov. 12, 2013).

resources available to meet that need.[6] The single largest category of public charities deliver human services — they "provide networks of direct services to people in need. They feed our hungry, strengthen our communities, shelter our homeless, care for our elderly, and nurture our young."[7] When charities lose funds because they cannot obtain timely recognition of their exempt status, or are erroneously treated as no longer exempt, these vulnerable populations suffer the consequences.

ANALYSIS OF PROBLEM

The single largest category of public charities deliver human services… They feed our hungry, strengthen our communities, shelter our homeless, care for our elderly, and nurture our young.

Background

EO Has Struggled for the Past Decade to Process Its Inventory of Applications for Exempt Status, and Automatic Revocations Made the Problem Worse.

Since 2004, the National Taxpayer Advocate has reported on the increased number of applications for exempt status and the decrease in the number of EO employees who handle them.[8] Three of the past six Annual Reports to Congress identified the delay in processing applications for exempt status as among the Most Serious Problems.[9] EO's workload grew substantially in 2010, when it began notifying organizations their exempt status had been automatically revoked.[10] Many of these organizations applied for reinstatement, and they have done so in increasing numbers. EO, however, had projected a decrease in the number of applications for reinstatement over time. Figure 1.15.1 shows the relationship between EO's projected and actual receipts of reinstatement applications.

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6 Marcus Baram, *Filling The Gap: As Government Shrinks, Community Groups Seek Local Solutions*, The Huffington Post (May 2, 2012), *available at* http://www.huffingtonpost.com/2012/05/02/filling-the-gap-crisis-assistance_n_1379761.html; Annie Lowrey, *Government Giving Nonprofits Angst*, The New York Times (Nov. 7, 2013), *available at* http://www.nytimes.com/2013/11/08/giving/government-giving-nonprofits-angst.html?_r=0.

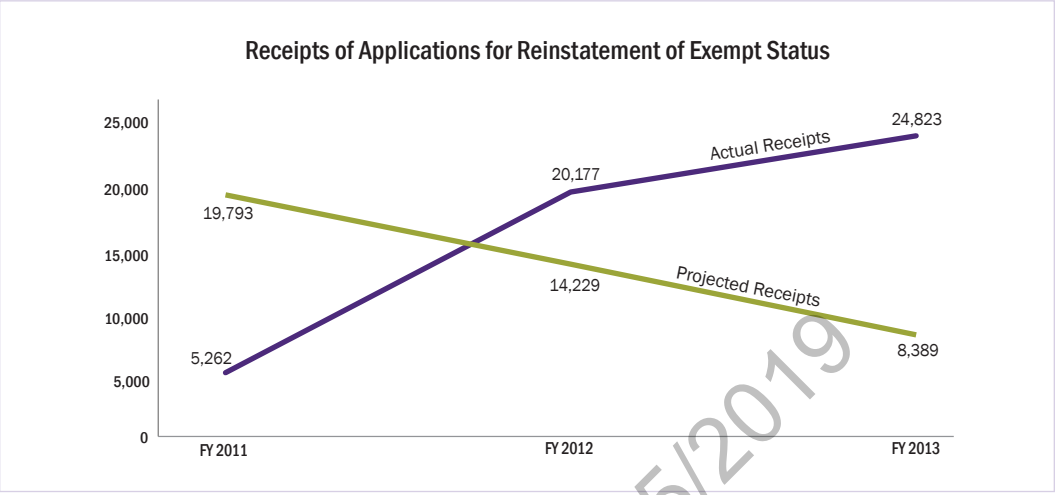
7 Charity Navigator, *available at* http://www.charitynavigator.org/index.cfm?bay=search.categories&categoryid=6; Sarah L. Pettijohn, Urban Institute, *The Nonprofit Sector in Brief 4* (2013), *available* at www.urban.org/UploadedPDF/412923-The-Nonprofit-Sector-in-Brief.pdf, noting that of 335,037 public charities reporting to the IRS in 2011, 116,643 (35 percent) were classified as part of the human services subsector.

8 National Taxpayer Advocate 2004 Annual Report to Congress 193, 203 (Most Serious Problem: *Application and Filing Burdens on Small Tax-Exempt Organizations*).

9 National Taxpayer Advocate 2012 Annual Report to Congress 192 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2007 Annual Report to Congress 210 (Most Serious Problem: *Determination Letter Process*).

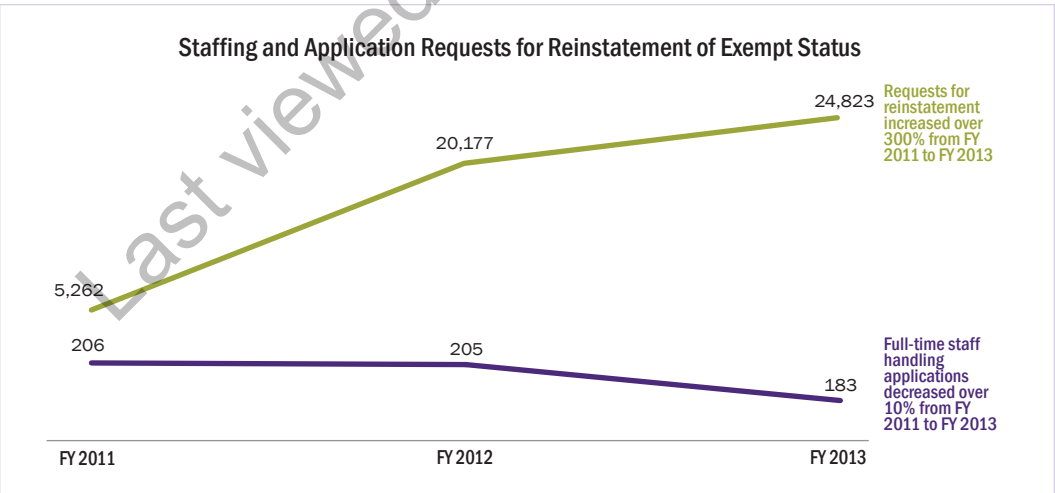
10 Section 1223 of the Pension Protection Act of 2006 (PPA) (Pub. L. No. 109-280, 120 Stat. 780 (2006)) imposed a new annual reporting requirement, Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt EOs Not Required to File Form 990 or 990-EZ*, on small exempt organizations and mandated automatic revocation of tax-exempt status of organizations that fail to file required returns or e-Postcards for three consecutive years.

FIGURE 1.15.1, Projected and Actual Receipts of Applications for Reinstatement of Exempt Status, FY 2011–2013[11]



EO and the IRS also ignored TAS's repeated warnings that EO was seriously understaffed to handle the influx of applications, with the result that applications continue to outstrip EO resources, as shown by Figure 1.15.2.[12]

FIGURE 1.15.2, Applications for Reinstatement of Exempt Status and Full-time Cincinnati Staff Handling the Applications FY 2011–2013[13]



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11 TE/GE response to TAS information request (Nov. 12, 2013). AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section, Oct 5, 2013, *available at* https://persinfo.web.irs.gov/track/workorg.asp.

12 EO does not assign specific employees to work only on applications for reinstatement. TE/GE response to TAS information request (Nov. 12, 2013).

13 TE/GE response to TAS information request (Nov. 12, 2013) noting that "all Exempt Organizations, Determinations (EOD) and Exempt Organizations, Technical (EOT) employees who work on applications may work on reinstatement requests" and "[t]he approximate number of employees in EOD working applications is 150. The approximate number of employees in EOT working applications is 30." TAS found that as of Oct. 5, 2013, there were 183 full-time Cincinnati Determinations staff. AWSS Employee Support Services, Payroll/Personnel Systems, HR Reporting Section, *available at* https://persinfo.web.irs.gov/track/workorg.asp.

EO's budget as a portion of TE/GE's budget hovered between 35 and 38 percent for FYs 2011-2013 and remained relatively stable in dollar terms, but EO's volume of open inventory (*i.e.*, total unresolved cases) more than tripled.[14] According to the "Where is My Exemption Application?" page on IRS.gov, applications that need development take 18 months to be assigned to a reviewer, up from the nine months cited in last year's Annual Report and the seven months cited in the 2011 Annual Report.[15]

Organizations affected by delays in obtaining recognition of exempt status include those that deliver human services such as food and shelter. Of public charities that report to the IRS, there are more in this category than in any other.[16] Increased need for their assistance coincides with reductions in the amount of government funds to meet the need, especially at the state and local levels. For example, according to a 2012 survey by the U.S. Conference of Mayors:[17]

- Over 80 percent of the survey cities reported an increase in requests for emergency food assistance over the past year and three fourths expect such requests to increase in the future.[18]
- Nearly half of the survey cities expect that resources to provide emergency food assistance will decrease over the next year.[19]
- More than half the survey cities reported an increase in the total number of persons experiencing homelessness and expect the number of homeless families to increase in the future.[20]
- More than half of the survey cities expect resources to provide emergency shelter to decrease over the next year.[21]

The difficulties organizations encounter in obtaining timely recognition of their exempt status directly affects the members of their communities most in need of assistance.

EO Erroneously Notified Thousands of Organizations Their Exempt Status Had Been Revoked. Since the first automatic revocations became effective in 2010, EO has notified about 550,000 organizations they are no longer exempt, with about 9,000 of these notifications being in error.[22] The IRS notes the loss of exempt status on an electronic list of organizations whose exempt status was automatically

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14 EO's budget equaled $98,759,800 or 35.6 percent of TE/GE's budget in FY 2011; $100,547,400 or 37.2 percent in FY 2012; and $97,154,000 or 38.1 percent in FY 2013; TE/GE response to TAS information request (Nov. 12, 2013). For FY 2011, the level of open inventory was 20,603 cases compared to the FY 2013 level projected to be 66,000 cases. IRS response to TAS fact check, referencing TE/GE's fourth quarter 2013 Business BPR (Dec. 16, 2013).

15 *See* National Taxpayer Advocate 2012 Annual Report to Congress 196 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 449; Where Is My Exemption Application?, *available at* http://www.irs.gov/Charities-&-Non-Profits/Where-Is-My-Exemption-Application (informing taxpayers that, as of Nov. 14, 2013, EO was assigning applications it received in May of 2012). The web page was last updated on Sept. 23, 2013.

16 Sarah L. Pettijohn, Urban Institute, The Nonprofit Sector in Brief 4 (2013), *available at* www.urban.org/UploadedPDF/412923-The-Nonprofit-Sector-in-Brief.pdf. Of the 335,037 public charities reporting to the IRS in 2011, 116,643 (35 percent) were classified as part of the human services subsector. The next largest category included the 58,568 educational organizations (17.5 percent of the total), followed by the 41,619 health organizations (12.4 percent of the total). All other classifications (arts, culture and humanities; environment and animals; international and foreign affairs; public and social benefit; and religion related) each accounted for less than 12 percent of the total.

17 The U.S. Conference of Mayors, Hunger and Homelessness Survey (Dec. 2012), *available at* http://usmayors.org/publications/.

18 *Id*., at 1-2, reporting that 82 percent of the cities reported an increase in requests for emergency food assistance and three fourths of the survey cities expect requests for emergency food assistance to increase over the next year.

19 *Id*., at 2, reporting that 48 percent expect that resources to provide emergency food assistance will decrease over the next year.

20 *Id*., at 2-3, reporting that 60 percent of the cities reported an increase in homelessness and 60 percent expect the number of homeless families to increase over the next year.

21 *Id,*. at 3, reporting that 58.5 percent of the cities expect resources to provide emergency shelter to decrease over the next year.

22 TE/GE response to TAS information request (Nov. 12, 2013); IRS response to TAS fact check (Dec. 16, 2013).

revoked and removes the organization from the list of organizations to which deductible contributions may be made. An organization will likely immediately suffer the consequences of being taken off the "right" list and placed on the "wrong" list, while it faces potentially lengthy timeframes in the reinstatement process. EO refuses to implement a review procedure that would avert these drastic consequences long enough to allow it to consider the possibility that the revocation might have been erroneous.[23] In the meantime, an organization may become ineligible for grants and may lose donor funding it needs to survive.

As described in last year's Annual Report, after the Treasury Inspector General for Tax Administration found a programming problem existed, EO identified more than 2,270 cases in which an organization was erroneously listed as having had its exempt status revoked, and 300 to 400 additional entities identified themselves as erroneously listed as revoked. The most common reason for the erroneous revocations was that IRS systems did not recognize subordinate organizations as part of a group return when the subordinates and the parent organizations had different accounting periods.[24]

The inventory backlog of applications for exempt status now stands at about 66,000 cases, more than the number of initial applications the IRS usually receives in an entire year, four times the 2010 level, and more than triple the 2011 level.

This year, EO reported to TAS additional programming conditions that caused erroneous revocations. As reported in the National Taxpayer Advocate's Fiscal Year 2014 Objectives Report to Congress, one programming change caused IRS computers to calculate the three-year nonfiling period that triggers automatic revocation only with reference to the date the organization obtained its Employer Identification Number (EIN).[25] An organization obtaining its EIN in 2007, for example, would be treated as having had reporting obligations since 2007, even if the organization commenced operations and obtained recognition of its exempt status only in 2011. Systemic review of filing activity would show three or more consecutive years of nonfiling (2007-2010) and EO would notify the organization that it was no longer exempt. EO does not track the number of organizations it treated as automatically revoked because of this issue.[26]

EO relies on affected organizations to come forward and seek relief, then rectifies an error by restoring the organization's exempt status on its databases and issuing a letter attesting to its exempt status.[27] In an effort to minimize erroneous revocations, EO plans to change its procedures by identifying taxpayers who, in the process of obtaining an EIN, indicate they are nonprofit organizations.[28] The IRS will then send these organizations that do not file returns Notice 259A. The notice does not actually remind (or inform)

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23 *See* National Taxpayer Advocate 2012 Annual Report to Congress 192, 202 (IRS Response: Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*).

24 *Id.* at 199.

25 National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 33 (June 30, 2013). An EIN is a nine-digit number assigned by the IRS to sole proprietors, corporations, partnerships, estates, trusts, and other entities for tax filing and reporting purposes. An organization requests an EIN by submitting IRS Form SS-4, *Application for Employer Identification Number (EIN)*. The form does not require that the organization already be operational. For example, the applicant may select "banking purpose" as the reason for applying for the EIN. Thus, a new organization might obtain an EIN, set up a business bank account, and then use a check or credit card from the business bank account to pay the incorporation fee imposed by the state in which the organization is created. The EIN application asks what type of entity the applicant is, and contains a box for "other nonprofit organization."

26 TE/GE response to TAS information request (Nov. 12, 2013).

27 TE/GE response to TAS information request (Nov. 12, 2013).

28 *Id*. This capability is expected to be available beginning in January of 2014.

When charities lose funds because they cannot obtain timely recognition of their exempt status, or are erroneously treated as no longer exempt, these vulnerable populations suffer the consequences.

the organization of its filing obligation, but is captioned simply "You didn't file a Form 990/990-EZ or Form 990-N." The recipient is told that if it did not file, it should respond to the letter, and EO believes that this may prompt organizations that do not have a filing requirement to contact the IRS.[29] However, the portion of the notice "If We Don't Hear From You" begins, "[b]ecause you have tax-exempt status, you must file Form 990/990-EZ or Form 990-N." An organization that does not (yet) have exempt status would likely conclude that the notice simply doesn't apply to it. Nothing in the notice or any other IRS communication alerts the taxpayer that as far as the IRS is concerned, the three-year nonfiling period for automatic revocations has begun.

EO's decision to continue to measure the three-year nonfiling period with reference to issuance of the EIN is essentially a business decision. EO reasons that because an organization generally has an annual filing requirement from the time it forms and generally obtains an EIN in conjunction with its legal formation, "the EIN establishment date is an appropriate, and the best available, metric from which to begin looking for filings."[30] We agree that this may be an accurate description of how events generally unfold, and we recognize the convenience of using the EIN establishment date as a point of reference. However, the National Taxpayer Advocate takes issue with the imposition of this general rule because it is coupled with EO's refusal to provide administrative review of automatic revocations. By computing the three-year nonfiling period with reference to the EIN date, EO is perpetuating erroneous revocations. Some taxpayers may obtain EINs without actually forming a legal entity or conducting any activity. These taxpayers would not, as a matter of law, have a filing obligation. Other taxpayers, as generic organizations, may obtain EINs, have no filing requirements, and only later become nonprofit organizations, yet the nonfiling period would start on the date the EIN was obtained. Because the best available metric also ensures continued error, EO should allow administrative review of automatic revocations that result from this business decision.

A related procedure unfairly penalizes organizations that do file for exempt status as soon as they obtain their EINs, namely EO's inclusion in the three-year nonfiling period the time an e-Postcard filer was waiting for EO to process its application for exempt status. It is impossible to submit an e-Postcard in that period without assistance from the IRS.[31] TAS's position, with which the IRS has not agreed, is that it is unfair to "count" any failure to file during this period as one of the three periods that triggers automatic revocation, when the Internal Revenue Code *requires* electronic filing of the postcard and the IRS has designed a system that makes it physically impossible for the EO to make such an e-filing on its own. EO expects to partially address this problem with the same change in its procedures described above. Taxpayers that indicate on their applications for an EIN that they are nonprofit organizations will be

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29 TE/GE response to TAS information request (Nov. 12, 2013).

30 *Id*.

31 One of the Frequently Asked Questions about exempt organizations' annual filing requirements is "Does an organization whose gross receipts are normally $25,000* or less have to file the *e-Postcard* if its application for tax exemption is pending?" The answer is "Yes, but to do so an officer of the organization must first call Customer Account Services at 1-877-829-5500 (a toll-free number) and ask that the organization be set up to allow filing of the *e-Postcard*." Exempt Organizations Annual Reporting Requirements — Annual Electronic Notice (Form 990-N): Frequently Asked Questions and Answers, *available at* http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Annual-Reporting-Requirements-Annual-Electronic-Notice-(Form-990-N):-Organization-With-Application-Pending-Must-File. Taxpayers who call the number cited above can expect to wait 17 minutes to speak to an IRS employee. The level of service (the percentage of callers requesting a customer service representative who received assistance) is 68.58 percent. TE/GE response to TAS information request (Nov. 12, 2013).

able to file a return or e-Postcard without assistance from the IRS.[32] This solution will not help taxpayers whose EIN applications do not show they are nonprofits. As noted above, it also does not help taxpayers who, although they have an EIN, have not commenced operations or do not respond to the IRS's notice because they do not believe it applies to them.

A separate programming change affected reinstated organizations. IRS databases did not show that organizations whose exempt status had been reinstated had a new three-year automatic revocation period. This caused the IRS to revoke exempt status a second time shortly after granting reinstatement.[33] The IRS does not know how many organizations it treated as automatically revoked because of this change.[34] While the IRS has resolved the problem for many of these organizations, it does not know how many it may have overlooked.[35] EO requested programming changes that will essentially suspend the three-year nonfiling period while the organization's exempt status remains automatically revoked. If approved, the changes will be implemented in January of 2015.[36] As the National Taxpayer Advocate has repeatedly pointed out, administrative review of all *proposed* automatic revocations (rather than the current ad hoc and nonpublic approach) would likely have averted many errors.[37]

CONCLUSION

EO's inventory backlog, which now exceeds the number of initial applications it usually receives in an entire year, burdens taxpayers who must wait for 18 months for their applications to be assigned to an analyst. Thousands of organizations were forced to cope with EO's troubled inventory management only because EO erroneously treated them as having had their exempt status automatically revoked and they were required to apply for reinstatement. EO is aware that measuring the three-year nonfiling period with reference to the EIN date causes erroneous revocations, yet it intends to retain that practice. It does not adequately inform organizations how the practice may affect them or provide organizations any way to seek administrative review of automatic revocations.

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32 TE/GE response to TAS information request (Nov. 12, 2013). In fact, as described above, the IRS will issue these taxpayers notice CP 259A to notify them they did not file a return.

33 Upon learning that EO programming was causing erroneous revocations, TAS issued guidance to its employees explaining how to identify and advocate for taxpayers who come to TAS with these problems.

34 TE/GE response to TAS information request (Nov. 12, 2013).

35 *Id*.

36 *Id*.

37 National Taxpayer Advocate 2012 Annual Report to Congress 192 (Most Serious Problem: *Overextended IRS Resources and IRS Errors in the Automatic Revocation and Reinstatement Process Are Burdening Tax-Exempt Organizations*); National Taxpayer Advocate 2011 Annual Report to Congress 442 (Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Revocation Unnecessarily Burdensome*); National Taxpayer Advocate 2011 Annual Report to Congress 562 (Legislative Recommendation: *Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant*).

RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Issue a letter informing the organization when the IRS proposes to treat it as having had its exempt status automatically revoked and providing an opportunity to correct the condition that caused the proposed automatic revocation within 30 days. The letter should specify the availability of administrative review for organizations raising concerns that the IRS is proceeding in error.
2. When notifying organizations that they did not submit a required return or e-Postcard, inform them that EO calculates the three-year nonfiling period using the date the organization obtained its EIN. Advise them to contact EO if its use of the EIN date may result in an erroneous revocation.
3. Do not include in the three-year nonfiling period for purposes of automatic revocations any period for which an organization could not submit an e-Postcard without contacting the IRS.

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MSP #16 REVENUE PROTECTION: Ongoing Problems with IRS Refund Fraud Programs Harm Taxpayers by Delaying Valid Refunds

RESPONSIBLE OFFICIALS

Jodi Patterson, Director, Return Integrity and Correspondence Services
Mary Howard, Director, Privacy, Governmental Liaison and Disclosure
Debra Holland, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

Return integrity programs are designed to detect and prevent civil fraud in tax returns before the IRS issues refunds to taxpayers, as part of the overall revenue protection strategy. The National Taxpayer Advocate identified problems with these programs as early as 2005. However, despite improvements, issues within the return integrity strategies persist and continue to harm taxpayers.[1]

- The IRS eliminated the Pre-Refund Program Executive Steering Committee (ESC) at the end of fiscal year (FY) 2012. This left no overarching governance of the design or implementation of revenue protection strategies or filters to detect fraud, and inhibited an integrated approach, resulting in potentially duplicative or over-inclusive filters.
- Filters delayed 308,868 refunds due to "false positive" signs of fraudulent activity in filing season 2013.[2]
- If certain letters informing taxpayers of the status of refunds caught in filters are returned as undeliverable, the IRS destroys them, and the taxpayers may never learn the status of their cases or receive their refunds.[3]
- Many taxpayers caught in the Automated Questionable Credit (AQC) program do not receive letters informing them of the status of their accounts and what to do next.[4]
- Taxpayers caught in the bank/external leads program only received letters informing them that their financial institutions could not process their direct-deposit refunds from the IRS and to allow an additional ten weeks to receive them in about 12 percent of cases.[5]

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1 See National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*).

2 IRS Return Integrity & Correspondence Services (RICS), Update of the Taxpayer Protection Program (TPP) (Oct. 31, 2013); IRS Return Integrity & Correspondence Services (RICS), Update of the Taxpayer Protection Unit (TPU) (Oct. 31, 2012).

3 IRM Exhibit 3.13.62-55 (May 10, 2013) and IRM 25.25.5.5 (Oct. 1, 2013). The letters classified as "just destroy" are the CP05 (*We're holding your refund until we finish reviewing your tax return*), CP05A (*We need more information to determine whether you're due a refund*), 4115C (*Information Regarding Your Refund*), and 4464C (*Questionable Refund 3rd Party Notification*).

4 IRS response to TAS research request (Oct. 15, 2013). As of October 15, 2013 RICS had issued 82,109 4800C letters and has 111,670 cases in inventory.

5 Refund Fraud & ID Theft Global Report, July 2013; CP 53A, A *Message About Your Request*, for an Electronic Deposit Refund, SNIP CP53A data as of cycle 201344. Through September 30, 2013, the Refund Fraud & ID Theft Global Report reports bank/external leads affecting 171,189 accounts, but the IRS sent only 20,409 letters to taxpayers.

- TAS receipts of Integrity Verification and Operation (IVO) cases have increased over 45 percent for the year to date from FY 2012 to FY 2013.[6]
- In about 80 percent of cases closed in FY 2013, taxpayers who contacted TAS about delayed refunds flagged by the Electronic Fraud Detection System (EFDS) received full or partial relief from the IRS.[7]
- The IRS's failure to implement the new Return Review Program (RRP) on schedule could lead to a crash of EFDS until the aged system could be repaired, which would force the IRS to decide whether to stop issuing refunds in the event of crash, or issue billions of dollars in potentially fraudulent refunds without screening.[8]

The continued failure of the IRS to address problems in return integrity programs burdens taxpayers who filed legitimate returns, but have been wrongly ensnared in a myriad of filters from various units of the IRS.[9] The failure of these units to coordinate may result in duplicate, over-inclusive, and unnecessary filters that are not routinely reviewed for accuracy or continued need. With the elimination of the return integrity steering committee, problems associated with fraud detection filters will not be discussed at a servicewide level and may create additional burden.

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ANALYSIS OF PROBLEM

Background

The return integrity process is complex and multifaceted. A tax return must travel a long path with many potential roadblocks before the IRS accepts it as filed. The main goal of IVO is to stop fraudulent refunds before they are issued by identifying potentially false returns, usually through wages or withholding reported on the returns. The IRS does this primarily with the Electronic Fraud Detection System, which was built in the 1990s. EFDS runs all individual tax returns through various filters to identify characteristics that may indicate a high risk of fraud.[10]

Once EFDS completes the initial screening and flags a return as having a high likelihood of fraud, the IRS freezes the taxpayer's refund for 11 weeks so IVO can attempt to verify wages and withholding. The IRS sends a letter to the taxpayer explaining that income, withholding, or tax credits are being reviewed and the refund is being held pending this review.[11]

6 Data obtained from Business Performance Management System (BPMS) (Oct. 1, 2012; Oct. 1, 2013). IVO is an IRS unit within the Wage and Investment (W&I) operating division, the purpose of which is to support civil fraud detection and prevention. TAS received 18,012 cases in FY 2012 and 26,136 cases in FY 2013.

7 Data obtained from BPMS (Oct. 1, 2013).

8 Privacy Impact Assessment (PIA) 250 (Oct. 2, 2012), *available at*: http://www.irs.gov/pub/irs-utl/RRP_TS_pia.pdf. A PIA is a process for examining the risks and ramifications of using information technology to collect, maintain and disseminate information in identifiable form about members of the public and agency employees.

9 Filters are created and implemented by at least three distinct IRS units: Criminal Investigation (CI); Privacy, Governmental Liaison and Disclosure (PGLD); and RICS.

10 Based on prior years' returns, including those involving "verified" fraud, models are built and implemented for detecting fraud. Incoming returns requesting refunds are passed through the knowledge base and scored for likelihood of fraud. Returns that are flagged are diverted into a workload for further inspection before any refund is issued. IRS, Kenneth A. Kaufman, *An Analysis of Data Mining in the Electronic Fraud Detection System* (Apr. 28, 2010).

11 Notice CP 05, *Information Regarding Your Refund*.

One way the IRS attempts to verify information during this period is to compare it with the Information Returns Master File (IRMF). The IRMF is populated with third-party reporting data such as wage and withholding reported on Form W-2, *Wage and Tax Statement*, and most Forms 1099, *U.S. Information Return*.[12] If the return information cannot be automatically verified through the IRMF database, the next step is manual verification. IVO employees will attempt to contact the employers listed on the return to verify the wages and withholdings reported.[13] If the employer verifies the information and IVO is satisfied that the return is valid, the IRS will release the refund.

If certain letters informing taxpayers of the status of refunds caught in filters are returned as undeliverable, the IRS destroys them, and the taxpayers may never learn the status of their cases or receive their refunds.

The IRS formed an Information Returns Acceleration team in 2012 to develop a way for the IRS to obtain W-2 information from the Social Security Administration (SSA) earlier in the processing season to verify wages claimed on returns with information reported by payors. The team also continued to utilize the Disc program, where multiple major employers submit a copy of W-2 data directly to the IRS by mid-March to allow the IRS to match potentially fraudulent information returns to the employer database. Both programs are a step in the right direction by allowing the IRS to verify income and withholding information before releasing a refund.

If IVO cannot verify the return information through IRMF or employer contact, the IRS sends a letter to the taxpayer requesting documentation to substantiate the information.[14] Finally, if IVO cannot verify the return information before the 11-week hold expires, the IRS will make the hold permanent.[15]

A taxpayer caught in a variety of filters may believe he or she has been audited multiple times.

- A return could possess certain characteristics of identity theft and be stopped by the Taxpayer Protection Program (TPP) until the taxpayer verifies that he or she is not an identity thief;[16]
- The same return could then be selected for a pre-refund audit of a claimed Earned Income Tax Credit (EITC); or
- A return can be selected for income and withholding verification, and then also be audited.

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12 Under present law, issuers who file these forms electronically have until March 31 to file them with the government. Issuers send Forms 1099 directly to the IRS and Forms W-2 directly to the Social Security Administration (SSA), which in turn sends information extracted from the forms to the IRS each week, starting in late March. Internal Revenue Code (IRC) §§ 6051(a), 6049(a), 6042(a); *see IRS Instructions for Forms W-2 and W-3, Wage and Tax Statement and Transmittal of Wage and Tax Statements*; Social Security Administration, *Employer W-2 Filing Instructions & Information, available at* http://www.ssa.gov/employer/gen.htm (last visited Oct. 24, 2012). For a more detailed discussion of third- party information reporting and its uses, see National Taxpayer Advocate 2012 Annual Report to Congress (Status Update: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*).

13 IRM 21.9.1.8(1) (May 4, 2012). The IRS employs several methods to contact employers for verification of wages, adhering to the employer preference if one exists. Letters are sent annually to certain large employers, requesting them to provide wage information on a computer disc. Requests for verification are automatically generated by fax; phone calls are made based on employer preference.

14 IRM 21.9.1.8(1) (May 4, 2012). Letter 4115 requests income documentation from the taxpayer/employee (*e.g.*, copies of checks, bank statements, pay statements, check stubs, and employer letters).

15 Email from AMTAP analyst (Sept. 28, 2011).

16 IRM 21.9.1.14, *Taxpayer Protection Program* (June 4, 2013). For a full discussion of the National Taxpayer Advocate's concerns about identity theft, see Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers, supra*.

The lack of integration of IRS filters can create multiple delays in releasing the refund and significantly increase taxpayer burdens and frustration with the IRS.

The National Taxpayer Advocate Continues to Identify Return Integrity Programs as a Most Serious Problem.

Return integrity programs first made the National Taxpayer Advocate's list of the most serious problems facing taxpayers in 2005 and were discussed in a corresponding research study.[17] The National Taxpayer Advocate has recommended many improvements to limit the burden these programs cause for taxpayers seeking legitimate refunds, while still protecting the IRS's very valid need to reduce and prevent fraud. While the IRS has altered return integrity programs and strategies, it has failed to implement many of these recommendations.[18]

TAS monitors the IRS's progress on all recommendations in the National Taxpayer Advocate's Annual Reports to Congress, documenting whether the IRS agreed to take action and what it has done. In the three reports where various return integrity programs were cited as most serious problems facing taxpayers, the National Taxpayer Advocate made 21 recommendations to improve the programs.[19] The IRS agreed to fully or partially implement nine of the 14 recommendations in the 2011 and 2012 Annual Reports and declined to accept five others.[20]

The National Taxpayer Advocate Disagrees with the Elimination of the Pre-Refund Program Executive Steering Committee.

The IRS eliminated the Pre-Refund Program Executive Steering Committee at the end of FY 2012. This left the IRS with no overarching governance of the design or implementation of revenue protection strategies or filters and inhibited an integrated approach, resulting in potentially duplicative or over-inclusive filters. The committee provided a forum where decision makers from various parts of the IRS could not only inform other areas of new programs, but also allowed the parties to raise concerns. It provided the IRS, including TAS, a forum to work as one to identify and prevent fraud. Dismantling the ESC was a step in the wrong direction. By not addressing fraud globally and in a collaborative manner, the IRS is missing opportunities to share information and prevent innocent taxpayers from being caught in fraud filters.

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17 See National Taxpayer Advocate 2005 Annual Report to Congress (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (Criminal Investigation Refund Freeze Study).

18 See National Taxpayer Advocate 2005 Annual Report to Congress (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2011 Annual Report to Congress (Most Serious Problem: *The IRS's Wage and Withholding Verification Procedures May Encroach on Taxpayer Rights and Delay Refund Processing*); and National Taxpayer Advocate 2012 Annual Report to Congress (Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters*).

19 See National Taxpayer Advocate 2005 Annual Report to Congress (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2011 Annual Report to Congress (Most Serious Problem: *The IRS's Wage and Withholding Verification Procedures May Encroach on Taxpayer Rights and Delay Refund Processing*); and National Taxpayer Advocate 2012 Annual Report to Congress (Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters*).

20 Annual Report to Congress 2011 Report Card, *available at* http://www.irs.gov/Advocate/Annual-Report-to-Congress-Report-Cards. The seven recommendations made in the 2005 Annual Report to Congress were not reported and tracked in the same manner as the TAS tracking system was not implemented until 2007. The IRS now responds in a standardized manner to Annual Report to Congress recommendations. Therefore, only information on the 14 recommendations in the 2011 and 2012 Annual Reports to Congress is available. (The 2012 Report Card is not finalized, will provide link and potentially update numbers when it is available.)

Taxpayers are Harmed by Various Uncoordinated Return Integrity Strategies.[21]

The Automated Questionable Credit (AQC) program may be confusing to taxpayers.

In November 2011, RICS developed and implemented a streamlined statutory notice of deficiency pilot program — the AQC. AQC expanded the IRS's use of automation to prevent improper refunds of questionable withholding and refundable credits.[22] TAS identified and elevated areas of concern, including the possible expansion of math error authority. Significant concerns included a statement in the initial AQC letter to taxpayers that the inquiry is not an audit and the IRS may examine the return again later, leaving the taxpayer with little certainty.[23]

As of October, 2013 RICS had issued over 80,000 4800C letters but has nearly 112,000 cases in inventory received through AQC.[24] TAS reviewed 50 of these cases from TAS inventory; of those, only 16 taxpayers received the 4800C letter informing them of the actions proposed for their accounts and the next steps the taxpayers needed to take.[25]

External Leads Program burdens taxpayers

In 2011, RICS implemented the External Leads Program, which is responsible for receiving and processing informational leads and funds returned by partner financial institutions and various other sources because the funds were deemed questionable. External leads may involve Treasury checks, direct deposits/Automated Clearing House, refund anticipation loans or checks, and pre-paid debit cards. The program receives leads from over 130 external sources as well as internal leads from throughout the IRS.[26]

Within approximately 15 business days of receiving an external lead, RICS employees begin their research to determine the validity of the refund and will advise the financial institution to return the funds if it cannot determine the refund was valid.[27] The RICS employee is not required to notate the taxpayer's account to show the interception of the refund, and only in limited circumstances must notify the taxpayer before the financial institution returns the funds to the IRS.[28] Consequently, if the taxpayer contacts the IRS about his or her refund, a Customer Service Representative (CSR) cannot identify RICS involvement by reviewing the main tax account database or provide any guidance on what the IRS is doing. In most instances, the CSR refers the taxpayer back to the financial institution, even though it was the IRS that decided the funds must be returned. Additionally, financial institutions are advised to inform their account holders that:

> Since it takes several weeks for funds to be processed through accounting, [IRS] phone assistors may not have information regarding the returns. Once appropriate research has been conducted, taxpayers should receive further correspondence from the IRS in most cases.

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21 For a discussion of the National Taxpayer Advocate's concerns regarding identity theft fraud programs, see Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers, supra*.

22 TAS, Business Performance Review First Quarter FY 2012.

23 IRS, 4800C, *Questionable Credit 30 Day Contact Letter*.

24 IRS response to TAS research request (Oct. 15, 2013). As of October 15, 2013 RICS had issued 82,109 4800C letters and has 111,670 cases in inventory.

25 TAMIS data, June 12, 2013.

26 Publication 5033, *External Leads Guidelines* (Feb. 2013).

27 *Id*.

28 IRM 25.25.8.2 (Oct. 29, 2013). A notation on the account could be made in Integrated Data Retrieval System (IDRS), the IRS system that allows employees to see activity on taxpayers' accounts, to inform employees of the status of a refund intercepted through the external leads program.

> When receiving inquiries, account holders can be advised that funds have been returned to the IRS; however, it takes 6-8 weeks before account information is readily available. There is not a specific IRS phone line for these inquiries.[29]

Through September 30, 2013, the Refund Fraud & ID Theft Global Report reports bank/external leads affecting 171,189 accounts, resulting in $441,834,298 in stopped refunds.[30] However, the IRS sent only 19,985 letters to taxpayers to tell them that their financial institutions could not process their direct-deposit refunds and to allow an additional ten weeks.[31] RICS also had to alert CSRs to stop referring taxpayers back to their financial institutions.[32]

Undelivered mail procedures may mean taxpayers never learn about refund delays.

When corresponding with a taxpayer, the IRS uses the "address of record," which is generally the address given on the taxpayer's last return.[33] When the IRS sends a notice or document to a "last known address," it is legally effective even if the taxpayer never receives it.[34] The IRS issues several important refund status notices following the last known address rule.[35] If a preparer makes a mistake in entering the address, or the taxpayer moves without leaving a forwarding address, the IRS will destroy the undelivered letters upon their return. This means the taxpayer never learns that his or her return is under review and has no chance to prove the wages and withholding are valid.[36]

Often, however, the IRS already has the correct address in its records and could resolve the issue with a simple review. For example, if a preparer makes a transposition error on the house number, the notice will be returned as undeliverable. However, the taxpayer may have filed from the same address for several years, so by checking the address history the IRS could easily correct the address and resend the notice, thus providing the taxpayer an opportunity to provide supporting documentation. By reclassifying these letters so employees would conduct further research when they come back as undeliverable, the IRS could direct them to the proper addresses.[37]

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29 Publication 5033, External Leads Guidelines, Rev. 02-2013.

30 IRS, *Refund Fraud & ID Theft Global Report* (Sept. 2013).

31 CP 53A, A Message About Your Request for an Electronic Deposit Refund, SNIP Notice Volume through Oct. 5, 2013 (Cycle 40).

32 Servicewide Electronic Research Program (SERP) Alert 13A0407, *Direct Deposit Reject Calls Related to Reason Code* 17 (June 27, 2013).

33 IRS policy requires the taxpayer to provide "clear and concise" notice of any change of address during telephone calls with the IRS, in correspondence submitted to the IRS, or through a change of address filed with the U.S. Postal Service (USPS) and transmitted to the IRS via the National Change of Address (NCOA) system. Treas. Reg. § 301.6212-2: Definition of Last Known Address; Rev. Proc. 2010-16.

34 Treas. Reg. § 301.6212-2; Rev. Proc. 2010-16.

35 Notices classified as "just destroy" informing taxpayers of the status of their refunds caught in fraud filters include CP05 (*We're holding your refund until we finish reviewing your tax return*), CP05A (*We need more information to determine whether you're due a refund*), 4115C (*Information Regarding Your Refund*), and 4464C (*Questionable Refund 3rd Party Notification*).

36 IRM 3.13.62-55 (May 10, 2013); IRM 25.25.5.5 (Oct. 1, 2013). The letters classified as just destroy are the CP05 (*We're holding your refund until we finish reviewing your tax return*), CP05A (*We need more information to determine whether you're due a refund*), 4115C (*Information Regarding Your Refund*), and 4464C (*Questionable Refund 3rd Party Notification*).

37 For a full discussion of the National Taxpayer Advocate's concerns regarding undelivered mail, see National Taxpayer Advocate 2012 Annual Report to Congress (Status Update: *Underfunding IRS Initiatives to Modernize Its Taxpayer Address Correspondence Systems Undermines Taxpayers' Statutory Rights and Impedes Efficient Resource Allocation*) and National Taxpayer Advocate 2010 Annual Report to Congress (Most Serious Problem: *The IRS Has Not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*). One of the National Taxpayer Advocate's primary recommendations to address the problems created by undelivered mail is for the IRS to create a single unit responsible for processing all undelivered mail, including searches for a better taxpayer address. This would provide an IRS-wide solution and strategy to address undelivered mail.

Delays in implementation of the Return Review Program may result in harm to the government and taxpayers.

The Electronic Fraud Detection System is the IRS's primary frontline system for detecting fraudulent returns. Although it assisted the IRS in successfully preventing the release of over $18 billion in fraudulent refunds,[38] the Treasury Inspector General for Tax Administration (TIGTA) has estimated the IRS still may have paid $5.2 billion in potentially fraudulent tax refunds on 1.5 million returns in tax year 2010.[39] The IRS has declared EFDS "too risky to maintain, upgrade, or operate beyond 2014."[40]

TAS has identified multiple instances where the case was lost in transit, thus imposing severe burden on the taxpayer and significantly delaying resolution.

In 2009, the IRS began developing the Return Review Program (RRP) to replace EFDS; Congress approved $54 million for IRS Information Technology (IT) to establish the RRP. RRP is expected to enhance revenue by $28.8 million per year when fully implemented, and its estimated five-year rate of return is 15,800 percent. More simply put, the IRS estimates it will recoup over $15,000 for every dollar spent.[41] RRP also will automate a variety of tasks, many of them manual, that employees now perform. For example, today when a case is referred for an audit, employees enter data on a spreadsheet, which is then transferred to headquarters personnel who open and assign the case. TAS has identified multiple instances where the case was lost in transit, thus imposing severe burden on the taxpayer and significantly delaying resolution.

Despite estimated high levels of return, significant monetary investment, and a huge resource investment in teams and development of system requirements, the IRS is now forced to consider non-deployment or a limited deployment of RRP. On January 15, 2013, IT reported it did not have enough resources to bring RRP online by the January 1, 2015 deadline.[42]

Not deploying the RRP as intended could impose significant harm and cost on both the IRS and the public. A failure of the EFDS system, which according to a 2010 IRS statement is becoming increasingly likely, would force the IRS to decide whether to stop issuing refunds until the system could be repaired, or issue billions of dollars in potentially fraudulent refunds without screening.[43] In addition, as EFDS becomes harder to update and maintain, it could erroneously stop an increasing number of valid refunds. The lack of automation to handle administrative adjustments and actions is straining the IRS's limited resources as fraud and identity theft grow and staffing declines.

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38 IRS, *W&I Business Performance Review* (Nov. 14, 2012).

39 TIGTA, Ref. No. 2013-40-015, *Improper Payments Elimination and Recovery Act Risk Assessments of Revenue Programs Are Unreliable* (Jan. 31 2013).

40 Privacy Impact Assessment (PIA) 250 (Oct. 2, 2012). http://www.irs.gov/pub/irs-utl/RRP_TS_pia.pdf. A PIA is a process for examining the risks and ramifications of using information technology to collect, maintain and disseminate information in identifiable form about members of the public and agency employees.

41 Wage & Investment Division Summary of Proposed FY 2013 Budget Initiatives (as of Feb. 1, 2011).

42 Email from Supervisory Tax Analyst, Wage & Investment, Business Modernization dated Jan. 15, 2013.

43 Privacy Impact Assessment (PIA) 250 (Oct. 2, 2012). http://www.irs.gov/pub/irs-utl/RRP_TS_pia.pdf.

Service to Taxpayers Ensnared by Filters Continues to Decline.

Over the last three years, TAS has seen a significant increase in wage verification cases. In FY 2011, TAS received just over 21,000 such cases; in FY 2013 the number rose to more than 26,000.[44] Cases involving taxpayers facing an economic burden increased 111 percent during that time.[45] This increase shows that although the wage verification unit tries to get innocent taxpayers out of the process as fast as possible, it still holds up many refunds when a filter inadvertently catches a valid return.

The number of taxpayers who came to TAS seeking and received the release of IVO refund holds shows the IRS continues to impose significant delays on innocent taxpayers. The percentage of taxpayers who received full or partial relief after contacting TAS, has increased from 75 percent in FY 2012 to 80 percent in FY 2013.[46]

According to the IRS, the Taxpayer Protection Program (TPP) stopped 1,039,000 refunds with a false positive rate of 29.7 percent in FY 2013, compared to 402,000 refunds stopped in FY 2012 with a false positive rate of 17.7 percent.[47] The significant growth in refunds stopped correlates to an increase in the number of filters the TPP uses, from 11 in FY 2012 to more than 80 in the FY 2013 filing season.[48] The increase in innocent taxpayers being caught in the filters has significantly taxed the TPP's ability to respond to taxpayer inquiries. Overall, fewer than six of ten calls to the TPP reached a live assistor for help, and only after waiting an average of almost 21 minutes.[49]

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CONCLUSION

The National Taxpayer Advocate recognizes the need for return integrity strategies and the importance of automated filters to screen returns for potential fraud. However, automated screens will never achieve perfection. The IRS must remain cognizant of the taxpayers who are innocently caught by these screens and work diligently to timely resolve their cases and adjust filters. Dismantling the Pre-Refund Executive Steering Committee was a step in the wrong direction, contravening IRS efforts to work globally to address screening returns, and eliminating the opportunity for separate IRS functions, including TAS, to work together. This action further handicaps the development and refining of filters, thereby not only jeopardizing revenue but also the legitimate taxpayers whose returns are dragged into this process.

44 Data obtained from BPMS, Oct. 1, 2011; Oct. 1, 2013. TAS received 21,286 cases in FY 2011 and 26,136 in FY 2013.

45 *Id*. Economic burden cases increased 111.2 percent from FY 2011 to FY 2013.

46 Data obtained from BPMS, Oct. 1, 2012; Oct. 1, 2013.

47 IRS Return Integrity & Correspondence Services, *Update of the Taxpayer Protection Program (TPP)* (Oct. 31, 2013); *Update of the Taxpayer Protection Unit (TPU)* (Oct. 15, 2012).

48 TIGTA, Ref. No. 2013-40-083, *Income, and Withholding Verification Processes Are Resulting in the Issuance of Potentially Fraudulent Tax Refunds* (Aug. 7, 2013).

49 Joint Operations Communications (JOC) Executive Level, Taxpayer Protection Program (TPP) performance report (Sept. 28, 2013).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Reinstate the Pre-refund Executive Steering Committee or form a new, similar committee with TAS as a charter voting member.
2. Perform regular global reviews and updates of all return integrity filters.
3. Introduce a computer code to indicate that a refund is under investigation through the bank leads program.
4. Reclassify the letters intended to inform taxpayers of the status of a refund caught by filters from "just destroy" to "perform further research" when they are returned as undeliverable.

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MSP #17 ACCURACY RELATED PENALTIES: The IRS Assessed Penalties Improperly, Refused to Abate Them, and Still Assesses Penalties Automatically

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division
William J. Wilkins, Chief Counsel

DEFINITION OF PROBLEM

In 2012, in a reversal of prior advice, the IRS Office of Chief Counsel determined that the IRS was not authorized to impose an accuracy-related penalty under Internal Revenue Code (IRC) § 6662 against taxpayers for claiming refundable credits that it had frozen (*i.e.*, not actually paid or credited to the account).[1] Yet, the IRS declined to identify and abate (or refund) more than $40 million in penalties that it imposed against more than 46,000 taxpayers prior to changing its position.[2] The IRS's failure to expend the resources needed to remove these improper and inapplicable penalties signals disrespect for the law and a disregard for taxpayer rights, which in turn, is likely to reduce voluntary tax compliance.[3]

The IRS's decision not to abate inapplicable penalties illustrates its resource-driven approach to them. As described in prior reports, the IRS continues to propose penalties automatically when they might apply — before performing a careful analysis of the relevant facts and circumstances — and then burdens taxpayers by requiring them to prove the penalties do not apply.[4] For example, in fiscal year (FY) 2012 the IRS sent over 93,000 (CP 2000) letters as part of its matching program, which proposed nearly $100 million in accuracy-related penalties without first contacting the taxpayers to determine the reason for the apparent mismatch.[5] Thus, contrary to congressional intent, the IRS automatically *assumes* the taxpayer acted negligently and places the burden on the taxpayer to prove otherwise.[6]

In particular, this automated approach imposes a disproportionate burden on unsophisticated taxpayers who have difficulty communicating with the IRS or do not understand the relevant facts and legal rules. The National Taxpayer Advocate is concerned the IRS may take the same automated approach to the new penalty under IRC § 6676, which applies to excessive claims for credit or refund.

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1 Program Manager Technical Advice (PMTA) 2012-16 (May 30, 2012) (concluding that the claim for a refund that is frozen by the IRS does not give rise to an underpayment, as defined in IRC § 6664, to which an accuracy-related penalty could apply).

2 IRS Compliance Data Warehouse, Individual Master File (Nov. 26, 2013).

3 Research suggests that sole proprietors who believe the government, the IRS, and the tax laws are fair are more likely to comply. *See* National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-28. *Accord* National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, *infra (Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?)*; IRM 20.1.1.1.3(4) (Dec. 11, 2009) ("A wrong [penalty] decision, even though eventually corrected, has a negative impact on voluntary compliance.").

4 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 275; National Taxpayer Advocate 2010 Annual Report to Congress 198; Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*, *infra/supra*.

5 IRS Compliance Data Warehouse, Individual Master File (Nov. 26, 2013) (excluding taxpayers who first received CP 2501, which the IRS sometimes uses to inquire about an apparent discrepancy). Moreover, the IRS abated about 20 percent of the tax it assesses through AUR in FY 2012. IRS Compliance Data Warehouse, Individual Master File (Dec. 17, 2013).

6 *See* H.R. Rep. No. 101-386, at 661 (1989) (Conf. Rep.) (directing the IRS to "make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later.").

The National Taxpayer Advocate is concerned the IRS may take the same automated approach to the new penalty under IRC § 6676, which applies to excessive claims for credit or refund.

ANALYSIS OF PROBLEM

A refundable credit claim can give rise to an "underpayment" triggering an accuracy-related penalty, according to the IRS.

A taxpayer who submits a return that is not accurate (*i.e.*, reflects an "underpayment") may be subject to an accuracy-related penalty under IRC § 6662. For example, the penalty may apply if the error is "substantial" or if the IRS determines the taxpayer was negligent. Generally, an "underpayment" is W - (X+Y-Z) where:

- W = the correct amount of tax required to be shown on the return;
- X = the tax reported (actually shown) on the return;
- Y = the amount not shown, but previously assessed (or collected without assessment); and
- Z = certain rebates.[7]

It has long been unclear whether or how refundable credits, such as the Earned Income Tax Credit (EITC), the First-Time Homebuyer Credit, (FTHBC), the Additional Child Tax Credit (ACTC), and the Economic Stimulus Payment (ESP) are included in this computation, or how the analysis changes if the IRS has refunded, credited, or frozen these credits.[8] However, the IRS has taken the position that a refundable credit claim can produce an underpayment, and if the underpayment is attributable to a substantial understatement or negligence, the IRC § 6662 penalty applies.[9] In general, the IRS believes these claims reduce the amount shown on the taxpayer's return (X, above).[10] Thus, it continues to impose substantial understatement penalties against taxpayers who make improper credit claims (provided they are not frozen, as discussed below).

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7 IRC § 6664(a)(1)-(2); Treas. Reg. § 1.6664-2(a)(1)-(2).

8 *See, e.g.*, TAM 2841039058 (Mar. 21, 1998) (acknowledging disagreements between Examination and Counsel); SCA 200113028 (Feb. 26, 2001) (concluding penalty is applicable on frozen EITC refunds, but acknowledging a contrary conclusion in prior advice); *Akhter v. Comm'r*, T.C. Summ. Op. 2001-20 (concluding frozen refund claims could not give rise to underpayments); *Solomon v. Comm'r*, Summ. Op. 2008-95 (same); CCA 200851079 (Dec. 19, 2008) ("The court [in *Solomon*] seems to have gotten it wrong"); PMTA 2010-01 (Nov. 20, 2009) (the regulations "do not specifically address how to factor the FTHBC into the formula for calculating an underpayment"); PMTA 2011-03 (Aug. 27, 2010) (addressing confusion); PMTA 2012-16 (May 30, 2012) ("We have reconsidered our advice…"). *See also* Carlton Smith, *IRS Wrongly Ignores the 20 Percent Excessive Refund Penalty*, 2013 TNT 39-10 (Feb. 27, 2013) (discussing longstanding uncertainty).

9 *See, e.g.*, TAM 2841039058 (Mar. 21, 1998); SCA 200113028 (Feb. 26, 2001); CCA 200851079 (Dec. 19, 2008); PMTA 2011-03 (Aug. 27, 2010); PMTA 2012-16 (May 30, 2012). For individuals, a "substantial understatement" penalty may apply if an understatement exceeds the greater of $5,000 or ten percent of the tax required to be shown on the return. *See* IRC § 6662(d)(1)(A)(i)-(ii). Understatements generally must be reduced by any portion attributable to (1) an item for which the taxpayer had substantial authority; or (2) any item for which the taxpayer adequately disclosed the relevant facts affecting the item's tax treatment, provided the taxpayer had a reasonable basis for such treatment. IRC § 6662(d)(2)(B).

10 PMTA 2012-16 (May 30, 2012). The Tax Court recently agreed, in part, with the IRS, holding that for purposes of computing the IRC § 6662 penalty a refundable credit claim reduces the amount shown on the taxpayer's return. *See Rand v. Comm'r*, 141 T.C. No. 12 (2013) [hereinafter *Rand*]. However, it disagreed with the IRS's computation of the penalty, holding that the claim could not reduce the amount shown below zero. *Id*.

In 2012, the Office of Chief Counsel determined it was not appropriate to impose the accuracy-related penalty for "frozen" refundable credit claims.

On May 30, 2012, the IRS Office of Chief Counsel changed its position, as advocated by TAS.[11] It concluded that when a taxpayer claimed a refundable tax credit that the IRS had frozen, there could be no underpayment of tax, and consequently the IRC § 6662 penalty was not applicable. Counsel reasoned that a frozen refundable credit is an amount "assessed or collected without assessment" (Y, above). Thus, if the only error on a return is a frozen refundable credit claim, which is treated as collected, there is no "underpayment" (*i.e.*, X and Y cancel each other out). Without an underpayment, the accuracy-related penalty (including the substantial understatement penalty) does not apply.[12]

The IRS abated some improper penalties, but not others.

The IRS continued imposing substantial understatement penalties on frozen refund claims for about ten months after receiving the May 30, 2012 guidance. Following additional advocacy by TAS, the IRS identified and abated the penalties imposed on frozen refunds between June 1, 2012 and March 31, 2013, as shown in the following table.

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TABLE 1.17.1, Substantial Understatement Penalty Abatements on Frozen Credit Refund Claims[13]

Type of Work	Total Cases	Total Abatements
EITC	99,303	$131,450,817
Discretionary	9,471	11,395,629
Total	**108,774**	**$142,846,446**

However, the IRS has not identified and abated (or refunded) penalties imposed on other similarly-situated taxpayers before June 1, 2012.[14] For example, the IRS has failed to remove over 46,000 penalties totaling more than $40 million that it imposed in the two and a half years between the issuance of the first Counsel opinion (November 20, 2009) (which Counsel has implicitly acknowledged was incorrect) and the most recent Counsel opinion (May 30, 2012).[15] Moreover, it is still trying to collect over $20 million in accuracy related penalties improperly assessed against more than 23,000 taxpayers.[16]

11 After TAS questioned the position taken by Counsel in PMTA 2010-01 (Nov. 20, 2009) and PMTA 2011-03 (Aug. 27, 2010), the Office of Chief Counsel revised this advice. See PMTA 2012-16 (May 30, 2012).

12 This change does not affect the IRS's position that it may assert the accuracy-related penalty (including the substantial understatement penalty) for refundable credit claims that it has not frozen. While the court's holding in *Rand* confirms that refundable credit claims can trigger an accuracy-related penalty, its analysis suggests the penalty would only apply to the portion of the credit(s) used to reduce the tax otherwise due.

13 IRS response to TAS information request (May 10, 2013) (reflecting abatements from June 1, 2012 to March 31, 2013).

14 The IRS's only explanation is that IRS Office of Chief Counsel advised, in an unpublished email, that the IRS is not required to abate these penalties. Email from Attorney, IRS Office of Associate Chief Counsel (P&A) to Senior Analyst, SBSE Campus Compliance Services, Exam Policy (Sept. 12, 2012). According to the IRS, however, it is working to estimate the volume of cases involving similarly situated taxpayers. IRS response to TAS information request (Nov. 20, 2013).

15 IRS Compliance Data Warehouse, Individual Master File (Nov. 26, 2013).

16 *Id*.

In other contexts, the IRS has failed to minimize taxpayer burden by proposing penalties automatically, before making more than a *de minimis* effort to determine if they apply.

The IRS's administration of penalties sometimes prioritizes automation and efficiency rather than accuracy and fairness. For example, before it can be sure if a penalty for negligence applies, the IRS needs to determine if the taxpayer was actually negligent or if an error was due to reasonable cause and not willful neglect.[17] As shown in the following table, however, the IRS may use different levels of effort to communicate with taxpayers and ascertain the reason for an apparent discrepancy before proposing a penalty, depending on the type of examination or matching program.

TABLE 1.17.2, Procedures for Proposing Accuracy-Related Penalties by Program

Program	Significant address research? [18]	Common letter to propose penalty	Examiner's contact information on letter? [19]	Examiner discusses reason(s) for the discrepancy before penalty asserted? [20]	Penalty assessed if taxpayer not located? [21]
Field Exam	Yes	Letter 950 [22]	Yes	Yes	Not usually
Office Exam	Yes	Letter 915 [23]	Yes	Yes	Not usually
Corr. Exam	No	Letter 525 [24]	No	No	Yes
Automated Underreporter	No	Letter CP 2000 [25]	No	No	Yes

If a mismatch occurs with respect to the same item of income reported by a third party but not reported on the return in more than one year, the IRS's Correspondence Examination and Automated Underreporter (AUR) functions automatically propose a negligence penalty.[26] AUR often does so in the

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17 IRC §§ 6662, 6664(c)(1); Treas. Reg. § 1.6664-4(b)(1).

18 *Compare* IRM 4.10.2.7.2 (Apr. 2, 2010) (describing how field and office exam employees may use asset locator services, postal traces, credit reports, internet searches, IDRS searches, third party contacts, research of related TINs, and personal visits to locate the taxpayer) *with* IRM 4.19.13.13 (Jan. 1, 2013) (discussing how corr. exam employees research addresses using IRDRs); IRM 4.19.3.19.2 (Sept.1, 2013) (discussing AUR's review of other correspondence to find an updated address); IRM 4.19.3.20.11.2 (Sept. 1, 2013) (discussing AUR default procedures, which do not include additional address research).

19 *See* IRM 4.10.1.5.3.2(4) (May 14, 1999) ([For field and office exams] "[A]ll correspondence must contain an employee name, contact telephone number, employee identification number, and signature"). While corr. exam and AUR letters include a general number, an examiner may not be assigned to a case in corr. exam or AUR unless the IRS receives a response to its computer-generated letters. *See, e.g.*, IRM 4.19.20.1(1) (Jan. 1, 2013). Accordingly, the IRS cannot list the examiner's name or number.

20 For field and office exams, employees are required to communicate with the taxpayer before asserting penalties. *See* IRM 4.10.6.3.5 (May 14, 1999) ("To ensure the proper consideration and appropriate application of penalties, it is very important to solicit the taxpayer's explanation for adjustments"); IRM 4.10.6.4(3) (May 14, 1999) ("The assertion of penalties, including alternative positions, should be discussed with the taxpayer and/or representative prior to issuing an examination report"). These requirements do not apply in corr. exam or AUR. *See, e.g.*, IRM 4.19.13.5.3 (Jan. 1, 2013) ("[when documenting penalties on a lead sheet] the taxpayer's position must be addressed [only] if the taxpayer responds to the Exam report and addresses the underpayment in the response.").

21 *Compare* IRM 4.10.2.7.2.7 (Apr. 2, 2010) (for field and office exams a penalty is not assessed unless non-assessment would undermine compliance) *with* IRM 20.1.5.7.1(5)(a) (Jan. 24, 2012) (indicating corr. exam will assert the negligence penalty even if a taxpayer is not located); IRM 20.1.5.3.1(2) (Jan. 24, 2012) (discussing how AUR may automatically assert negligence or substantial understatement penalties when a taxpayer does not respond); IRM 4.19.3.16.5 (Sept. 1, 2012) (same for substantial understatement); IRM 4.19.3.16.6 (Sept. 1, 2008) (same for negligence/disregard).

22 IRM 4.10.8.11 (Aug. 11, 2006).

23 *Id*.

24 IRM 4.19.10.1.6 (Feb., 24, 2011).

25 IRM 4.19.3.1 (Sept. 1, 2012).

26 *See, e.g.*, IRM 4.119.4.18.1.4 (Oct. 1, 2012) (BMF AUR); IRM 4.19.3.16.6 (Sept. 1, 2008) (IMF AUR); IRM 20.1.5.7.1(5)(a) (Jan. 24, 2012) (indicating that corr. exam should assert negligence based on a mismatch in a single year if the taxpayer does not respond).

The IRS's general approach to accuracy-related penalties burdens taxpayers by requiring them to prove the penalties are inapplicable.

first letter it sends to the taxpayer that identifies a deficiency (*i.e.*, the CP 2000).[27] The IRS issued 4.5 million CP 2000s in FY 2012.[28] Over 93,000 of these letters proposed nearly $100 million in accuracy-related penalties before the IRS inquired about the discrepancy or called the taxpayer.[29]

The IRS's automatic penalty assessment procedures, which do not even require IRS employees to make outgoing calls (unless the taxpayer responds to a letter)[30] to determine whether the taxpayer was negligent or had "reasonable cause," ignore direction from Congress that the IRS should "make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later."[31] Other stakeholders have expressed similar concerns.[32] Penalties that the IRS automatically proposes do not take the taxpayer's effort to comply into account — at least not before being proposed. The latest research also suggests that administering penalties in this way may reduce long-term voluntary compliance by those who are subject to them.[33]

The IRS's general approach to accuracy-related penalties burdens taxpayers by requiring them to prove the penalties are inapplicable.[34] This approach violates taxpayer rights and imposes a disproportionate burden on unsophisticated taxpayers who have difficulty communicating with the IRS or do not understand the relevant facts and legal rules — precisely the taxpayers that Congress intends to benefit with many refundable credits, such as the FTHBC.[35]

The National Taxpayer Advocate is concerned the IRS may take the same automated approach to the new penalty under IRC § 6676, which applies to excessive claims for credit or refund.

Notwithstanding the IRS's practice of imposing a substantial understatement penalty on those claiming refundable credits, the Treasury Department requested and received legislation in 2007 to impose a new

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27 In some cases, AUR sends a CP 2501, which asks about the discrepancy before sending the CP 2000. IRM 4.19.3.6 (Sept. 1, 2010).

28 IRS Data Book, *Table 14, Information Reporting Program* (FY 2012), http://www.irs.gov/uac/SOI-Tax-Stats-Information-Reporting-Program-IRS-Data-Book-Table-14.

29 IRS Compliance Data Warehouse, Individual Master File (Nov. 26, 2013). This figure omits the accuracy-related penalties assessed in FY 2012 as a result of AUR cases opened in earlier periods. It also omits taxpayers who received a CP 2000 only after receiving a letter (CP 2501) inquiring about the reason for the discrepancy.

30 Exam generally sends Letter 566 to ask for documentation before sending Letter 525 to propose a deficiency and penalty. IRM 4.19.10.4.10.1 (Jan. 1, 2013). However, even Exam will only try to call the taxpayer if it receives a response. *See* IRM 4.19.13.11 (Jan. 1, 2013).

31 H.R. Rep. No. 101-386, at 661 (1989) (Conf. Rep.). *See also* IRC § 6751(b)(1) (generally requiring penalties to be personally approved by a supervisor before assessment unless automatically calculated through electronic means).

32 American Institute of Certified Public Accountants (AICPA), *Report on Civil Tax Penalties: The Need for Reform* (Aug. 28, 2009) ("[I]ncreasingly, penalties are assessed using automated processes … without the benefit of pre-assessment rights to pursue reasonable cause and other defenses. In many instances, taxpayers pay penalties even if they are unwarranted because it is so difficult and costly to challenge a penalty once it is assessed."). American Bar Association (ABA) Tax Section, *Comments Concerning Possible Changes to Penalty Provisions of the Internal Revenue Code* (1999) ("Automatic assertion, followed by abatement, is far less satisfactory than assertion after inquiry, because taxpayers resent being penalized first and then having to prove compliance, and because many penalties that are asserted and paid probably should never have been assessed."). *See also* IRM 20.1.1.2.2(1)(b) (Nov. 25, 2011) ("[E]rroneous penalty assessments and incorrect calculations confuse taxpayers and misrepresent the overall competency of the IRS.").

33 National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 *infra*, *(Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?)*.

34 *See, e.g.*, National Taxpayer Advocate 2007 Annual Report to Congress 275; National Taxpayer Advocate 2010 Annual Report to Congress 198; Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*, *infra/supra*.

35 For a discussion of taxpayer rights, including the rights to be informed, heard, and pay no more than the correct amount of tax see, *e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 493-518.

penalty for excessive claims for credit or refund under IRC § 6676.[36] It applies to claims (other than those involving the EITC) to which the penalty under IRC § 6662 does not apply.[37]

The National Taxpayer Advocate is concerned that the IRS may similarly apply the new penalty under IRC § 6676 any time a claim for a refundable credit trips whatever "filters" the IRS has established, even if the IRS freezes the claim and does not make a payment to the taxpayer.[38] Because this new penalty contains no reasonable cause exception, such an approach would turn many refundable credits into traps for the unwary.

CONCLUSION

The IRS has improperly assessed accuracy related penalties, has refused to abate them on assessments made prior to June 1, 2012, and continues to assess them automatically without properly determining that they actually apply. The National Taxpayer Advocate is concerned the IRS may take the same automated approach to the new penalty under IRC § 6676, which applies to excessive claims for credit or refund.

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RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Identify and abate (or refund) all accuracy-related penalties on frozen refundable credit claims for all open years.[39]
2. If a court determines that accuracy-related penalties do not apply to refundable credit claims that the IRS has paid, and the IRS does not appeal, then identify and abate (or refund) all such penalties on open years.[40]
3. In the meantime, the IRS should direct attorneys handling refundable credit cases involving IRC § 6662 penalties to notify the court and opposing counsel (or *pro se* petitioner) if the IRS is pursuing a larger penalty than would apply under the Tax Court's recent analysis in *Rand*.
4. Avoid proposing the new penalty under IRC § 6676 automatically (*i.e.*, before contacting the taxpayer, considering the facts, and determining that it actually applies).
5. Work with the Treasury Department to seek an amendment to IRC § 6676 to provide a reasonable cause exception, as previously recommended by the National Taxpayer Advocate.

36 For a discussion of the Treasury's request and recommendations to improve this new penalty, see National Taxpayer Advocate 2010 Annual Report to Congress 544-47.

37 IRC § 6676(d).

38 For a discussion of the problems with pre-refund filters, see, *e.g.*, National Taxpayer Advocate 2011 Annual Report to Congress 15-27; National Taxpayer Advocate 2011 Annual Report to Congress 28-47.

39 PMTA 2012-16 (May 30, 2012). The IRS may abate penalties erroneously assessed if it has not collected them. IRC § 6404. Similarly, the IRS may refund any penalties the taxpayer already paid if the period of limitations for filing a claim for refund remains open. IRC § 6511.

40 If the IRS decides to follow *Rand*, it should abate accuracy-related penalties applied to refundable credits (even if not frozen) to the extent the IRS treated them as reducing the tax shown as due below zero.

MSP #18 ONLINE SERVICES: The IRS's Sudden Discontinuance of the Disclosure Authorization and Electronic Account Resolution Applications Left Practitioners Without Adequate Alternatives

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage and Investment Operating Division
Rajive Mathur, Director, Office of Online Services

DEFINITION OF PROBLEM

The IRS offers practitioners the option to interact electronically through an e-Services suite of web-based products. In early 2013, the IRS decided to retire the Disclosure Authorization (DA) and Electronic Account Resolution (EAR) applications in e-Services without discussing the matter with the practitioner community beforehand. DA enabled practitioners to electronically submit Form 2848, *Power of Attorney and Declaration of Representative*, and Form 8821, *Tax Information Authorization*. DA processed approximately one-tenth of all disclosure authorizations (over 372,000 authorizations) submitted to the IRS in fiscal year (FY) 2013.[1] The EAR application enabled practitioners to interact with the IRS electronically on a client's account-related issues. EAR competed more than 31,000 transactions in FY 2013.[2]

The IRS cited two reasons for discontinuing the programs: low usage and increased operating costs.[3] The National Taxpayer Advocate is concerned that, in making this decision, the IRS failed to take the following actions:

- **Base the Decision on a Strategic Plan to Promote and Develop e-Services.** The IRS failed to make the decision pursuant to an overarching strategic plan to expand e-service options to all tax partners. For example, it did not attempt to reevaluate and modify its marketing strategy for the two applications to increase usage and lower the cost per transaction. The IRS also failed to consider the additional long-term costs of practitioners' migration away from the online services to paper and phone-based systems.[4]
- **Provide an Electronic Alternative.** The IRS failed to take concrete steps to replace the programs with less costly alternative applications despite the clear demand for more electronic services by the practitioner community and the IRS's own strategic objective of expanding e-services to its tax partners.[5]

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1 On September 2, 2013, the IRS retired the DA & EAR systems. Wage and Investment division (W&I) response to information request (Oct. 31, 2013). The amount of transactions in FY 2013 (372,681 through the week ending Sept. 7, 2013) was a slight increase over the 332,198 in FY 2012 and 282,987 in FY 2011. Ten percent is an understatement as the Centralized Authorization File (CAF) numbers include revocations of authorizations and other forms not processed through DA.

2 W&I response to TAS information request (Oct. 31, 2013). The number of transactions in FY 2013 (31,338 through the week ending Sept. 7, 2013) was a slight decrease from the 33,677 in FY 2012 (but a slight increase over the 30,457 in FY 2011).

3 *Id*.

4 *Id*.

5 IRS Strategic Plan 2009-2013 at 16.

- **Consult with Stakeholders Beforehand.** The IRS did not engage its stakeholders before making the final decision to retire the applications. Had the IRS done so, it might have recognized that growth potential warranted the investment in redesign and continuation of these two services.
- **Pay Due Consideration to the Increased Burden on Practitioners and Taxpayers.** Once the IRS retired the programs, practitioners who used DA reverted back to either mailing or faxing their disclosure authorization forms to the Centralized Authorization File (CAF), which has experienced increasing processing times and issues, in part, due to its outdated systems.[6] In addition, those who used EAR must now contact the IRS through the Practitioner Priority Service (PPS), which has experienced decreasing customer service representative (CSR) levels of service and increasing wait times since fiscal year (FY) 2010.[7]

ANALYSIS OF PROBLEM

Background

The IRS has a strategic goal to provide more electronic services to its partners.[8] The vehicle for providing such online tools to tax professionals is "e-services," a suite of web-based products that allow tax professionals and payors to conduct business with the IRS electronically. Disclosure Authorization (DA) and Electronic Account Resolution (EAR) were two applications offered in IRS e-Services. DA allowed registered users to create, view, and modify Forms 2848, *Power of Attorney and Declaration of Representative*, and 8821, *Tax Information Authorization* (collectively referred to as disclosure authorizations herein).[9] For example, when clients receive notices from the IRS, in order for their tax professionals to understand and address the notices, they file an authorization (such as Form 2848 or Form 8821) to contact the IRS on behalf of their clients. Using e-Services, tax professionals could instantaneously file an authorization through DA. The benefits of DA included quick processing and immediate acknowledgement of submissions, which are vital to stop levy actions and notices of deficiency.

Once a disclosure authorization was processed, the professional could later request clarification of the notice through EAR. EAR allowed tax professionals to expedite resolution of clients' account problems by electronically sending and receiving related inquiries. This meant practitioners could:

- Instantly inquire about client refunds;
- Request account changes;
- Establish installment agreements for clients to pay taxes; and
- Submit other inquiries—all without long wait times or faxing authorizations during a call to the IRS.

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6 National Taxpayer Advocate 2012 Annual Report to Congress 281-301 (Most Serious Problem: *IRS Processing Flaws and Service Delays Continue to Undermine Fundamental Taxpayer Rights to Representation*); National Taxpayer Advocate 2010 Annual Report to Congress 171-186 (Most Serious Problem: *Persistent Breakdown in Power of Attorney Processes Undermine Fundamental Taxpayer Rights*); National Taxpayer Advocate 2009 Annual Report to Congress 256-271 (Most Serious Problem: *IRS Power of Attorney Procedures Often Adversely Affect the Representation Many Taxpayers Need*).

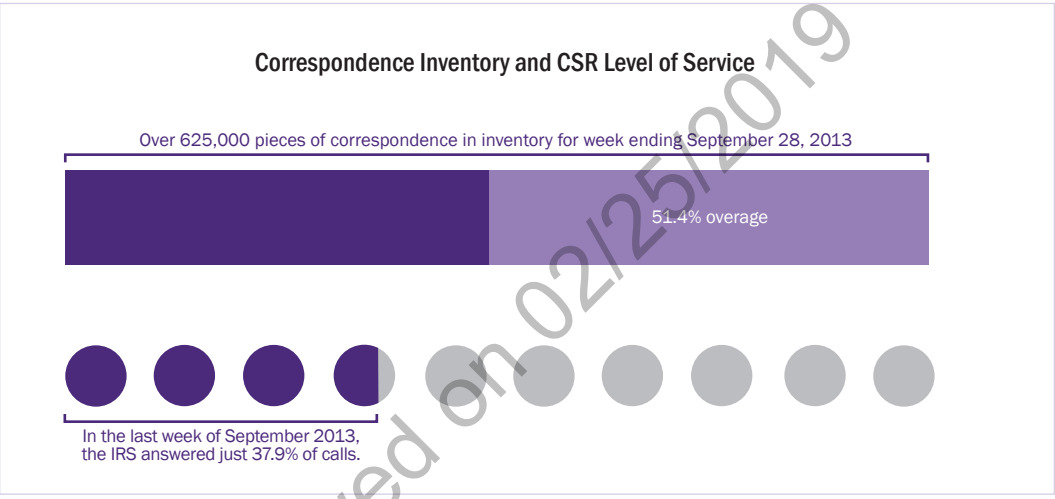
7 Internal Revenue Service Oversight Board Annual Report 2012 at 23. Monthly CSR level of service (LOS) rates varied but declined overall in FY 2013. Rates also declined for full FYs 2010 through 2012, but there was a slight increase in level of service in FY 2013 (when compared to 2012, but 2013 CSR LOS is less than 2010 levels) overall. Enterprise Snapshot Reports (Sep. 28, 2013). IRS, Joint Operations Center, Executive Level Summary Reports (Nov. 25, 2013).

8 IRS Strategic Plan 2009-2013 at 16.

9 W&I Operating Division Business Performance Review (BPR), FY 2013: First Quarter 7 (Mar. 2013).

The IRS responded to the EAR inquiry to a secure electronic mailbox within three business days, which is significantly less time than it would take to receive a response by mailing correspondence to the IRS. In fact, at the end of September 2013 the IRS had over 625,000 pieces of correspondence in inventory, of which more than half were considered overage.[10] For taxpayers and representatives who attempted to talk to a customer service representative on the IRS Customer Account Services telephone lines, the IRS reported a level of service of less than 40 percent during the last week of FY 2013, which means for this week the IRS did not answer more than six out of every ten calls.[11]

FIGURE 1.18.1, Correspondence Inventory and CSR Level of Service for Week Ending September 28, 2013



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In March 2013, the IRS decided to retire the DA and EAR applications effective August 11, 2013.[12] This date was subsequently postponed to September 2, 2013, to coincide with the migration to a new web portal.[13] The IRS cited low usage and costs as reasons to retire the applications.[14]

The IRS's Decision to Retire the Two Applications Based on Increased Costs and Low Usage Does Not Comport with its Strategic Plan to Promote and Develop e-Services.

The IRS Strategic Plan in place at the time of the decision to terminate the programs has as its first goal to "[i]mprove service to make voluntary compliance easier." To achieve this goal, Objective Four provides that it will "[s]trengthen partnership with tax practitioners, tax preparers, and other third parties in order

10 IRS, Joint Operations Center, *Accounts Management Information Report (AMIR) National Summary* (week ending Sept. 28, 2013). The IRS had 626,451 pieces of correspondence in inventory of which 51.4 percent were considered overage. The definition of overage varies by topic but it is generally over 45 days old.

11 IRS, Joint Operations Center, Executive Level Summary Reports (week ending Sept. 28, 2013). For this week, IRS reported a 37.9 percent CSR LOS. IRS now refers to Customer Account Services telephone lines as Accounts Management (AM) telephone lines. This is a compilation of 27 lines (AM is a sum of 27 (1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 1778, 9887, 9982, 2942, 4184, 7388, 0452, 0352, 7451, 9946, 5215, 3536, 2050, 4778, 4259, 8482, 8775, 5500 and 4490).

12 W&I Operating Division BPR, FY 2013: First Quarter 7 (Mar. 2013).

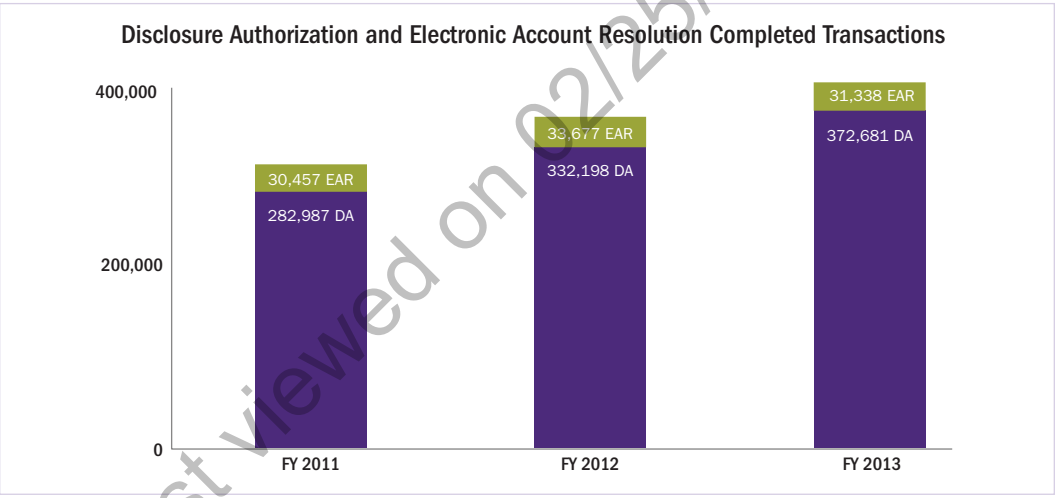
13 W&I response to TAS information request (Oct. 31, 2013). A portal is a critical interface between the IRS and the public. It is a point of entry to a network system that includes a search engine or collection of links to other sites arranged by topic. The IRS's Internet portal provides the infrastructure that allows users (IRS employees and taxpayers) to have Web-based access to IRS information and file tax returns electronically.

14 *Id*.

to ensure effective tax administration." Among the many ways the IRS will increase the quality of service to tax partners, the strategic plan clearly states that the IRS will "expand e-service options."[15] In addition, the second objective under the Plan's Strategic Foundation to "[i]nvest for high performance" provides that the IRS should "[b]uild and deploy advanced information technology systems, processes, and tools to improve IRS efficiency and productivity" and provides as its fourth strategy thereunder to "[e]xpand online tools and services."[16] Therefore, by discontinuing two applications within e-Services without offering improved electronic alternatives, the IRS appears to have failed several objectives and strategies of its own Strategic Plan.

Before retirement, the DA system processed approximately 300,000 disclosure authorizations annually, with usage increasing steadily over the past three years. EAR experienced lower usage numbers with over 31,000 transactions completed in FY 2013, which is consistent with the previous two fiscal years. The chart below shows the transactions completed in DA and EAR.[17]

FIGURE 1.18.2, DA & EAR Completed Transactions — FY 2011–2013[18]



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The Centralized Authorization File units in Accounts Management received the larger portion of the disclosure authorizations (approximately 3.4 million annually).[19] Consequently, roughly ten percent of the authorizations were transmitted through DA.[20] The chart below illustrates authorizations received by the CAF unit for FY 2011 through 2013.

15 IRS Strategic Plan 2009–2013 at 16.

16 *Id*.

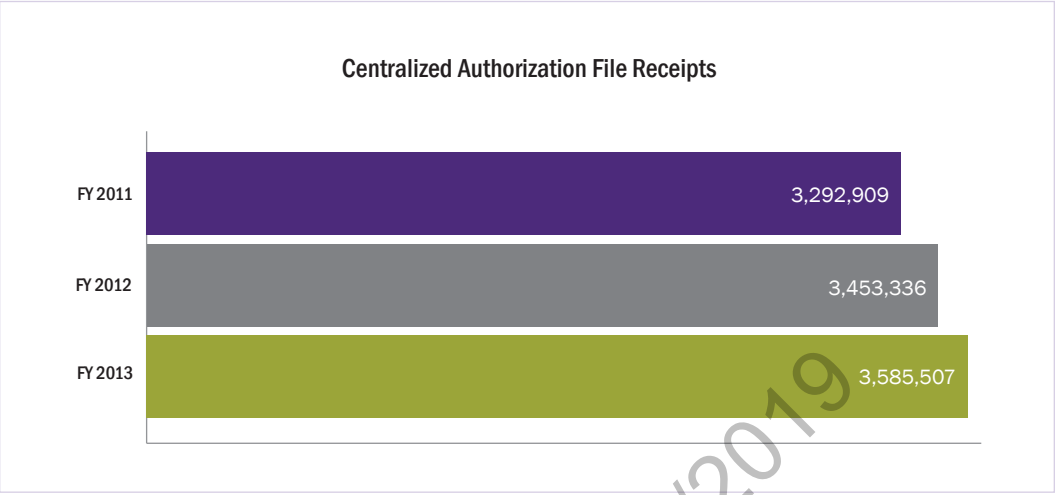
17 EAR completed 31,338 transactions in FY 2013, 33,677 transactions in FY 2012 and 30,457 in FY 2011. W&I response to TAS information request (Oct. 31, 2013).

18 The IRS retired the DA & EAR systems Sept. 2, 2013, thus the data reflects transactions completed through the week ending Sept. 7, 2013. *Id*.

19 W&I response to TAS information request (Oct. 31, 2013, and Dec. 18, 2013). DA processed 282,987 transactions in FY 2011, 332,198 in FY 2012 and 372, 681 in FY 2013. CAF had 3,292,909 receipts in FY 2011, 3,453,336 in FY 2012 and 3,585,507 in FY 2013. W&I Operating Division BPR, FY 2013: First Quarter 7 (Mar. 2013).

20 The CAF data reflects receipts while the DA data reflects transactions completed. Ten percent is a conservative estimate and likely an understatement as the CAF numbers include revocations of authorizations and other forms not processed through DA.

FIGURE 1.18.3, CAF RECEIPTS FY 2011–2013[21]



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While the IRS promoted these e-service applications through various media over the years, it did not attempt to modify its marketing plan once low usage became a concern and possible basis for termination. Rather than attempting to increase use, the IRS decided to decrease it to zero.[22]

In addition to low usage, the IRS has cited costs as a main reason for discontinuing these applications. The IRS retired the applications upon the launch of a new web portal that is considered more modern, with increased flexibility and security. Facing a limited budget, the IRS could not afford to redesign the two e-services applications to transition them to the new portal.[23]

The IRS's final decision to terminate the programs runs counter to the goals of the Strategic Plan. Cost is an important program redesign objective, but in itself is insufficient without factoring in the objectives of time reduction and the measure of output quality. In fact, due to its budget restrictions, the IRS appears to have targeted "low hanging fruit" to suit its short-term fiscal needs without considering the long-term costs of paper and phone-based systems to replace the two applications.[24] In addition, the IRS made no effort to modify its current marketing strategy to increase usage and thereby lower the cost per transaction.[25] Finally, in this case, technology was viewed solely as a cost issue as opposed to a way of reshaping and improving business processes and eliminating expensive downstream rework.

The IRS also failed to give due consideration to the long-term impact on its tax partners. When the IRS suddenly terminates an online self-service tool geared toward the tax practitioner community, it does not instill an atmosphere of trust. Practitioners may be wary and unwilling to invest resources in future IRS

21 W&I response to TAS information request (Oct. 31, 2013).

22 The IRS promoted the programs at the Tax Forums, in seminars to practitioner groups, and on PPS. However, it did not modify its marketing plan to increase usage before termination. *Id*.

23 *Id*.

24 *Id*.

25 In a response to a 2009 Annual Report Recommendation 5-1, the IRS recently stated, "The IRS has already completed a short term research study and identified several quick-hits pertaining to existing electronic services that offer opportunities to enhance our e-services portfolio. Longer-term internet strategy key initiatives are underway for completion March 15, 2014." OLS response and request to close 2009 Annual Report to Congress Recommendation 5-1 (Sept. 13, 2013).

products and change their practices accordingly if they have no assurance that the IRS will support the product in the future.

The IRS Did Not Consider Replacement Electronic Applications Before Terminating the Applications

The IRS has said it intends to replace DA with a more cost-effective automated system that will save time with more user-friendly features.[26] However, it has not provided any concrete plans to roll out a comparable electronic alternative. The IRS Office of Online Services told TAS that it has an unfunded and yet-to-be prioritized work request to replace DA as a web-based stand-alone product.[27] In addition, we have recently learned the IRS will begin a limited pilot to use eFax for the storage and receipt of incoming powers of attorney in 2014.[28] While not as efficient as DA, we believe eFax could be a non-paper alternative with some of the benefits of electronic transmission.

The IRS's final decision to terminate the programs does not display any strategic forethought and runs contrary to the goals of the IRS Strategic Plan.

Any new online application will have significant start-up costs, but the IRS must factor into its cost analysis the long-term savings of eliminating the need for manual processing. Once a new application is proven to operate effectively, the IRS could even phase in a mandate of its use for practitioners governed by Circular 230, *Regulations Governing Practice before the Internal Revenue Service.*

The IRS Retired the Applications Without Soliciting Stakeholder Comments Beforehand or Adequately Addressing Practitioners' Needs

The IRS made the final decision to terminate the two applications without soliciting comments from its stakeholders beforehand. Almost immediately after the IRS announced the decision on its website, there was outcry from the practitioner community, many of whom contacted the Taxpayer Advocate Service to voice their significant concerns.[29] Practitioners were outraged that they were never consulted before the announcement, and nearly 4,000 of them signed a petition urging the IRS to reverse its decision.[30] By not consulting practitioners in advance, the IRS deprived itself of advice on how to improve the two programs or even market them to increase usage. Thus, at least in this instance, the IRS designed its e-services in a vacuum.

Many practitioner groups have voiced concern that the applications had low usage because the practitioners were not adequately informed of their availability, and have even offered to assist the IRS in raising awareness.[31] While the IRS may cite low past usage of the products, the public outcry alone demonstrates there is great potential demand for the services. Had the IRS consulted with those stakeholder groups

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26 W&I response to TAS information request (Oct. 31, 2013).

27 *Id*.

28 William Hoffman, *Werfel Warns of Service Cuts from Further IRS Budget Reductions, Tax Notes Today* (Nov. 21, 2013).

29 Kristin Esposito, *IRS E-Services: Can They Come Back Better Than Before?* AICPA Insights (Aug. 5, 2013); Jeff Stimpson, *Thousands of Practitioners Protest End of e-Services Tools*, Accounting Today (July 19, 2013).

30 Jeff Stimpson, *Thousands of Practitioners Protest End of e-Services Tools*, Accounting Today (July 19, 2013).

31 Joint Letter from National Association of Enrolled Agents, National Society of Accountants, and National Association of Tax Professionals to Acting IRS Commissioner (June 21, 2013), *available at* http://www.naea.org/advocacy/comments-letters/irs-retiring-da-ar-e-services; Letter from Florida Institute of Certified Public Accountants to Acting Commissioner (July 15, 2013), *available at* http://www.ficpa.org/Content/News/NewsFlash/July-25-2013.aspx.

prior to making its decision, it might have recognized the growth potential warranted the investment in redesign and continuation of these two services.

To many practitioners, the sudden and unexpected announcement appeared inconsistent with previous IRS communications encouraging practitioners to use e-Services — and even mandating that they e-file their clients' returns. Until this point, there was a perceived momentum on the part of the IRS to implement electronic solutions. Thus, the announcement came as a complete surprise to the practitioner community.[32]

When the IRS Oversight Board conducted discussion groups with practitioners at the 2012 Nationwide Tax Forums, one of the ten main themes that emerged in those discussions was the practitioner demand for electronic tools to interact with the IRS.[33] Moreover, the IRS Electronic Tax Administration Advisory Committee (ETAAC) criticized the decision by stating, "removing online tools and reverting to a paper submission process is counter-productive.[34]

The National Taxpayer Advocate understands that the IRS has a limited budget for online services and must prioritize applications based on costs, usage, and impact. However, we believe the IRS should have engaged the stakeholder community and the National Taxpayer Advocate before making a final decision. As noted above, once the IRS announced the planned retirement, the practitioner community immediately raised its concerns; thus it is very likely that the practitioner community would have been responsive to the IRS in providing pre-decisional comments.

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The IRS Decision Has Increased the Burden on Tax Practitioners and Their Taxpayer Clients.

In retiring the applications, the IRS acknowledged the customer impact to practitioners who used DA but now must go back to submitting paper POA and authorization forms by fax or regular mail. This change will significantly increase turnaround time from almost immediate processing with the online program to approximately five days of processing through the CAF.[35] To handle the increased workload, the IRS increased CAF staffing from nearly 220 full-time equivaents (FTEs) during FY 2012 to over 230 in FY 2013 with a goal of maintaining the level of service of five days or less going forward.[36] However, the IRS also has acknowledged, "current budget cuts will impact their dedicated resources to this program and they are working to determine the impact on processing time."[37]

The National Taxpayer Advocate is concerned that the IRS believes it has adequately addressed practitioner needs by directing Forms 2848 and 8821 away from an effective online system, which gained increasing acceptance from the practitioner community, toward a paper-based system with a poor track

32 Jim Buttonow, *Eight Ways to Improve IRS e-Services*, AICPA Tax Insider (July 11, 2013).

33 IRS Oversight Board Annual Report 2012 at 6, 33.

34 Electronic Tax Administration Advisory Committee, 2012 Annual Report to Congress 38 (June 3, 2012). ETAAC is an advisory committee pursuant to Federal Advisory Committee Act and established under the IRS Restructuring and Reform Act of 1998 (RRA 98) with the primary duty to provide input to the IRS on its strategic plan for electronic tax administration.

35 W&I response to TAS information request (Oct. 31, 2013). *See also* e-Services for Low Income Taxpayer Clinics (Nov. 13, 2013), *available at* http://www.irs.gov/Advocate/e-Services-for-Low-Income-Taxpayer-Clinics.

36 W&I Operating Division BPR, FY 2013: First Quarter 7 (Mar. 2013); W&I response to TAS information request (Oct. 31, 2013) shows a staffing increase from 218 in FY 2012 to 232 in FY 2013.

37 W&I response to TAS information request (Oct. 31, 2013); W&I Operating Division BPR, FY 2013: First Quarter 7 (Mar. 2013).

record, increased overall processing times, and a lack of acknowledgement upon receipt of submissions. Practitioners have also voiced similar concerns that they will be forced to revert to inefficient, old-fashioned methods.[38]

In the 2009, 2010, and 2012 Annual Reports, we have written about the problems experienced with processing authorization requests through the CAF unit. Specifically, the ineffective and outdated high-speed fax machines used by the CAF have failed to transmit all pages, break down frequently, and sometimes do not even receive authorizations. In addition, the unit has misplaced or failed to record authorizations. Practitioners do not receive an acknowledgement upon submission and many actually submit authorizations in duplicate to ensure receipt, which only creates a greater backlog.[39] Moreover, for authorization requests it actually works, the CAF has experienced long processing times in the past.[40] The IRS has stated that it has a goal to maintain processing times of five days or less, but this still increases the risk that taxpayers will not receive the benefit of representation during critical periods, such as levy actions.[41] Furthermore, the longer processing times increase the likelihood that the practitioner will contact the IRS several times, which only increases costs to the IRS.[42] Any additional time the practitioner spends submitting disclosure authorization is a cost of representation likely passed on to the client.

Practitioners who used EAR for assistance with client account issues must now call the PPS, which experienced a steady decline in service between FY 2010 and FY 2012. For example, in FY 2010, the CSR level of service was 80 percent, with a decrease to 78 percent in FY 2011 and 73 percent in FY 2012. The CSR level of service slightly increased to 75 percent in FY 2013, but the average wait time to receive an answer nearly doubled from over 10 minutes in FY 2010 to nearly 20 minutes in FY 2013.[43] The graphic below shows the fluctuation in the wait times as well as level of service on PPS during each month of FY 2013:

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38 Letter from Florida Institute of Certified Public Accountants to Acting Commissioner (July 15, 2013); Joint Letter from National Association of Enrolled Agents, National Society of Accountants, and National Association of Tax Professionals to Principal Deputy Commissioner Daniel Werfel (June 21, 2013).

39 National Taxpayer Advocate 2012 Annual Report to Congress 281-301 (Most Serious Problem: *IRS Processing Flaws and Service Delays Continue to Undermine Fundamental Taxpayer Rights to Representation*); National Taxpayer Advocate 2010 Annual Report to Congress 171-186 (Most Serious Problem: *Persistent Breakdown in Power of Attorney Processes Undermine Fundamental Taxpayer Rights*); National Taxpayer Advocate 2009 Annual Report to Congress 256-271 (Most Serious Problem: *IRS Power of Attorney Procedures Often Adversely Affect the Representation Many Taxpayers Need*). Disclosure Authorization issues a real-time acknowledgement of accepted submissions. *See* http://www.irs.gov/Advocate/e-Services-for-Low-Income-Taxpayer-Clinics (last visited Dec. 11, 2013).

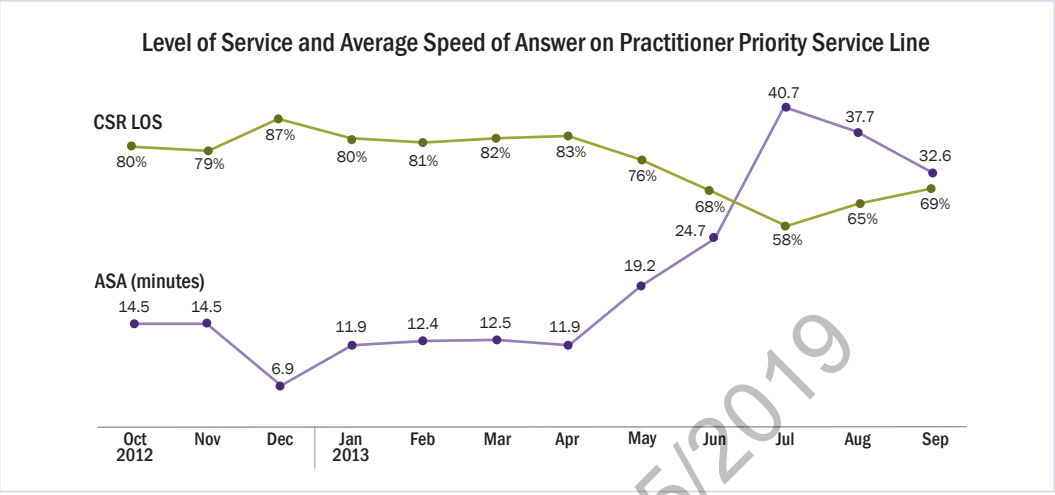
40 National Taxpayer Advocate 2012 Annual Report to Congress 281-301 (Most Serious Problem: *IRS Processing Flaws and Service Delays Continue to Undermine Fundamental Taxpayer Rights to Representation*); National Taxpayer Advocate 2010 Annual Report to Congress 171-186 (Most Serious Problem: *Persistent Breakdown in Power of Attorney Processes Undermine Fundamental Taxpayer Rights*).

41 W&I response to TAS information request (Oct. 31, 2013). The IRS states "In 2013 Accounts Management CAF processing was consistently 5 days or less."

42 *Id*. Authorizations input via e-Services Disclosure Authorization (DA) were immediately loaded to the Centralized Authorization File (CAF).

43 Internal Revenue Service Oversight Board Annual Report 2012 at 23; IRS Joint Operations Center, Snapshot Product Line Detail Reports (Sept. 30, 2011, Sept. 30, 2012, Sept. 30, 2013). The CSR LOS for the PPS was 79.8 percent for FY 2010, 78.3 percent for FY 2011, 73.4 percent for FY 2012, and 75.0 percent for FY 2013.

FIGURE 1.18.4, FY 2013 Monthly CSR Level of Service and Average Speed of Answer on PPS[44]



CONCLUSION

The IRS discontinued the DA and EAR applications undermining its strategic plan to expand e-service options to all tax partners. The decision was made without first consulting the practitioner community. Requiring practitioners to revert to paper and phone-based systems, which have had declining service in recent years, sends a message to the community that the IRS is unresponsive to practitioners' needs in favor of its own short-term budgetary needs. In addition, taxpayers will pay the ultimate price when their disclosure authorizations are not processed timely.

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RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Consult with and solicit comments from impacted stakeholders, *i.e.,* the practitioner community, before deciding whether to retire applications.
2. Establish a strategic plan to identify, develop, and promote viable electronic alternatives to discontinued applications prior to discontinuance.
3. For online practitioner applications experiencing low usage, solicit comments from the users on how to improve the applications to boost usage to acceptable levels.
4. Solicit suggestions from practitioners on marketing strategies and potentially develop a joint marketing initiative, leveraging stakeholders' ability to communicate with their members.
5. Evaluate potential electronic alternatives to the retired e-services applications.

44 IRS Joint Operations Center, Snapshot Product Line Detail Reports (Sept. 30, 2011, Sept. 30, 2012, Sept. 30, 2013). Average speed of answer was 10.5 minutes in FY 2010 compared to 19.7 minutes in FY 2013.

MSP #19 IRS WORKER CLASSIFICATION PROGRAM: Current Procedures Cause Delays and Hardship for Businesses and Workers by Failing to Provide Determinations Timely and Not Affording Independent Review of Adverse Decisions

RESPONSIBLE OFFICIALS

Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

The delay in classification of workers as employees or independent contractors by the IRS's SS-8 Unit has significant tax consequences for businesses and individuals. The classification impacts employment tax liabilities, income tax withholding obligations, information reporting, the allowance of expenses that may be derived from a "trade or business," and eligibility for employee benefit or pension plans.[1] The enactment of the Affordable Care Act magnifies the tax consequences of worker classification. The National Taxpayer Advocate has previously recommended that the IRS simplify its worker classification criteria, and has offered legislative and administrative remedies to alleviate the burden on applicants. These proposals include the development of a free online self-help tool that would give employers a preliminary determination of employment status based on their responses to specific questions.[2]

As of fiscal year (FY) 2013, 81 percent of cases in the IRS SS-8 Worker classification program are "overage."[3] This means that applicants must wait an average of a year before receiving a determination.[4]

The National Taxpayer Advocate has several additional concerns. First, the SS-8 Program uses new Internal Revenue Manual (IRM) guidance that results in premature rejection of legitimate applications without giving applicants an opportunity to respond and cure minor defects. Second, applicants who receive adverse determinations from this unit do not automatically receive administrative appeal options.

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1 Internal Revenue Code (IRC) §§ 162, 401, 411.

2 *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.

3 Treasury Inspector General for Tax Administration (TIGTA), Ref No. 2013-30-058, *Employers Do Not Always Follow Internal Revenue Service Worker Determination Rulings* (June 14, 2013); IRS Response to TAS Research Request (Nov. 20, 2013).

4 Minutes of the Meeting of the SS-8 Worker Classification Advocacy Project Team, Jan. 16, 2013.

ANALYSIS OF PROBLEM

Background

Delay in classification of workers as employees or independent contractors has serious tax consequences.

Proper worker classification, whether as an employee or independent contractor, is critical to both businesses and workers. Generally, if a worker is misclassified as an independent contractor by a firm that is paying for services and the IRS reclassifies the worker as an employee, he or she is responsible for federal income tax and an employee's share of Federal Insurance Contributions Act (FICA) tax on the income.[5] If that reclassified worker already paid self-employment tax, he or she may be eligible for a refund. The related firm is responsible for federal income tax withholding, Federal Unemployment Tax Act (FUTA), and Social Security and Medicare taxes on the earnings unless special rates apply.[6] Specifically, the following employment taxes are at issue in an SS-8 determination:

- Federal income tax withholding at source of wages as provided by Internal Revenue Code (IRC) § 3402;
- FICA tax as provided by IRC § 3101; and
- FUTA tax as provided by IRC § 3301.

A business that has treated a worker's income incorrectly, or has been notified by the IRS that its worker's employment status has been reclassified, may have to file or adjust the related employment tax return(s) to pay the appropriate amount.[7]

Proper worker classification, whether as an employee or independent contractor, is critical to both businesses and workers.

A delay in worker classification decision impacts workers and businesses adversely, as any delinquent income and employment taxes are subject to penalties and interest. In some situations, a delayed determination may cause workers to lose refunds of overpaid self-employment taxes if the refund statute of limitations has expired. The filing of a Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, does not prevent the expiration of the time in which a refund must be claimed.[8] Many other benefits and determinations hinge on whether a worker is considered an employee or an independent contractor.[9]

Congress Has Passed Legislation to Address Ambiguities in Worker Classification but Additional Action Should be Taken.

The basis for determining the status of a worker as an independent contractor or employee had primarily rested on a common-law test of 20 factors that enumerated the degree of control that a person engaging

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5 IRC §§ 3401, 3012(a), as amended by the Social Security Protection Act of 2004, Pub. L. No. 108-203.

6 IRC §3406(a)(1).

7 *See, e.g.*, Publication 4341, 20 (Rev. 01/2010).

8 In general, the statute of limitations period for credits or refunds is governed under IRC § 6511, which states such claims must be filed within three years from the time a return is deemed to be filed or two years from the time the tax was paid, whichever is later.

9 For example, IRC § 404(d) which limits deductions for deferred compensation paid to independent contractors; Section 531, The Deficit Reduction Act of 1984, Pub. L. No. 98-369, (addressing employee fringe benefits), IRC §401, *supra*.

the services of another had on the work, detail, and means by which the work was performed.[10] Congress addressed employment status by enacting Section 530 of the Revenue Act of 1978.[11] This section prohibits the IRS from reclassifying independent contractors as employees provided the payor consistently treated the payee as a contractor in good faith. It also barred the IRS from issuing guidance on the employment status of individuals.[12]

Congress' objective was to *temporarily* relieve businesses of uncertainties and provide a "safe harbor" if payors reasonably relied on past audit practices, published rulings, or judicial precedents, recognized practices in an industry, or long-standing treatment by the payors with regard to employment taxes.[13] However, the "temporary" relief was extended and then made permanent by the 1982 Tax Equity and Fiscal Responsibility Act.[14]

The National Taxpayer Advocate has previously recommended that Congress repeal § 530 and replace it with safe harbors applicable to employment and income tax determinations.[15] Repeal would also remove restrictions on IRS guidance.[16]

The Form SS-8 Process Can Require Lengthy Fact Gathering, Investigation, and Application of Law.

A worker or business may file Form SS-8 to receive a determination from the IRS as to whether the person in question is an employee or independent contractor.[17] The four-page, five-part form requires the submitter to answer numerous questions and provide a detailed explanation of the work relationship between the business and the worker. The SS-8 Unit screens the forms and returns them to the submitters if they are incomplete.[18] Once a form is complete and accepted for processing, the SS-8 technician will send a letter to the business, if the worker was the submitter, and ask the business to complete Form SS-8, because the determination of employment status affects both parties.[19] The technician may ask for additional information from the submitter, other involved parties, or third parties to help clarify the work relationship.

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10 *See* Rev. Rul. 87-41, 1987 C.B. 296.

11 Section 530, Revenue Act of 1978, P.L. 95-600 (Nov. 6, 1978), as amended.

12 Section 530(b), Revenue Act of 1978, Pub. L. No. 95-600 (Nov. 6, 1978), as amended.

13 S. Rep. 95-1263 (Oct. 1, 1978).

14 Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, § 269(c).

15 *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.

16 Congress expressed a concern that the IRS's increased enforcement of employment tax classifications could result in a heavy liability for employers: "If the IRS prevailed on a [worker] reclassification, the [business] became liable for employment taxes — withholding, Social Security, and unemployment — which neither had been withheld nor paid to the Treasury... many [businesses] lack [information that could offset the liabilities] about their workers and cannot benefit…" (S. Rep. 95-1263 (Oct. 1, 1978, *supra*)). In addition, businesses have expressed concern to TAS that any IRS-issued guidance would weigh heavily towards a determination that there is an employer-employee relationship. The online tool proposed by the National Taxpayer Advocate would provide an objective system that would be impartial to workers and employers based on their accurate responses to questions.

17 A Form SS-8 determination may be requested only to resolve federal tax matters. The Form SS-8 is filed according to the firm's location. In general, forms from western states are sent to Holtsville, NY and those from the East are sent to Newport, VT.

18 IRM 7.50.1.3.1 (Oct. 3, 2013). New Form SS-8 Receipts: First Read Screening Process.

19 The language specified by IRM Exhibit 7.50.1-17 (Oct. 3, 2013) assumes that the worker is the applicant; however, it instructs the SS-8 technical employee to send a letter "to the other party involved with the SS-8 determination" when preparing a full determination case for assignment. IRM Exhibit 7.50.1-17 (10-03-2013).

The technician reviews the facts, applies the law, and makes a determination. The determination is generally made under a facts-and-circumstances analysis that seeks to ascertain whether the worker is subject to the control of the service recipient, not only as to the nature of the work performed, but also the circumstances under which it is performed. In Rev. Rul. 87-41, the IRS enumerated 20 factors for determining whether an employer-employee relationship exists.[20] The importance of each factor varies depending on the occupation and the factual context in which the services are performed.[21]

A determination issued in response to a Form SS-8 request is binding to the IRS and applies only to the business and the worker to which it is addressed. If only one worker provided information about a work relationship, but the facts are not materially different for other workers in the same class, the SS-8 Unit may apply a written determination to those workers.[22]

A worker or business that disagrees with a determination may request a reconsideration if additional information is provided. However, the same group considers the reconsideration and almost all of the original determinations are upheld.[23] Under current procedures, no administrative appeal rights are allowed.

The IRS's last comprehensive estimate of the number of workers improperly classified was for tax year (TY) 1984. At that time, it found that 15 percent of employers misclassified 3.4 million workers as independent contractors. This resulted in an estimated total tax loss of $1.6 billion in Social Security taxes, Medicare taxes, federal unemployment taxes, and federal income taxes (for 1984).[24] The IRS has included a worker classification study in its ongoing National Research Program (NRP), but results will not be available until 2015.[25]

The SS-8 Unit Has a Backlog of Inventory.

In fiscal year 2013, the SS-8 program received 3,982 requests for determination filed by workers and 128 by employers.[26] The unit had a total inventory of approximately 11,545 cases of which 9,387 — more than 81 percent — were considered "overage," having been in process for 180 days or more. As the following chart shows, although the volume of overage cases has fluctuated over the last three years, the overall trend is worsening.

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20 *See* Rev. Rul. 87-41, 1987 C.B. 296.

21 If the business fails to complete and return the form to the SS-8 Unit, the technician will base the determination solely on the information in the worker's Form SS-8. If both parties complete Form SS-8, the technician mails the determination letter to the business and a copy with a cover letter to the worker, regardless of which party is the requester.

22 IRM 7.50.1.5.2 (Rev. Oct. 3, 2013).

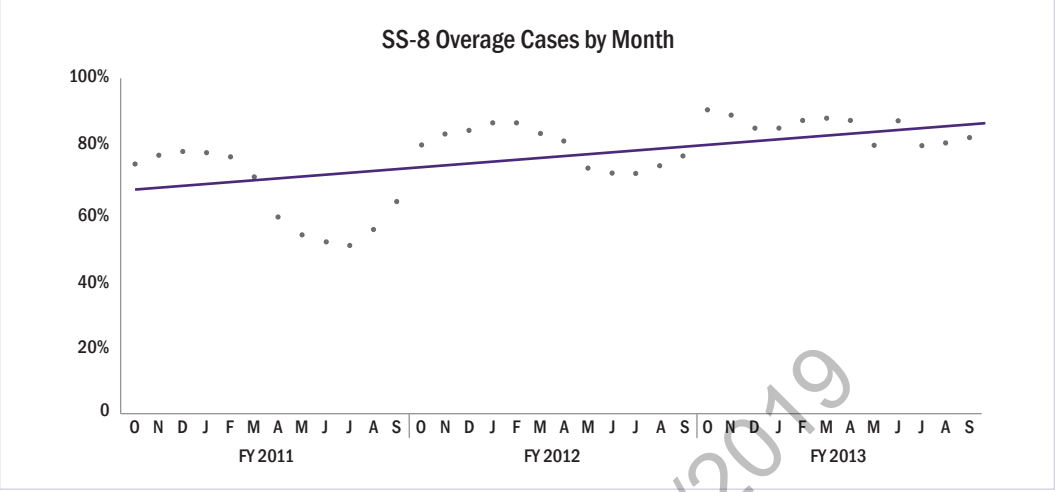
23 In FY 2011 318 reconsideration requests were received and one resulted in reversal. In FY 2012 119 reconsideration requests were received and three resulted in reversal. In FY 2013 196 reconsideration requests were received and four resulted in reversal. IRS response to research request (Nov. 20, 2013). There are no provisions in the IRM for quality or managerial review. (*See* IRM 7.50.1.5.10.1 (Oct. 3, 2013)).

24 Beier, Ken. "Strategic Initiative on Withholding Noncompliance (SVC-1), Employer Survey, Report of Findings." Unpublished: Department of the Treasury, Internal Revenue Service, June 1989. Beier, Ken. "Strategic Initiative on Withholding Noncompliance (SVC-1), Misclassified Employee Survey, Report of Findings." Unpublished: Department of the Treasury, Internal Revenue Service, September 1989. TIGTA, Ref No. 2013-30-058, *Employers Do Not Always Follow Internal Revenue Service Worker Determination Rulings* (June 14, 2013).

25 The NRP is a comprehensive, statistical effort by the IRS to measure compliance for different types of taxes and various sets of taxpayers. (IRM 4.22.1.3 (Apr. 25, 2008)). The scope of the NRP includes worker classification issues. (IRM 4.22.10.3.3 (Oct. 1, 2011)). An examiner must review Form 1099s issued to individuals, determine that the classification of employees was correct and, if adjustments are proposed, determine if the taxpayer qualifies for Section 530 relief or if settlement programs apply, as part of the NRP's required analysis of Form 1099. (IRM 4.22.10.5.1 (Oct. 1, 2011)).

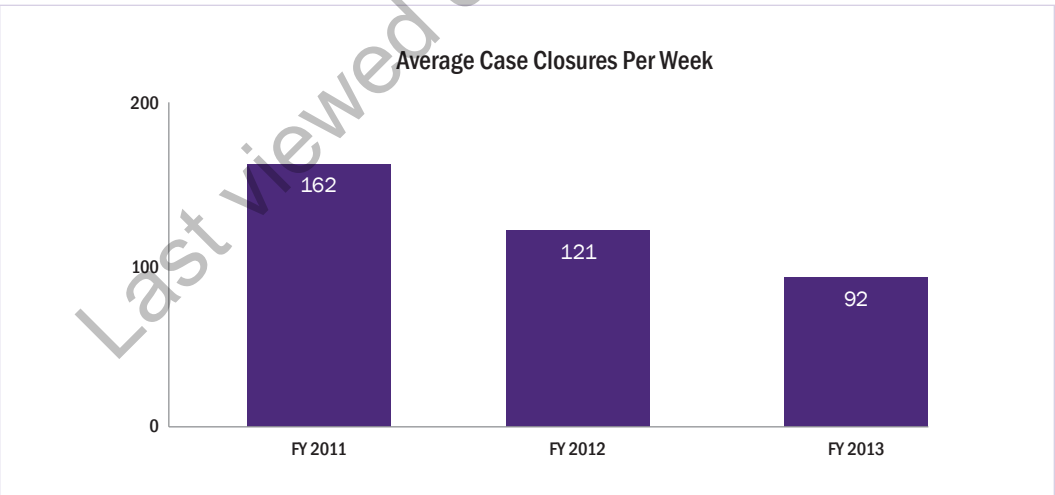
26 IRS response to TAS research request (Nov. 20, 2013).

FIGURE 1.19.1, SS-8 Overage Cases By Month[27]



The IRS has claimed that its large inventory was partially due to the SS-8 Unit's previous policy of accepting all forms filed.[28] The program's managers have since instituted "first read screening" procedures for new receipts — outlined above — to reduce incomplete filings. Despite these new procedures, the average case closures continue to decline.

FIGURE 1.19.2, AVERAGE WEEKLY CLOSURES[29]



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27 IRS response to TAS research request (Nov. 20, 2013).

28 TAS call with IRS Operating Division (Jul. 19, 2013).

29 IRS response to TAS research request (Nov. 20, 2013).

IRS Procedures Direct Employees to Reject Legitimate Applications Without Substantive Applicant Contact.

In accordance with its new IRM, the SS-8 Unit's clerical staff screens new Form SS-8 receipts to ensure the documents are complete, accurate, and meet criteria.[30] Until recently, the examiners have been working without formal guidance, but the standards in the new IRM (which encompasses the "first screening process") for rejecting cases are skewed. For example, the Unit can reject cases if the forms are incomplete or have missing information. The Form SS-8 instructions state all questions must be answered or state "Unknown" or "Does not apply."[31]

Some questions are necessary to make a determination as they shed light on the level of control by the business over the worker. However, other questions could be left unanswered. The SS-8 Unit is currently returning many forms as incomplete even though taxpayers, in most cases, will come back with the needed information. The IRS has allowed taxpayers to "cure" incomplete submissions in other areas, including the Collection offer in compromise program. The National Taxpayer Advocate described the hardships faced by taxpayers whose offers were rejected by the IRS during initial screening before they were considered for investigative review.[32] Collection employees are now guided to call taxpayers, before sending correspondence or rejecting an offer, and solicit any missing or incomplete information.[33] A similar approach could be beneficial in this instance; rather than rejecting incomplete SS-8 filings and increasing future receipts, simply picking up the phone and calling the taxpayer to request additional information could move a case forward with little burden to either party.

As shown below, a substantial number of Form SS-8 submissions have been returned to the submitters since the institution of first read screening procedures.[34] In fact, as technicians work through the backlog of unprocessed forms, they are now returning almost as many submissions as they are receiving.

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FIGURE 1.19.3, SS-8 Submissions and Returns[35]

Form SS-8 Submissions	Fiscal 2011	Fiscal 2012	Fiscal 2013
Filed by workers	9,198	5,392	3,982
Filed by firms	645	264	128
Returned	0	3,104	3,905

Currently, the SS-8 Unit immediately closes cases under a counter-productive standard based on "the adequacy of information provided," rather than keeping them open and notifying submitters of deficiencies. The Unit sends the submitter an information courtesy letter advising that it could not process the request for a determination since the form was incomplete or missing documentation.[36] If the submitter subsequently submits a completed form, the Unit opens a new case and starts aging the case at that time. This

30 IRM 7.50.1.3.1 (Oct. 3, 2013).

31 Form SS-8 (Rev. Aug. 2011) *Disclosure of Information, Parts I–IV*: "If you cannot answer a question, enter "Unknown" or "Does not apply."

32 National Taxpayer Advocate 2007 Annual Report to Congress 380.

33 IRM 5.8.4.7 (May 10, 2013).

34 IRS response to TAS research request (Nov. 20, 2013).

35 Id.

36 IRS Courtesy Information Letter 4949.

allows the Unit to return substantial numbers of forms and delete them from its open inventory. Due to the importance of a determination, the Unit should give the submitter at least 30 days to cure the defects and submit a completed Form SS-8, rather than rejecting it out of hand. In some cases, an outbound call from the SS-8 unit to the submitter could cure any perceived defects in the submission and quickly resolve the case for both the applicant and the IRS, as opposed to statistical gamesmanship.

A delay in a worker classification decision impacts workers and businesses adversely, as any delinquent income and employment taxes are subject to penalties and interest.

The IRS can address the backlog by providing a self-help tool for businesses to receive classification determinations. The United Kingdom provides a free, web-based, non-binding "indication of employment status" to requestors through an online tool called Electronic Status Indicator (ESI).[37] A similar tool would benefit U.S. taxpayers and the government.[38] Unless facts and circumstances have materially changed, workers and employers could rely on an online determination without submitting a Form SS-8.

The current SS-8 program is a paper-based system in which forms must be mailed to the IRS — faxed, photocopied, or electronic versions forms are not accepted for initial determinations.[39] An online system that would prevent requestors from submitting forms with missing data could help applicants by minimizing delays in the application cycle and the IRS by avoiding complications and downstream costs associated with resubmitted forms.

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Applicants Who Receive Adverse Determinations from the SS-8 Unit Lack Independent Administrative Appeal Options.

Applicants whose cases are in the SS-8 Unit have no option for an independent review if they receive an adverse determination. Instead, any disagreement is referred back to the unit, with no safeguards to ensure that the reviewer is independent of the group that made the original decision.[40] While the statute does not expressly provide appeal rights, nothing prevents the IRS from providing appeal rights to workers or businesses as to a status determination, even where there is no examination of a federal return. As noted above, the SS-8 Unit upholds almost all of its original determinations, which raises concerns about the impartiality of those reviews. An incorrect decision by the IRS has significant consequences to the income and employment tax liabilities of the affected parties. The IRS should provide applicants the right to an independent, administrative appeals review of adverse determinations.

37 HM Revenue & Customs http://www.hmrc.gov.uk/calcs/esi.htm (last visited Nov. 3, 2013). According to the site, "The ESI tool is helpful for anyone who takes on workers, such as employers and contractors. (The tool refers to anyone in this position as an engager.) Individual workers can also use the tool to check their employment status. The tool cannot, however, be used to check the employment status of some workers: company directors and other individuals who hold office, agency workers, [or] anyone providing services through an intermediary…"

38 National Taxpayer Advocate 2008 Annual Report to Congress, 376.

39 Form SS-8 (Rev. Aug. 2011).

40 IRM 7.50.1.5.10 (Oct. 3, 2013); IRM 8.7.16.1 (Oct. 1, 2012).

CONCLUSION

The National Taxpayer Advocate remains concerned that Congress and the IRS have not acted on previous recommendations in this area. The inventory backlog in the SS-8 unit means that businesses and applicants incur substantial tax consequences as they wait for classifications, and applications may be rejected in a narrow and rote screening process, leading to even more delays. The IRS has yet to provide online tools that applicants can rely on to determine their worker classification status and that would reduce SS-8 submissions. Further, businesses and workers alike are denied their full administrative appeal rights.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt the National Taxpayer Advocate's previous recommendation to develop an electronic self-help tool for employers or workers to determine employment status.[41]
2. Allow applicants the right to an independent administrative appeals review of adverse determinations by the SS-8 unit.
3. Increase staffing to address the existing backlog and prevent future accumulation of worker classification requests.
4. Provide applicants an opportunity to cure perceived deficiencies in their initial filings rather than rejecting the applications outright through an initial screening process.

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41 National Taxpayer Advocate 2012 Annual Report to Congress 19-20.

MSP #20 INTERNATIONAL TAXPAYER SERVICE: The IRS is Taking Important Steps to Improve International Taxpayer Service Initiatives, but Sustained Effort will be Required to Maintain Recent Gains

RESPONSIBLE OFFICIALS

Heather C. Maloy, Commissioner, Large Business & International Division
Debra Holland, Commissioner, Wage and Investment Division
Sarah Hall Ingram, Director, Affordable Care Act Implementation

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DEFINITION OF PROBLEM

In 2008, when the National Taxpayer Advocate first described the difficulties international taxpayers face in complying with their U.S. tax obligations, about five million U.S. citizens were living abroad. This compared to just over four million in 1999, a 22 percent increase in a nine-year period.[1] By 2013, the number of U.S. citizens overseas had jumped to 7.6 million — an additional increase of more than 50 percent in just five years.[2] The National Taxpayer Advocate continues to describe the challenges the Foreign Account Tax Compliance Act (FATCA) and Report of Foreign Bank and Financial Accounts (FBAR) regimes pose for international taxpayers.[3] Adding to their compliance obligations, beginning in 2014, U.S. taxpayers living abroad will face unique challenges in complying with their obligations under the Affordable Care Act (ACA).[4]

The National Taxpayer Advocate has continued to call attention to the service needs of international taxpayers, and the IRS has taken important steps to address some immediate concerns.[5] However, the IRS has not yet undertaken the long-term commitment necessary to meet the needs of this important, fast-growing group of taxpayers.

International taxpayers who do not find the online services they need may call the international call site, a *toll* number. The call site answered approximately 330,000 calls in fiscal year (FY) 2012. Callers, some

1 National Taxpayer Advocate 2008 Annual Report to Congress 141 (Most Serious Problem: *Access to the IRS by Taxpayers Located Outside of the U.S*); United Nations Secretariat Department of Economic and Social Affairs, Statistics Division, *Estimation of emigration from the United States using international data sources* 4 (Nov. 2006) *available at* http://unstats.un.org/unsd/Demographic/meetings/egm/migrationegm06/DOC%2019%20ILO.pdf#page=4, estimating that 4.1 million US citizens lived abroad in 1999.

2 U.S. Dept. of State Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers, available at* http://travel.state.gov/pdf/ca_fact_sheet.pdf, estimating that 7.6 million U.S. citizens live abroad (May 2013 update).

3 See Most Serious Problem (Reporting Requirements: *The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*) and Most Serious Problem (*The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those who Made Honest Mistakes*), *supra*.

4 The Patient Protection and Affordable Care Act of 2010 (ACA), Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010). For a more complete discussion of IRS outreach and education about the ACA see Most Serious Problem: *Affordable Care Act: The IRS Communication and Implementation Strategy Needs Improvement, supra*.

5 National Taxpayer Advocate 2012 Annual Report to Congress 262 (Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*); National Taxpayer Advocate 2011 Annual Report to Congress 129-272, which included six serious problems international taxpayers face in understanding and meeting their U.S. tax obligations.

of whom were phoning from overseas, waited ten minutes on average to speak to an assistor.[6] More than a quarter of the time, the caller did not succeed in speaking to an assistor at all.[7] International taxpayers may find information online about how to meet their filing obligations, and especially seek information about how to obtain an Individual Taxpayer Identification Number (ITIN), but they still cannot electronically file Form W-7, *Application for IRS Individual Taxpayer Identification Number* or Form 1040NR, *U.S. Nonresident Alien Income Tax Return*.

ANALYSIS OF PROBLEM

Background

More U.S. Citizens Live Abroad and a Greater Proportion are Renouncing their Citizenship. U.S. citizens or resident aliens are subject to tax on their worldwide incomes.[8] They have the same general tax reporting requirements whether they reside in the United States or abroad, an obligation that at one time could have been viewed as "nontrivial but not onerous."[9] However, as the National Taxpayer Advocate noted, the tax requirements have become so confusing and the compliance burden so great that some taxpayers give up their U.S. citizenship.[10] As Figure 1.20.1 shows, since 1999, the number of U.S. citizens living abroad has increased 85 percent while the number of annual expatriations has skyrocketed nearly 500 percent. Perhaps because renouncing citizenship "may be easier than staying in compliance with U.S. tax laws that can be onerous for citizens of other countries," expatriations are expected to continue to increase, with an expected 2013 level at least 33 percent more than the previous high in 2011.[11]

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6 As discussed below, there were 304,866 unique visitors in fiscal year 2013 to the IRS.gov landing page for international taxpayers. Taxpayers spoke to an assistor at the international call site 332,246 times in FY 2012. IRS Snapshot Report run Nov. 14, 2013. According to one IRS survey, 60 percent of international taxpayers who filed a return and called the IRS (67 out of 112) stated that they personally paid for the international phone call. Wage and Investment Research & Analysis (WIRA): 2012 *Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* 47 (Aug. 2012).

7 The Customer Service Representative (CSR) level of service at the international call site was 72 percent, meaning 28 percent of calls went unanswered.

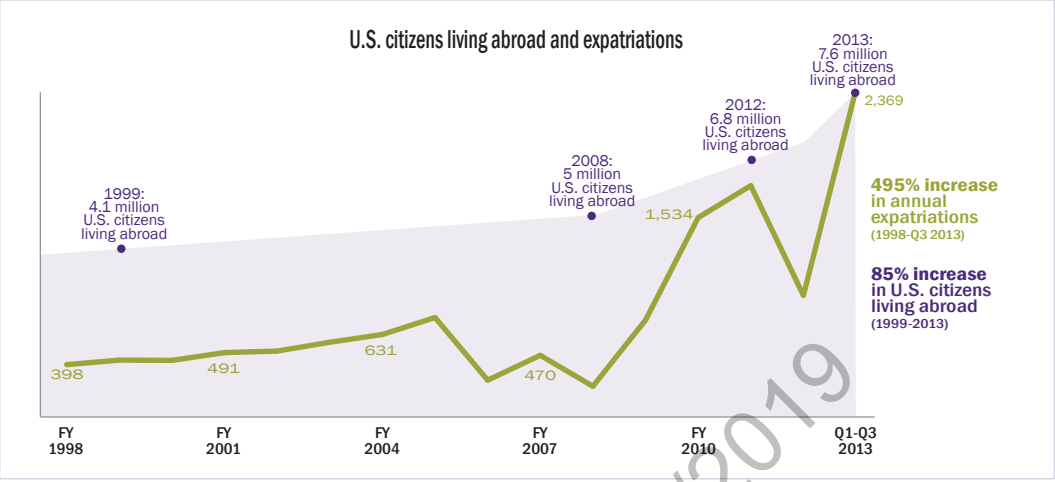
8 IRC § 61.

9 Peter J. Spiro, *The (Dwindling) Rights and Obligations of Citizenship*, 21 William and Mary Bill of Rights Journal 899 at 920 (Mar. 2013).

10 National Taxpayer Advocate 2012 Annual Report to Congress 262 (Most Serious Problem: *Challenges Persist for international Taxpayers as the IRS Moves Slowly to Address Their Needs*); National Taxpayer Advocate 2011 Annual Report to Congress 151 (Most Serious Problem: Individual U.S. Taxpayers Working, Living, or Doing Business Abroad Require Expanded Service Targeting their Specific Needs and Preferences).

11 Laura Saunders, *More Taxpayers Are Abandoning the U.S. Year's Tally for Expatriations Sets Record; Increase Comes Amid Tax Crackdown on Offshore Assets*, The Wall Street Journal (Nov. 13, 2013) *available at* http://online.wsj.com/news/articles/SB10001424052702304243904579195923107439130. See also William Douglas, *Tax Law is Putting a Strain on Expatriates: Record Number Are Ditching U.S. Passports Out of Frustration, Fear*, The Washington Post (Nov. 20, 2013) A24.

FIGURE 1.20.1, U.S. Expatriations Since 1998[12]



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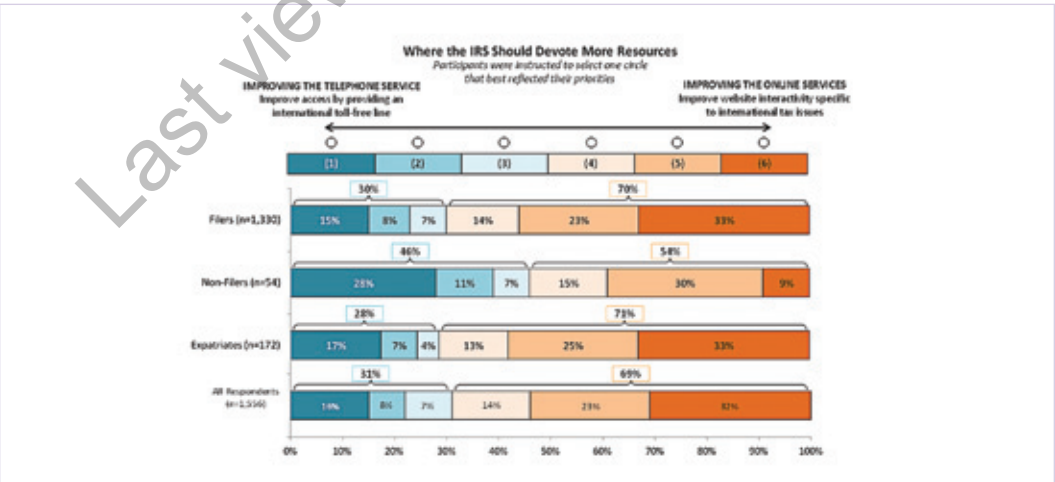
The IRS Focuses on Improving IRS.gov, but Telephone Communication Remains Essential for Many International Taxpayers.

In the past few years, the IRS has published research studies that explore the needs and preferences of international taxpayers.[13] As Figure 1.20.2 shows, while taxpayer preferences may best be described as falling on a continuum, most respondents to an IRS survey indicated that the IRS should devote resources to improving online services rather than to improving telephone services.[14] However, a significant minority preferred improvements to telephone service by providing an international toll-free line.

FIGURE 1.20.2, Preferences of Filers, Non-filers, and Expatriates[15]



Source: 2011 Survey of Individuals Living Abroad: Top Line Report. ICF Macro, September 16, 2011.

12 See Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*, *infra/supra* for further discussion of this trend.

13 *See, e.g.*, WIRA: 2012 Taxpayer *Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* (Aug. 2012); *WIRA: Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors, Research Study Report* (Feb. 2010).

14 WIRA: 2012 Taxpayer *Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* 60 (Aug. 2012).

15 *Id*. at 44.

The IRS report concludes, "[i]n light of recent budget cuts, tight resources, and an increased workload, the IRS must labor to improve voluntary compliance with international tax provisions and reduce the tax gap attributable to international transactions. This effort will require a strategic balance of both service and enforcement initiatives grounded in targeted, relevant outreach and the effective use of technology."[16] As part of this effort, the IRS's Office of Online Services (OLS) adopted a five-year strategy to provide taxpayers a range of online service options.[17] However, many of these services are not yet available. In the meantime, international taxpayers can obtain information or assistance with their individual accounts by calling the international call site, and they are doing so with increasing frequency, but the service they receive there is worsening.

… as the National Taxpayer Advocate noted, tax requirements have become so confusing and the compliance burden so great that some taxpayers give up their U.S. citizenship.

IRS.gov has a "Contact My Local Office Internationally" page that provides a telephone number (not toll-free) to the international call site, which taxpayers used to speak with an IRS employee about 330,000 times in FY 2012.[18] The customer service representative (CSR) level of service decreased from 78 percent in FY 2011 to 72 percent in FY 2012.[19]

The IRS's lack of online services forces taxpayers to call from overseas. This system may not accommodate their preferences, and is not the best use of IRS resources.[20]

At least one IRS Tax Attaché office uses the Department of State's voice-over-Internet- protocol (VoIP) system at the U.S. Embassy where it is located to reach taxpayers by telephone.[21] The service permits an unlimited number of international outbound calls for the same low rate.[22] If call forwarding were also part of the service, a taxpayer could dial the number listed in a local telephone directory as the IRS taxpayer service line and reach an IRS assistor in the U.S. - without paying international call rates.

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The IRS is Planning Significant Improvements to its Communications Capabilities that will Benefit International Taxpayers and is Undertaking Further Research About Their Filing Compliance but Needs to Prioritize Developing Online Services for These Taxpayers.

The IRS is launching a pilot program in which taxpayers will be able to securely exchange messages and documents with IRS employees through a secure messaging portal (SMP). Taxpayers who register for the service will receive system-generated notifications by email or SMS text notifying them they received a message on the SMP. The notification will not contain any personally identifiable information.

16 WIRA: 2012 Taxpayer *Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* 11 (Aug. 2012).

17 See National Taxpayer Advocate 2012 Annual Report to Congress 252 (Most Serious Problem: *The IRS is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to be Done*)

18 Taxpayers called this number and spoke with an assistor 332,246 times in FY 2012. IRS Snapshot Report (report run Nov. 14, 2013).

19 *Id*. We do not show data for FY 2013 because the numbers are not compatible with earlier years due to a change in the report structure.

20 See National Taxpayer Advocate 2012 Annual Report to Congress 151 (Most Serious Problem: *The IRS is Striving to Meet Taxpayers' Increasing Demand for Online Services, Yet More Needs to be Done*), noting that "[w]hile such [online service] projects involve upfront development and implementation costs, the IRS would realize savings in the short term from decreased call volume and in the long term from improved tax compliance and a reduction in costly enforcement contacts for basic issues."

21 National Taxpayer Advocate Nov. 15, 2013 in-person meeting and Nov. 26 and 27, 2013 telephone conversations between TAS Attorney Advisor and IRS Deputy Tax Attaché, United Kingdom.

22 Nov. 26, 2013 conversation with IRS Deputy Tax Attaché, United Kingdom, describing the applicable Vonage subscription. Vonage rates generally are *available at* http://vonage-promotions.com/?s=100&k=187&gclid=CM6T7-P_ILsCFTNp7AodIWoAUw. The IRS cannot confirm the cost of the service, but it appears that it would be approximately $30 per month.

Upon logging in through the SMP authentication page, the taxpayer will be able to read and respond to correspondence with the IRS, attach documents to messages to the IRS, and download attachments in messages from the IRS. Future pilot phases will include live chat, "click to call," screen sharing, and online video meetings.[23] One initiative tailored to taxpayers living abroad is a pilot project to offer Virtual Volunteer Income Tax Assistance (VITA). The pilot is scheduled to begin with the 2014 filing season at two sites, in Warsaw, Poland and Beijing, China. Another planned pilot that is not yet underway will provide virtual service and tax workshops in Virtual Town Hall meetings overseas.[24] The National Taxpayer Advocate applauds these efforts, and urges the IRS to include include international taxpayers in the earliest phases of the various online service pilots.

The IRS has also contracted with an independent consultant to survey 4,000 individuals residing abroad who the IRS believes have U.S. filing requirement and did not file a return.[25] The survey, to be conducted by mail and online, will "focus on why some individuals living abroad do not file a tax return, their awareness of certain tax provisions and forms specific to International Taxpayers, and how the IRS can encourage voluntary compliance among this population."[26] The IRS previously described such a survey, and while the National Taxpayer Advocate generally supports the initiative, she is concerned that the IRS is proceeding without vetting it with stakeholders, including TAS.[27]

The IRS's lack of online services forces taxpayers to call from overseas. This system may not accommodate their preferences, and is not the best use of IRS resources.

International Taxpayers Cannot Call the IRS for Some Important Services They Need and Do Not Have Access to Those Services Online.

The IRS website, with a new version (or "content management system") as of August 31, 2012, has a page for international taxpayers, but the IRS.gov homepage does not link directly to it. A user can select information for individual taxpayers from an obscure dropdown menu on the homepage and from there access the international taxpayer landing page.[28] Alternatively, from the homepage, a user can type in a search term such as "international" that opens the international taxpayer landing page. Google Analytics data, available since the launch of the new IRS.gov on August 31, 2012, shows the individual international taxpayer landing page was viewed approximately 450,000 times by about 300,000 unique visitors in FY 2013.[29] The five most frequently visited IRS web pages that pertain

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23 LB&I response to TAS information request (Oct. 28, 2013).

24 W&I response to TAS information request (Oct. 28, 2013).

25 *Id*. These presumed non-filers will be identified using the IRS Compliance Data Warehouse non-filer database and U.S. Department of State passport data.

26 *Id*.

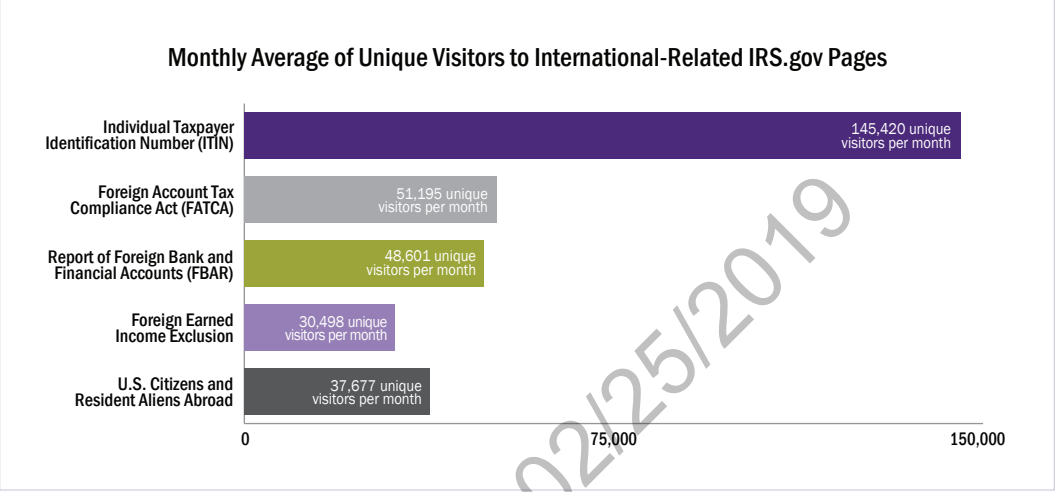
27 National Taxpayer Advocate 2012 Annual Report to Congress 262, 271 (Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*). The IRS indicates that "fielding for this survey is expected to begin in early January 2014 and concluded in March 2014." W&I response to TAS information request (Oct. 28, 2013).

28 The international taxpayer landing page is at http://www.irs.gov/Individuals/International-Taxpayers. Before the migration to the new Content Management System, the International Taxpayer content resided in the Businesses channel of IRS.gov rather than with the Individual channel.

29 The IRS uses Google Analytics to obtain metrics about IRS.gov webpage usage. Data includes the number of page views, the number of unique visitors, bounce rates, average time on pages, the number of exits, and average visit duration. There were 447,074 page views of the landing page, by 304,866 unique visitors during FY 2013. Large Business & International Division (LB&I) response to TAS information request (Nov. 18, 2013). Google Search Analytics also powers the new Content Management search engine on IRS.gov, allowing users to obtain more efficient search results.

to international taxpayers (other than the international taxpayer landing page) are shown in Figure 1.20.3 below.[30]

FIGURE 1.20.3, Monthly Average of Unique Visitors to International-Related IRS.gov Pages



Keeping in mind that "international taxpayers may best be served through investment and improvements in IRS.gov and online services," the IRS's Large Business & International Division considered Form W-7, the ITIN application, a candidate for electronic filing.[31] The Google Analytics data that has since become available confirms taxpayers' overwhelming interest in information about ITINs relative to other international topics. Nevertheless, LB&I no longer supports electronic filing of Form W-7 and taxpayers still cannot file it electronically.[32]

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30 LB&I response to TAS information request (Oct. 28, 2013). The IRS individual international page invites users to search TaxMap, an IRS-developed tax law discovery tool that refers taxpayers to information available on IRS.gov. TaxMap is *available at* http://taxmap.ntis.gov/taxmap. Approximately 13,000 unique visitors selected among the more than 200 topics in the TaxMap international index, but the IRS does not have data on which topics are visited most often. The TaxMap international index is hosted by another government agency, the National Technical Information Service (NTIS). The software NTIS uses is not configured to capture the frequency with which taxpayers select various index topics. However, the top five countries from which visitors accessed TaxMap, and the respective number of unique visitors in a recent six-month period were:

United States – 155,903 visitors; China – 5,937 visitors; Canada – 3,413 visitors; United Kingdom – 2,974 visitors; and Germany – 1,852 visitors. LB&I response to TAS information request (Oct. 28, 2013). The data is for the period March 22, 2013 to September 16, 2013 and was created through reverse domain name system lookups of the Internet protocol addresses of TaxMap visitors.

31 2012 WIRA Research Study; WIRA, *Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors, Research Study Report* 43, 60 (Feb. 2010).See National Taxpayer Advocate 2012 Annual Report to Congress 262, 274 (IRS Response, Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*).

32 The IRS advised that "The IRS does not plan to pursue electronic filing of the ITIN application. Form W-7, Application for IRS Individual Taxpayer Identification Number (ITIN),is not a candidate form for electronic filing for the following reasons: 1. Modernized e-File (MeF) is unable to accept both the W-7 and associated tax return(s) in the same transaction. Taxpayers are required to include their original, valid tax return(s) for which the ITIN is needed. [We note that this requirement is subject to a few exceptions. Nonresident aliens claiming the benefits of a tax treaty and persons with income, payments, or transactions subject to third party reporting or withholding may apply for an ITIN separately from filing a tax return. *See* Instructions for Form W-7 (Aug. 2013).] 2. MeF requires a valid Taxpayer Identification Number (TIN) at the time the return is submitted for processing. The tax returns submitted with the W-7 applications do not have a TIN when the return is submitted to IRS. 3. Taxpayers must also submit documentation that supports the information provided on the Form W-7. The applicant can submit original documents or certified copies from the issuing agency.

[We note that certain applicants are exempt from the requirement to submit original documents: spouses and dependents of military taxpayers; students who are part of the Student and Exchange Visitor Program (SEVP); and nonresident aliens claiming tax treaty benefits.] Attaching a pdf version of the supporting documentation will not allow IRS to authenticate the documents per IRM 3.21.263." TAS SharePoint (tracking annual report to Congress recommendations), 2012 Rec. 15-4.

LB&I did request inclusion of Form 1040NR, *U.S. Nonresident Alien Income Tax Return,* in the 2015 release of the IRS's Modernized E-file platform, which would permit taxpayers to file the return electronically. The IRS Submission Processing Executive Steering Committee declined to do so due to "other priorities and resource constraints."[33] However, as the National Taxpayer Advocate urged, the IRS now includes Form 8938, *Statement of Specified Foreign Financial Assets*, among those that can be submitted electronically.[34]

The IRS Still Maintains Only Four Foreign Tax Attaché Offices for Interaction with International Taxpayers.

The "How to Contact the IRS" webpage provides the contact information for four embassies or consulates where the IRS has tax attachés and for the local Puerto Rico office. Taxpayers contacted their foreign attaché offices 26,205 times in FY 2013, by way of:

- 6,929 in-person contacts (walk-in or by appointment);
- 10,546 telephone contacts; and
- 8,730 correspondence contacts (by letter, fax, or email).[35]

The four tax attaché offices held outreach events as follows:[36]

	Beijing	Frankfurt	London	Paris	Total
FY 2011	12	2	6	7	27
FY 2012	17	3	6	7	33
FY 2013	10	3	17	6	36

The topics of these outreach events and tax workshops, at which the number of attendees ranged from 20 to 200, included:

- Filing requirements for taxpayers living abroad;
- Foreign earned income exclusion;
- Foreign tax credit;
- Treaty-related issues; and
- ITIN, FBAR, FATCA, and other topics of interest for international taxpayers.[37]

Despite the growth of the U.S. population overseas and repeated urging by the National Taxpayer Advocate, the IRS has not increased the number of attachés and has no plans to do so.[38]

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33 LB&I response to TAS information request (Oct. 28, 2013).

34 See National Taxpayer Advocate 2012 Annual Report to Congress 262, 280 (Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*)

35 LB&I response to TAS information request (Oct. 28, 2013).

36 *Id*.

37 LB&I response to TAS information request (Oct. 28, 2013).

38 See National Taxpayer Advocate 2011 Annual Report to Congress 151,157 (Most Serious Problem: Individual U.S. Taxpayers Working, Living, or Doing Business Abroad Require Expanded Service Targeting Their Specific Needs and Preferences) for a description of the IRS attaché post expansion analysis, in which it identified nine countries as candidates for post expansion. The study abruptly ended due to "budgetary and other considerations." The IRS has no plans to increase the number of foreign tax attaché posts. LB&I response to TAS information request (Oct. 28, 2013).

The Individual Taxpayer Assistance Team is a Promising Development, but Needs to be Made Permanent.

In June 2012, LB&I, the Wage & Investment Division (W&I), and TAS created the International Individual Taxpayer Assistance Team (IITA) to develop international taxpayer service initiatives.[39] The IRS Office of Online Services (OLS) joined the group in August of 2012. The team has been instrumental in updating and streamlining various IRS webpages for international taxpayers, identifying areas and issues of most concern to them and working with TaxMap. The National Taxpayer Advocate has recommended that the IRS make IITA permanent, with a formal charter.[40] She has further recommended that IITA be required to provide periodic written reports and formal recommendations to Business Operating Division (BOD) executives through the existing Services Committee, and the IRS has agreed to consider the proposal. Once IITA is a permanent, accountable group, it can engage in long-term planning, and the IRS can measure its effectiveness. LB&I has appointed a permanent full-time program manager for IITA, an important first step, but there are no other full-time employees dedicated to IITA.[41] IITA continues to function through "cross functional ad hoc teams" — exactly the approach the National Taxpayer Advocate would prefer to avoid, in favor of a more holistic approach.[42]

International Taxpayers Face Unique Challenges under the Affordable Care Act.

The Affordable Care Act of 2010 generally requires "applicable individuals" to have minimal essential health coverage (MEC) beginning in 2014 or pay a penalty.[43] U.S. citizens abroad who are subject to the requirement will be treated as having MEC under circumstances described in the statute (for example, if they are eligible for the foreign earned income exclusion).[44] In addition, according to the Department of Labor, U.S. citizens living abroad who do not meet the statutory requirements may still be considered as having MEC if they are covered by an "expatriate health plan."[45] However, Treasury regulations do not reflect this rule and important details about how U.S. taxpayers living abroad can meet their obligations under the ACA remain undeveloped.[46] The IRS has posted only two FAQs about how ACA applies to

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39 For a complete discussion of the steps the IRS has taken to provide better service to international taxpayers, see National Taxpayer Advocate 2012 Annual Report to Congress 262, 265 (Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*).

40 National Taxpayer Advocate 2012 Annual Report to Congress 262, 280 (Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs*).

41 LB&I response to TAS information request (Oct. 28, 2013).

42 Nov. 4, 2013 email from IITA program manager to TAS Senior Technical Advisor.

43 The Patient Protection and Affordable Care Act of 2010, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010). An "applicable individual" does not include "an individual for any month if for the month the individual is not a citizen or national of the United States or an alien lawfully present in the United States." *See* IRC § 5000A(a), (b), (d), and (f).

44 IRC § 5000A(f)(4) provides: "Individuals residing outside United States or residents of territories. — Any applicable individual shall be treated as having minimum essential coverage for any month — (A) if such month occurs during any period described in subparagraph (A) or (B) of section 911(d)(1) which is applicable to the individual, or (B) if such individual is a bona fide resident of any possession of the United States (as determined under section 937(a) for such month."

45 An expatriate health plan for purposes of certain transitional relief is "an insured group health plan with respect to which enrollment is limited to primary insureds who reside outside of their home country for at least six months of the plan year and any covered dependents, and its associated group health insurance coverage." U.S. Dep't. of Labor, *FAQs about the Affordable Care Act Implementation Part XII* (March 8, 2013), *available at* http://www.dol.gov/ebsa/faqs/faq-aca13.html.

46 Letter from the American Benefits Council to the U.S. Dep't. Of Labor (May 8, 2013) *available at* http://www.americanbenefitscouncil.org/index.cfm.

U.S. citizens residing abroad, neither of which sheds any additional light on this issue.[47] The international taxpayer landing page does not contain a direct link to these FAQs.

CONCLUSION

The population of U.S. international taxpayers is growing rapidly, and is subject to increasingly burdensome tax compliance obligations. The IRS emphasizes service to these taxpayers via IRS.gov pages, but taxpayers increasingly call the IRS for information and matters relating to their accounts even if they have to pay for the call and even though they would prefer online services. At the same time, important online services continue to be unavailable. The IRS is making incremental progress with developing the International Individual Taxpayer Assistance Team, but needs to do more.

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RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Make the IITA a permanent initiative with reporting responsibilities.
2. Develop and implement free electronic filing of Forms 1040NR and W-7.
3. Prioritize the delivery of online services to the overseas population of international taxpayers, given their special circumstances and communication barriers, by including them in the first group of pilot projects the IRS launches.
4. Improve the CSR level of service for international taxpayers who call the international call site.
5. Explore the use of voice-over-Internet-protocol and other alternative methods of telephone services that will allow the IRS to contact taxpayers, and taxpayers to contact the IRS, without paying international call rates.
6. Open more foreign tax attaché offices, and locate a Local Taxpayer Advocate at each site.
7. Develop dedicated FAQs that ultimately become formal published guidance about how U.S. citizens abroad who are subject to the reporting requirements of the Affordable Care Act (ACA) can meet their obligations, and provide links to this guidance on the ACA webpage from the international taxpayer webpage.

47 The FAQs appear at http://www.irs.gov/uac/Questions-and-Answers-on-the-Individual-Shared-Responsibility-Provision and include answers to: 12. Are US citizens living abroad subject to the individual shared responsibility provision? 13. Are residents of the territories subject to the individual shared responsibility provision? ACA Implementation response to TAS information request (Nov. 1, 2013).

MSP #21 INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS: ITIN Application Procedures Burden Taxpayers and Create a Barrier to Return Filing

RESPONSIBLE OFFICIAL

Debra Holland, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

In late 2012, in response to a Treasury Inspector General for Tax Administration (TIGTA) report, the IRS announced permanent changes to its Individual Taxpayer Identification Number (ITIN) application procedures. Under the new procedures, primary and secondary applicants may use a certifying acceptance agent (CAA) to certify their supporting documents and submit copies rather than originals to the IRS. However, persons applying for an ITIN for a dependent still must mail original documents or copies certified by the issuing agency to the IRS, unless the dependent has the documents certified at an IRS Taxpayer Assistance Center (TAC) or a U.S. tax attaché's office.

The new procedures are one reason ITIN applications filed with returns during calendar year 2013 plunged 48.4 percent from the 2010-2012 baseline.[1] During the same time, the percentage of rejected applications has soared to 50.2 percent.[2] Without an ITIN, taxpayers ineligible for a Social Security number (SSN) cannot meet their tax return filing obligations or claim the personal exemptions for spouses and children and the tax credits and refunds to which they are legally entitled. Taxpayers also need ITINs to participate in the global economy by having the proper amount of taxes withheld, claiming tax treaty benefits, and complying with reporting laws such as the Foreign Account Tax Compliance Act (FATCA).[3]

A fundamental problem with the IRS's ITIN application procedures is that they exacerbate the issues identified by TIGTA instead of mitigating them, including:

- The lack of appropriate employee training and sufficient time to review ITIN applications, made worse by the new CAA limitations;
- The inability of CAAs, who often have specialized knowledge of identification documents used in certain communities and regions, to assist the IRS in identifying fraud because they cannot certify dependent documents; and
- The continued requirement to submit ITIN applications with a paper tax return during the filing season, which burdens taxpayers and the IRS, and squanders opportunities to detect fraud.

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1 IRS, ITIN Production Reports (Oct. 30, 2010, Oct. 29, 2011, Oct. 27, 2012, and Oct. 26, 2013). Totals are year-to-date from January 1 through the date of each report.

2 *Id.*

3 See Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights, infra*.

A second major problem is that with the ITIN unit's increased focus on fraud and enforcement, it has given taxpayer service short shrift. Issues related to this approach include:

- Long wait times for applications to be processed, lost mail, and inadequate customer service and assistance at TACs;
- Barriers to resolving suspended or rejected applications, and the inability to speak with an IRS employee and learn the reason for a suspension or a rejection;
- New CAA procedures that discourage participation in the program and fail to provide appropriate training to CAAs; and
- Procedures for retiring old or inactive ITINs that may harm taxpayers and deprive them of their rights.

ANALYSIS OF PROBLEM

Background

The National Taxpayer Advocate has drawn attention to issues with the ITIN application process for many years.[4] In 2003, the National Taxpayer Advocate reported the IRS did not have adequate staffing to process ITIN applications and tax returns during the filing season.[5] She also identified processing delays, inadequate phone assistance, and the seemingly arbitrary acceptance or rejection of applications. Many of these problems still burden applicants a decade later. In July of 2012, TIGTA reported the ITIN application process was "so deficient that there is no assurance that ITINs are not being assigned to individuals submitting questionable applications."[6] While not minimizing compliance concerns, the National Taxpayer Advocate disagreed with some of TIGTA's conclusions about the amount of fraud associated with ITINs,[7] as well as recommendations such as requiring only original or certified copies of documents and discontinuing the CAA program.[8]

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Overview of New Procedures

In response to the TIGTA report, the IRS made wholesale interim changes to the ITIN program in June 2012, many of which were made permanent in November 2012 revisions.[9] Under the new procedures, taxpayers (subject to a few exceptions) must send to the IRS original documents or copies certified by the issuing agency to support their ITIN applications unless they:

1. Use a CAA;
2. Apply at a Taxpayer Assistance Center; or

4 *See* National Taxpayer Advocate 2003 Annual Report to Congress 60-86; National Taxpayer Advocate 2004 Annual Report to Congress 143-162; National Taxpayer Advocate 2008 Annual Report to Congress 126-140; National Taxpayer Advocate 2010 Annual Report to Congress 319-338; National Taxpayer Advocate 2012 Annual Report to Congress 154-79.

5 National Taxpayer Advocate 2003 Annual Report to Congress 60-86.

6 TIGTA, Ref. No, 2012-42-081, Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications (July 16, 2012) (hereinafter TIGTA report).

7 *See* National Taxpayer Advocate 2012 Annual Report to Congress 157 (finding that the complexity of the requirements for claiming the Child Tax Credit or Additional Child tax credit lead to widespread erroneous claims or omissions that cannot be attributable solely to fraud, as the TIGTA reports imply).

8 *Id.* at 159; TIGTA Report.

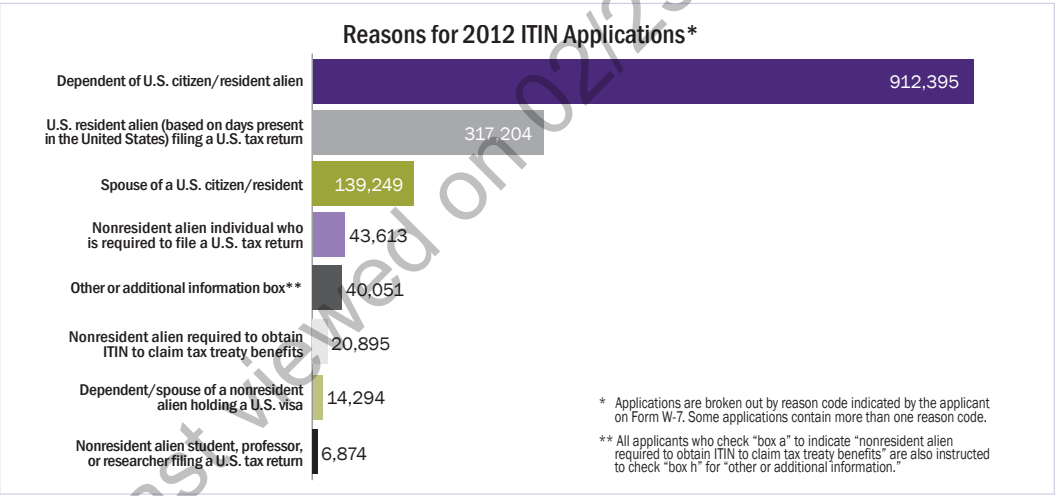
9 *See* IRS, IRS Strengthens ITIN Application Requirements; Interim Changes Will Protect the Integrity of the ITIN Process, IR 2012-62 (June 22, 2012); IRS, IRS Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season, IR 2012-98 (Nov. 29, 2012).

3. Apply at a U.S. tax attaché office.

Only primary and secondary applicants can use a CAA to certify their supporting documentation.[10] All applicants, including dependents, can apply at a TAC, but TACs will only certify passports and national ID cards.[11] Applicants living overseas can also apply at one of four U.S. tax attaché offices, which will certify all 13 approved types of documentation.[12] The new original document requirement exempts military spouses and dependents, students who are part of the Student and Exchange Visitor Program (SEVP),[13] and nonresident aliens claiming tax treaty benefits.

The revised procedures left in place the requirement that absent certain exceptions, an applicant must submit the application with a paper federal tax return during the filing season, to prove the taxpayer has a valid filing requirement. Nonresident aliens claiming the benefits of a tax treaty and persons with income, payments, or transactions subject to third-party reporting or withholding may apply for an ITIN separately from filing a tax return.[14] However, these applicants make up a minority of ITIN filers.

FIGURE 1.21.1, Calendar Year 2012 ITIN Applications by Reason Code[15]



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10 To send in copies of the documents instead of originals or certified copies, CAAs must conduct an in-person interview or a live video electronic interview with the applicant. *See* IRM 3.21.263.3.2 (Jan. 2, 2013).

11 The IRS increased the number of TACs certifying ITIN applications to 100 during the end of the 2013 filing season but has not committed expanding this program to more TACs in 2014. http://www.irs.gov/uac/TAC-Locations-Where-In-Person-Document-Verification-is-Provided (last updated June 3, 2013). IRS response to TAS information request (Nov. 7, 2013).

12 The attachés are based in Beijing, Frankfurt, London, and Paris. *See* 2013 ITIN Updated Procedures Frequently Asked Questions, http://www.irs.gov/Individuals/2013-ITIN-Updated-Procedures-Frequently-Asked-Questions (last updated Sept. 13, 2013).

13 The Taxpayer Advocate Service was instrumental in bringing about this exception for SEVP students. TAS held multiple conference calls and meetings with stakeholders during 2012 and advocated for revised procedures for students.

14 *See* Instructions for Form W-7 (Aug. 2013).

15 TAS Research, Compliance Data Warehouse, Entity Application Programs, Form_W7 table, data drawn November 19, 2013. The reason code for dependents is derived from the W-7 application itself that lumps dependents of U.S. Citizens and resident aliens (for tax purposes) together.

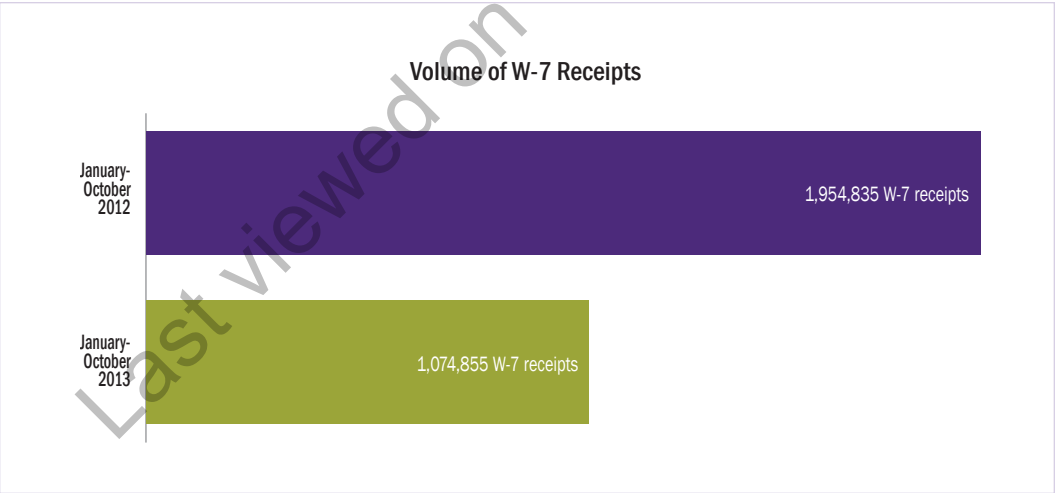
The National Taxpayer Advocate, Low Income Taxpayer Clinics (LITCs), and outside stakeholders warned the IRS about the negative consequences of the interim procedures, and of retaining the rule that an applicant must apply with a tax return during filing season, which include the following:[16]

- Taxpayers may forgo filing a joint return and claiming any exemptions, or file with an incorrect filing status because their spouses and dependents cannot obtain ITINs before the return filing date. Thus, they may pay more than they owe.
- Some affected taxpayers may stop filing returns altogether due to the difficulty of obtaining an ITIN.
- Taxpayers will experience hardship from not having their original documents for an extended period (often many months), risking fines and incarceration in some locations, and facing the costs of obtaining duplicates if lost.

Current and Future Volumes of ITIN Applications

From January 1 through October 27, 2012 the IRS received nearly two million ITIN applications.[17] During the same period in 2013, having projected receipts of over 1.8 million, the IRS received just over one million as shown below.[18]

FIGURE 1.21.2, Volume of W-7 Receipts, 2012 and 2013



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While a decline in unauthorized immigration may have contributed to the decrease, recent data suggests that unauthorized immigration has actually increased since 2009.[19] In addition, while economic activity slowed during the global downturn, it has picked up again and applicants need ITINs for purposes of

16 *See* National Taxpayer Advocate 2012 Annual Report to Congress 159-63.

17 ITIN Comparative Report (Oct. 26, 2013). There were 1,954,836 W-7 receipts, 1,241,031 ITINs assigned, and 720,771 applications rejected from January through October, 2012.

18 *Id*. The IRS projected receipts of 1,820,782 for October 26, 2013. There were only 1,074,855 W-7 receipts, the IRS assigned 550,840 ITINs, and rejected 538,544 applications from January through October 2013. The term projected receipts is synonymous with the IRS term "scheduled receipts."

19 *See* Pew Research Hispanic Trends Project, *Population Decline of Unauthorized Immigrants Stalls, May Have Reversed* (Sept. 23, 2013), *available at* http://www.pewhispanic.org/2013/09/23/population-decline-of-unauthorized-immigrants-stalls-may-have-reversed/. The estimated number of unauthorized immigrants peaked at 12.2 million in 2007, fell to 11.3 million in 2009, but has been increasing since to 11.7 million in 2012. *Id*.

withholding or claiming tax treaty benefits.[20] One plausible explanation for the decrease in applications is the chilling effect of the new procedures.[21] LITCs reported to TAS that in 2013, people chose not to apply for ITINs due to the burden of giving up original documents.[22]

The burden associated with the IRS's new procedures will only be exacerbated by any upcoming immigration reform. In 2013, the Senate passed the Border Security, Economic Opportunity, and Immigration Modernization Act.[23] Under section 2101 of this bill, persons cannot apply for registered provisional status until they have satisfied "any applicable Federal tax liability," which includes any income taxes assessed under IRC § 6203.

Having satisfied an assessed tax liability would usually mean a taxpayer has already filed a return with an ITIN. However, the legislation also requires applicants to meet an employment or education requirement, and one method for meeting this is to provide proof of income. Thus, there may be an upsurge in ITIN applicants who need to file past returns. The Senate bill is estimated to result in a net increase of 9.6 million people residing in the United States by 2023.[24] When asked if it considers how immigration patterns affect ITIN applications, and how it will manage an increase in applications due to reform, the IRS provided no details about these issues or whether it has done any planning.[25]

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ITIN Applicant Characteristics

ITIN filers, on average, report low adjusted gross income (AGI), with most of it coming from wages. They also claim lower refunds and lower child tax credits, but higher additional child tax credits, as shown in Figure 1.21.3.[26]

FIGURE 1.21.3, Income and Credits of ITIN and Non-ITIN Filers – Tax Year 2010, Processing Year 2011*

	Average For ITIN Filers	Average for Non-ITIN Filers
Adjusted Gross Income	$ 32,616	$ 59,984
Wage Income	$ 33,584	$ 50,376
Refund Amount	$ 2,824	$ 3,516
Child Tax Credit	$ 878	$ 1,227
Additional Child Tax Credit	$ 1,944	$ 1,236

* Average amount is calculated for returns where the line item is greater than zero.

ITIN filers possess a lower proportion of single filers than the overall population, claim more dependents, and as a group are younger.

20 In 2012, almost 21,000 people applied for an ITIN to claim tax treaty benefits, as shown by checking box "a" on Form W-7. TAS Research, Compliance Data Warehouse, Entity Application Programs, Form_W7 table, data drawn November 19, 2013.

21 *See* IRS response to TAS information request (Nov. 7, 2013) ("Recent implemented changes to the ITIN program, including more rigid documentation requirements, may have contributed to the recent decrease in applications received and the number of applications rejected and suspended. Another factor may be a change to the population that applies for ITINs.").

22 TAS conference call with Low Income Taxpayer Clinics (May 23, 2013).

23 S.B. 744, 113th Cong. (2013).

24 CBO, Letter to Patrick Leahy, Chairman, Committee on Judiciary 1 (July 3, 2013), *available at* http://www.cbo.gov/publication/44397.

25 The IRS's response states: "The IRS will take the necessary steps to administer any tax related requirements of legislation if and when a new law is enacted." IRS response to TAS information request (Nov. 7, 2013).

26 IRS, Wage and Investment Research and Analysis (WIRA) ITIN Preliminary Findings and Recommendations (July 13, 2012).

FIGURE 1.21.4, DEMOGRAPHICS OF ITIN FILERS – TAX YEAR 2010, PROCESSING YEAR 2011*

Filing Status	ITIN Filers	Non-ITIN Filers
Single	20%	46%
Married Filing Joint	41%	38%
Married Filing Separate	4%	2%
Head of Household	35%	15%

Dependent Count	ITIN Filers	Non-ITIN Filers
0	18%	64%
1	14%	17%
2	23%	13%
3	23%	5%
4+	22%	2%

Age Category (Primary Taxpayer)	ITIN Filers	Non-ITIN Filers
0-18	0%	1%
19-25	11%	13%
26-35	35%	19%
36-45	30%	17%
46-55	15%	19%
56-65	6%	15%
66+	3%	15%

* Numbers may not total due to rounding.

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For Tax Year 2011, ITIN filers reported $8.4 billion in total tax liability.[27]

The New Procedures Are Not Tailored to Address Fraud.

According to the TIGTA report, major issues with the IRS's processing of ITIN applications include:

- The environment created by management, including short processing timeframes, discourages employees from detecting fraudulent applications.
- Employee training on questionable documents is inadequate.
- The processes do not verify applicants' identity and foreign status.
- IRS management eliminated steps to identify questionable application patterns and schemes, including using application data such as duplicate mailing addresses as an indication of fraud.[28]

If one of the primary problems is that IRS employees are not sufficiently trained or given adequate time to process ITIN applications, the IRS's decision to only allow primary and secondary applicants to use CAAs only worsens this problem. Under the new procedures, the ITIN unit will likely receive more applications

27 *See* IRS response to TAS information request (Nov. 7, 2013), Individual Taxpayer Identification Number (ITIN) Usage Analysis: Tax Year (TY) 2010 to 2012.

28 *See* TIGTA Report.

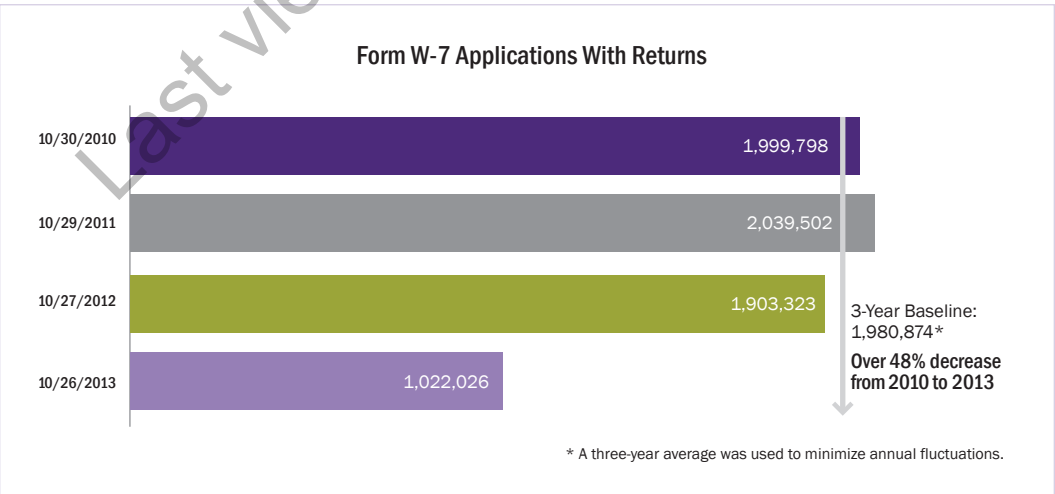
that have not been certified by a CAA, requiring greater scrutiny and more time to review. The reduction in the CAA program also does not help resolve problems with verifying identity and foreign status. CAAs are embedded in the communities they serve, and often their clientele consists largely of people from a few specific countries. Unlike IRS employees, who must be able to review identity documents from hundreds of countries, CAAs often have specific knowledge of a country's or region's documentation, putting them in a better position to verify identity and foreign status and identify fraud.

Some affected taxpayers may stop filing returns altogether due to the difficulty of obtaining an ITIN.

The TIGTA report includes a detailed section about how many ITINs and associated refunds were sent to a single address, implying that these ITIN applications were fraudulent.[29] During the 2013 filing season, the IRS instructed employees to "correct" the taxpayer's mailing address listed on the application (Form W-7) if the address belonged to a CAA.[30] This policy harmed applicants who may not have had long-term addresses where they could receive official documents. Based on the theory that a large number of documents sent to a single address is an indicator of fraud, the IRS made changes that burden taxpayers without actually addressing any proven fraud in the context of ITINs. TAS is pleased that the IRS has since accepted its recommendation to remove this instruction from the IRM and allow applicants to use a CAA's address to receive original documents.[31]

The IRS also changed its employee training to address the TIGTA comments about an environment that leaned towards accepting applications. However, it appears the pendulum may have swung too far in the opposite direction. Through October 2013, the number of W-7 applications with filed returns has plummeted 48.4 percent from the previous three-year baseline as shown below.

FIGURE 1.21.5, 2013 Form W-7 Applications with Returns Plunged 48.4 Percent from the 2010–2012 Baseline[32]



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29 *See* TIGTA Report at 17.

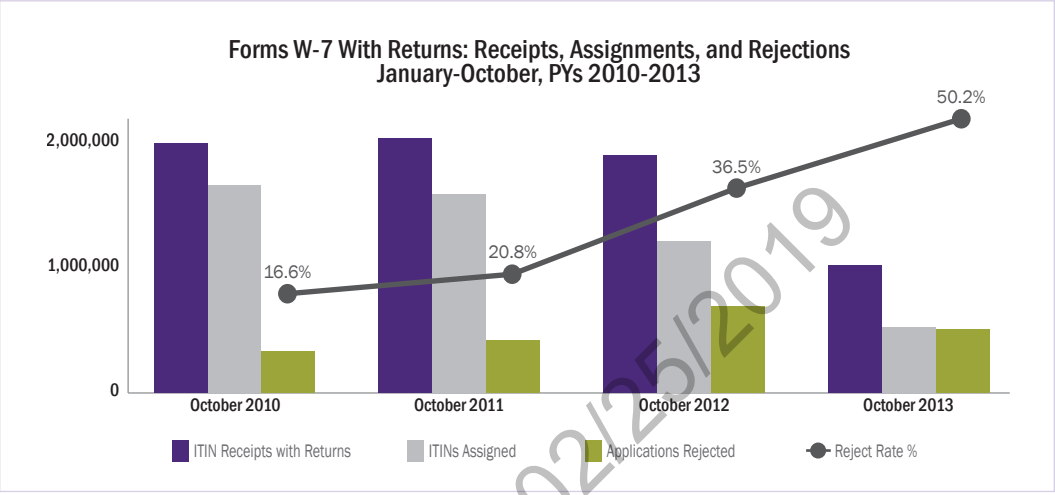
30 This address is used to return original documents to the applicant. "If the address on line 2 is the business address of the CAA, edit the taxpayer's address from the tax return to the Form W-7." IRM 3.21.263.5.3.5.5 (Jan. 1, 2013).

31 *See* TAS IMD Review Comments, IRM 3.21.263, SAMS 27612 (July 25, 2013). *See also* Interim Procedural Update 13U1417, IRM 3.21.263.5.3.5.5(2) (Sept. 3, 2013). Stakeholders also advocated for this change. IRS conference call with practitioners (Aug. 16, 2013).

32 IRS, *ITIN Production Reports* (Oct. 30, 2010, Oct. 29, 2011, Oct. 27, 2012, and Oct. 26, 2013). Receipts are year-to-date totals from January 1 through the date of each report.

Even with a near 50-percent decline in ITIN applications and accompanying tax returns, the percentage of rejected applications has soared to 50.2 percent as shown in Figure 1.21.6 below.

FIGURE 1.21.6, Forms W-7 with Returns, Assigned ITINs, Rejected Applications, and IRS Reject Rate[33]



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If most of the increase in the rejection rate is due to the new procedures, the net effect of the rule change has resulted in an additional 300,000 applications denied in 2013 alone.[34]

According to the IRS, the number one reason applications were placed in suspense was that "supporting identification documentation that was submitted is unacceptable."[35] The top reason for rejecting applications was that the applicant did not respond to the suspense notice requesting additional information.[36] Practitioners and applicants commonly report that the IRS is rejecting documentation they believe to be legitimate. There are multiple reasons for this:

- An IRS employee might not recognize that a document is valid, such as in cases where legitimate passports are rejected.
- An IRS employee may not recognize that a document is sufficient, which happened when the IRS rejected over 200 Canadian student applications because they lacked visas, even though the U.S. State Department does not require visas for Canadian students.[37]
- An official document from another country or region within that country, *e.g.*, a foreign birth certificate or school record, might not conform to the IRS's standards for these documents.

33 IRS, *ITIN Production Reports* (Oct. 30, 2010, Oct. 29, 2011, Oct. 27, 2012, and Oct. 26, 2013). Receipts are year-to-date totals from January 1 through the date of each report.

34 IRS, *ITIN Production Reports* (Oct. 29, 2011, Oct. 27, 2012, and Oct. 26, 2013). The rise in the reject rate from 16.6 percent in 2010 to 50.2 percent in 2013 shows an increase of approximately 300,000 additional rejected applications for PY 2013.

35 IRS response to TAS information request (Nov. 7, 2013).

36 *Id*.

37 TAS Systemic Advocacy Management System (SAMS) issue 28728.

The first and the second examples indicate a lack of employee training. The last example indicates the IRS's new procedures are poorly executed because they make certain forms of documentation inapplicable by not considering what these documents actually contain.[38]

Indications that the IRS suspended or rejected applications that it later approved, without receiving any additional documentation, are also disturbing.[39] Practitioners reported reapplying with identical supporting documents following a rejection and having the second application accepted.[40] In early 2013, the IRS placed 120,000 ITIN applications in R98 status pending a decision on acceptable certified copies of documents from the issuing agency.[41] Documents were held for 30 days before a decision was made to begin processing the applications.

Although both TIGTA and IRS's Wage and Investment, Research and Analysis (WIRA) have supplied research that touches on the level of compliance among ITIN filers, the IRS does not appear to have a comprehensive picture of the payment compliance, filing compliance, and return accuracy of this population.[42] Without this information, IRS personnel cannot adequately assess the benefits and detriments of various ITIN policy options. Instead of creating sweeping rules that block over half of ITIN applications, the IRS should evaluate how to detect fraud and prevent fraudulent refunds by running these returns through filters and databases, perhaps even an ITIN specific filter.

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Requiring ITIN Applications to be Filed with Paper Returns During the Filing Season Burdens Affected Taxpayers and the IRS Alike, Hampering Efforts to Detect and Deter Fraud.

Requiring the majority of ITIN applicants to file during the filing season forces applicants to wait up to ten weeks for their applications to be processed and their original documentation returned, and even longer to receive refunds.[43] The IRS has stated, "associating the issuance of the ITIN with the filing of a tax return is still the only reliable method for the IRS to verify the number is being requested and properly used for tax administration purposes."[44] However, as demonstrated by exceptions for certain applicants, such as those claiming the benefits of a tax treaty or who are subject to withholding, there are ways for applicants to prove a tax administration purpose without filing a return. Indeed, the IRS allows applicants to provide copies of pay stubs with year-to-date information to verify that the applicant earned income in the case of a Form W-7 and Form W-2 mismatch.[45] There is no reason one or more pay stubs could not be accepted to prove income and a filing requirement prior to the filing of the tax return.

38 The IRS changed some requirements to accommodate records that did not comply with its standards. *See, e.g.*, Interim Procedural Update WI-03-0613-1108 (June 13, 2013) (updating IRM 3.21.263.5.3.4.2(3) to specify that nursery or kindergarten school letters for applicants under six do not require listing course work or grades). However, multiple practitioners reported to TAS at the Nationwide Tax Forums in August 2013 that clients frequently had records that they could not use or were rejected because the record did not comply with the IRS's standards despite it being a legitimate record.

39 For example, a practitioner at the 2013 IRS Nationwide Tax Forums informed TAS about receiving rejection notices for ITIN applicants, followed weeks later by notices that the ITINs were assigned.

40 Practitioners at the 2013 IRS Nationwide Tax Forums reported this issue.

41 R98 status is a rejection code for an application received without a mailing address. IRS response to TAS information request (Nov. 7, 2013).

42 *See* TIGTA Report. *See also* IRS, WIRA ITIN Preliminary Findings and Recommendations (July 13, 2012).

43 These were the expected wait times for the 2013 filing season. *See* IRS, Stakeholder Partnerships, Education and Communications (SPEC), *Certifying Acceptance Agent and Forensic Training* (Jan. 29, 2013).

44 IRS response to TAS information request (Nov. 7, 2013).

45 *Id*.

Requiring ITIN applications during the filing season forces the IRS to process them under short timelines and does not provide sufficient time for fraud review, a concern raised by TIGTA. The IRS has advised it does not plan to pursue electronic filing of the ITIN application, despite the increased potential to detect fraudulent applications through electronic filters.[46] If the IRS accepted applications throughout the year, with proof of a legitimate filing requirement, its employees could spend more time verifying applications and supporting documents, detecting fraudulent schemes, and creating filters to catch fraudulent applications. This approach would also allow the initial ITIN returns to be e-filed and run through the IRS's regular fraud and identity theft filters.

The IRS Provides Inadequate Customer Service to ITIN Applicants and Improperly Suspends or Rejects Thousands of Applications.

The IRS's inability to process ITIN applications efficiently, timely, and correctly deprives taxpayers of their fundamental right to quality service. The average ITIN unit process cycle time during calendar years 2011, 2012, and 2013 was 20, 21, and 20 days respectively, which at first glance appears to be an acceptable time.[47] However, the IRS does not measure cycle time on suspended and rejected applications from the taxpayer's perspective, *i.e.* from start to finish. Instead, the IRS only measures how quickly it arrives at a preliminary decision, without considering the time taxpayers wait for the IRS to respond to additional information that taxpayers submit following the initial suspension or rejection.[48] Furthermore, the IRS does not take into account reworked applications that were erroneously rejected, or delays in processing due to mail misrouting, a process that remains unimproved despite a nearly 50 percent drop in workload.[49] Delays in processing ITIN applications cause the applicants to wait long periods of time for their refunds without receiving interest on overpayments.[50]

The IRS also fails to deliver adequate customer service by its inability to track and locate ITIN applications and supporting documents. In a recent example, a taxpayer who needed to travel abroad for a medical emergency was unable to do so because the IRS could not locate the passport of the taxpayer's child.[51] The IRS conducted about 60 lost document searches in the ITIN program in 2013, and was successful in finding just 40 of them.[52] The current system for receiving and processing ITIN applications often does not allow the IRS to track applications until they are entered into a database, and once they are entered, there are still challenges to locating the documents.[53]

The lack of focus on customer service is also apparent through the ITIN services offered at TACs. The IRS promised to provide "*full-service assistance* for primary and dependent taxpayers at some key IRS

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46 For a further discussion of this issue, see Most Serious Problem: International Service: *The IRS Is Taking Important Steps to Improve International Taxpayer Service Initiatives, but Sustained Effort Will Be Required to Maintain Recent Gains, supra*.

47 IRS, *ITIN Production Reports* (Oct. 29, 2011, Oct. 27, 2012, and Oct. 26, 2013). The IRS defines cycle time as "the number of work days in the processing cycle for documents and tax returns." IRS response to TAS information request (Nov. 7, 2013).

48 IRS response to TAS information request (Nov. 7, 2013). The National Taxpayer Advocate has previously raised concerns about how the IRS calculates cycle time on ITIN Applications. *See* National Taxpayer Advocate 2010 Annual Report to Congress, 324, 333.

49 *Id*.

50 Under IRC § 6611, overpayment interest is calculated based on when the return is filed in processable form, which includes the taxpayer's identifying number.

51 Taxpayer Advocate Management Information System (TAMIS) Case File 5573740. The consent to release taxpayer information is on file with TAS.

52 IRS response to TAS information request (Nov. 7, 2013) (stating that "[t]he volume of lost identity [document] searches in ITIN was not recorded for 2011 and 2012.").

53 For more details about the IRS's system for batching ITIN applications, see National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 45.

[TACs]," but many TACs require a valid U.S.-issued ID just to enter the building, which makes this option unavailable for many taxpayers.[54] In addition, the IRS permits TAC employees to certify only passports and national identity cards.[55] The IRS acknowledges that civil birth certificates and school records are used more frequently with ITIN applications than passports or national ID cards, yet TACs cannot certify these documents.[56] Only 17.8 percent of all applicants proved identity by CAA-certified copies of passports or national ID cards, or by mailing them directly to IRS, whereas birth certificates and school records comprised 61.6 percent of all documents submitted for identification.[57]

The IRS assigned 68.2 percent of all ITINs to alien dependents, the majority of whom proved identity by providing birth certificates and school records.[58] Because many, if not most, dependent aliens do not possess passports or national ID cards, they cannot have their documents certified by either a TAC or a CAA. Although the IRS increased the number of TACs certifying ITIN applications to 100 during the end of the 2013 filing season, it has not committed to expanding this program to more sites in 2014.[59]

ITIN applicants have reported multiple problems with applications being suspended or rejected, including:

- The lack of communication regarding the reason for the action;
- The inability to speak with IRS employees;
- The IRS's failure to notify taxpayers about the status of their applications and what steps are available to them;
- The rejection of applications with legitimate documents; and
- The inexplicable suspension or rejection of applications that were later processed without any further documentation.

A frequent complaint among taxpayers and practitioners is that the CP 566, *Suspense Notice*, does not explain why the application was suspended. The IRS revised suspension notices in January of 2013 to clarify requirements for school and medical records.[60] Still, these notices often fail to identify which document is unacceptable, meaning applicants must call the IRS to attempt to find out.

When taxpayers do receive a suspension notice, they may not hear anything more after submitting further documents as the IRS does not contact applicants again before issuing the rejection notice.[61] Once it

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54 National Taxpayer Advocate 2012 Annual Report to Congress 176. Representatives of Low Income Taxpayer Clinics raised concerns about the requirement of many TACs or federal buildings in which some TACs are located to produce a valid, U.S.-issued ID to enter the building. 2013 Annual Low Income Taxpayer Clinic Grantee Conference, Recent Developments in IRS Policies and Procedures Related to ITIN Applications, panel discussion (Dec. 6, 2012).

55 *Cf*. National Taxpayer Advocate 2012 Annual Report to Congress 154, 173; and Servicewide Electronic Research Program (SERP) IRM 3.21.263.6.1.5 (Jan. 2, 2013).

56 IRS response to TAS information request (Nov. 7, 2013).

57 IRS response to TAS information request (Sept. 27, 2012). The above RTS measures are from PY 2012.

58 *Id*. The above RTS measures are from PY 2012.

59 *Id*.

60 IRS response to TAS information request (Nov. 7, 2013).

61 *Id.*

suspends an application, the IRS imposes another restriction that makes it difficult to submit replacement documents: applicants can no longer have a TAC certify their documents.[62]

Taxpayers will experience hardship from not having their original documents for an extended period (often many months), risking fines and incarceration in some locations.

A common complaint from tax practitioners is that they have no way of speaking with an IRS employee with access to the ITIN real-time system (RTS).[63] CAAs have reported to TAS that calls to the ITIN unit often go unanswered. During calendar year 2013, the average level of service for ITIN calls was only 55.3 percent, and the average speed per answer was 926 seconds, or more than 15 minutes.[64] According to the IRS, all toll-free assistors have access to RTS. However, the ITIN Real Time System Navigation Training, the only training course that teaches employees how to access RTS and search ITIN application records, contains no knowledge check or test to measure what employees learned.[65] Access to RTS is insufficient if employees do not know how to use the system and effectively answer applicants' questions. Furthermore, although toll-free assistors have the ability to transfer calls directly to the ITIN unit, the IRS does not publish this instruction in the IRM.[66]

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The IRS did not adequately engage the stakeholder community during 2013 and continues to make burdensome changes without consulting or notifying stakeholders.

In 2013, the IRS conducted three meetings or calls with the stakeholder community.[67] Nevertheless, a common complaint among stakeholders is the IRS makes sudden changes to ITIN application procedures without communicating these changes to the public. An example involves the requirements for proving an exception to the requirement of filing the ITIN application with a return. TAS spoke to a corporation that pays out hundreds of thousands of royalty payments each year, including some to nonresident aliens who claim tax treaty benefits and thus need ITINs.[68] To assist nonresident aliens in obtaining an ITIN without having to file the Form W-7 with a tax return, this corporation provides payees with a standard supporting letter to submit to the IRS. Recently, the payees began receiving letters from the IRS stating that even though these standard letters were previously accepted, effective September 10, 2013, they will no longer be accepted without an original signature. This sudden unilateral procedural change without consulting stakeholders or providing them advanced notice shows a disregard for customer service in the ITIN program.

New CAA Procedures and Policies Discourage Program Participation.

CAAs provide a valuable resource to the IRS in ensuring an applicant is eligible for an ITIN and supporting documents are valid. However, the IRS has failed CAAs in terms of customer service,

62 *See* CP 566. *See* IRM 21.3.1.4.61.2 (June 11, 2013) ("Do not refer applicants receiving a CP 566 to a Taxpayer Assistance Center (TAC). Current procedures require the applicant to submit their original documents directly to SPC ITIN Operations in response to a suspense notice.").

63 TAS conversations with practitioners at IRS Nationwide Tax Forums in July and August of 2013.

64 IRS response to TAS information request (Nov. 7, 2013).

65 *See id*.

66 *See id.*

67 *Id.*

68 TAS phone conversation with stakeholder (Nov. 1, 2013). Applicants claiming tax treaty benefits do not have to file a Form W-7 with a federal tax return. *See* Instructions to Form W-7.

communication, and education.[69] Although the IRS implemented new training requirements for CAAs during 2013, including completion of mandatory forensic training by the end of the calendar year, the IRS waited to provide detailed guidance on what this entails. In a response to TAS on November 7, 2013, it stated, "IRS has identified two vendors who meet the established requirements for forensic training and anticipate providing further guidance to certifying acceptance agents on the website and by email distribution."[70] The IRS did not notify CAAs of this information by email or on IRS.gov until November 18, 2013, a little over a month before the due date for the training.

The IRS is Developing Procedures for Deactivating Old or Inactive ITINs That May Harm Taxpayers and Deprive Them of Their Rights.

The IRS is exploring options for deactivating ITINs issued before 2013 after certain periods of time or nonuse. While the National Taxpayer Advocate has recommended this approach in the past, she is concerned that the IRS may deactivate ITINS or let them expire without notifying taxpayers.[71] The IRS has not addressed a specific question from TAS about whether it would notify taxpayers before expiring or retiring ITINs in all circumstances.[72] It is imperative that the IRS communicate with taxpayers and notify them before deactivating or allowing existing numbers to expire.

CONCLUSION

Since the new IRS ITIN procedures were put into place, the number of ITIN applications and attendant tax returns has plummeted, while rejection levels have soared. The new procedures created barriers that prevent applicants from declaring income, filing returns, receiving refunds they are due under the law, and participating in the global economy. Absent necessary changes to the program, recommended by the National Taxpayer Advocate for several years, the ITIN program will continue to suffer in terms of facilitating compliance by ITIN taxpayers and preventing fraud.

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69 For a further discussion of the IRS's lack of communication and education for CAAs, see National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 49.

70 IRS response to TAS information request (Nov. 7, 2013).

71 *See* National Taxpayer Advocate 2010 Annual Report to Congress 333; National Taxpayer Advocate 2008 Annual Report to Congress 130.

72 The IRS merely stated that "The Service is continuing to analyze the feasibility of expiring ITINs issued prior to 2013. We are on target to complete the analysis by the June 2014." IRS response to TAS information request (Nov. 7, 2013).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Allow filing of ITIN applications throughout the year if submitted with proof of taxable income or a filing requirement.
2. Allow ITIN applications to be filed electronically.
3. Allow CAAs to certify copies of dependents' documentation instead of requiring original documents or copies certified by the issuing agency.
4. Allow TAC employees to certify all identity documents (beyond passports and national identity cards) that ITIN examiners currently accept for primary, secondary, and dependent applicants.
5. Require training with a knowledge check or test on the ITIN real time system for employees answering the toll-free lines and update the IRM to advise toll-free assistors of the capability to transfer calls to the ITIN unit.
6. Require notification to a taxpayer before an ITIN expires and allow the taxpayer time to apply for and obtain a new ITIN before the expiration of the old number.

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MSP #22 OFFSHORE VOLUNTARY DISCLOSURE: The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Made Honest Mistakes

RESPONSIBLE OFFICIALS

John Dalrymple, Deputy Commissioner, Services and Enforcement
Heather C. Maloy, Commissioner, Large Business and International Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland , Commissioner, Wage and Investment Division
William J. Wilkins, Chief Counsel

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DEFINITION OF PROBLEM

Since 2009, the IRS has generally required those who failed to report offshore income and file one or more related information returns (*e.g.*, the *Report of Foreign Bank and Financial Accounts* (FBAR)) to enter into successively more punitive offshore voluntary disclosure (OVD) programs.[1] Designed for "bad actors," these programs burdened "benign actors" who inadvertently violated the rules by requiring them to "opt in and opt out" to get a fair result. The programs were punitive, charging average penalties of more than double the unpaid tax and interest associated with the unreported accounts.[2] Because those opting out faced prolonged uncertainty and a risk of even more severe penalties, some agreed to pay more than they should, as described in prior reports.[3]

Unlike those who remain in the programs, those who opt out are audited, which essentially penalizes them for coming forward. On average, the IRS assessed penalties of nearly 70 percent of the unpaid tax and interest in the audits of those who opted out.[4] Thus, while those who opt out generally face smaller penalties than those inside the OVD programs, they still face very significant ones.

For those who remained in the 2009 program, the median offshore penalty applied to those with the smallest accounts (*i.e.*, those in the 10th percentile with accounts of $87,145 or less) was disproportionate — nearly six times the median unpaid tax.[5] Among unrepresented taxpayers with small accounts it

1 IRS, *Voluntary Disclosure: Questions and Answers*, http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers (first posted May 6, 2009) [hereinafter "2009 OVDP FAQ"]; IRS, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers (first posted Feb. 8, 2011) [hereinafter "2011 OVDI FAQ"]; IRS, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (first posted June 26, 2012) [hereinafter "2012 OVDP FAQ," or collectively the "OVD programs"]. The IRS subsequently established a "streamlined" program for certain non-residents, as described below.

2 IRS response to TAS information request (Sept. 17, 2013) (indicating $1.46 billion in tax and interest was assessed in connection with the 2009 and 2011 program certifications and amended returns, as compared to $3.95 billion in penalties).

3 *See* National Taxpayer Advocate 2012 Annual Report to Congress 134-153; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id*. at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id*. at 21-29. *See also* Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011).

4 IRS response to TAS information request (Sept. 17, 2013) (indicating the IRS assessed about $30.38 million in tax and interest and $20.89 million in penalties).

5 Compliance Data Warehouse (CDW) (Sept. 27, 2013) (TAS analysis of closed cases where an offshore penalty was assessed, as reflected on AIMs and ERIS).

The National Taxpayer Advocate has offered many common sense recommendations that would bring taxpayers into compliance and help restore confidence in the IRS, but IRS has not fully adopted them.

was even more disproportionate — nearly eight times the unpaid tax.[6] It was also disproportionately greater than the median penalty paid by those with the largest accounts (*i.e.*, those in the 90th percentile with accounts of more than $4.2 million) who paid about three times the unpaid tax.[7] Given the harsh treatment applied to those with small accounts, some have made "quiet" disclosures by correcting old returns and others have begun to comply prospectively — in each case without subjecting themselves to the lengthy and seemingly-unfair OVD process.

While 7.6 million U.S. citizens reside abroad and many more U.S. residents have FBAR filing requirements,[8] the IRS received only 807,040 FBAR submissions in 2012.[9] Yet the FBAR audit rate is less than one quarter of one percent.[10] Thus, the IRS has likely failed to address significant information reporting noncompliance. The National Taxpayer Advocate has offered many common sense recommendations that would bring taxpayers into compliance and help restore confidence in the IRS, but IRS has not fully adopted them.

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ANALYSIS OF PROBLEM

The IRS's OVD settlement programs are a good deal for "bad actors" but not for "benign actors."

The combination of the FBAR statute and the way the IRS administers it creates the potential for such draconian penalties that some taxpayers may agree to pay unwarranted amounts. The statute authorizes a maximum penalty of up to 50 percent of the maximum balance in each overseas account for each year of non-reporting (or, if greater, $100,000 per violation).[11] Because the statute of limitations period is six years, the maximum penalty for large accounts is essentially 300 percent of the maximum account balances (assuming a relatively constant balance).[12]

> **Example:** Assume a U.S. resident has a joint account with extended family abroad. The account has had a constant balance of $1 million for at least the past six years. Because this individual violated the reporting requirements by failing to file an FBAR over a six-year period, the penalty could be as high as $3 million — three times the balance! The penalty may be an even greater percentage of the balance if the account value has fallen since the end of the

6 Compliance Data Warehouse (CDW) (Sept. 27, 2013) (TAS analysis of closed cases where an offshore penalty was assessed, as reflected on AIMs and ERIS).

7 *Id*.

8 U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (May 2013), http://travel.state.gov/pdf/ca_fact_sheet.pdf.

9 IRS response to TAS information request (Aug. 12, 2013). As of November 25, 2013, the Treasury Department had processed only 594,061 FBAR filings in 2013, including 556,739 paper filings thru June 27 and E-filings thru September 30. IRS response to TAS information request (Dec. 6, 2013).

10 Even if the universe of potential violations only consisted of the FBARs filed in 2011, the 1,626 civil FBAR examinations closed in 2012 would reflect an audit rate of 0.2 percent (1,626/741,249). U.S. Department of the Treasury, *A Report to Congress in Accordance With § 361(B) of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* (CY 2012) (reporting 741,249 FBAR filings in 2011 and 1,626 civil FBAR examinations closed in 2012).

11 31 U.S.C. § 5321(a)(5)(C). The maximum penalty for nonwillful violations is $10,000, but it is difficult for taxpayers to predict in advance whether the IRS will seek the willful or the nonwillful penalty. *See* 31 U.S.C. § 5321(a)(5)(B).

12 A six-year statute of limitations applies to the civil FBAR penalty. *See* 31 U.S.C. § 5321(b)(1). Criminal penalties of up to $500,000 and 10 years in prison may also apply. 31 U.S.C. § 5321(a)(5)(C) and 5322; 31 C.F.R. § 1010.840(b).

sixth year (or if the account is less than $200,000, as the maximum penalty is never less than $100,000). This would be true even if the taxpayer did not owe any U.S. tax on unreported income from the account, and even if the taxpayer's tax preparer did not inform him or her of the FBAR filing requirement.[13]

Far from allaying taxpayer concerns about the draconian impact of this statute, the IRS OVD programs magnify them. In general, the programs offer to settle potential FBAR and other penalties for failure to file information returns for a fixed amount called the "offshore penalty." The offshore penalty is 27.5 percent (or 20 or 25 percent for the 2009 and 2011 programs, respectively) of the highest account value during an eight-year period.[14] For taxpayers who believe the IRS can prove they willfully violated the disclosure statute and who might otherwise be subject to criminal prosecution, this is probably a good deal.[15] For others, the maximum civil penalty under the statute is $10,000 for each non-willful failure or zero if the reasonable cause exception applies.[16] Thus, the IRS settlement programs were generally not a good deal for those whose failure was not willful.[17]

Unrepresented taxpayers with small accounts paid more than those with representation or large accounts.

Under a "fair" settlement program, one might expect that those with larger undisclosed accounts — that produced greater amounts of unreported income – would be asked to pay a proportionately greater penalty.[18] By this measure, the IRS's 2009 program was unfair. The median offshore penalty under the 2009 OVDP for those with the smallest accounts was nearly six times the median unpaid tax, whereas it was only about three times the unpaid tax for those with the largest accounts, as shown in the following table.

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13 However, a penalty may not apply if the taxpayer establishes reasonable cause. *See* 31 U.S.C. § 5321(a)(5)(B).

14 A six-year period (2003-2008) applied to the 2009 program. Our discussion focuses on the FBAR because it is often the largest and most disproportionate penalty involved. In very limited circumstances, some could qualify for an offshore penalty rate of 5 percent or 12.5 percent, applicable to certain dormant or small accounts, respectively. 2011 OVDI FAQ #52 and #53; 2012 OVDP FAQ #52 and #53.

15 Even in criminal cases, however, the government has had difficulty obtaining a penalty of more than 50 percent of the highest account balance, at least where the taxpayer has tried to correct the problem. *See, e.g.*, Jeremiah Coder, *Judge Chastises DOJ for Offshore Account Prosecution, Suggests Pardon*, 2013 TNT 81-3 (Apr. 26, 2013).

16 1 U.S.C. § 5321(a)(5)(B). *See also* IRM 4.26.16.4.4(2) (July 1, 2008) (reasonable cause); IRM 4.26.16.4.5.3 (July 1, 2008) ("The burden of establishing willfulness is on the Service."); IRM 4.26.16.4.7(3) (July 1, 2008) (warning letter in lieu of penalties); IRM Exhibit 4.26.16-2 (July 1, 2008) (mitigation guidelines); IRM 4.26.16.4.7(4) (July 1, 2008) ("the assertion of multiple [FBAR] penalties … should be considered only in the most egregious cases.").

17 The offshore penalty is even more disproportionate if you consider that taxpayers are required to pay both an offshore penalty and an accuracy related penalty under the OVD programs. *See, e.g.*, 2012 OVDP FAQ 51.1. An accuracy-related penalty does not normally apply when a taxpayer files an amended return to correct an error before the error is detected by the IRS. *See, e.g.*, Treas. Reg. § 1.6664-2 (discussing qualified amended returns).

18 For example, under the IRS's "mitigation guidelines" those with unreported accounts of less than $250,000 are eligible for reduced FBAR penalties in connection with an examination. *See, e.g.*, IRM Exhibit 4.26.16-2 (July 1, 2008).

TABLE 1.22.1, Comparison of median 2009 OVD penalties to median unpaid tax by account size[19]

	Bottom 10 percent	Middle 80 percent	Top 10 percent
Offshore account(s) balance	$44,855	$607,875	$7,259,580
2009 OVDP penalty	$8,540	$117,803	$1,410,517
Additional tax, tax years 2002–2011	$1,472	$30,894	$452,966
Offshore penalty as a percent of tax assessed	580%	381%	311%

Moreover, among those with the smallest accounts (*i.e.*, the bottom 10 percent), those who were unrepresented paid an even greater median 2009 OVD penalty — 794 percent of the additional tax assessment for tax years 2003-2008.[20] By comparison, represented taxpayers in this group paid a median of 514 percent.[21] Perhaps unrepresented taxpayers with small accounts felt more pressure to accept a disproportionate offshore penalty than those who were represented or had larger accounts.

A new "streamlined" program is less burdensome, but is overly narrow and does not provide certainty.

Recognizing the OVD programs were excessively burdensome and unfair to benign actors, in 2012 the IRS created a "streamlined" program that allows some "low risk" nonresidents to avoid the burdensome opt-in-opt-out process.[22] However, the program still requires a voluminous submission (*e.g.*, a questionnaire, three returns, and six FBARs), is closed to U.S. residents, and fails to provide certainty for those deemed "high risk." Worse, the IRS has not clearly explained what will trigger this high risk designation.[23] For example, are you high risk if you owe $25,000 in tax? Applicants deemed high risk may be worse off than those making quiet disclosures or even ignoring the problem. After making a streamlined submission, the applicant may still face the possibility of draconian civil penalties and criminal

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19 CDW (Sept. 27, 2013) (TAS analysis of closed cases where an offshore penalty was assessed, as reflected on AIMs and ERIS). All figures are medians rather than the averages because the data contains extreme outliers. These findings are consistent with data published by the Government Accountability Office (GAO), which suggests an even greater disparity between those with large and small accounts. *See* National Taxpayer Advocate 2014 Objectives Report to Congress 37-38 (discussing GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but may be Missing Continued Evasion* 13 (Mar. 2013) (Table 2)).

20 CDW (Nov. 14, 2013). TAS identified "unrepresented" taxpayers as those with no representative reflected on the Centralized Authorization File (CAF) — a database used to record third-party representation in tax matters — for any of the tax years 2003 to present. Taxpayers with a representative on the CAF at any time for any of those years were counted as "represented," even though they may have been unrepresented in connection with the OVD program. By this measure, 44 percent of those with accounts in the bottom 10 percent were unrepresented, as compared to 22 percent of those with accounts in the middle 80 percent, and 16 percent of those with accounts in the top 10 percent. CDW (Nov. 14, 2013). A third party who is only authorized to address delinquent FBAR issues and not tax issues might not be reflected on the CAF. However, representatives of OVD program participants should be reflected on the CAF because taxpayers who did not have income tax issues should not have applied to the OVD program(s). *See, e.g.*, 2009 OVDP FAQ 9.

21 *Id*.

22 GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* 20 (Mar. 2013) (discussing the reasons for the streamlined program).

23 In 2012, the IRS began allowing certain "low risk," nonresident nonfilers — those with simple returns and owing less than $1,500 in tax — to file the returns without triggering penalties. See IRS, *Instructions for New Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers* (Aug. 31, 2012), http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers. In early 2013, following publication of the National Taxpayer Advocate's recommendation to expand the streamlined program to both U.S. residents and those owing more than $1,500, the IRS eliminated the $1,500 threshold. *See* National Taxpayer Advocate 2014 Objectives Report to Congress 37-38.

prosecution. As of September 2013, 2,990 taxpayers had submitted returns under the streamlined program, reporting an additional $3.8 million in taxes, and 57 were identified as high risk.[24]

The IRS expects other benign actors to opt in and then opt out of an OVD program, subjecting themselves to more burden and risk than bad actors.

The only option for benign actors who feel the offshore penalty is "too severe given the facts of the case" is to opt out and be audited.[25] This is unappealing for many. Because IRS settlement programs are a good deal for bad actors concerned about criminal prosecution, bad actors do not need to opt out or risk draconian penalties. Moreover, the IRS initially processed applications from benign actors who are expected to opt out much more slowly than others, though it has recently begun to process them more quickly, as shown by the following table.

TABLE 1.22.2, OVD Program Applications, Dispositions, and Processing Times as of September 30, 2013[26]

	2009 OVDP		2011 OVDI		2012 OVDP	
	Number	Average Processing Days	Number	Average Processing Days	Number	Average Processing Days
Total cases	**11,217**	**N/A**	**13,160**	**N/A**	**4,046**	**N/A**
Total closed cases	**11,132**	**319.6**	**7,391**	**194.6**	**216**	**115.9**
Closed certifications	10,760	310.4	6,578	203.2	216	115.9
Closed opt-outs	277	590.6	813	128.6	0	N/A
Closed removals	95	651.8	0	N/A	0	N/A
Total open cases	**85**	**896.4**	**5,769**	**248.9**	**3,830**	**75.9**
Open certifications	32	970.5	5,482	245.0	3,821	75.9
Open opt-outs	33	780.5	249	302.4	2	125.3
Open removals	14	989.9	15	272.6	0	N/A
Open suspense	6	997.0	23	212.8	7	59.0

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24 IRS response to TAS information request (Sept. 17, 2013). This figure does not include taxpayers who opted out of the 2011 OVD program into the streamlined program. For example, it does not include 339 of the 475 Canadians who opted out of the 2011 OVD program and who were placed into the streamlined program. *Id*. We understand this is an estimate, as a system error prevented accurate reporting on these cases before September 2013. The IRS was unable to provide data regarding the resources it used or the time it took to process streamlined submissions. *Id*.

25 2011 OVDI FAQ 51; 2012 OVDP FAQ 49 and 51.

26 IRS response to TAS information request (Oct. 29, 2013). These figures do not include the time that taxpayers waited for the IRS's Criminal Investigation Division to clear them to participate or for the IRS to load their cases onto its tracking system.

TAS has recently assisted benign actors who waited for extended periods, as illustrated in the example below. Thus, the IRS's inflexible opt-in-opt-out approach offered bad actors a relatively better deal and also provided them with better customer service than benign actors.[27]

> **Example**: A U.S. citizen residing in Sweden had a life savings of less than $1 million in various foreign accounts and funds. In 2010, he applied to the IRS's 2009 OVD program. Only after TAS issued a Taxpayer Assistance Order in 2012 did the IRS assign a revenue agent to review the submission. In February 2013, the taxpayer opted out. In May 2013 — more than two years after receiving the application — the IRS issued a warning letter. Although unrepresented during most of the process, the taxpayer still spent over $50,000 in fees and mailing costs, and countless hours typing emails to the IRS (that the IRS could not return) or on the phone during business hours in the U.S. — often at night in Sweden.[28]

The IRS's one-size-fits-all approach disproportionately penalizes those who apply.

As of September, 2013, nearly ten IRS examiners (9.5 FTEs) had examined 2,828 returns as a result of opt-out and removal cases, and assessed penalties equivalent to nearly 70 percent (on average) of the tax and interest due.[29] While these results are not as draconian as many fear, the IRS is still assessing substantial penalties against taxpayers who have voluntarily come forward to correct a mistake. By contrast, those who make quiet disclosures or ignore the problem are unlikely to be detected or penalized.[30] As the IRS closed only 1,626 civil FBAR examinations in 2012, its FBAR audit rate is less than one quarter of one percent.[31] Moreover, many of these examinations involved taxpayers who opted in and out of an OVD program in an effort to correct a mistake, rather than more egregious cases that the IRS could identify on its own.[32] Although it may try to do more in this area, the IRS is unlikely to have the resources to do significantly more. Its resources are tied up auditing (or certifying) those who came forward voluntarily. Thus, the IRS's programs effectively penalize taxpayers for coming forward even if they opt out. The National Taxpayer Advocate has recommended the IRS substitute a more nuanced three-category approach for its one-size-fits-all programs, as follows:[33]

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27 This process made it difficult for benign actors to compute and pay the correct amount, while delaying their right to appeal and to be heard, each of which are fundamental taxpayer rights. For proposals to clarify these rights and others, see National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights) and The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration, supra*.

28 TAS has permission from the taxpayer to discuss these facts. For similar examples, see, *e.g.*, Marie Sapirie, *The Personal Impact of Offshore Enforcement*, 2013 TNT 136-1 (July 16, 2013).

29 IRS response to TAS information request (Sept. 17, 2013) (reporting the IRS examined 2,828 returns associated with opt outs or removals, spent 7 hours per return, assessed $24,373,726 in income tax, $6,005,301 in interest, $16,819,876 in tax-related penalties, and $4,069,795 in FBAR penalties). These examiners are very productive because those entering the program have already provided nearly everything they need to close the case — and have agreed to most, if not all, of the assessment for tax, interest, and tax-related penalties.

30 *See generally*, GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* (Mar. 2013) (GAO recommended and the IRS agreed to do more to detect quiet disclosures).

31 IRS response to TAS information request (Sept. 23, 2013) (reporting 1,626 FBAR examination closures for 2012, about 15 percent (or 239) of which resulted in warning letters). Although the number of people who should be filing an FBAR is unknown, even if it consists solely of those who actually filed one in 2012, the audit rate would be 0.2 percent (1,626 / 807,040). Thus, the IRS is using the relatively empty threat of criminal prosecution to drive people — including benign actors — into its programs. We say "relatively empty" because the IRS initiated only 30 criminal investigations of FBAR violations in 2012. *Id.*

32 As noted on the table above, the IRS has closed 277 opt outs from the 2009 program and 813 from the 2011 program. As all taxpayers who opt out are subject to an exam, IRS-reported examination closures likely included many who opted out.

33 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 134-153.

Category 1. Full relief from FBAR and information reporting penalties. Taxpayers who underreported offshore income by less than a reasonable threshold amount — at least as high as the IRC § 6662(d) threshold (*i.e.*, the greater of $5,000 or 10 percent of the tax required to be shown) — should be permitted to file delinquent returns without penalty, regardless of whether they are residents.[34] They should not be subject to the threat of being deemed "high risk" and potentially hit with the maximum penalties, as is the case under the new streamlined program.[35]

Category 2. Taxpayers who have reasonable cause or who acted non-willfully. Taxpayers who underreported more than the threshold but who believe they have reasonable cause or who acted non-willfully should explain their circumstances, file delinquent returns, pay any applicable tax, interest, and penalties under Title 26 (unless asserting reasonable cause). Depending on the circumstances and explanation, these taxpayers should be required to pay either the non-willful FBAR penalty or no penalty under the reasonable cause exception.[36] Because they are required to cooperate, the IRS should have little difficulty evaluating their circumstances without requiring them to opt in and then opt out. Rather than examining each of these returns in full, the IRS should examine a small percentage of them using its normal audit selection techniques, thereby improving its ability to identify noncompliance and encouraging voluntary compliance without unnecessarily burdening taxpayers.

The combination of the FBAR statute and the way the IRS administers it creates the potential for such draconian penalties that some taxpayers may agree to pay unwarranted amounts.

Category 3. Taxpayers not included in Category 1 or 2. Taxpayers who do not fall into categories one or two, but voluntarily come forward to correct their violations should be required to file delinquent or amended returns and pay tax, interest, delinquency and accuracy-related penalties, and the offshore penalty, as currently required under the 2012 OVDP.

For those in Category Two, the IRS could provide more comprehensive guidance and examples to help taxpayers, practitioners, and IRS employees determine whether reasonable cause applies, potentially reducing anxiety, uncertainty, and controversy in this area. Anti-abuse rules could discourage Category Three taxpayers from self-selecting into Category Two. This three-category approach could prevent the IRS from being viewed as extorting or bullying unjustified penalties from taxpayers — particularly unrepresented taxpayers with small accounts — and ultimately improve voluntary compliance.

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34 Persons who failed to file an FBAR and did not report all of their income are currently required to pay the offshore penalty, even if they do not have a tax deficiency (*e.g.*, due to an offsetting foreign tax credit). *See, e.g.*, 2011 OVDI FAQ 17; 2012 OVDP FAQ 17; and 2012 OVDP FAQ 33.

35 IRS, *Instructions for New Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers* (Aug. 31, 2012), http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers.

36 Although IRS Fact Sheet 2011-13 provides some guidance, the IRS should more expressly define what constitutes "reasonable cause" for purposes of FBAR and provide examples about the difference between willful and non-willful violations based on the taxpayer's background, education level, cultural concerns, etc. The IRS should also clarify that it will not seek a penalty for a willful violation unless it can show "a voluntary intentional violation of a known legal duty." *See Ratzlaf v. U.S.*, 510 U.S. 135 (1994) (U.S. Supreme Court case discussing Bank Secrecy Act violations; however, not dealing with FBAR directly).

The government has imposed new and duplicative information reporting requirements, and made filing an FBAR more difficult.

Beginning in tax year 2011, the IRS has required some taxpayers to file duplicative information about foreign accounts on the FBAR and Form 8938, *Statement of Foreign Financial Assets*.[37] Thus far, the IRS has not adopted the National Taxpayer Advocate's recommendation (or a similar recommendation by the GAO) to reduce this duplicative reporting.[38]

Moreover, after June 30, 2013, the Financial Crimes Enforcement Network (FinCEN) requires the FBAR to be filed electronically on a new system that does not accept attachments (such as explanations for late filings), making compliance more difficult for some.[39] While the FinCEN BSA E-File system still does not accept attachments, as of October 1, 2013, it was updated to allow late FBAR filers to provide a 750 character explanation.[40] However, the system's inability to accept attachments could potentially generate unnecessary inquiries or audits.

Education, burden reduction, and improved guidance could bring millions of benign actors into compliance, while preserving respect for the IRS.

While 7.6 million U.S. citizens reside abroad and many more U.S. residents have FBAR filing requirements,[41] the Treasury Department processed only 807,040 FBAR filings in 2012.[42] Further, GAO has reported significant confusion about the reporting requirements, identified a significant number of participants in the IRS's programs who were unaware of the FBAR filing requirements, observed the IRS has failed to educate recent immigrants and that it has not formally evaluated any of its outreach efforts.[43] Thus, a more effective initiative — one combined with burden reduction and education — could prompt significantly more taxpayers to come into compliance.

The IRS has discontinued an FBAR Compliance Initiative Project to educate those with foreign bank accounts who are most likely to have FBAR violations (*e.g.*, immigrants to the U.S. and U.S. citizens

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37 Sections 511 and 521 of the Hiring Incentives to Restore Employment Act (the HIRE Act), Pub. L. No. 111-147, 124 Stat. 71 (2010) (codified at IRC §§ 6038D and 1298(f)) enacted these new reporting requirements. It applied to taxable years beginning after March 18, 2010, but implementation was delayed. See Notice 2011-55, 2011-29 I.R.B. 53 (July 18, 2011). For further discussion of FATCA, see Most Serious Problem: *The Foreign Account Tax Compliance Act Has the Potential to Be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights, infra*.

38 *See, e.g.*, FinCEN, *Final Reminder for Electronic Filing Requirement* (June 29, 2012), http://www.fincen.gov/news_room/nr/html/20120629.html. For GAO's recommendation, see GAO, GAO-12-403, *Reporting Foreign Accounts to the IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 26 (Feb. 2012) (recommending "[A]s data becomes available, determine whether the benefits of implementing a less duplicative reporting process exceed the costs and if so, implement that process.").

39 *See, e.g.*, FinCEN, *Final Reminder for Electronic Filing Requirement* (June 29, 2012), http://www.fincen.gov/news_room/nr/html/20120629.html. Paper IRS FBAR Form TD F 90–22.1 was replaced by FinCEN FBAR Report 114, which must be filed electronically. Although international taxpayers report having access the internet from home more often than domestic taxpayers (85 percent vs. 77 percent for domestic), a smaller percentage actually e-file (27 percent vs. 72 percent overall in 2011). *See* Wage and Investment, Research and Analysis, *Understanding the International Taxpayer Market* 7, 13 (June 2011), www.irs.gov/pub/irs-utl/5_david_cico.pdf. It is unclear whether the FBAR e-filing requirement has reduced compliance. As of November 25, 2013, the Treasury Department had processed 594,061 FBAR filings in 2013, including 556,739 paper filings thru June 27 and 37,322 E-filings thru September 30. IRS response to TAS information request (Dec. 6, 2013). By comparison, there were 798,993 paper filings and 8,047 electronic filings, for a total of 807,040 FBAR filings in 2012. IRS response to TAS information request (Sept. 23, 2013).

40 IRS response to TAS information request (Dec. 6, 2013) (citing FinCEN Notice, *Important Notice to BSA E-Filers: Updated Report of Foreign Bank and Financial Accounts (FBAR), FBAR Batch Capability, and Web Site Updates* (Sept. 30, 2013), http://www.fincen.gov/whatsnew/html/20130930.html).

41 U.S. Department of State, Bureau of Consular Affairs, *Who We Are and What We Do: Consular Affairs by the Numbers* (Jan. 2013), http://travel.state.gov/pdf/ca_fact_sheet.pdf.

42 IRS response to TAS information request (Aug. 12, 20013).

43 GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* 21-22 (Mar. 2013).

abroad).[44] The National Taxpayer Advocate previously recommended the IRS reinstate this program.[45] The IRS could also reach out to those who immigrate to the U.S. when they apply for an ITIN, visa, or residency status. It could work with other agencies such as the State Department and the Department of Homeland Security.[46]

The National Taxpayer Advocate has also recommended the IRS use its normal guidance-making process to redesign its settlement programs, after taking stakeholder concerns into account, and publish the resulting guidance in the Internal Revenue Bulletin to avoid any confusion about what the rules are or whether the IRS will change them — by changing an FAQ posted to a website — without consulting with stakeholders. These steps would go a long way toward improving the fairness of the tax system, restoring respect for the IRS, and improving voluntary compliance.[47]

Moreover, the IRS should provide guidance about the information reporting required with respect to common situations.[48] For example, most people who have worked in Mexico have a government-mandated retirement account (called an AFORES).[49] In at least one case, an IRS Technical Advisor concluded a taxpayer should report them on Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, and Form 3520-A, *Annual Information Return of Foreign Trust With a U.S. Owner*, before the IRS could process the taxpayer's decision to opt out of the OVD program. Imposing new requirements at the end of the process without having clear public guidance on the subject delayed the process and frustrated the taxpayer.[50] Moreover, by some accounts, more than one million U.S. citizens reside in Mexico and many Mexican citizens reside in the U.S., and a large percentage of each group could be subject to information reporting on AFORES.[51] Thus, the IRS should issue clear guidance about what accounts are reportable (and on what form(s)) before it requires taxpayers to report them.

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44 U.S. Department of the Treasury, *A Report to Congress in Accordance With § 361(B) of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* 5 (CY 2009) ("the [IRS] project remains viable … [but] is currently closed."). Many foreign accounts are reflected in the Web-CBRS database. *Id*. at 5.

45 National Taxpayer Advocate 2012 Annual Report to Congress 134-153.

46 The IRS has shared FBAR information and filing reminders with the Department of State. IRS response to TAS information request (Sept. 23, 2013).

47 Research suggests that seemingly unfair procedures may increase tax evasion by Schedule C filers. *See e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

48 Taxpayer are confused about what foreign account information should be reported and how. *See, e.g.*, GAO, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion*, GAO-13-318, 21 (Mar. 2013); GAO, GAO-12-403, *Reporting Foreign Accounts to the IRS, Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* 2, 18 (Feb. 2012).

49 *See, e.g.*, State Bar of California, Taxation Section, *Proposed Guidance: Why Mexican Retirement Funds Should not be Subject to the New Reporting Requirements Under IRC Section 1298(f)*, 2012 TNT 166-60 (Aug. 27, 2012).

50 TAS has permission from the taxpayer to discuss these facts.

51 *See id*. For further analysis, see, *e.g.*, State Bar of California, Taxation Section, *Proposed Guidance: Why Mexican Retirement Funds Should not be Subject to the New Reporting Requirements Under IRC Section 1298(f)*, 2012 TNT 166-60 (Aug. 27, 2012) (suggesting these holdings are reportable as PFICs on Form 8621, but urging an exception); Mexican Banking Association and Mexican Securities Industry Association, *Comments on the Foreign Account Tax Compliance Act, regulations to be issued thereunder, and Notice 2010-60* (Apr. 1, 2011), http://www.bsmlegal.com/PDFs/FATCA_MexicanComments.pdf (urging the IRS to exempt AFOREs from information reporting under FATCA).

RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Expand and clarify the streamlined program to encourage all benign actors (including U.S. residents) to correct past noncompliance using less burdensome and punitive procedures (*e.g.*, expand and clarify who qualifies). Alternatively, adopt the three-category approach (described above), which does not require benign actors to opt out of the OVD program(s). As with other changes to OVD programs, the IRS should allow those who previously applied (even if they have signed closing agreements) to take advantage of the new approach.
2. Educate persons likely to have foreign accounts (*e.g.*, recent immigrants and U.S. citizens residing overseas) about the information reporting requirements. For example, consider working with other agencies such as the U.S. State Department and the Department of Homeland Security to provide information about the requirements to those who apply for an ITIN, visa, or residency status.
3. Issue guidance about what, if any, information reporting applies to AFOREs (*i.e.*, privatized social security accounts held by those who have worked in Mexico).
4. Incorporate all OVD FAQs and the streamlined program into a Revenue Procedure (or similar guidance published in the Internal Revenue Bulletin) that incorporates comments from internal and external stakeholders.
5. Reduce the duplicative reporting required on both Form 8938, *Statement of Foreign Financial Assets* and the FBAR.[52]

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52 The IRS could reduce duplicative reporting by adding items reported on an FBAR to the existing list of items that taxpayers do not have to report on Form 8938. *See* Treas. Reg. § 1.6038D–7T. TAS understands the IRS has access to the FinCEN Query System, which allows IRS employees direct electronic access to the FinCEN database. Using this system, the IRS could download FBAR data for analysis. Therefore, it is unclear why the IRS would need taxpayers to report the same information on a Form 8938. However, the IRS continues to weigh the costs and benefits of this recommendation. IRS response to TAS information request (Dec. 6, 2013).

MSP #23 REPORTING REQUIREMENTS: The Foreign Account Tax Compliance Act Has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights

RESPONSIBLE OFFICIALS

John Koskinen, Commissioner of Internal Revenue
Heather C. Maloy, Commissioner, Large Business and International Division
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division
William J. Wilkins, Chief Counsel

DEFINITION OF PROBLEM

Congress has long been concerned that U.S. taxpayers are not fully disclosing the extent of financial assets held abroad.[1] In 2010, Congress passed the Foreign Account Tax Compliance Act (FATCA) to address this issue.[2] FATCA imposes extensive reporting obligations on U.S. taxpayers, foreign entities, and withholding agents.[3] Sanctions for FATCA noncompliance are so severe that failure to undertake the requisite reporting and disclosure can conceivably result in penalties in excess of the unreported foreign assets.[4]

The reporting obligations and potential penalties FATCA implements are, according to some expatriates and practitioners, responsible for the surge in the number of Americans renouncing their citizenship or permanent resident status.[5] Moreover, some foreign financial institutions (FFIs), such as DeutcsheBank, HSBC, and ING have reportedly been closing out foreign accounts of U.S. citizens in response to FATCA's "onerous U.S. Regulations."[6] Some stakeholders and commentators have questioned, from both a financial and tax policy perspective, whether the benefits of FATCA, including the additional tax

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1 Some international tax policy experts believe that tax revenue losses are in the billions of dollars annually. Government Accountability Office (GAO), GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements can be Clarified*, App. 2 (Feb. 2012). A relatively recent response to this concern was passage of the Bank Secrecy Act, which requires U.S. citizens and residents to report foreign accounts on the FinCEN Report 114, *Report of Foreign Bank and Financial Accounts* ("FBAR"). *See* 31 U.S.C. § 5314(a).

2 Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat 71 (2010) (adding Internal Revenue Code (IRC) §§ 1471-1474; 6038D).

3 For example, U.S. citizens, resident aliens, and certain non-resident aliens must file a Form 8938, *Statement of Specified Foreign Financial Assets*, with their annual federal income tax returns, reporting foreign assets exceeding certain thresholds. IRC § 6038(D)(a); Treas. Reg. § 1.6038D-2T(a). Reporting by certain domestic entities of interests in specified foreign financial assets will be required after the IRS issues final regulations under IRC § 6038D. IRC § 6038D(f); Prop. Reg. § 1.6038D-6; Notice 2013-10, 2013-8 I.R.B. 503. An individual may also have to file the FBAR and separate penalties may apply for failure to file each form.

4 IRC § 6038D(d); IRC § 6662(j). Any associated FBAR penalties would be in addition to these penalties imposed by the FATCA regime.

5 *See* Tom Geoghegan, *Why Are Americans Giving up Their Citizenship?*, BBC News Mag., Sept. 26, 2013, *available at* http://www.bbc.co.uk/news/magazine-24135021. More renunciations have occurred in 2013 than in any other year on record. *See* Laura Sanders, *More U.S. Taxpayers Renounce Citizenship,* Wall St. J., Nov. 14, 2013, at C3; 78 Fed. Reg. 68151, 2013-27072.

6 Rowan Morrison, *When Banks Pay the Price*, Editions Financial (Aug. 30, 2012), *available at* http://www.editionsfinancial.co.uk/2012/08/30/when-banks-pay-the-price/. *See also* Sofia Yan, *Banks Lock out Americans Over New Tax Law*, CNNMoney (Sept. 15, 2013), *available at* http://money.cnn.com/2013/09/15/news/banks-americans-lockout/; Simon Bradley, *U.S. Expats Feel the Burden of FATCA* (May 28, 2013), *available at* http://www.swissinfo.ch/eng/politics/US_expats_feel_the_burden_of_FATCA.html?cid=35932576; Tom Geoghegan, *Why Are Americans Giving up Their Citizenship?*, BBC News Mag. (Sept. 26, 2013), *available at* http://www.bbc.co.uk/news/magazine-24135021; Katie Holliday, *HSBC Cuts Ties with US Clients Ahead of FATCA*, Investment Week (July 21, 2011), *available at* http://www.investmentweek.co.uk/investment-week/news/2095508/hsbc-cuts-ties-clients-ahead-fatca.

revenue it is estimated to raise, are sufficient to justify the compliance burdens and economic hardships to which it subjects individuals and business entities.[7]

The ultimate undertaking of FATCA will be an international financial data regime with global information transparency.[8] Questions remain, however, about whether such a course is advisable, whether the information being compiled is necessary and will be effectively utilized, and whether the due process rights of taxpayers will be preserved.

To date, the IRS has provided guidance on, and implemented some key components of the administratively challenging FATCA regime. The law is still in its relative infancy, however, and the IRS should proceed with great care as it moves forward with FATCA implementation. The National Taxpayer Advocate cautions the IRS to gather only the information that it will actually use, to learn from its experiences with the Offshore Voluntary Disclosure programs to more effectively preserve the due process rights of taxpayers, and to burden impacted parties as little as possible.[9] Specifically, the National Taxpayer Advocate is concerned that:

- Reasonable cause relief or other leniency procedures for FATCA non-filers are not yet fully developed enough to favorably distinguish benign actors from bad actors, and to make penalty abatements or similar relief consistently available to good faith taxpayers.
- Absent a timely and effective mechanism for addressing inaccurate information reporting, taxpayers could face adverse consequences as a result of lax due diligence on the part of FFIs in the collection and transmission of accountholder data.
- The IRS has been slow in acting upon recommendations it has received from some well-informed stakeholders, including the Electronic Tax Administration Advisory Committee (ETAAC), the Government Accountability Office, and the National Taxpayer Advocate.

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ANALYSIS OF PROBLEM

Background

Under FATCA, U.S. citizens, resident aliens, and certain non-resident aliens have expanded disclosure obligations and increased penalty exposures.

Two of FATCA's distinguishing characteristics are the vast quantity of taxpayer information it compiles and the potentially punitive measures it brings to bear in furtherance of its goal. U.S. citizens, resident aliens, and certain non-resident aliens must file a Form 8938 with their individual returns, reporting foreign assets exceeding specified thresholds.[10] American Citizens Abroad, a group speaking for non-resident

7 Frederic Alain Behrens, *Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand*, 2013 Wis. L. Rev. 205 (2013); David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, NY Times, Dec. 26, 2011, at B1. *See also* Joint Comm. on Taxation (JCT), JCX-5-10, *JCT Estimates Budget Effect of HIRE Act* (Feb. 23, 2010).

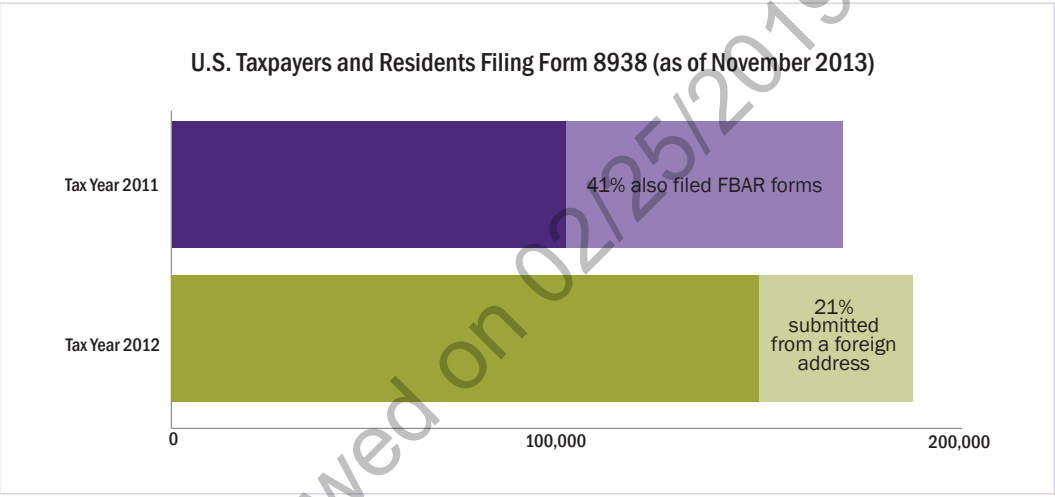
8 J. Richard Harvey, *Report from the Front Lines*, Tax Notes Today, 2012 TNT 151-9 (Aug. 6, 2012).

9 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 134-153 (Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*).

10 Treas. Reg. § 1.6038D-2T(a). An unmarried taxpayer living in the U.S. must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. This threshold is doubled in the case of specified individuals who are married filing jointly. A qualifying unmarried taxpayer living abroad must file a Form 8938 if the total value of the taxpayer's specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the tax year. This threshold is doubled as well in the case of qualified individuals living abroad who are married filing jointly. *Id*.

U.S. taxpayers, estimates that completing the form will add an extra three hours to the tax preparation activities of its members.[11] Expatriates further complain that the additional complexity of the reporting obligations often requires professional assistance, which only adds to their compliance costs, even when they ultimately owe no additional U.S. tax.[12]

U.S. taxpayers and residents meeting the specified criteria have been required to file Forms 8938 with their annual income tax returns for their 2011 and 2012 taxable years. As of November 2013, approximately 170,000 taxpayers had filed Forms 8938 for Tax Year (TY) 2011, while about 187,000 had filed for TY 2012.[13] Roughly twenty-one percent of TY 2012 Form 8938 returns were submitted to the IRS from a foreign address.[14] Of the taxpayers filing Forms 8938 in TY 2011, approximately 41 percent also filed FBAR forms.[15]



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Taxpayers who filed TY 2012 Forms 8938 were compliant overall, with virtually no returns showing Tax Delinquent Investigation (TDI) or Tax Delinquent Account (TDA) activity.[16] Analysis of the Form 8938 filer pool indicates Tax Delinquent Account activity on only one-half of one percent of those taxpayers' TY 2012 returns as opposed to TDA activity of approximately four percent for the overall universe of taxpayers for that tax year.[17]

Although a complete and reliable profile of Form 8938 filers has yet to fully emerge, this preliminary data suggests that those taxpayers who are following the FATCA filing requirements are generally compliant

11 David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, NY Times, Dec. 26, 2011, at B1.

12 Tom Geoghegan, *Why Are Americans Giving up Their Citizenship?*, BBC News Mag. (Sept. 26, 2013), *available at* http://www.bbc.co.uk/news/magazine-24135021.

13 TAS Research, Compliance Data Warehouse, IRFT Entity and IRTF F1040 tables, data drawn Nov. 6, 2013. These numbers may change as more Tax Year 2012 returns filter in to the IRS.

14 Large Business & International Division (LB&I), International Business Compliance (IBC), and International Data Management (IDM) response to TAS research request (Nov. 1, 2013).

15 *Id*.

16 TAS Research, Compliance Data Warehouse, IRFT Entity table, data drawn Nov. 6, 2013. Virtually 100 percent of the population was in filing compliance according to repeater switch numbers on the CDW IRTF Entity table, and 99.5 percent were in payment compliance using the CDW IRTF Entity Open TDA Code.

17 TAS Research, Compliance Data Warehouse, IRFT Entity table, data drawn Nov. 6, 2013.

with respect to their overall tax obligations. Thus, to this point, the IRS is imposing additional reporting burdens and increased potential penalties primarily on a category of taxpayers that, under principles of quality tax administration, should be encouraged, rather than penalized.

Failure to timely file Form 8938 can result in a $10,000 penalty for failure to disclose, plus additional penalties escalating as high as another $50,000, if such nondisclosure continues after notification from the IRS.[18] Thus, a taxpayer with a $51,000 asset falling within the FATCA regime who does not receive or respond to an IRS notice that a Form 8938 must be filed is potentially subject to $60,000 of non-disclosure penalties with respect to the $51,000 asset. The severity of this regime is difficult to reconcile with the IRS principle that "Penalties should … be objectively proportioned to the offense."[19] Moreover, a failure to file, or even an omission of information on Form 8938, could, as a preliminary matter, cause the statute of limitations to remain open with respect to the Form 8938 and any related tax liability.[20] Despite the severity and impact of the penalty, the IRS has no mechanism for identifying the non-filing of Forms 8938, save for when the omission is uncovered as part of a standard, non-FATCA audit.[21]

In addition to the FATCA non-disclosure penalty, a taxpayer with an "undisclosed foreign financial asset understatement" may be liable for an accuracy penalty of 40 percent of the understatement of income occurring on the tax return itself.[22] Such sanctions would be in addition to any penalties arising under the FBAR regime of Title 31.[23] Given the large penalties for errors put forth by FATCA, taxpayers and their representatives have expressed concern for the "vast swath of the normally law-abiding filer community unable to afford the expensive services of a professional tax adviser."[24]

The FATCA reporting regime places significant burdens on FFIs and withholding agents.

Beyond the substantial risks and burdens facing taxpayers, another important aspect of FATCA is its approach to gathering information to validate and enforce the reporting of offshore income. Unless a foreign financial institution agrees to provide comprehensive information with respect to U.S. account holders, except for individuals with depository accounts having an aggregate value of $50,000 or less, either as a participating FFI or pursuant to an intergovernmental agreement negotiated between the U.S. and the FFI's home country, a broad range of U.S.-source payments to the FFI will be subject to a 30 percent withholding tax.[25]

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18 IRC §§ 6038D(d)(1) and (d)(2). The two penalties contemplated by IRC § 6038D(d) can potentially aggregate to $60,000. These penalties are subject to abatement under IRC § 6038D(g) if the failure to file is "shown to be due to reasonable cause and not due to willful neglect." This determination will be made on a case-by-case basis taking into account all pertinent facts and circumstances. *See* Treas. Reg. § 1.6038D-8T(e).

19 Internal Revenue Manual (IRM) 20.1.1.2.1 (Nov. 25, 2011).

20 IRC § 6501(c)(8)(A).

21 LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013).

22 IRC § 6662(j) defines an "undisclosed foreign financial asset understatement" as "the portion of the understatement for such taxable year which is attributable to any transaction involving an undisclosed foreign financial asset." The generation of taxable income from a foreign account to which IRC § 6038D would apply is considered to represent a "transaction" for purposes of the 40 percent understatement penalty. *See* JCT, JCX-4-10, *JCT Estimates Budget Effect of HIRE Act* 63, 64 (Feb. 23, 2010). Thus, the IRC § 6662(j) penalty is triggered by an understatement of income on the return associated with the non-reporting of a foreign asset, whereas the IRC § 6038D penalty arises solely on account of non-disclosure of the foreign asset, regardless of whether or not the asset generates taxable income during the year.

23 GAO, GAO-12-403, *Reporting Foreign Accounts to IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified*, App. 2 (Feb. 2012). *See also* National Taxpayer Advocate 2012 Annual Report to Congress 134, 141 (Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*).

24 David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, NY Times, Dec. 26, 2011, at B1. *See also* Tom Geoghegan, *Why Are Americans Giving up Their Citizenship?*, BBC News Mag. (Sept. 26, 2013), *available at* http://www.bbc.co.uk/news/magazine-24135021.

25 IRC § 1471(a); IRC § 1473(1).

FATCA imposes extensive reporting obligations on U.S. taxpayers, foreign entities, and withholding agents.

Beginning after June 30, 2014, FATCA will charge withholding agents with the responsibility of determining whether they are obliged to undertake FATCA withholding, and of implementing that withholding whenever it is required.[26] This endeavor represents a large undertaking, both in terms of time and resources, the difficulty of which has been compounded by IRS delays in issuing regulations and finalizing forms.[27] FATCA compliance requires the development of substantial new systems and processes on the part of most withholding agents.[28] If a withholding agent fails to undertake the required withholding, the agent is personally liable for the uncollected funds.[29] On the other hand, if withholding agents unreasonably over-withhold, they are subject to claims from their counterparties.[30]

Starting in January 2014, FFIs will be expected to finalize their registration information with the IRS through a dedicated online IRS portal.[31] As the IRS finalizes and approves registrations, it will issue FFIs a global intermediary identification number (GIIN).[32] The IRS will electronically post the first FFI list in June 2014, and update it monthly. Review of this list will allow withholding agents to determine whether or not to withhold on payments made to FFIs.

Registered FFIs will be required to file information reports on their U.S. account holders beginning with respect to accounts held during the 2014 calendar year.[33] This reporting will be due no later than March 31 of the following year, and will typically occur through an electronic Form 8966, *FATCA Report*.[34] The primary identification mechanism of U.S. account holders on the Form 8966 will be taxpayers' Social Security numbers or tax identification numbers.[35] Taxpayers without such identifying numbers will generally be treated as recalcitrant account holders and will be subject to withholding undertaken by the FFI.[36]

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26 Notice 2013-43, 2013-31 I.R.B. 113.

27 Payson Peabody, *SIFMA*, *Comments on the Final FATCA Regulations* (June 21, 2013), at p. 2, *available at* http://www.sifma.org/comment-letters/2013/sifma-submits-comments-to-the-us-department-of-treasury-and-the-irs-on-final-fatca-regulations/.

28 Payson Peabody, SIFMA, *Comments on the Proposed FATCA Regulations* (Apr. 30, 2012), *available at* http://www.sifma.org/issues/item.aspx?id=8589938585.

29 IRC § 1474(a).

30 Payson Peabody, *SIFMA*, *Comments on the Final FATCA Regulations* (June 21, 2013), at p. 2, *available at* http://www.sifma.org/comment-letters/2013/sifma-submits-comments-to-the-us-department-of-treasury-and-the-irs-on-final-fatca-regulations/; Treas. Reg. § 1.1474-1(f).

31 Notice 2013-43, 2013-31 I.R.B. 113.

32 *Id*. The GIIN will be used by the IRS in the application of FATCA as a global identifier of registered FFIs, and will also be used by withholding agents to validate the FATCA compliance of FFIs.

33 Notice 2013-43, 2013-31 I.R.B. 113. Given current uncertainties created by IRS delays in the issuance of guidance and final forms, however, a number of banking and financial industry associations have requested an extension in the milestone dates for implementing FATCA. *See* Payson Peabody, SIFMA *et al*., *Letter to Treasury and IRS, Request for Additional Extension of the FATCA, Phased Timeline* (Nov. 18, 2013), *available at* http://www.sifma.org/issues/item.aspx?id=8589946219.

34 Notice 2013-43, 2013-31 I.R.B. 113

35 Both the paper and the electronic versions of the Form 8966 will specify applicable conventions for providing the name of the account holder. As in the case of Chapter 3 reporting, however, the name field will be subordinate to the SSN/TIN field for purposes of data collection and manipulation under FATCA. LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013).

36 LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013); *see also* Treas. Reg. §1.1471-4.

Given the delays and other shortcomings associated with the IRS Individual Taxpayer Identification Number (ITIN) application procedures, some account holders, despite their best efforts, could find themselves subject to withholding as they experience the long wait for ITINs to be issued.[37]

The approach adopted by FATCA could be a highly effective means of obtaining the desired information, but, in addition to objections based on resource burdens, it has given rise to discussions of sovereignty issues, as well as concerns regarding economic repercussions. For example, Murray Rankin, the Canadian equivalent of a "Shadow Minister" for National Revenue, recently reiterated his party's concerns regarding FATCA:

> New Democrats are concerned with the prospect of a foreign nation unilaterally imposing obligations on Canadian banks to disclose personal information. The Canadian Government has a responsibility to protect Canada's tax base, and while we understand the United States' desire to protect their own tax base, this should not come at the cost of the rights of individuals residing in our own country. Cracking down on tax cheats should occur through international cooperation rather than unilateral action.[38]

By most measures, FATCA-related costs equal or exceed projected FATCA revenue.

The Congressional Joint Committee on Taxation estimates FATCA will generate additional tax revenue of approximately $8.7 billion over the next ten years.[39] By way of comparison, industry sources believe that overall private sector implementation costs could equal or exceed the amount that FATCA is projected to raise.[40] The IRS costs associated with long-term development and implementation of the FATCA regime have not been systematically quantified.[41] Similarly, the compliance costs and penalty exposure burdens on individual taxpayers are difficult to estimate, while, in addition to the compliance costs, business entities face possible application of the 30 percent withholding tax against non-compliant FFIs and potential liability against agents who do not undertake proper withholding.[42]

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37 For more detailed information, see Most Serious Problem: *ITINs: ITIN Application Procedures Burden Taxpayers and Create a Barrier to Return Filing*, *supra*.

38 Letter from Murray Rankin, Member of Parliament for Victoria, Official Opposition Critic for National Revenue, to Canadian Minister of Finance James M. Flaherty (Sept. 25, 2013), *available at* http://maplesandbox.ca/wp-content/uploads/2013/09/Rankin-Letter-to-Flaherty.pdf; *see also* James Jatras, *Canada's Shadow Revenue Minister Warns Government against Sellout on FATCA!*, OpEdNews (Oct. 5, 2013), *available at* http://www.opednews.com/articles/Canada-s-Shadow-Revenue-Mi-by-James-Jatras-Canada-us-Integration-131005-282.html. For the IRS's response to allegations such as those raised by Mr. Rankin, see Robert Stack, *Myth vs. FATCA: The Truth about Treasury's Effort to Combat Offshore Tax Evasion*, Myth No. 7, Lexis Nexis (Sept. 20, 2013).

39 *See* JCT, JCX-5-10, *JCT Estimates Budget Effect of HIRE Act* (Feb. 23, 2010).

40 Deloitte Regulatory Review, *FATCA: Determined to Pierce the Corporate Veil* (Apr. 2011), p. 3, *available at* http://www.deloitte.com/assets/Dcom-Australia/Local%20Assets/Documents/Industries/Financial%20services/Regulatory%20Review%20April%202011/Deloitte_Regulatory_Review_April_2011_FATCA.pdf. Brian Kindle, *FATCA May Identify Tax Cheats, but Its Dragnet for Financial Criminals May Produce an Even Bigger Yield*, Association of Certified Financial Crime Specialists (Mar. 1, 2012), *available at* http://www.acfcs.org/fatca-may-identify-tax-cheats-but-its-dragnet-for-financial-criminals-may-produce-an-even-bigger-yield/.

41 GAO, GAO-12-484, *Foreign Account Reporting Requirements: IRS Needs to Further Develop Risk, Compliance, and Cost Plans* (Apr. 2012). In response to this GAO report, the IRS did quantify its 2011 and 2012 costs, and likewise projected costs through the end of FY 2013. LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013). Nevertheless, this analysis provides an incomplete picture of the required economic resources, as FATCA development and implementation will continue at least until 2017.

42 *See, e.g.*, Deloitte Regulatory Review, *FATCA: Determined to Pierce the Corporate Veil* (Apr. 2011), p. 3, *available at* http://www.deloitte.com/assets/Dcom-Australia/Local%20Assets/Documents/Industries/Financial%20services/Regulatory%20Review%20April%202011/Deloitte_Regulatory_Review_April_2011_FATCA.pdf.

The technology necessary for the IRS to utilize the information being gathered under FATCA is still in the early stages of development.

The IRS has started developing a data platform, referred to as the International Compliance Management Model (ICMM), to compile the information drawn from the Form 8966 that will employ recent and newly-designed technology and will adopt common international protocols.[43] These protocols will be used to facilitate bilateral information exchanges, which some governments require as a precondition for their cooperation in the FATCA regime. Such exchanges, which will occur under negotiated intergovernmental agreements, have given rise to substantial privacy concerns because they often will involve providing foreign governments with information regarding accounts held in the U.S.[44]

The reporting obligations and potential penalties FATCA implements are, according to some expatriates and practitioners, responsible for the surge in the number of Americans renouncing their citizenship or permanent resident status.

Eventually, the IRS plans to use the ICMM data platform to match information collected on Forms 8938 against the information gleaned from Forms 8966, 1042, and 1042S to identify and pursue non-filers.[45] The ICMM data platform, however, has not yet been built.[46] The technology project, which is a core feature of FATCA implementation, is in the early stages of developing business requirements, and funding for the project has only recently been approved.[47] The compliance application, which would match and compare the information reported by the various parties, is not scheduled for release until 2016 at the earliest.[48] Successful development of a functional, cutting-edge, data platform to compare and analyze the range of information gathered will be crucial to the long-term effectiveness of FATCA.

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The IRS Should Preserve the Due Process Rights of Taxpayers by Issuing FATCA-specific Relief Procedures with Respect to Benign Non-filers.

FATCA sets forth substantial penalties to enforce compliance on the part of U.S. taxpayers, FFIs, and withholding agents. Given their relative lack of resources, however, individual taxpayers, particularly those residing abroad, are disproportionately likely to be subject to burdensome compliance initiatives and unnecessarily high penalties. As a result, the IRS should learn from its history with its OVD programs and proactively take steps to protect due process rights of taxpayers falling within the FATCA regime.[49]

Reasonable cause relief is contemplated for both the failure to file Form 8938 and for the related "undisclosed foreign financial asset understatement" penalties related to FATCA. The language of the associated regulations and IRM Part 20, however, is quite broad, and provides IRS personnel with little guidance

43 LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013).

44 Letter from Congressman Bill Posey to Jack Lew, Secretary of the Treasury (July 1, 2013).

45 Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Person*; Form 1042S, *Foreign Person's U.S. Source Income Subject to Withholding*.

46 LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013).

47 LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013).

48 *Id*.

49 FATCA non-filers are subject to the OVDP program and related guidance. *See Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers. This program, however, has substantial deficiencies. *See* Most Serious Problem: *Offshore Voluntary Disclosure: The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Made Honest Mistakes*, *infra/supra*.

specific to FATCA regarding circumstances under which relief would be appropriate and should be granted.[50]

For example, IRM Part 20 explains that in considering a request for a reasonable cause abatement based on ignorance of the law, IRS personnel should weigh factors such as recent changes to the tax forms or law and the level of complexity of a tax or compliance issue. However, it also says ignorance of the law will constitute a valid excuse for non-compliance only if the taxpayer could not reasonably have been expected to know of the law.[51] Thus, a likelihood exists that IRS employees could take the position that, in all but extraordinary circumstances, even non-resident filers should be aware of FATCA, and therefore would have no basis for seeking relief from applicable penalties. Accordingly, without FACTA-specific guidance, the approach adopted by the IRS could be, at best, anecdotal, inconsistent, and unpredictable, and at worst, could systematically fail to properly address the circumstances of benign non-filers.

The IRS should quickly establish reasonable cause or similar relief procedures for FATCA non-filers that favorably distinguish benign actors from bad actors. Without such guidance, a real danger exists that reasonable cause relief under the FATCA regime may be available in theory but not be applied in practice. As a result, the National Taxpayer Advocate recommends that the IRS issue guidance indicating lenient treatment of benign non-filers with respect to the non-application or abatement of IRC §§ 6038D and 6662(j) penalties. Specifically, such leniency is particularly appropriate in the early years of the FATCA regime, where there is no indication of bad faith on the part of the taxpayer, and where penalties are, or would be, disproportionate as compared with the size of the foreign accounts in question and the related taxable income to be reported. The IRS should collaborate and consult with the National Taxpayer Advocate in the development of standards for reasonable cause or similar relief in this context.

The IRS Should Develop a Timely and Effective Mechanism for Addressing Information Reporting Errors of FFIs.

FFIs reporting account holder information either directly or indirectly to the IRS under the FATCA regime are subjected to a variety of due diligence requirements. Most of these rules focus on ensuring that the FFI is scrutinizing potential U.S. account holders with sufficient vigor, that adequate procedures and systems are in place for this process and that, indeed, the FFI is not in any way assisting account holders in escaping detection from the IRS.[52] Moreover, the IRS is developing technology to verify that the desired data fields on the electronic forms 8966 are complete.[53] Nevertheless, the IRS seems to have dedicated less energy to ensuring that the account holder information provided to the IRS is accurate or to establishing relief mechanisms for circumstances in which FFIs transmit erroneous information.

Given the vast swath of information being transferred by FFIs and compiled by the IRS as part of the FATCA regime, the information reported with respect to some U.S. taxpayers and residents will inevitably be wrong. Some will certainly be reported to have assets beyond what they actually possess, while others

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50 Treas. Reg. § 1.6038D-8T; IRC § 6664(c); IRM Part 20, *Penalty and Interest*, which provides internal IRS guidance implementing the applicable reasonable cause regulations. In particular, see IRM 20.1.9.22 (Mar. 21, 2013), relating to IRC § 6038D penalties, and IRM 20.1.5.13 (Jan. 24, 2012) relating to IRC § 6662(b)(7) and (j) penalties. These sections incorporate the FATCA penalties into the IRM, but provide no FATCA-specific guidance with respect to reasonable cause or similar procedures.

51 IRM 20.1.1.3.2.2.6 (Nov. 25, 2011).

52 Treas. Reg. §§ 1.1471-4(c)(7) and 1.1471-4(f)(3).

53 LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013).

will undoubtedly be listed as having accounts or assets they never owned. Common challenges banks face include "data quality errors caused by inaccurate translation, invalid addresses and aliases and data corruption caused by combining similar information across multiple systems."[54] Individuals and entities impacted by such inaccuracies run the risk of substantial penalties.

Intergovernmental agreements do address this issue in passing, but in a non-systematic and unsatisfactory fashion. They typically allude to the matter and then make provision for the U.S. Competent Authority (Competent Authority) to contact an FFI that is providing inaccurate information.[55] The IRS does furnish guidance to taxpayers for bringing issues before the Competent Authority, but the extent of the related time delays and administrative burdens on taxpayers is unknown.[56]

While Competent Authority intervention would certainly be beneficial in the most complex cases, the IRS should develop a more streamlined approach for resolving routine reporting errors by FFIs that is both timely and readily accessible to average taxpayers. Such a mechanism should certainly be in place by the time FFIs begin reporting account holder information in March 2015. Otherwise, the only practical recourse for affected taxpayers would appear to involve either prevailing on audit or petitioning the U.S. Tax Court for review of a notice of deficiency. In addition to the taxpayer's burden, the amount of IRS resources dedicated to this review would be staggering and also completely avoidable.

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The IRS Should Act Responsively and Expeditiously to Implement Stakeholder Suggestions.

The IRS has sought and received significant comments and recommendations from stakeholders with respect to the ongoing development and implementation of FATCA. To its credit, the IRS has been responsive to many of these comments and suggestions. Nevertheless, the IRS has yet to act on important responses from some well-informed stakeholders.

For example, ETAAC has recommended that, to facilitate efficient compliance with the FATCA regime, the IRS should create mechanisms enabling withholding agents to undertake the real-time electronic matching and identification of GIINs assigned by the IRS to registered FFIs.[57] Such compliance technology would replace the current plan of requiring withholding agents to download GIIN numbers monthly and develop their own mechanisms for the review and validation of FATCA compliance by FFIs. ETAAC similarly recommended that the IRS further ease compliance burdens on FFIs by allowing direct uploads of registration information with, and related updates to the IRS.[58]

In response to an information request from the National Taxpayer Advocate, however, the IRS indicated that it would not implement ETAAC's recommendation regarding the real-time matching of

54 Informatica, *Ensure Accurate Account Holder Identification, Matching, and Quality Data for FATCA Compliance* (2013), *available at* http://www.informatica.com/us/solutions/industry-solutions/banking-and-capital-markets/fatca-compliance/.

55 Model Intergovernmental Agreement (Model 1), Article 5, No. 1, *available at* http://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf; Model Intergovernmental Agreement (Model 2 Template), Article 4, No.1, *available at* http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-2-Agreement-to-Implement-11-14-2012.pdf. As per Rev. Proc. 2006-54, the Deputy Commissioner (International), Large and Mid-Size Business Division, acts as the U.S. competent authority in administering the operating provisions of tax treaties, including reaching mutual agreements in specific cases, and in interpreting and applying tax treaties. *See* Delegation Order 4-12 (Rev. 2), IRM 1.2.43 (July 1, 2010).

56 *See* IRS, Competent Authority Assistance, *available at* http://www.irs.gov/Individuals/International-Taxpayers/Competent-Authority-Assistance.

57 The Electronic Tax Administration Advisory Committee Annual Report to Congress (June 2013).

58 *Id*. at 30.

GIIN numbers because the recommendation involved significant technical and data protection issues.[59] According to the IRS, ETAAC's second suggestion regarding direct uploads of registration information is on the list for a system upgrade at some point in the future. As of the date of the National Taxpayer Advocate's inquiry, the IRS had yet to provide ETAAC with a reply to its recommendations.[60] Improved responsiveness to the suggestions and comments of well-informed stakeholders such as ETAAC is indispensable for FATCA implementation to move forward in a most efficient and least burdensome manner.

On a separate front, the National Taxpayer Advocate and the GAO have recommended that the IRS combine, or at least substantially revise, the Form 8938 and the FBAR form because the forms are significantly duplicative, which increases confusion and adds to the compliance burden for taxpayers.[61] In addition, a taxpayer who fails to report a single account on both forms could face two sets of penalties — the FBAR penalty under Title 31 and the non-disclosure penalty under Title 26.[62] To address this point, the IRS has published a FATCA/FBAR comparison chart on IRS.gov. While this chart is a helpful tool, it is not a comprehensive solution to this serious problem. Accordingly, the National Taxpayer Advocate reiterates her recommendation that the two forms be combined or at least substantially revised to eliminate or reduce duplication.

Another group whose input should be considered is the estimated seven million American citizens living abroad. The reporting obligations, the penalties for even inadvertent non-compliance, and the unintended economic consequences of FATCA, including the reported refusal by some FFIs to transact business with would-be U.S. account holders, fall with disproportionate force on this segment of taxpayers. As a result, their ideas for mitigating the negative impact of FATCA should be solicited and carefully examined. The National Taxpayer Advocate suggests the IRS work to obtain the recommendations of American citizens living abroad by holding roundtables or similar mechanisms.

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CONCLUSION

The National Taxpayer Advocate recognizes that the implementation of FATCA is still a work in progress. Nevertheless, the IRS has not developed FATCA-specific guidelines under which benign non-filers can seek and obtain reasonable cause or similar relief with respect to related non-disclosure and underreporting penalties, and has yet to provide an adequate mechanism for addressing reporting errors of FFIs regarding U.S. account holders. Moreover, although the IRS has been responsive to some comments and suggestions throughout the development of the FATCA regime, the IRS has not acted upon advice it has received from some well-informed stakeholders. FATCA carries with it the potential for substantial resource burdens and significant due process concerns that will arise to the extent that the regime is not correctly and effectively implemented in practice as well as properly conceived in theory.

59 LB&I, IBC, and IDM response to TAS research request (Nov. 1, 2013).

60 Email correspondence from ETAAC Chair to TAS (Nov. 7, 2013).

61 National Taxpayer Advocate 2012 Annual Report to Congress 134, 141 (Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*).

62 *Id*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Undertake proactive steps to preserve the due process rights of taxpayers, by issuing FATCA-specific guidance for reasonable cause or similar relief, which adopts a measured approach to the imposition of penalties with respect to benign non-filers.
2. Ensure that U.S. taxpayers and non-residents have at their disposal a timely and effective mechanism for addressing information reporting errors of FFIs.
3. Act responsively and expeditiously to implement recommendations of stakeholders that have particular expertise on the effective implementation of FATCA.
4. Take immediate steps to eliminate or reduce duplication between the Form 8938 and the FBAR form.

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MSP #24 DIGITAL CURRENCY: The IRS Should Issue Guidance to Assist Users of Digital Currency

RESPONSIBLE OFFICIALS

William J. Wilkins, Chief Counsel
Karen Schiller, Commissioner, Small Business/Self-Employed Division
Debra Holland, Commissioner, Wage and Investment Division
Heather C. Maloy, Commissioner, Large Business and International Division

DEFINITION OF PROBLEM

The use of digital currencies, such as bitcoin, is growing. In the four months between July and December 2013, bitcoin usage has increased by over 75 percent — from about 1,700 transactions per hour to over 3,000.[1] Over the same period, the market value of bitcoins in circulation increased more than ten-fold from about $1.1 billion to $12.6 billion.[2] Over 10,000 businesses reportedly accept payment in bitcoins.[3]

The IRS has not issued specific guidance addressing the tax treatment or reporting requirements applicable to digital currency transactions. Differing opinions are available on the Internet. People who are trying to comply with their federal income tax reporting obligations have complained that they are unsure about the rules.[4] Thus, IRS-issued guidance would promote tax compliance, particularly among those who want to comply. Moreover, it would eliminate the ambiguity that may encourage some digital currency users to avoid taxation and information reporting.

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ANALYSIS OF PROBLEM

Digital currency is different from government-backed currency.

Unlike the U.S. dollar, a digital currency does not rely on a banking network for payment processing and is not backed or controlled by a government. Bitcoin is an example of a digital currency.

Bitcoin relies on cryptography and a peer-to-peer network to process and verify payments.[5] People can purchase bitcoins on an exchange or "mine" a limited amount by solving cryptographic problems — an activity that facilitates commerce by verifying or clearing transactions in the public ledger (called a "block

1 Bitcoin Watch, www.bitcoinwatch.com (visited July 23 and Dec.2, 2013). Wikipedia, the online encyclopedia, lists eight digital currencies. *See* http://en.wikipedia.org/wiki/Digital_currency (last visited Nov. 8, 2013). This discussion will focus on bitcoin because it appears to be the most widely used digital currency.

2 Bitcoin Watch, www.bitcoinwatch.com (visited July 23, 2013, and Nov. 8, 2013).

3 Bitpay, www.bitpay.com (last visited Nov. 8, 2013).

4 *See, e.g.*, David Steward, *Digital Currency: A New Worry for Tax Administrators?*, 2012 TNT 209-4 (Oct. 17, 2012); Trace Mayer, *A Lawyer's Take on Bitcoin and Taxes* (Jan. 18, 2012).

5 Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (Oct. 31, 2012), https://en.bitcoin.it/wiki/Bitcoin:A_Peer-to-Peer_Electronic_Cash_System.

chain").[6] If a customer wants to send bitcoins to a merchant, the merchant gives the customer a public key.[7] The customer completes the transaction by signing with his or her public and private keys.

Digital currency is not subject to government manipulation, and facilitates quick, anonymous, irreversible, low-cost transactions.

Bitcoin appeals to those who do not trust banks or other financial institutions, who want to make quick, irrevocable transfers without paying for currency conversion, or who value privacy.[8] The supply of bitcoins is limited and controlled by an algorithm.[9] Unlike government-backed currency, no central authority can devalue bitcoins by printing more. Created in 2009, the supply of bitcoins will gradually increase, as they are minted (*i.e.*, "mined") at a controlled rate, until approximately 2140 when about 21 million are in circulation.[10] Thus, it is less likely to lose value as a result of government intervention or mismanagement than a government-backed currency. Indeed, turmoil in Cyprus reportedly led to a sharp increase in the price of bitcoins as people sought refuge in the digital currency as a kind of cyber gold.[11]

Bitcoin is convenient. International buyers and sellers can conduct transactions without the expense of having an intermediary clear them or convert funds into a national currency.

Bitcoin promotes anonymity because it uses peer-to-peer technology to operate with no central authority or clearinghouse. Although every transaction is open to the public, the identity of the parties is not. A person's bitcoins exist only on his or her computer, rather than on a centralized server that could be monitored and linked to an identity.[12]

Bitcoin is also convenient. International buyers and sellers can conduct transactions without the expense of having an intermediary clear them or convert funds into a national currency. Certain automated teller machines (ATMs), which went

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6 *See, e.g.*, Government Accountability Office (GAO), *Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks*, GAO-13-516 (May 2013); Anthony Faiola, *The Rise of the Bitcoin: Virtual Gold or Cyber-Bubble?* Washington Post (Apr. 4, 2013), http://articles.washingtonpost.com/2013-04-04/world/38280106_1_bitcoin-satoshi-nakamoto-monetary-policy.

7 The public key is like an account number and the private key is like a password or PIN. The network uses these numbers to update the block chain, but they are not actually associated with any particular person. An e-wallet is a file on the owner's computer or similar device where bitcoin is stored. If the bitcoin keys are lost, so is the bitcoin. Thus, bitcoin stored in an e-wallet is more analogous to currency than to an account.

8 *See, e.g.*, Maureen Farrell, *Bitcoin Prices Surge Post-Cyprus Bailout*, CNN Money (Mar. 28, 2013), http://money.cnn.com/2013/03/28/investing/bitcoin-cyprus/index.html?iid=HP_LN. For these very reasons, the Federal Bureau of Investigation (FBI) is concerned about the illicit use of bitcoin by criminals, the European Central Bank (ECB) is concerned about the risk it could pose to the financial system, and the Treasury Department's Financial Crimes Enforcement Network (FinCEN) is concerned about its potential to circumvent Bank Secrecy Act (BSA) reporting requirements. *See* FBI, *Bitcoin Virtual Currency Unique Features Present Distinct Challenges for Deterring Illicit Activity*, Intelligence Assessment (Apr. 24, 2012), http://www.wired.com/images_blogs/threatlevel/2012/05/Bitcoin-FBI.pdf; ECB, *Virtual Currency Schemes* (Oct. 2012), http://www.ecb.int/pub/pdf/other/virtualcurrencyschemes201210en.pdf; FIN-2013-G001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (Mar.18, 2013), http://www.fincen.gov/statutes_regs/guidance/pdf/FIN-2013-G001.pdf.

9 Jon Matonis, *How Cryptocurrencies Could Upend Banks' Monetary Role*, American Banker (Mar. 15, 2013), http://www.americanbanker.com/bankthink/how-cryptocurrencies-could-upend-banks-monetary-role-1057597-1.html.

10 About Bitcoin, http://bitcoin.org/en/about (last visited Nov. 8, 2013). Bitcoins are created each time a miner solves an algorithm to "discover" a new "block" of bitcoin. The rate of block creation is approximately six per hour. *See* Bitcoin, *Controlled supply*, https://en.bitcoin.it/wiki/Controlled_Currency_Supply (last visited Nov. 8, 2013). The number of bitcoins generated per block is set to decrease geometrically, with a 50 percent reduction every four years. *Id*. Bitcoin supply will eventually decline as bitcoins are lost.

11 *See, e.g.*, Hibah Yousuf, *Bitcoins are a Bubble*, CNN Money (Apr. 5, 2013), http://buzz.money.cnn.com/2013/04/05/bitcoin-bubble/?section=money_topstories&utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3a+rss/money_topstories+%28Top+Stories. A significant reduction in the rate at which new bitcoin was awarded to miners in 2013 also could have contributed to the recent run-up. *Id*.

12 Anonymous hackers reportedly demanded a ransom paid in bitcoins in exchange for the tax returns of former Republican presidential nominee, Mitt Romney. David Steward, *Digital Currency: A New Worry for Tax Administrators?*, 2012 TNT 209-4 (Oct. 17, 2012).

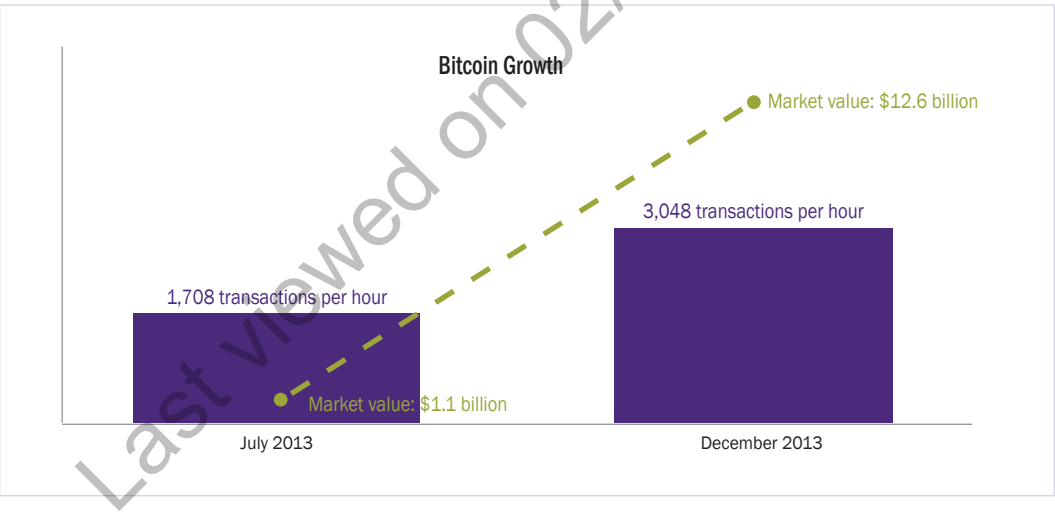
on sale in 2013, can convert between dollars and bitcoins, and bitcoins can be spent via computer or mobile phone.[13]

Among the potential benefits to merchants of bitcoin transactions are that they usually clear relatively quickly, are irreversible, carry low processing fees, and may avoid information reporting.[14] By comparison, credit card transactions generally take longer to clear, can be reversed, and are frequently subject to higher fees and greater information reporting.[15]

Bitcoin is growing.

As noted above, in the five months between July and December 2013, bitcoin usage has increased by over 75 percent — from about 1,700 transactions per hour to over 3,000.[16] Over the same period, the market value of bitcoins in circulation increased more than ten-fold from about $1.1 billion to $12.6 billion.[17] Traders at major banks reportedly keep watch on the bitcoin exchange rate.[18] Over 10,000 businesses reportedly accept payment in bitcoins.[19] BitPay, a business that helps merchants accept bitcoins, reports that over 10,000 businesses accept them.[20] About 60 percent of its clients are in the United States.[21]

FIGURE 1.24.1, Growth in Bitcoin Usage and Market Value



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13 See BitcoinATM, https://bitcoinatm.com/ (last visited Nov. 8, 2013); Maureen Farrell, *Bitcoin ATMs Coming Soon*, CNN Money (Apr. 4, 2013), http://money.cnn.com/2013/04/04/investing/bitcoin-atms/index.html?source=cnn_bin.

14 About Bitcoin, http://bitcoin.org/en/about (last visited Nov. 8, 2013).

15 *See, e.g.*, Emily Jane Fox, *The New York Bar that Takes Bitcoins*, CNNMoney (Apr. 8, 2013), http://money.cnn.com/2013/04/08/investing/bitcoin-bar-new-york-city/index.html?source=cnn_bin.

16 Bitcoin Watch, www.bitcoinwatch.com (visited July 23, 2013, and Dec. 2, 2013).

17 *Id*.

18 Naomi O'Leary, *Bitcoin, the City traders' Anarchic New Toy*, Reuters (Apr. 1, 2012).

19 Bitpay, www.bitpay.com (last visited Nov. 8, 2013).

20 *Id*.

21 Brian Browdie, *BitPay Signs 1,000 Merchants to Accept Bitcoin Payments*, American Banker, Bank Technology News (Sept. 11, 2012), http://www.americanbanker.com/issues/177_176/bitpay-signs-1000-merchants-to-accept-bitcoin-payments-1052538-1.html. BitPay features merchants in the following categories: software, hardware, IT services, bars/restaurants, publishing, games, transportation, food delivery, dental services, metal dealers, and political campaign contributions. BitPay, *Featured Merchants*, https://bitpay.com/featured-merchants (last visited Aug. 6, 2013).

The IRS has not issued specific guidance addressing the tax treatment or reporting requirements applicable to digital currency transactions. People who are trying to comply with their federal income tax reporting obligations have complained that they are unsure about the rules.

Recent developments could increase bitcoin acceptance. The World Wide Web Consortium (W3C), a web browser standard-setting body, recently took steps that will allow most browsers to recognize bitcoin payment links.[22] For example, a website could have a "purchase with bitcoin" button, making it easier for consumers to use bitcoins for Internet purchases.

In addition, pending sales tax legislation could increase the use of bitcoins. Several bills would allow states to require out of state vendors to collect sales tax on sales to in-state residents.[23] These bills only provide for sales tax collection when the seller knows the purchaser's address. Unlike credit card sales that transmit the customer's billing address, a bitcoin sale does not identify the residence of the buyer, potentially allowing purchasers to avoid sales tax if they use bitcoins to pay for property that does not require a shipping address (*e.g.*, software or music).[24] For all of these reasons, bitcoins could become more popular as a result of this legislation.

Moreover, if digital currency establishes itself as a new asset class that is not correlated with other asset classes, then investors who want a diversified portfolio may begin to purchase it as an investment rather than as a medium of exchange. Thus, the use of bitcoin and similar digital currencies is likely to increase.

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Taxpayers want to know the tax consequences of digital currency transactions.

Legitimate businesses — those who want to comply with the rules and do not want to be associated with tax evaders or criminal enterprises — have urged the government to issue clear rules about the tax consequences of digital currency transactions.[25] Following a 2008 recommendation by the National Taxpayer Advocate to issue guidance on the tax treatment of the transfer of digital items and currency,[26] the IRS created a web page that says it has already "provided guidance on the tax treatment of bartering, gambling, business and hobby income — issues that are similar to activities in online gaming worlds."[27] It suggests that existing guidance covers digital currency transactions, but does not explain when these transactions are sufficiently analogous to the transactions described in the guidance to be covered by existing rules.[28]

To fill the void left by the IRS's lack of specific guidance, interested parties are posting answers to "frequently asked questions" on the Internet about the tax treatment of digital currency transactions, some of

22 Christopher Mims, *Bitcoin Takes An Important Step Toward Becoming Part of Every Web Browser on the Planet*, Quartz (Apr. 25, 2013), http://qz.com/78014/bitcoin-is-now-part-of-the-web-sort-of/.

23 These various bills are generally titled the "Marketplace Fairness Act of 2013." *See e.g.*, S. 743; S. 336; and H.R. 684.

24 *See* Brian Fung, *What an Internet Sales Tax Could Mean for Your Bitcoin Stash,* National J. (Apr. 25, 2013), http://www.nationaljournal.com/tech/what-an-internet-sales-tax-could-mean-for-your-bitcoin-stash-20130425.

25 *See, e.g.*, David Steward, *Digital Currency: A New Worry for Tax Administrators?*, 2012 TNT 209-4 (Oct. 17, 2012). Representatives of the Cryptocurrency Legal Advocacy Group (CLAG), a nonprofit organization based at the University of Mississippi School of law, have also called for the IRS to issue guidance. *Id*.

26 National Taxpayer Advocate 2008 Annual Report to Congress 213.

27 IRS, *Tax Consequences of Virtual World Transactions* (Aug. 3, 2012), http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Tax-Consequences-of-Virtual-World-Transactions.

28 The IRS's posting does not fully address the concerns raised by the National Taxpayer Advocate. *See* National Taxpayer Advocate 2008 Annual Report to Congress 213. At a recent hearing before Congress, government officials indicated the IRS is "actively working" on rules for bitcoin. Nathaniel Popper, *Regulators See Value in Bitcoin, and Investors Hasten to Agree*, N.Y. Times B1 (Nov. 19. 2013).

which may be incorrect, incomplete, or misleading.[29] For example, a popular tax preparation company's blog describes bitcoin as "The Taxless Currency."[30] Scholarly papers and at least one digital book are also available on the subject.[31] These materials often raise more questions than they answer.

For example, a U.S. resident generally does not recognize gain or loss when using dollars to purchase goods and services. As a result, some people may be surprised to learn that using bitcoins to purchase goods or services could trigger taxable gains or losses on the bitcoins themselves. Moreover, the character of any such gains or losses is not readily apparent. If a bitcoin is deemed property, then spending it could produce capital gains or losses.[32] On the other hand, if a bitcoin is a "nonfunctional currency" for tax purposes,[33] then spending it could produce ordinary income or loss under Internal Revenue Code (IRC) § 988(a)(1).[34]

Transactions involving digital currency may trigger information reporting, but the IRS is unlikely to get many reports unless it explains the rules.

U.S. citizens and residents who hold more than $10,000 in foreign accounts are required to report the accounts on Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR).[35] Those with certain foreign financial assets in excess of $50,000 must also report foreign accounts (and certain other foreign financial asset information) on Form 8938, *Statement of Specified Foreign Financial Assets*.[36] Like cash, bitcoins that are not held in an "account" may not be subject to these reporting requirements. However, some have speculated about whether bitcoins in e-wallets located on servers in foreign countries should be

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29 *See, e.g.*, GAO, *Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks*, GAO-13-516 (May 2013) (discussing unanswered questions and misinformation available on the Internet). *See also* Bitcoin, *Tax Compliance*, https://en.bitcoin.it/wiki/Tax_compliance (last visited Nov. 8, 2013); Bitcoin Forum, *Bitcoin Accounting and taxes*, https://bitcointalk.org/index.php?topic=14334.0 (last visited Nov. 8, 2013); Cryptocurrency Legal Advocacy Group, Inc., CM#1001: *Staying Between the Lines: A Survey of U.S. Income Taxation and its Ramifications on Cryptocurrencies* (Apr. 15, 2012), http://theclag.org/CM%231001Final.pdf; Trace Mayer, *A Lawyer's Take on Bitcoin and Taxes* (Jan. 18, 2012).

30 Josh Ritchie, Bitcoins: *The Taxless Currency*, TurboTax blog (July 18, 2011), http://blog.turbotax.intuit.com/2011/07/18/bitcoins-the-taxless-currency/. Some people may be attracted to bitcoin because they want to avoid taxes. *See, e.g.*, Emily Corwin, *Early Champions of Bitcoin Reap Unexpected Windfall*, NPR (Nov. 29, 2013), http://www.npr.org/2013/11/29/247765501/some-n-h-bitcoin-adopters-favor-cryptocurrency-economy ("The idea here is to create a currency that circumvents both the government and taxes; and avoids banks and transaction fees. As Anarchist Curt Howland puts it...").

31 *See, e.g.*, Lowy and Abraham, *Taxation of Virtual Currency*, 2013 TNT 219-10 (Nov. 13, 2013); Adam Chodorow, *Tracing Basis Through Virtual Spaces*, 95 Cornell L. Rev. 283 (2010); Nell Beekman, *Virtual Assets, Real Tax: The Capital Gains/Ordinary Income Distinction in Virtual Worlds*, 11 Colum. Sci. & Tech. L. Rev. 152 (2012); Steven Chung, *Real Taxation of Virtual Commerce*, 28 Va. Tax. Rev. 733 (2009); Leandra Lederman, *EBay's Second Life: When Should Virtual Earnings Bear Real Taxes?*, 118 Yale L.J. 136 (2009); Theodore P. Seto, *When Is a Game Only a Game?: The Taxation of Virtual Worlds*, 77 U. Cin. L. Rev. 1027 (2009); Bryan T. Camp, *The Play's the Thing: A Theory of Taxing Virtual Worlds*, 59 Hastings L. J. 1 (2007); Leandra Lederman, *"Stranger than Fiction:" Taxing Virtual Worlds*, 82 NYU L. Rev. 1620 (2007); Trace Mayer, *A Lawyer's Take on Bitcoin and Taxes* (Jan. 18, 2012).

32 *See, e.g., Philip Morris Inc. v. Comm'r*, 71 F.3d 1040 (2d Cir. 1995), *aff'g* 104 T.C. 61 (1995); *National-Standard Company v. Comm'r*, 749 F.2d 369 (6th Cir. 1984), *aff'g* 80 T.C. 551 (1983)). However, if bitcoin were deemed personal use property, then taxpayers could not claim losses. IRC § 165(c). A different information-reporting regime may apply if bitcoin is treated as barter exchange credits or scrip. *See generally* Treas. Reg. §§ 1.6045-1(a)(4); 1.6045-1(e), 1.6045-1(f). Because there is no centralized clearinghouse for bitcoins, barter-exchange information reporting would be impractical.

33 In general, a nonfunctional currency is a currency other than the dollar. *See, e.g.*, Treas. Reg. § 1.988-1(c) (defining nonfunctional currency as a currency other than a taxpayer's (or qualified business unit's) functional currency); IRC § 985 (generally defining a taxpayer's (or qualified business unit's) functional currency as the dollar unless it uses another currency in the economic environment in which a significant part of its activities are conducted and in keeping its books and records).

34 IRC § 988(c)(1)(C). However, personal transactions (*i.e.*, those not related to a trade or business or the production of income) by an individual generally trigger capital gains (rather than ordinary income). *See* IRC § 988(e); Treas. Reg. § 1.988-1(a)(9). A limited exception provides that an individual recognizes no gain upon the disposition of a nonfunctional currency in a personal transaction unless the gain exceeds $200. *See* IRC § 988(e)(2). Other unanswered questions may arise in connection with bitcoin "mining."

35 *See generally* 31 U.S.C. § 5321(a)(5); 31 C.F.R. § 1010.350; Internal Revenue Manual (IRM) 4.26.16 (July 1, 2008). The FBAR is now filed on Form 114, which recently replaced Form TD F 90–22.1. *See* Form 114 (2013), http://www.fincen.gov/forms/bsa_forms/.

36 IRC § 6038D and 1298(f); Notice 2011-55, 2011-29 I.R.B. 53 (July 18, 2011). An FBAR is due on June 30 if the aggregate value of the foreign accounts exceeded $10,000 during the prior calendar year. 31 C.F.R. § 1010.306(c).

reported on these forms.[37] Moreover, when a business receives more than $10,000 in cash, it is generally required to report the transaction on Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business*, but it is not clear that the receipt of $10,000 in bitcoins would trigger this reporting requirement.[38]

In addition, bitcoin transactions are not necessarily subject to the information reporting that applies to credit cards and other payment cards under IRC § 6050W. Under this provision, a "payment settlement entity" is required to report the amount paid to those who receive more than 200 payments, provided they receive more than $20,000 in total.[39] A payment settlement entity generally must have a contractual obligation to make a payment in settlement of a transaction.[40] However, bitcoin transactions use a peer-to-peer network that does not depend on a contractual settlement mechanism. For this reason, it is not clear that they would trigger a reporting requirement. Thus, it would be helpful for the government to provide examples illustrating the extent to which each of these reporting regimes apply to common digital currency transactions.

CONCLUSION

It is the government's responsibility to inform the public about the rules they are required to follow.[41] The lack of clear answers to basic questions such as when and how taxpayers should report gains and losses on digital currency transactions probably encourages tax avoidance.

Many law-abiding taxpayers want to comply and to distinguish themselves from tax evaders.[42] Some are frustrated by the IRS's lack of guidance. According to the summary of a book that purports to identify bitcoin-related tax issues:

> The IRS is famous for expecting people to comply with tax rules that aren't even written yet. And, they have given no indication that they are going to help Bitcoin users out any time soon…. Because Bitcoin is new technology and not easily defined, in a legal sense, this will allow you to be much more creative and flexible and legally reduce your tax liability.[43]

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37 The TD F 90-22.1 Form for Bitcoin, https://bitcointalk.org/index.php?topic=55260.msg657831 (last visited Aug. 6, 2013). Some guidance also suggests that persons who receive money for bitcoins may be required to file Form 104, *Currency Transaction Report*. FIN-2013-G001, *Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies* (Mar. 18, 2013), http://www.fincen.gov/statutes_regs/guidance/html/FIN-2013-G001.html. However, a merchant who accepts and transmits funds only as part of the sale of goods or services (other than money transmission services) is apparently excluded. *See id*. n. 10 (citing the exception provided by 31 CFR § 1010.100(ff)(5)(ii)(F)). Comments and articles posted to various websites suggest that some taxpayers are confused about what level of information reporting applies to them. Patrick Murck, *Today, We Are All Money Transmitters… (No, Really!)* (Mar. 19, 2013), https://bitcoinfoundation.org/blog/?p=152.

38 IRC § 6050I; Treas. Reg. § 1.6050I-1. *See also* 31 C.F.R. § 1010.330.

39 IRC § 6050W(a), (e).

40 IRC § 6050W(b).

41 The IRS mission is to "[P]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities…" IRM 1.1.1.1 (Mar. 1, 2006). Notwithstanding the National Taxpayer Advocate's 2008 recommendations, the IRS has still declined to help taxpayers "understand and meet their tax responsibilities" in connection with virtual economies and currencies. *See* National Taxpayer Advocate 2008 Annual Report to Congress 213.

42 *See generally* David J. Mack, ITAX: *An Analysis of the Laws and Policies Behind the Taxation of Property Transactions in a Virtual World*, 60 Admin. L. Rev. 749, 759 (Summer 2008) (urging the IRS to issue guidance on the taxation of virtual transactions, in part, to avoid creating "a society of unintentional tax cheats").

43 Trace Mayer, *A Lawyer's Take on Bitcoin and Taxes* (Jan. 18, 2012).

Promulgating guidance would make it more difficult for taxpayers to be "creative," allow law-abiding taxpayers to keep up with the times without undue burden, reduce traps for the unwary, and make it easier for IRS employees to enforce the law.

RECOMMENDATIONS

The IRS has not explained how existing rules apply to digital currency transactions with enough specificity to allow taxpayers to be sure they are following them or for IRS employees to enforce them.[44] The National Taxpayer Advocate recommends that the IRS issue guidance that at least answers the following questions:[45]

1. When will receiving or using digital currency trigger gains and losses?
2. When will these gains and losses be taxed as ordinary income or capital gains?
3. What information reporting, withholding, backup withholding, and recordkeeping requirements apply to digital currency transactions?
4. When should digital currency holdings be reported on an FBAR or Form 8938, *Statement of Specified Foreign Financial Assets*?

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44 Without additional guidance, it will be very difficult for the government to determine (or prove) if a failure to report digital currency income or transactions is inadvertent or willful.

45 The GAO recently made similar recommendations. *See* GAO, *Virtual Economies and Currencies: Additional IRS Guidance Could Reduce Tax Compliance Risks*, GAO-13-516 (May 2013).

MSP #25 DEFENSE OF MARRIAGE ACT: IRS, Domestic Partners and Same-Sex Couples Need Additional Guidance

RESPONSIBLE OFFICIALS

Debra Holland, Commissioner, Wage & Investment Operating Division
William J. Wilkins, Chief Counsel

DEFINITION OF PROBLEM

Recently, the Supreme Court held unconstitutional the Defense of Marriage Act of 1996 (DOMA), § 3, which effectively had precluded federal recognition of same-sex marriage.[1] Recent IRS guidance resolved certain questions of same-sex spouses anticipated by the National Taxpayer Advocate in her 2012 Annual Report to Congress. While the decision and guidance answer fundamental questions, questions about implementation remain unanswered. Additionally, questions of unmarried domestic or civil union partners persist, such as:

- Is alimony after dissolution of a civil union includible by the recipient and deductible by the payer?
- Is community property created upon partnering with an individual of the same sex a taxable gift?

ANALYSIS OF PROBLEM

On June 26, 2013, *United States v. Windsor* generally ruled DOMA unconstitutional, resulting in federal recognition of same-sex marriages.[2] Specifically, the Supreme Court allowed an estate tax marital deduction to a widow whose wife had died in New York. In a companion case, the Supreme Court effectively allowed a lower court to strike Proposition 8, which had essentially banned same-sex marriage in California.[3] Immediately, the administration directed agencies to develop guidance to implement the law as interpreted by the Court.[4]

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1 *See* 1 U.S.C. § 7, Pub. L. No. 104-199, 110 Stat. 2419.

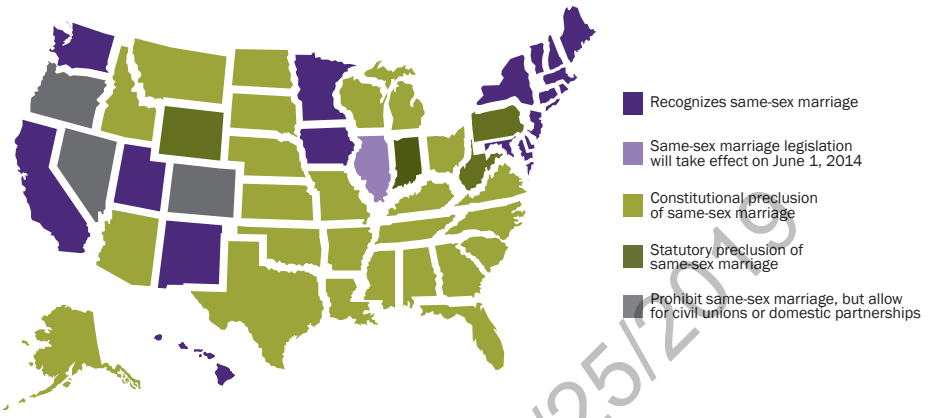
2 *See U.S. v. Windsor*, 570 U.S. ___ (2013).

3 *See Hollingsworth v. Perry*, 570 U.S. ___ (2013).

4 *See* White House Office of the Press Sec'y, Statement by the Pres. on the Supreme Ct. Ruling on DOMA (June 26, 2013), at http://www.whitehouse.gov/doma-statement (last visited July 3, 2013) ("So we welcome today's decision, and I've directed the Attorney General to work with other members of my Cabinet to review all relevant federal statutes to ensure this decision, including its implications for Federal benefits and obligations, is implemented swiftly and smoothly.").

Currently, 16 foreign jurisdictions, 18 states, and the District of Columbia recognize same-sex marriage, while 32 states do not.[5] Of the latter, three states allow civil unions or domestic partnerships of same- or opposite-sex partners.[6]

Same-Sex Marriage Legislation in the United States (as of December 2013)



Analysis of the latest Census data reflects about 132,000 same-sex marriages and 515,000 unmarried partnerships, about a fifth of which are raising children.[7] These numbers indicate that over a million individual taxpayers need guidance.

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5 *See* Council on Foreign Rel'ns, *Same-Sex Marriage: Global Comparisons* (July 31, 2013) (Argentina, Belgium, Brazil, Canada, Denmark, France, Iceland, Mexico, Netherlands, New Zealand, Norway, Portugal, Spain, So. Africa, Sweden, Uruguay), *available at* http://www.cfr.org/society-and-culture/same-sex-marriage-global-comparisons/p31177 (last visited Aug. 19, 2013). American jurisdictions recognizing same-sex marriage are: Calif., Conn., Del., Hawaii, Ill., Iowa, Me., Md., Mass., Minn., N.H., N.J., N.M., N.Y., R.I., Vt., Wash. & D.C. Same-sex marriage legislation will take effect in Ill. on June 1, 2014. *See* http://www.ncsl.org/research/human-services/same-sex-marriage.aspx (last visited Nov. 25, 2013). The N.M. Supreme Court has effectively recognized same-sex marriage. *See Griego v. Oliver*, Docket No. 34,306 (N.M. Dec. 19, 2013). Twenty-nine states with constitutional preclusion of same-sex marriage are: Ala., Aka., Ariz., Ark., Colo., Fla., Ga., Id., Kans., Ken., La., Mich., Miss., Mo., Mont., Neb., Nev., N.C., N.D., Oh., Okla., Ore., S.C., S.D., Tenn., Tex., Utah, Va., Wisc.; four states with statutory preclusion of same-sex marriage are: Ind., Penn., W.V. & Wyo. *See* Nat'l Conference of State Legislatures, *Defining Marriage: Defense of Marriage Acts & Same-Sex Marriage Laws* (July 26, 2013), *available at* http://www.ncsl.org/issues-research/human-services/same-sex-marriage-overview.aspx (last visited Oct. 21, 2013). As of Dec. 23, 2013, Utah was issuing same-sex marriage licenses. *See Kitchen v. Herbert*, No. 2:13-cv-217 (D. Utah, Dec. 20, 2013).

6 Civil unions or domestic partnerships are allowed by three states (Colo., Nev., & Ore.) that prohibit same-sex marriage. *See* Nat'l Conference of State Legislatures, *Defining Marriage: Defense of Marriage Acts & Same-Sex Marriage Laws* (Jul. 26, 2013), *available at* http://www.ncsl.org/issues-research/human-services/same-sex-marriage-overview.aspx (last visited Oct. 23, 2013).

7 *See* Brief of Gary J. Gates as *Amicus Curiae* Supporting Respondents, *Hollingsworth v. Perry*, 570 U.S. ___ (2013) (No. 12-144) 25, 31, *available at* http://www.americanbar.org/publications/preview_home/12-144.html (last visited Aug. 19, 2013); *see also* Gary J. Gates, Ph.D., *Same-sex & Different-sex Couples in the American Community Survey: 2005-2011*, Williams Inst., Univ. of Calif. – L.A. (Feb. 2013), *available at* http://williamsinstitute.law.ucla.edu/research/census-lgbt-demographics-studies/ss-and-ds-couples-in-acs-2005-2011/ (last visited Aug. 19, 2013); Gary J. Gates & Abigail M. Cooke, *U.S. Census Snapshot*: 2010, Williams Inst., Univ. of Calif. – L.A, *available at* http://williamsinstitute.law.ucla.edu/ (last visited Nov. 27, 2013).

Because of the difference between federal and state law, same-sex spouses may have to file tax returns as single at one level but as married at the other. Before *Windsor*, spouses whose state recognized their marriage would file singly for federal but jointly for state tax purposes. While spouses whose state does not recognize their marriage may continue to file singly for state tax purposes, IRS guidance of August 29, 2013, clarified that they should file as married for federal tax purposes.[8]

After the Supreme Court Decision, the IRS Has Answered Questions from Prior ARCs.

The National Taxpayer Advocate's 2010 Annual Report to Congress requested guidance, listing five particular questions.[9] The IRS responded that guidance for a relatively small taxpayer population would be premature pending litigation, yet answered two of our questions along with several others in FAQs on IRS.gov. In anticipation of the Supreme Court decision, the 2012 Annual Report to Congress posed questions about amended returns and conflict of laws which IRS guidance now has answered, as discussed below.[10] In addition, the IRS clarified the rules of construction, which generally allow interpretation of gendered terms in context.[11] In particular, the IRS guidance interprets terms like "husband" and "wife" to apply to same-sex couples.[12]

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8 *See* Rev. Rul. 2013-17, 2013-38 I.R.B. 21 (Aug. 29, 2013); *see e.g.* Va. Dep't of Tax'n, Tax Bull. 13-13, *Va. Income Tax Treatment of Same-Sex Marriage* (Nov. 8, 2013).

9 *See* National Taxpayer Advocate 2010 Annual Report to Congress 211, 215 (Most Serious Problem: *State Domestic Partnership Laws Present Unanswered Federal Tax Questions*).

10 *See* National Taxpayer Advocate 2012 Annual Report to Congress 449 (Status Update: *Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses*).

11 *See* Rev. Rul. 2013-17; IRC § 7701; 1 USC § 1.

12 *See* Rev. Rul. 2013-17.

Taxpayers May Amend Returns in Open Years.

The 2012 Annual Report to Congress asked:

> If the Supreme Court finds a constitutional flaw in the statute, would that finding be retroactive? Could same-sex spouses amend their returns to file jointly? Conversely, would same-sex spouses who had avoided federal marriage penalties be held harmless?[13]

On the announcement of *Windsor*, no authority appeared to preclude same-sex spouses who would have owed less tax but for DOMA from amending returns for open years, extending to those for which they had filed "protective" claims, as some practitioners had advised, in anticipation of the Supreme Court decision, to preserve their rights to amend their single returns into joint returns.[14] By the same token, no authority appeared to compel same-sex spouses who had properly avoided marriage penalties under DOMA to amend.[15] The IRS guidance has confirmed these propositions.[16] Assuming that legitimate amended returns will arrive, the IRS should make sure that automatic sorting criteria do not ensnare these unusual filings, as discussed further below.

There Is a "Conflict of Laws."

For same-sex spouses whose state of domicile does not recognize their marriage duly celebrated in another state or country (*i.e.* a "conflict of laws"),[17] the *Windsor* case effectively forced the question of which law governs for federal tax purposes. Historically, the IRS had issued revenue rulings to recognize common-law marriage of taxpayers "who later move into a state in which a ceremony is required to initiate the marital relationship" and to disregard state anti-miscegenation statutes as unconstitutional.[18] The IRS cited this precedent in ruling that the state of celebration governs for federal tax purposes even if the taxpayers live in a state that does not recognize their marriage.[19]

The "conflict of laws" among states may be particularly acute for taxpayers who move frequently.[20] Various tax questions may turn on state law. In the case of a taxpayer who moves with a same-sex spouse and the spouse's child to a state that does not recognize their marriage performed in their home state, the IRS will continue to recognize both as spouses even if the taxpayer is no longer a stepparent.[21]

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13 National Taxpayer Advocate 2012 Annual Report to Congress 545-55 (Status Update: *Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses*).

14 *See, e.g.*, Firm Comments on Tax Implications of Supreme Court's DOMA Decision, Tax Notes Today 153-10 (Aug. 1, 2013), reflecting letter to IRS on behalf of Human Rights Campaign, citing *Badaracco v. Comm'r*, 464 U. S. 386, 393 (1984) ("the Internal Revenue Code does not explicitly provide either for a taxpayer's filing, or for the Commissioner's acceptance, of an amended return").

15 Although regulations refer to amendment of inclusions and deductions in open years, applicability to filing status under law then prevailing would be unclear. *See* Treas. Reg. §§ 1.451-1(a); 1.461-1(a).

16 *See* Rev. Rul. 2013-17.

17 "That part of the law of each state which determines whether in dealing with a legal situation the law of some other state will be recognized, be given effect or be applied is called the Conflict of Laws." Restatement of Conflict of Laws § 1 (1934, 2013 ed.).

18 *See* Rev. Rul. 58-66, 1958-1 C.B. 60; Rev. Rul. 68-277, 1968-1 C.B. 526 (citing *Loving v. Va.*, 388 U.S. 1 (1967)).

19 *See* Rev. Rul. 2013-17 (citing Rev. Rul. 58-66).

20 For example, military service members may be assigned to various posts of duty which may or may not recognize same-sex marriage. *See* Under Sec'y of Defense, Memo. re: Further Guidance on Extending Benefits to Same-Sex Spouses of Military Members (Aug. 13, 2013) (authorizing leave to travel to a state that allows same-sex marriage), *available at* http://www.defense.gov/releases/release.aspx?releaseid=16203 (last visited Oct. 22, 2013).

21 *See* Answers to Frequently Asked Questions for Individuals of the Same Sex who Are Married Under State Law, Q&A6, *available at* http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples (last visited Oct. 22, 2013) ("Q6. If same-sex spouses (who file using the married filing separately status) have a child, which parent may claim the child as a dependent?").

Domestic Partners Still Need Guidance.

Questions also remain for domestic partners of the same or opposite sex whose state authorizes registration or civil unions. The 2013 guidance provides that the IRS will not treat partners as spouses.[22] In a 2011 letter to H&R Block that has generated commentary since it came "as a surprise to practitioners,"[23] the IRS Office of Chief Counsel (CC) had appeared to allow Illinois opposite-sex civil union partners to file jointly, which DOMA presumably would not have allowed for same-sex partners.[24] On the other hand, state and federal courts have indicated that partners are not "spouses."[25]

Because of the difference between federal and state law, same-sex spouses may have to file tax returns as single at one level but as married at the other.

Suppose a civil union state, such as Oregon, grants alimony to a former same-sex partner. Presumably, non-spouse partners remain under pre-statutory case law whereby the Supreme Court had held that alimony was a "natural" obligation neither includible by the (ex-) wife nor deductible by the (ex-) husband.[26] For spouses (now including same-sex spouses), Internal Revenue Code (IRC) §§ 71 and 215 would prescribe inclusion of alimony in the gross income of the recipient with a correlative deduction by the payer. In a state that recognizes same-sex marriage, such as nearby Washington, a former same-sex spouse therefore could amend a pre-*Windsor* return to deduct alimony. Under the recent IRS guidance, there seems to be no need for a corresponding amendment by the other ex-spouse, who before *Windsor* had not been required to include alimony received.[27]

In a state like Nevada that authorizes domestic partnership (but not same-sex marriage) resulting in community property, would registration result in a taxable gift of community property?[28] A Private Letter Ruling suggests not, but definitive guidance has not yet appeared.[29] Presumably, sole proprietors will continue to face the anomaly whereby their domestic partners — even if not working in the business — become subject to self-employment tax on half the income from community property because they are not spouses.[30]

Another question persists if a court places a child with the parent's same-sex partner — who may be precluded from adoption in certain states.[31] Would that placement come within the definition of "eligible

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22 *See* Rev. Rul. 2013-17.

23 *See* Amy S. Elliott, *IRS Memo Indicates Civil Unions Are Marriages for Federal Tax Purposes*, Tax Notes Today 216-5 (Nov. 7, 2011).

24 *See* Gen. Info. Ltr. (Aug. 30, 2011) ("if Illinois treats the parties to an Illinois civil union who are of opposite sex as husband and wife, they are considered 'husband and wife' for purposes of Section 6013 of the Internal Revenue Code, and are not precluded from filing jointly").

25 *See Smelt v. Orange County*, 447 F.3d 673 (9th Cir. 2006) (denying standing to challenge DOMA by partners who "are not in a relationship that has been dubbed marriage by any state, much less by the State of California") *cert. den'd* 549 U.S. 959 (2006); *Bishop v. Okla.*, 447 F. Supp. 2d 1239, 1247 (N.D. Okla. 2006) (denying partners standing to challenge DOMA even though state statute grants a civil union "all the same benefits, protections and responsibilities under law" as marriage, because "a Vermont civil union is not the equivalent of a marriage"), *rev'd & remanded* on other issue 333 Fed. Appx. 361 (10th Cir. 2009); *Strauss v. Horton*, 46 Cal.4th 364, 445 (2009) ("the designation of 'marriage' is, by virtue of the new state constitutional provision, now reserved for opposite-sex couples"); *Knight v. Schwarzenegger*, 26 Cal.Rptr.3d 687, 690 (2005) ("domestic partners act did not constitute an amendment of the defense of marriage initiative").

26 *See Gould v. Gould*, 245 U.S. 151 (1917). As noted above, the IRS has not confirmed the applicability of this case law.

27 To avoid a "whipsaw," a payor claiming an alimony deduction must report the payee's Social Security number, facilitating IRS verification of the corresponding income inclusion. *See* Treas. Reg. § 1.215-1T, Q&A-1. In situations to which Rev. Rul. 2013-17 applies, however, this ruling would not require amendment of a return correctly filed before *Windsor*.

28 *See* National Taxpayer Advocate 2010 Annual Report to Congress 215.

29 *See* Priv. Ltr. Rul. 2010-21-048 (May 5, 2010).

30 *See* National Taxpayer Advocate 2012 Annual Report to Congress 452-53 (discussing IRC § 1402).

31 *See* Fla. Stat. § 63.042(2)(a) (limiting joint adoption to husband and wife); Miss. Code § 93-17-3 (disallowing adoption by same-sex couples); Utah Code § 78B-6-117 (prohibiting adoption "by a person who is cohabiting in a relationship that is not a legally valid and binding marriage").

foster child," meaning "an individual who is placed with the taxpayer by … judgment, decree, or other order of any court of competent jurisdiction" for tax dependency purposes?[32] Literally, a court may place the child, if not with a traditional foster parent, with a same-sex parent. Thus, the terms of the definition could apply to changing social and legal circumstances. This issue is particularly important for same-sex couples, who are six times more likely than opposite-sex couples to be raising foster children.[33] As a matter of rationale, the only reason to deny the dependency deduction would be failure to recognize the parental role of the partner.[34]

Employment Benefits May Present Conflict of Interest.

Generally, IRC §§ 105 and 106 exclude from gross income the value of employer-provided health coverage, which may extend to the employee's spouse and dependents. Before *Windsor*, in the case of a same-sex spouse who was neither a spouse nor a dependent for federal tax purposes, some employers extended health coverage that was not excludible. After *Windsor*, employers may seek payroll tax refunds to the extent coverage should have been excluded, and employees may amend returns to reduce gross income. IRS guidance confirms the viability of these amendments.[35] On the other hand, an employee who would face a marriage penalty may not wish to amend because in *"many cases the pre-tax savings will not outweigh the additional tax that may be due on an amended return claiming married status*."[36] As a matter of fact, employer and employee may have different desires.[37]

Same-Sex Spouses Now Are Related Parties.

Under DOMA, same-sex spouses were strangers at law, avoiding provisions that resulted in a marriage penalty.[38] By the same token, same-sex spouses did not need to file jointly to claim tax benefits for which opposite-sex spouses would have had to file jointly.[39] After *Windsor*, same-sex spouses are related parties for purposes such as installment sales, discharge of debt, losses, corporations, partnerships, and trusts.[40] If same-sex spouses had made arrangements assuming that their marriage was not recognized under DOMA, they must now make alterations, perhaps confronting property or contract law impediments, to reflect their marriage, at least for federal tax purposes.

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32 IRC § 152(f)(1)(C) (defining "eligible foster child").

33 *See* Brief of Gary J. Gates as *Amicus Curiae* Supporting Respondents, *Hollingsworth v. Perry*, 570 U.S. ___ (2013) (No. 12-144) 39, *available at* http://www.americanbar.org/publications/preview_home/12-144.html (last visited Aug. 19, 2013); *see also* Gary J. Gates, Ph.D., *LGBT Parenting in the U.S.*, Williams Inst., Univ. of Calif. — L.A. (Feb. 2013) 1, 3, *available at* http://williamsinstitute.law.ucla.edu/research/census-lgbt-demographics-studies/lgbt-parenting-in-the-united-states/ (last visited Aug. 19, 2013).

34 *See* National Taxpayer Advocate 2012 Annual Report to Congress 454.

35 *See* Notice 2013-61, 2013-42 I.R.B. 432 (setting forth guidance for employers and employees to make refund claims or adjustments of payroll tax withholding for some benefits provided and monies paid to same-sex spouses); Answers to Frequently Asked Questions for Individuals of the Same Sex who Are Married Under State Law, available at http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples (last visited Sept. 12, 2013). *See also* Notice 2014-1, 2014-2 I.R.B. 1.

36 CCH Tax Briefing, *IRS Guidance on Same-Sex Marriage* 5 (Sept. 3, 2013) (itals. original).

37 Generally, an employer may claim a refund of overpaid Social Security tax only upon reimbursing the employee portion or obtaining employee consent. *See* Treas. Reg. § 31.6402(a)-2(a).

38 *See* Theodore P. Seto, *Unintended Tax Advantages of Gay Marriage*, 65 Wash. & Lee L. Rev. 1529 (2008).

39 *E.g.* IRC §§ 21(e)(2) (child-care credit), 22(e)(1) (elderly or disabled credit), 23(f)(1) (adoption credit), 25A(g)(6) (Lifetime Learning, Hope Scholarship, and American Opportunity Tax Credits), 32(d) (Earned Income Tax Credit), 36(c)(5) (First-Time Homebuyer Credit), 135(d)(3) (U.S. savings bond interest exclusion for college expenses), 137(e) (adoption exclusion), 163(h)(4)(A)(ii) (home mortgage interest deduction), 221(e)(2) (student loan interest deduction).

40 *See* IRC §§ 453, 108, 267, 318, 707, 672.

…to avoid unnecessarily freezing or rejecting amended and new returns from same-sex married taxpayers, the IRS must train its employees to recognize the many and diverse scenarios that can arise as tax administration transitions to recognizing same-sex marriages.

IRS Employees and Taxpayers Need Instruction.

The IRS needs to train employees and program systems to process relevant returns accurately. From July 24 to August 29, 2013, IRS instructions told employees to hold amended returns that referenced DOMA or *Windsor*.[41] Consequently, the IRS suspended hundreds of these claims.[42] On the other hand, same-sex spousal amendments that were not so labeled may have proceeded without delay – resulting in disparate treatment. The instruction above exemplifies how delays in guidance could have delayed the processing of claims of same-sex spouses.[43]

As individual rather than sophisticated corporate or institutional taxpayers, same-sex spouses need user-friendly guidance. To facilitate compliance, the IRS should consolidate the FAQs and related guidance into a single publication for non-traditional families.

At the same time, the IRS should review its systems for processing amended and new returns.[44] As discussed elsewhere in this report, IRS revenue protection filters may put certain returns in the limbo of refund fraud processes.[45]

CONCLUSION

In response to our 2010 Most Serious Problem discussion, the IRS said that guidance was premature pending litigation for a small taxpayer population.[46] The Supreme Court decision and administration directive disposed of the first concern. Regarding the population, there are significant demographic data, yet the IRS has issued guidance for discrete populations historically.[47] In addition to FAQs, further guidance should be both more authoritative (through published rulemaking like Revenue Ruling 2013-17 and Notice 2013-61 cited above) and more accessible (through a plain-language IRS Publication). Moreover, to avoid unnecessarily freezing or rejecting amended and new returns from same-sex married taxpayers, the IRS must train its employees to recognize the many and diverse scenarios that can arise as tax administration transitions to recognizing same-sex marriages.

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41 Servicewide Electronic Research Program (SERP) Alert No. 13A0447 (July 24, 2013) ("If assigned a Form 1040X Amended return and "*Defense of Marriage Act,*" "*DOMA,*" "*Windsor v. the United States,*" or a reference pertaining to "*Recent Supreme Court Decision*" is notated on the claim, HOLD the claim.").

42 *See* IRS response to TAS research request (Oct. 29 & Nov. 1, 2013).

43 On a related note, IRM 21.7.5.3.4(3) (Oct. 1, 2013), relating to estate tax on same-sex couples, directs IRS employees to "Verify the validity of the marriage and U.S. citizenship." By contrast, Form 706, *U.S. Estate (and Generation-Skipping Transfer) Tax Return*, pt. 6 at 4, states: "A decedent with a surviving spouse elects portability of the deceased spousal unused exclusion (DSUE) amount, if any, by completing and timely-filing this return. No further action is required to elect portability of the DSUE amount to allow the surviving spouse to use the decedent's DSUE amount."

44 *See* IRM 21.6.1.4.3, Processing Separate-to-Joint Adjustments (Sept. 10, 2013); SERP Alert No. 13A0515 (Aug. 30, 2013) ("work all I[ndividual] M[aster] F[ile] DOMA claims in inventory or any new receipts following normal procedures").

45 *See supra* Status Update: *The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct, Despite Ample Guidance Allowing the Payment of Such Refunds*; Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers*.

46 *See* National Taxpayer Advocate 2010 Annual Report to Congress 218.

47 *See, e.g.*, Rev. Proc. 2010-41, 2010-48 I.R.B. 781 (including guidance for return preparers without a Social Security number due to religious objection); Rev. Proc. 2010-31, 2010-40 I.R.B. 413 (setting forth guidance on when a foreign adoption is final for parents who claim a tax credit for expenses of adopting a child); Notice 2010-30, 2010-18 I.R.B. 650 (containing guidance for military spouses who are civilians working in a U.S. territory but claiming residence in a state); Rev. Rul. 2004-71, 2004-2 C.B. 74 (applying IRC § 6402 refund offset to community property in Arizona and Wisconsin); Rev. Rul. 2004-72, 2004-2 C.B. 77 (applying refund offset to community property in California, Idaho, and Louisiana); Rev. Rul. 2004-73, 2004-2 C.B. 80 (applying refund offset to community property in Nevada, New Mexico, and Washington); Rev. Rul. 2004-74, 2004-2 C.B. 84 (applying refund offset to community property in Texas).

RECOMMENDATIONS

The IRS should issue formal and informal guidance for:

- Same-sex spouses as questions continue to arise;
- Same- and opposite-sex partners who have marital attributes under civil union or similar state law;
- IRS employees to promptly process the foregoing returns and related claims; and
- Review of identity theft and revenue protection filters in light of common filing scenarios by same-sex spouses to ensure that the IRS does not freeze and delay refunds to legitimately married taxpayers.

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LEGISLATIVE RECOMMENDATIONS: Introduction

Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The chart immediately following this Introduction summarizes congressional action on recommendations the National Taxpayer Advocate proposed in her 2001 through 2012 Annual Reports.[1] The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion details recent developments relating to the National Taxpayer Advocate's proposals.

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REAL TIME TAX SYSTEM

In the 2012 and 2011 Annual Report to Congress, the National Taxpayer Advocate recommended that the IRS provide taxpayers with electronic access to third-party data to assist taxpayers in return preparation and that the IRS develop a pre-populated return option for taxpayers.[2] On April 15, 2013, Senator Shaheen introduced the Simpler Tax Filing Act of 2013, requiring the Secretary of the Treasury to study the feasibility of providing certain taxpayers with an optional, pre-prepared tax return.[3] The bill also requires the Secretary of the Treasury, in consultation with the Taxpayer Advocate Service (TAS), to report to the House Ways and Means Committee and the Senate Finance Committee on actions necessary to achieve the goal of offering pre-prepared tax returns by tax year 2018. The report is to include analysis of the budgetary, administrative, and legislative barriers to achieving that goal, including the funding that it would require.[4]

TAXPAYER RECEIPT ACT OF 2013

To enhance taxpayer awareness of the connection between taxes paid and benefits received, the National Taxpayer Advocate recommended that Congress direct the IRS to provide all taxpayers with a "taxpayer receipt" showing how their tax dollars are being spent.[5] This "taxpayer receipt" could be a more detailed version of the pie chart showing federal income and outlays currently published by the IRS,[6] but would

1 An electronic version of the chart is available on the TAS website at www.TaxpayerAdvocate.irs.gov/2013AnnualReport. The chart describes all the legislative recommendations the National Taxpayer Advocate has made since 2001, and lists each Code section affected by the recommendations.

2 National Taxpayer Advocate 2012 Annual Report to Congress 180-191 (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*).

3 Simpler Tax Filing Act of 2013, S. 722, 113th Cong. (2013).

4 *Id*.

5 National Taxpayer Advocate 2012 Annual Report to Congress 8 (Most Serious Problem: *The Complexity of the Tax Code*).

6 IRC § 7523 requires the IRS to include pie-shaped graphs showing the relative sizes of major outlay categories and major income categories in its instructions for Forms 1040, 1040A, and 1040EZ; *see, e.g.*, IRS Form 1040 Instructions (2012), at 104.

be provided directly to each taxpayer in connection with the filing of a tax return.[7] On August 22, 2013, Representative McDermott proposed legislation that would provide individual taxpayers, via U.S. mail, annual receipts for income taxes reported for the preceding taxable year. The receipt would state the amount paid, the taxpayer's filing status, earned income, and taxable income. Additionally, the receipt would contain tables listing expenditures in various categories of the federal budget, the ten most costly tax expenditures, and related spending information.[8]

TAXPAYER BILL OF RIGHTS

Over the last decade, the National Taxpayer Advocate has recommended many legislative changes that would protect taxpayer rights at a time when the IRS budget is shrinking and resources are shifting to enforcement. The National Taxpayer Advocate urges Congress to enact the legislative recommendations detailed in previous annual reports, beginning with the 2007 recommendation to codify a taxpayer bill of rights (TBOR) that would explicitly detail the rights and responsibilities of taxpayers.[9] On July 22, 2013, Representative Roskam introduced the Taxpayer Bill of Rights Act of 2013,[10] which would amend IRC § 7803 to require the Commissioner of Internal Revenue to ensure that IRS employees are familiar with and act in accordance with taxpayer rights. These rights include the right to be informed, to be assisted, to be heard, to pay no more than the correct amount of tax, to an appeal, to certainty, to privacy, to confidentiality, to representation, and to a fair and just tax system.[11] On July 31, 2013, the bill passed the House of Representatives, and was referred to the Senate Committee on Finance on August 1, 2013.

SMALL BUSINESS TAXPAYER BILL OF RIGHTS ACT OF 2013

Senator Cornyn and Representative Richmond introduced companion bills that would enact a number of the National Taxpayer Advocate's previous recommendations.[12] The proposed legislation would prohibit *ex parte* communications (*i.e.*, those that do not include the taxpayer or the taxpayer's representative)

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7 In April 2011, the White House launched a calculator on its website titled "Your Federal Taxpayer Receipt" that allows taxpayers to enter the actual or estimated amounts of their Social Security, Medicare, and income tax payments and to see a breakdown showing how their payments are being applied to major categories of federal spending, including Social Security, Medicare, national defense, health care, job and family security programs, interest on the national debt, Veterans benefits, and education. *See* www.whitehouse.govfiles/taxreceipt/. While we view the availability of this calculator as a positive development, most taxpayers will not take the time to visit this website. We therefore believe a taxpayer receipt should be provided in connection with the filing of a return.

8 Taxpayer Receipt Act of 2013, H.R. 3039 113th Cong. (2013).

9 National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*). *See also* National Taxpayer Advocate's Report to Acting Commissioner Daniel Werfel, *Toward a More Perfect Tax System: A Taxpayer Bill of Rights as a Framework for Effective Tax Administration* (Nov. 4, 2013), *available at* www.Taxpayer Advocate.irs.gov/2013AnnualReport; Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration, supra*.

10 Taxpayer Bill of Rights Act of 2013, H.R. 2768, 113th Cong. (2013).

11 *Id*.

12 Small Business Taxpayer Bill of Rights Act of 2013, S. 725, 113th Cong. (2013) and H.R. 3479, 113th Cong. (2013). See also Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration, supra*.

between Appeals officers and other IRS employees.[13] In addition, the proposed legislation would extend the period in which a third party can bring a suit for return of levied funds or proceeds.[14]

The legislation also contains two of the National Taxpayer Advocate's recommendations regarding relief from joint and several liability. The bills would:

- Suspend the running of the period for filing a Tax Court petition seeking review of an innocent spouse claim for the time the taxpayer is prohibited by reason of the automatic stay imposed under section 362 of the Bankruptcy Code from filing such petition, plus 60 additional days;[15] and
- Clarify that the scope and standard of review for taxpayers seeking equitable relief from joint and several liability under IRC § 6015(f) is *de novo*.[16]

THE SMALL BUSINESS PAYROLL PROTECTION ACT OF 2013

In recent years, a number of third party payers have gone out of business or embezzled their customers' funds. Because employers remain liable for payroll taxes, self-employed and small business taxpayers who fall victim to these situations can experience significant burden. This burden includes not only being forced to pay the amount twice — once to the third party payer that absconded with or dissipated the funds, and a second time to the IRS — but also being liable for interest and penalties. Some small businesses may not be able to recover from these setbacks and will be forced to cease operations.

This issue demonstrates the vital need for taxpayer protection in the payroll service industry, particularly for small business taxpayers that hire smaller third party payers. Beginning with the 2004 Annual Report to Congress, the National Taxpayer Advocate has addressed the problem of third party payer failures and recommended several legislative changes to Congress that could prevent or minimize the negative impact of these failures, including amending the Code to:

- Define a third party payer;
- Make a third party payer jointly and severally liable for the amount of tax collected from client employers but not paid over to the Treasury, plus applicable interest and penalties;

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13 S. 725, 113th Cong. § 7 (2013) and H.R. 3479, 113th Cong. § 7 (2013). *See* National Taxpayer Advocate 2009 Annual Report to Congress 346-350 (Legislative Recommendation: *Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State*) (noting the IRS Restructuring and Reform Act of 1998 prohibits *ex parte* communication between Appeals employees and other IRS employees, but recent IRS practices allowing Appeals employees to share office space with other IRS employees foster a perception of a lack of independence).

14 Both bills extend the time for third parties to sue from nine months to three years. S. 725, 113th Cong. § 9 (2013); H.R. 3479, 113th Cong. § 9 (2013). *See* National Taxpayer Advocate 2001 Annual Report to Congress 202-209 (Legislative Recommendation: *Return of Levy or Sale Proceeds*).

15 S. 725, 113th Cong. § 11 (2013); H.R. 3479, 113th Cong. § 11 (2013). *See* National Taxpayer Advocate 2004 Annual Report to Congress 490-492 (Legislative Recommendation: *Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court*).

16 S. 725, 113th Cong. § 14 (2013); H.R. 3479, 113th Cong. § 14 (2013). *See* National Taxpayer Advocate 2011 Annual Report to Congress 531-536 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) Is De Novo*). We note that the Court of Appeals for the Ninth Circuit, in *Wilson v. Comm'r*, 705 F.3d 980 (9th Cir. 2013), held that the scope and standard of the Tax Court's review of claims for relief under IRC § 6015(f) is *de novo*. The IRS acquiesced in the *Wilson* decision. *Action on dec.*, 2012-07 (June 17, 2013). However, the National Taxpayer Advocate believes that an amendment to IRC § 6015 (the innocent spouse provision of the Code) is still necessary with respect another issue, the issue of whether a taxpayer can raise innocent spouse relief as a defense in collection actions, and recommended that Congress address this problem in three Annual Reports to Congress. National Taxpayer Advocate 2010 Annual Report to Congress 377; National Taxpayer Advocate 2009 Annual Report to Congress 378; National Taxpayer Advocate 2007 Annual Report to Congress 549. The problem appears to persist as two district courts issued opinions recently holding that they do not have jurisdiction over IRC § 6015 claims raised as a defense in an action to reduce joint federal tax assessments to judgment or in a lien foreclosure suit. *U.S. v. Popowski*, 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012); *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012). For more detailed information, see Most Litigated Issue: *Relief from Joint and Several Liability Under IRC § 6015, infra/supra*.

- Authorize the IRS to require third party payers to register with the IRS and be sufficiently bonded; and
- Clarify that the Trust Fund Recovery Penalty (TFRP) survives bankruptcy when the debtor is not an individual.[17]

On May 8, 2013, Senator Mikulski introduced the Small Business Payroll Protection Act of 2013, to amend the Code to require the Secretary to establish a registration system for payroll tax deposit agents (defined as any person that provides payroll processing or tax filing and deposit service to one or more employers). The proposal requires such agents to: (1) submit a bond or to submit to quarterly third-party certifications, (2) make certain disclosures to their clients concerning liability for payment of employment taxes, and (3) pay penalties for failing to collect or pay over employment taxes or for attempting to evade or defeat payment of such taxes.[18]

RESTRICT ACCESS TO THE DEATH MASTER FILE

As one means to stem the growing number of tax-related identity theft cases, the National Taxpayer Advocate recommended that Congress restrict access to the Social Security Administration's death master file (DMF).[19] The fiscal year 2014 budget bill contains a provision that restricts access to the DMF records of individuals who died during the previous three calendar years.[20]

CONSOLIDATE EDUCATION INCENTIVES

The National Taxpayer Advocate has suggested consolidating and simplifying various Code provisions to make compliance less difficult.[21] Senator Schumer and Representative Doggett introduced companion bills that include the National Taxpayer Advocate's recommendation to consolidate the education tax credits known as the Hope Scholarship and the Lifetime Learning Credits.[22] The proposed legislation would amend the Code to replace the two credits with a new American Opportunity Tax Credit that: (1) allows an income tax credit of up to $3,000 of the qualified tuition and related expenses of a student who is carrying at least one half of a normal course load; (2) increases the income threshold for reductions in the credit amount based upon modified adjusted gross income; (3) allows a lifetime dollar limitation on such credit of $15,000 for all taxable years; and (4) makes 40 percent of the credit refundable. Additionally, the bill allows an exclusion from gross income of any amount received as a federal Pell grant.

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17 National Taxpayer Advocate 2004 Annual Report to Congress 394-399 (Legislative Recommendation: *Protection From Payroll Service Provider Misappropriation*). *See also* National Taxpayer Advocate 2012 Annual Report to Congress 553-559 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); 2007 Annual Report to Congress 538-544 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*).

18 S. 900, 113th Cong. (2013).

19 *See* National Taxpayer Advocate 2011 Annual Report to Congress 519-523 (Legislative Recommendation: *Restrict Access to the Death Master File*). The DMF is a database available to the public that includes decedents' full names, Social Security numbers, dates of birth, dates of death, and the county, state, and Zip code of their last addresses.

20 The Bipartisan Budget Act of 2013, H.J. Res. 59, 113th Cong. § 203 (2013).

21 *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 370-372 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*).

22 S. 835, 113th Cong. (2013); and H.R. 1738, 113th Cong. (2013).

AMEND THE ADOPTION CREDIT TO ACKNOWLEDGE JURISDICTION OF NATIVE AMERICAN TRIBES

In the 2012 Annual Report, the National Taxpayer Advocate recommended that Congress amend IRC § 7871(a) to include the adoption credit (IRC § 23) in the list of Code sections for which a Native American tribal government is treated as a "State."[23] Because a Native American tribe is not considered a state for purposes of the credit and cannot certify a child's special needs, taxpayers who adopt a Native American special needs child cannot claim the special needs adoption credit. On June 12, 2013, Representative Kilmer introduced the Adoption Tax Credit Tribal Parity Act of 2013 that would allow tribal governments to determine a child is a "child with special needs" for purposes of the adoption tax credit.[24]

LEGISLATIVE RECOMMENDATIONS THAT HAVE LED TO ADMINISTRATIVE CHANGES

Sometimes legislative recommendations made by the National Taxpayer Advocate are accomplished through the issuance of regulations or other administrative guidance. Before proposing a legislative recommendation to Congress, the National Taxpayer Advocate attempts to work with the IRS to address her concerns through the issuance of regulations or other administrative guidance, if possible. When the IRS disagrees with a change that could be accomplished administratively or would not move quickly enough, the National Taxpayer Advocate proposes the change to Congress to give IRS direction. In some cases, the IRS has reconsidered its position and addressed issues raised by the National Taxpayer Advocate through the issuance of guidance, as described below.

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Authorize Voluntary Withholding Agreements

Even though withholding is not required on payments to independent contractors (payees), some contractors may wish to have customers (payors) withhold taxes for them, just like they do for employees. Such withholding would help contractors avoid the burdens of making timely quarterly estimated tax payments. It is unclear, however, whether statutory authority exists to enter into such agreements.[25] In an effort to ease compliance burdens for independent contractors, the National Taxpayer Advocate recommended that IRC § 3402(p)(3) be amended to specifically authorize voluntary withholding agreements between independent contractors and service-recipients (as defined in IRC § 6041A(a)(1)) in her 2007 Annual Report to Congress.[26]

In November of 2013, the IRS published temporary Treasury Regulations that permit the Secretary to issue guidance describing other payments for which withholding under a voluntary withholding agreement would be appropriate (*e.g.*, payors agree to withhold income tax on such payments if requested by the

23 National Taxpayer Advocate 2012 Annual Report to Congress 521-525 (Legislative Recommendation: *Amend the Adoption Credit to Acknowledge Jurisdiction of Native American Tribes*).

24 The Adoption Tax Credit Tribal Parity Act of 2013, H.R. 2332, 113th Cong. (2013).

25 IRC § 3402(p)(1) provides for voluntary withholding on certain federal payments (such as Social Security benefits). IRC § 3402(p)(2) provides for voluntary withholding on unemployment compensation payments. IRC § 3402(p)(3) provides for "other voluntary withholding" agreements and authorizes the Secretary, by regulation, to provide for withholding from (1) payments from employer to employee that do not constitute wages, and (2) "any other type of payment with respect to which the Secretary finds that withholding would be appropriate under the provisions of [IRC chapter 24, Collection of Income Tax at Source]."

26 National Taxpayer Advocate 2007 Annual Report to Congress 493-492 (Legislative Recommendation: *Measures to Address Noncompliance in the Cash Economy*).

payee).[27] Such guidance was issued shortly thereafter in the form of Notice 2013-77 which expanded the use of voluntary withholding agreements in the context of certain dividends and other distributions.[28]

Provide Relief for Untimely S Corporation Elections

The National Taxpayer Advocate has called attention to the harmful consequences of allowing taxpayers to elect S corporation status only if they do so by the 15th day of the third month of their taxable year.[29] Consequently, many taxpayers overlook the requirement to submit Form 2553, *Election by a Small Business Corporation*, subjecting themselves to serious tax consequences that include taxation at the corporate level and rendering shareholders unable to deduct operating losses on their individual tax returns. The National Taxpayer Advocate recommended that Congress amend IRC § 1362(b)(1) to allow a small business corporation to elect to be treated as an S corporation by checking a box on its first timely filed (including extensions) tax return, but acknowledged that the opportunities for relief through the issuance of administrative guidance exist and urged the IRS to expedite the issuance of a consolidated revenue procedure for late election relief.[30]

On September 3, 2013, the IRS published a revenue procedure that consolidates relief provisions included in prior revenue procedures and, *inter alia*, provides a simplified method for taxpayers to request relief for late S corporation elections within three years and 75 days after the date on which the S corporation election is intended to be effective.[31]

Aggregate Employment Tax Return Filing by a Designated Third Party Agent

For over a decade, the National Taxpayer Advocate addressed the problem of Third Party Payer (TPP) failures and recommended measures that could prevent or minimize the negative impact of these failures on common law employers, including home care service recipients (HCSRs).[32] Because common law employers remain liable for payroll taxes, those victimized in these situations (especially self-employed and small business taxpayers, and HCSRs) can experience significant burden. Among other things, the National Taxpayer Advocate proposed a legislative change to amend IRC § 3504 to require aggregate filers (*i.e.*, agents with an approved Form 2678, *Employer/Payer Appointment of Agent*) to allocate reported and paid employment taxes among their clients using a form prescribed by the IRS and impose a penalty for

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27 Treas. Reg. § 31.3402-1T(c), 78 Fed. Reg. 71476 (Nov. 29, 2013).

28 Notice 2013-77, 2013-50 I.R.B. 632. The Notice specifically addresses the Alaska Native Corporation (ANC) and allows an ANC and any shareholder of the ANC to enter into an agreement for voluntary withholding under IRC § 3402(p)(3)(B). Thus, dividends and other distributions paid by an ANC to a shareholder will be subject to voluntary income tax withholding under section 3402(p)(3)(B) if the shareholder requests the withholding and the ANC agrees to withhold.

29 *See* National Taxpayer Advocate 2010 Annual Report to Congress 410-411 (Legislative Recommendation: *Extend the Due Date for S Corporation Elections to Reduce the High Rate of Untimely Elections*). Senator Franken introduced legislation to allow corporations to elect S corporation status with their first filed returns. S. 2271, 112th Cong. (2012).

30 *See* National Taxpayer Advocate 2010 Annual Report to Congress 278-290 (Most Serious Problem: *S Corporation Election Process Unduly Burdens Small Businesses*).

31 Rev. Proc. 2013-30, 2013-36 I.R.B. 173.

32 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 553-559 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 556-557 (Legislative Recommendation: *Home Care Service Workers*). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 538-544; National Taxpayer Advocate 2004 Annual Report to Congress 394-399; National Taxpayer Advocate 2001 Annual Report to Congress 193.

the failure to file absent reasonable cause, and shift the liability for employment taxes from the service recipients, to the administrators of HCSR funding.[33]

The IRS has taken several steps to address the National Taxpayer Advocate's concerns through the issuance of Treasury Regulations and other administrative guidance.[34] The IRS has created Schedules R (*Schedule for Aggregate Form 941, Schedule for Aggregate Form 940*) for Form 941, *Employer's QUARTERLY Federal Tax Return*, and Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, for tracking employer-agent relationships for agents with an approved Form 2678.[35] Effective December 12, 2013, TPPs authorized to file in the aggregate must now allocate reported and paid employment taxes among their clients; in addition, the IRS has published special rules for agents of the home care service recipients, including state agents, who may file an aggregate Form 940.[36]

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SUMMARY OF 2013 LEGISLATIVE RECOMMENDATIONS

1. **Permanently repeal the Alternative Minimum Tax (AMT).**

   The AMT does not achieve its original goal — to ensure that wealthy taxpayers pay at least some tax. By one projection, about 1,000 millionaires will pay no federal income tax in 2013. Those with the highest incomes are actually less likely to pay AMT than those just below them. The AMT penalizes middle income taxpayers for having children, getting married, or paying state and local taxes. The AMT is also unnecessarily complicated and burdensome, even for those who are not subject to it. Many taxpayers must fill out a lengthy form only to find they owe little or no AMT after all. Moreover, the complexity of the AMT reduces the transparency of the tax system, making it more difficult for people to know their marginal tax rate and predict what they will owe. When people owe more than anticipated, voluntary compliance suffers.

2. **Amend IRC § 6511(h)(2) to provide that an individual is financially disabled when he or she has a physical or mental impairment, determined by a licensed medical or mental health professional, which materially limits the individual's management of his or her financial affairs.**

   In 1998 Congress amended IRC § 6511 by adding subsection (h), which suspends the running of the period for filing a claim for a refund where a taxpayer can show that he or she was financially disabled. However, the current, narrowly tailored provision fails to protect taxpayers who lack the capacity to file a refund claim. The statute requires a qualifying taxpayer to have a "medically determinable" physical or mental impairment, limiting the

33 National Taxpayer Advocate 2012 Annual Report to Congress 553-559; National Taxpayer Advocate 2007 Annual Report to Congress 556-557. Under IRC § 3504, the Secretary is authorized to issue regulations to "designate [a] fiduciary, agent, or other person" that has the "control, receipt, custody, or disposal of, or pays the wages of an employee or group of employees, employed by one or more employers," to perform acts required of employers. IRC § 3504. Both the designee and the employer remain liable for payroll taxes and all penalties as long as the agent authorization made on the Form 2678 is in effect. IRC § 3504; Treas. Reg. § 31.3504-1.

34 *See* T.D. 9649, 78 Fed. Reg. 75471 (Dec. 12, 2013) (amending Treas. Reg. § 31.3504-1 to provide that the IRS may authorize an agent to undertake the employment tax obligations of an employer with respect to Federal Unemployment Tax Act (FUTA) tax); Rev. Proc. 2013-39, 2013-52 I.R.B. 830 (updating the procedure for requesting the IRS authorize a person to act as agent under IRC § 3504).

35 The Schedule R includes a list of all employers using the agent with an approved Form 2678 and the payroll liabilities reported by the agent on the Form 941 for each employer. IRM 5.1.24.4.4.1 (Aug. 15, 2012); IRM 21.7.2.4.4.3 (Oct. 1, 2012). *See also* the Schedule R (Form 940), designed for filers of Form 940 having approved Forms 2678. IRM 21.7.3.4.7 (Oct. 1, 2012).

36 Rev. Proc. 2013-39, 2013-52 I.R.B. 830.

evidence the IRS could consider, such as determinations from psychologists or clinical social workers. It also requires that the taxpayer be "unable" to manage his or her financial affairs due to a physical or mental impairment. This forces the individual making the determination to provide a global, "all or nothing," statement about the effect of the impairments. These requirements have led the IRS to dismiss otherwise compelling evidence and deny relief to taxpayers.

3. **Amend IRC § 32(k) to clarify that the IRS has the burden of proof when proposing to impose the two-year ban on claiming EITC.**

   IRC § 32(k) authorizes the IRS to ban taxpayers from claiming the Earned Income Tax Credit (EITC) for two years if the IRS determines they claimed the credit improperly due to reckless or intentional disregard of rules and regulations. The IRS often ignores the statutory requirements for imposing the ban, contravenes its own Chief Counsel guidance, and bypasses its own procedural safeguards to impose the ban. For the vulnerable low income taxpayers who are otherwise eligible for EITC, inappropriately being deprived of the credit for two years is a serious burden. These taxpayers may be intimidated and fearful of protesting the IRS's treatment of them, may not understand they have been wronged when the IRS imposes the ban without following the statutory requirements, and consequently may not seek the assistance they need, such as from Low Income Taxpayer Clinics. A taxpayer may petition the Tax Court for review of the IRS's determination to impose the two-year ban, but the taxpayer may have the burden of proving the IRS acted improperly. The proposed change would require the IRS to produce evidence of the taxpayer's reckless or intentional disregard of rules and regulations and persuade the court that imposition of the ban would be appropriate.

4. **Clarify that the 9.5-percent affordability threshold for the Affordable Care Act's Premium Tax Credit pertains to the applicable type of insurance, whether self-only or family coverage.**

   The recommendation would align the rule with economic affordability. Under a Treasury Regulation implementing the Affordable Care Act, an employee's family may be ineligible for the premium tax credit if the cost of "self-only" insurance would be affordable, even though they pay more for family coverage. This is because a 9.5-percent affordability threshold in the regulation refers to self-only cost — even if the employee needs family coverage. As a logical matter, the affordability threshold creates a disjunct between a stipulated amount and the actual cost of family coverage. Illogical provisions, which run contrary to intuitive behavior, make tax administration difficult. As a practical matter, disqualification from the premium tax credit makes it harder for families to obtain health insurance.

5. **Expand the Taxpayer Identification Number matching statute for purposes of information reports on tuition to allow the IRS to alert colleges of mismatches to resolve with students prior to filing information returns.**

   Although the Internal Revenue Code requires colleges and universities to file information returns with the IRS reflecting tuition payments from students, the law does not permit these eligible educational institutions to verify Taxpayer Identification Numbers (TINs) with

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the IRS prior to filing. Unlike other information return filers who can perfect TINs once the IRS advises them of an error, colleges and universities must rely on student input while still facing penalties for errors. Existing law permits TIN matching by payers of income, who would have to do back-up withholding in the case of a payee with an inaccurate TIN. This would be inapplicable to colleges and universities when they are not paying income to students. Nevertheless, colleges and universities have a tuition information reporting requirement for which they need to verify TINs as a practical matter. A TIN may not match a student's name for various reasons, such as transposition errors or name changes.

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National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
Repeal the Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82–100; National Taxpayer Advocate 2004 Annual Report to Congress 383–385; National Taxpayer Advocate 2008 Annual Report to Congress 356–362.	Repeal the AMT outright.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 1616	Lee	10/30/2013	Referred to the Finance Committee
	HR 243	Ross	1/14/2013	Referred to Ways & Means Committee
Legislative Activity 112th Congress	HR 86	Bachmann	1/5/2011	Referred to Ways & Means Committee
	HR 99	Dreler	1/5/2011	Referred to Ways & Means Committee
	HR 547	Garrett	2/8/2011	Referred to Ways & Means Committee
	HR 3400	Garrett	11/10/2011	Referred to Ways & Means Committee
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 820	Shelby	4/14/2011	Referred to the Finance Committee
	HR 3804	Huelskamp	1/23/2012	Referred to Ways & Means Committee
Legislative Activity 111th Congress	S 3018	Wyden	2/23/2010	Referred to the Finance Committee
	HR 240	Garrett	1/7/2009	Referred to the Ways & Means Committee
	HR 782	Paul	1/28/2009	Referred to the Ways & Means Committee
	S 932	Shelby	4/30/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	S 55	Baucus	1/4/2007	Referred to the Finance Committee
	S 14	Kyl	4/17/2007	Referred to the Finance Committee
	S 1040	Shelby	3/29/2007	Referred to the Finance Committee
	HR 1365	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
	S 2293	Lott	11/1/2007	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464
Legislative Activity 109th Congress	HR 1186	English	3/9/2005	Referred to the Ways & Means Committee
	S 1103	Baucus	5/23/2005	Referred to the Finance Committee
	HR 2950	Neal	6/16/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee

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Legislative Activity 108th Congress	HR 43	Collins	1/7/2003	Referred to the Ways & Means Committee
	HR 1233	English	3/12/2003	Referred to the Ways & Means Committee
	S 1040	Shelby	5/12/2003	Referred to the Finance Committee
	HR 3060	N. Smith	9/10/2003	Referred to the Ways & Means Committee
	HR 4131	Houghton	4/2/2004	Referred to the Ways & Means Committee
	HR 4164	Shuster	4/2/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 437	English	2/6/2001	Referred to the Ways & Means Committee
	S 616	Hutchison	3/26/2002	Referred to the Finance Committee
	HR 5166	Portman	7/18/2002	Referred to the Ways & Means Committee
Index AMT for Inflation National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	If full repeal of the individual AMT is not possible, it should be indexed for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3223	McConnell	9/13/2010	Placed on the Senate Calendar
	HR 5077	Hall	4/20/2010	Referred to the Ways & Means Committee
	HR 719	Lee	1/27/2009	Referred to the Ways & Means Committee
	S 722	Baucus	3/26/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	HR 703	Garrett	2/9/2005	Referred to the Ways & Means Committee
	HR 4096	Reynolds	10/20/2005	12/7/2005–Passed the House; 12/13/2005–Placed on the Senate Legislative Calendar
Legislative Activity 108th Congress	HR 22	Houghton	1/7/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 5505	Houghton	10/1/2002	Referred to the Ways & Means Committee
Eliminate Several Adjustments for Individual AMT National Taxpayer Advocate 2001 Annual Report to Congress 82–100.	Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 336	DeMint	2/14/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 102	Kerry	1/4/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1861	Harkin	10/7/2005	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 1939	Neal	5/12/2003	Referred to the Ways & Means Committee

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Private Debt Collection (PDC)				
Repeal PDC Provisions National Taxpayer Advocate 2006 Annual Report to Congress 458–462.	Repeal IRC § 6306, thereby terminating the PDC initiative.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 796	Lewis	2/3/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	S 335	Dorgan	1/18/2007	Referred to the Finance Committee
	HR 695	Van Hollen	1/24/2007	Referred to the Ways & Means Committee
	HR 3056	Rangel	7/17/2007	10/10/2007-Passed the House; 10/15/2007-Referred to the Finance Committee

Tax Preparation and Low Income Taxpayer Clinics (LITC)				
Matching Grants for LITC for Return Preparation National Taxpayer Advocate 2002 Annual Report to Congress vii–viii.	Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.			
Legislative Activity 111th Congress	**Pub. L. No. 111-117, Div. C, Title I, 123 Stat. 3034, 3163 (2009).**			
Legislative Activity 110th Congress	**Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).**			
	Bill Number	Sponsor	Date	Status
	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
	S 1967	Clinton	8/2/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	S 476	Grassley	2/27/2003	Referred to the Finance Committee
	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

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Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2001	Referred to the Ways & Means Committee
	HR 7	Baucus	7/16/2002	Reported by Chairman Baucus with an amendment; referred to the Finance Committee
Regulation of Income Tax Return Preparers National Taxpayer Advocate 2002 Annual Report to Congress 216–230; National Taxpayer Advocate 2003 Annual Report to Congress 270–301; National Taxpayer Advocate 2007 Annual Report to Congress 83–95 & 140-155; National Taxpayer Advocate 2008 Annual Report to Congress 423–426; National Taxpayer Advocate 2009 Annual Report to Congress 41–69.	Create an effective oversight and penalty regime for return preparers by taking the following steps: ◆ Enact a registration, examination, certification, and enforcement program for federal tax return preparers; ◆ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight; ◆ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and ◆ Require the IRS to take steps within its existing administrative authority, including requiring a checkbox on all returns in which preparers would enter their category of return preparer (*i.e.*, attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

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Referrals to LITCs National Taxpayer Advocate 2007 Annual Report to Congress 551–553.	Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1573	Durbin	9/15/2011	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 171
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Public Awareness Campaign on Registration Requirements National Taxpayer Advocate 2002 Annual Report to Congress 216–230.	Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

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Increase Preparer Penalties National Taxpayer Advocate 2003 Annual Report to Congress 270–301.	Strengthen oversight of all preparers by enhancing due diligence and signature requirements, increasing the dollar amount of preparer penalties, and assessing and collecting those penalties, as appropriate.			
Legislative Activity 112th Congress	**Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011).**			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 4318	Crowley/ Ramstad	12/6/2007	Referred to the Ways & Means Committee
	S 2851	Bunning	4/14/2008	Referred to the Finance Committee
	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Refund Delivery Options National Taxpayer Advocate 2008 Report to Congress 427–441.	Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Senate Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee

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Small Business Issues				
Health Insurance Deduction/Self-Employed Individuals National Taxpayer Advocate 2001 Annual Report to Congress 223; National Taxpayer Advocate 2008 Annual Report to Congress 388–389.	Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.			
Legislative Activity 111th Congress	**Pub. L. No. 111-124, § 2041 STAT 2560 (2010).**			
	Bill Number	Sponsor	Date	Status
	S 725	Bingaman	3/26/2009	Referred to the Finance Committee
	HR 1470	Kind	3/12/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	S 2239	Bingaman	10/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 663	Bingaman	3/17/2005	Referred to the Finance Committee
	S 3857	Smith	9/16/2006	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 741	Sanchez	2/12/2003	Referred to the Ways & Means Committee
	HR 1873	Manzullo Velazquez	4/30/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	S 2130	Bingaman	4/15/2002	Referred to the Finance Committee
Married Couples as Business Co-owners National Taxpayer Advocate 2002 Annual Report to Congress 172–184.	Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of subchapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.			
Legislative Activity 110th Congress	**Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).**			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, with an amendment
	S 842	Kerry	4/9/2003	Referred to the Finance Committee
	HR 1640	Udall	4/3/2003	Referred to the Ways & Means Committee
	HR 1558	Doggett	4/2/2003	Referred to the Ways & Means Committee
Income Averaging for Commercial Fishermen National Taxpayer Advocate 2001 Annual Report to Congress 226.	Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).**			

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Election to be Treated as an S Corporation National Taxpayer Advocate 2004 Annual Report to Congress 390–393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, *U.S. Income Tax Return for an S Corporation*.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 2271	Franken	3/29/2012	Referred to the Finance Committee
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Regulation of Payroll Tax Deposits Agents National Taxpayer Advocate 2004 Annual Report to Congress 394–399.	Allow a small business corporation to elect to be treated as an S corporation by checking a box on it's timely filed Form 1120S U.S. Income Tax Return for an S Corporation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 900	Mikulski	05/08/2013	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Simplification				
Reduce the Number of Tax Preferences National Taxpayer Advocate 2010 Annual Report to Congress 365–372.	Simplify the complexity of the tax code generally by reducing the number of tax preferences.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
Simplify and Streamline Education Tax Incentives National Taxpayer Advocate 2008 Annual Report to Congress 370–372; National Taxpayer Advocate 2004 Annual Report to Congress 403–422.	Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221, (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer, (3) the definitions for "Qualified Higher Education Expenses" and "Eligible Education Institution" should be simplified, (4) the income level and phase-out calculations should be more consistent under the various provisions, (5) all dollar amounts should be indexed for inflation, and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 835	Schumer	4/25/2013	Referred to the Finance Committee
	HR 1738	Doggett	4/25/2013	Referred to the Ways & Means Committee
	HR 3476	Israel	11/13/2013	Referred to the Ways & Means Committee

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Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 3267	Schumer	6/6/2012	Referred to the Finance Committee
	HR 6522	Israel	9/21/2012	Referred to the Ways & Means Committee
Simplify and Streamline Retirement Savings Tax Incentives National Taxpayer Advocate 2008 Annual Report to Congress 373–374; National Taxpayer Advocate 2004 Annual Report to Congress 423–432.	Consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement plan for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 727	Wyden	4/5/2011	Referred to the Finance Committee
Tax Gap Provisions				
Corporate Information Reporting National Taxpayer Advocate 2008 Annual Report to Congress 388.	Require businesses that pay $600 or more during the year to non-corporate and corporate service providers to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 1796	Baucus	10/19/2009	10/19/2009 Placed on Senate Legislative Calendar under General Orders. Calendar No. 184
Reporting on Customer's Basis in Security Transaction National Taxpayer Advocate 2005 Annual Report to Congress 433–441.	Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B.			
Legislative Activity 110th Congress	**Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).**			
	Bill Number	Sponsor	Date	Status
	HR 878	Emanuel	2/7/2007	Referred to the Ways & Means Committee
	S 601	Bayh	2/14/2007	Referred to the Finance Committee
	S 1111	Wyden	4/16/2007	Referred to the Finance Committee
	HR 2147	Emanuel	5/3/2007	Referred to the Ways & Means Committee
	HR 3996 PCS	Rangel	10/30/2007	11/14/2007–Placed on the Senate Calendar; became Pub. L. No. 110-166 (2007) without this provision
Legislative Activity 109th Congress	S 2414	Bayh	3/14/2006	Referred to the Finance Committee
	HR 5176	Emanual	4/25/2006	Referred to the Ways & Means Committee
	HR 5367	Emanual	5/11/2006	Referred to the Ways & Means Committee
IRS Forms Revisions National Taxpayer Advocate 2004 Annual Report to Congress 480; National Taxpayer Advocate 2010 Annual Report to Congress 40.	Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee

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IRS to Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS) National Taxpayer Advocate 2005 Annual Report to Congress 381–396.	Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Study of Use of Voluntary Withholding Agreements National Taxpayer Advocate 2004 Annual Report to Congress 478–489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).			
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336. 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Require Form 1099 Reporting for Incorporated Service Providers National Taxpayer Advocate 2007 Annual Report to Congress 494–496.	Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.			
Legislative Activity 111th Congress	**Pub. L No. 111-148 § 9006 (2010).** However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over $600, but Require Reporting on Corporate and Certain Other Payments.			
Require Financial Institutions to Report All Accounts to the IRS by Eliminating the $10 Threshold on Interest Reporting National Taxpayer Advocate 2007 Annual Report to Congress 501–502.	Eliminate the $10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee

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Revise Form 1040, Schedule C to Break Out Gross Receipts Reported on Payee Statements Such as Form 1099 National Taxpayer Advocate 2007 Annual Report to Congress 40.	Administrative recommendation that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099 National Taxpayer Advocate 2007 Annual Report to Congress 40.	Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: "Did you make any payments over $600 in the aggregate during the year to any unincorporated trade or business?" and "If yes, did you file all required Forms 1099?" S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Authorize Voluntary Withholding Upon Request National Taxpayer Advocate 2007 Annual Report to Congress 493–494.	Authorize voluntary withholding agreements between independent contractors and service recipients.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Require Backup Withholding on Certain Payments When TINs Cannot Be Validated National Taxpayer Advocate 2005 Annual Report to Congress 238–248.	Administrative recommendation that the IRS require payors to commence backup withholding if they do not receive verification of a payee's TIN. (S. 3795 would require voluntary withholding on certain payments.)			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Worker Classification National Taxpayer Advocate 2008 Annual Report to Congress 375–390.	Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Taxpayer Bill of Rights and *De Minimis* "Apology" Payments				
Taxpayer Bill of Rights National Taxpayer Advocate 2007 Annual Report to Congress 486–489.	Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	HR 2768	Roskam	6/22/2013	Passed the House of Representatives, and was referred to the Senate Finance Committee on 8/31/2013
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Finance Committee

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Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
***De Minimis* "Apology" Payments** National Taxpayer Advocate 2007 Annual Report to Congress 490.	Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide *de minimis* compensation to taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the IRC § 7811 definition of significant hardship.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
Simplify the Tax Treatment of Cancellation of Debt Income				
Simplify the Tax Treatment of Cancellation of Debt Income National Taxpayer Advocate 2008 Annual Report to Congress 391–396.	Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	HR 4561	Lewis	2/2/2010	Referred to the Ways & Means Committee
Joint and Several Liability				
Tax Court Review of Request for Equitable Innocent Spouse Relief National Taxpayer Advocate 2001 Annual Report to Congress 128–165.	Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.			
Legislative Activity 109th Congress	**Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).**			
Effect of Automatic Stay Imposed in Bankruptcy Cases upon Innocent Spouse and CDP Petitions in Tax Court). National Taxpayer Advocate 2004 Annual Report to Congress 490–92.	Allow a taxpayer seeking review of an innocent spouse claim or a collection case in U.S. Tax Court a 60-day suspension of the period for filing a petition for review, when the U.S. Bankruptcy Court has issued an automatic stay in a bankruptcy case involving the taxpayer's claim.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Ways & Means Committee
Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is *De Novo*. National Taxpayer Advocate 2011 Annual Report to Congress 531–536.	Amend IRC § 6015 to specify that the scope and standard of review in tax court determinations under IRC § 6015(f) is *de novo*.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 113th Congress	S 725	Cornyn	4/15/2013	Referred to the Finance Committee
	HR 3479	Thornberry	11/13/2013	Referred to the Ways & Means Committee
Legislative Activity 112th Congress	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 60550	Becerra	6/28/2012	Referred to the Ways & Means Committee

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Collection Issues				
Improve Offer In Compromise Program Accessibility National Taxpayer Advocate 2006 Annual Report to Congress 507–519.	Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee
Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens 2009 National Taxpayer Advocate Report to Congress 357–364.	Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFTL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 6439	Hastings	11/18/2010	Referred to the Ways & Means Committee
Permit the IRS to Release Levies on Small Business Taxpayers 2011 National Taxpayer Advocate Report to Congress 537–543.	Amend IRC § 6343(a)(1)(d) to: permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4368	McDermott	4/17/2012	Referred to the Ways & Means Committee
Return of Levy or Sale Proceeds National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee

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Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House
	HR 586	Lewis	2/13/2001	4/18/02–Passed the House with an amendment; referred to the Senate
Reinstatement of Retirement Accounts National Taxpayer Advocate 2001 Annual Report to Congress 202–214.	Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343: ◆ § 401 – Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans ◆ § 408 – Individual Retirement Account, and SEP-Individual Retirement Account ◆ § 408A – Roth Individual Retirement Account			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in H.R. 1528 through an amendment and HR 1528 passed in lieu of S 882
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Consolidation of Appeals of Collection Due Process (CDP) Determinations National Taxpayer Advocate 2004 Annual Report to Congress 451–470.	Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.			
Legislative Activity 109th Congress	**Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).**			

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Partial Payment Installment Agreements National Taxpayer Advocate 2001 Annual Report to Congress 210–214.	Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the IRS.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 833, 118 Stat. 1589-1592 (2004).**			
Waiver of Installment Agreement Fees for Low Income Taxpayers National Taxpayer Advocate 2006 Annual Report to Congress 141–56 (Most Serious Problem: Collection Issues of Low Income Taxpayers).	Implement an installment agreement (IA) user fee waiver for low income taxpayers and adopt a graduated scale for other IA user fees based on the amount of work required.			
Legislative Activity 112th Congress	Bill Number	Sponsor	Date	Status
	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State National Taxpayer Advocate 2009 Annual Report to Congress 346-350.	Provide that each Appeals office maintains separate office space, separate phone lines, facsimile, and other electronic communications access, and a separate post office address from any IRS office co-located with the Appeals office.			
Legislative Activity 112th Congress	Bill Number	Sponsor	Date	Status
	HR 4375	Johnson	4/17/2012	Referred to the Ways & Means Committee
	S 2291	Cornyn	4/17/2012	Referred to the Finance Committee
Penalties and Interest				
Interest Rate and Failure to Pay Penalty National Taxpayer Advocate 2001 Annual Report to Congress 179–182.	Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.			
Legislative Activity 108th Congress	Bill Number	Sponsor	Date	Status
	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Interest Abatement on Erroneous Refunds National Taxpayer Advocate 2001 Annual Report to Congress 183–187.	Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice.			
Legislative Activity 109th Congress	Bill Number	Sponsor	Date	Status
	HR 726	Sanchez	2/9/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

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First Time Penalty Waiver National Taxpayer Advocate 2001 Annual Report to Congress 188–192.	Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in the House
Federal Tax Deposit (FTD) Avoidance Penalty National Taxpayer Advocate 2001 Annual Report to Congress 222.	Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 109th Congress	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
	S 1321RS	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
Family Issues				
Uniform Definition of a Qualifying Child National Taxpayer Advocate 2001 Annual Report to Congress 78–100.	Create a uniform definition of "qualifying child" applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	**Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).**			
Means Tested Public Assistance Benefits National Taxpayer Advocate 2001 Annual Report to Congress 76–127.	Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or "not married" status.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee

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Credits for the Elderly or the Permanently Disabled National Taxpayer Advocate 2001 Annual Report to Congress 218–219.	Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 107th Congress	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee
Electronic Filing Issues				
Direct Filing Portal National Taxpayer Advocate 2004 Annual Report to Congress 471–477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006–Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Free Electronic Filing For All Taxpayers National Taxpayer Advocate 2004 Annual Report to Congress 471–477.	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	S 2861	Schumer	4/15/2008	Referred to the Finance Committee
Office of the Taxpayer Advocate				
Confidentiality of Taxpayer Communications National Taxpayer Advocate 2002 Annual Report to Congress 198–215.	Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to TAS.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Access to Independent Legal Counsel National Taxpayer Advocate 2002 Annual Report to Congress 198–215.	Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of *amicus* briefs.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	Referred to the Senate
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee

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Taxpayer Advocate Directive National Taxpayer Advocate 2012 Annual Report to Congress 573–602; National Taxpayer Advocate 2002 Annual Report to Congress 419–422.	Amended IRC § 7811 to provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the Internal Revenue Service with respect to any program, proposed program, action, or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large.			
Legislative Activity 112th Congress	Bill Number	Sponsor	Date	Status
	S 3355	Bingaman	6/28/2012	Referred to the Finance Committee
	HR 6050	Becerra	6/28/2012	Referred to the Ways & Means Committee
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Other Issues				
Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact National Taxpayer Advocate 2008 Annual Report to Congress 419–422.	Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of $100,000 per individual per year and $200,000 per entity per year for failure to make special disclosures of a "listed transaction."			
Legislative Activity 111th Congress	**Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).**			
	Bill Number	Sponsor	Date	Status
	S 2771	Baucus	11/16/2009	Referred to the Finance Committee
	HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
	S 2917	Baucus	12/18/2009	Referred to the Finance Committee
Eliminate Tax Strategy Patents National Taxpayer Advocate 2007 Annual Report to Congress 512–524.	Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.			
Legislative Activity 112th Congress	**Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).**			
Disclosure Regarding Suicide Threats National Taxpayer Advocate 2001 Annual Report to Congress 227.	Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.			
Legislative Activity 112th Congress	Bill Number	Sponsor	Date	Status
	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Attorney Fees National Taxpayer Advocate 2002 Annual Report to Congress 161–171.	Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees "above the line." Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.			
Legislative Activity 108th Congress	**Pub. L. No. 108-357, § 703, 118 Stat. 1546-1548 (2004).**			
Attainment of Age Definition National Taxpayer Advocate 2003 Annual Report to Congress 308–311.	Amend IRC § 7701 by adding a new subsection as follows: "Attainment of Age. An individual attains the next age on the anniversary of his date of birth."			

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Legislative Activity 108th Congress	Bill Number	Sponsor	Date	Status
	HR 4841	Burns	7/15/2004	7/21/2004–Passed the House; 7/22/2004–Received in the Senate
Home-Based Service Workers (HBSW) National Taxpayer Advocate 2001 Annual Report to Congress 193–201.	Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.			
Legislative Activity 110th Congress	Bill Number	Sponsor	Date	Status
	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
Legislative Activity 107th Congress	S 2129	Bingaman	4/15/2002	Referred to the Finance Committee
Restrict Access to the Death Master File National Taxpayer Advocate 2011 Annual Report to Congress 519–523.	Restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.			
Legislative Activity 113th Congress	**H.J. Res. 59, 113th Cong. § 203 (2013).**			
Legislative Activity 112th Congress	Bill Number	Sponsor	Date	Status
	S 3432	Nelson	7/25/2012	Referred to the Finance Committee
	HR 6205	Nugent	7/26/2012	Referred to the Ways & Means Committee

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LR #1 Repeal the Alternative Minimum Tax

PROBLEM

The Alternative Minimum Tax (AMT) does not achieve its original goal — to ensure that wealthy taxpayers pay at least some tax.[1] By one projection, about 1,000 millionaires will pay no federal income tax in 2013.[2] Those with the highest incomes are less likely to be affected by the AMT than those just below them.[3]

To help prevent the AMT from hitting the middle class, the American Taxpayer Relief Act of 2012 (ATRA) increased the AMT exemption amount.[4] While this change reduces the number of people subject to the AMT, it does nothing to fix the system's flaws. Today's AMT primarily affects taxpayers for paying state and local taxes and having children.[5] While it is hard to imagine the drafters of the original AMT provision would view the expenses of having children or paying local taxes as tax-avoidance loopholes, that is how those expenses are treated today.

More importantly, the AMT is unnecessarily complex and burdensome for everyone. It requires taxpayers — even if they do not owe AMT — to compute their taxes twice, once under the regular tax rules and again under the AMT rules.

Moreover, the complexity of the AMT reduces the transparency of the tax system, making it more difficult for people to know their marginal tax rate and predict what they will owe. When people owe more than anticipated, voluntary compliance suffers.[6]

Even without any decline in voluntary compliance, the AMT is only projected to bring in $25.6 billion in 2013.[7] Thus, tax simplicity, transparency, voluntary compliance, and taxpayers who live in high-tax states or have children have become collateral damage in the battle to prevent middle- and high-income people from reducing their taxes by applying the regular tax rules enacted by Congress. If Congress does not like those rules, it should change them rather than applying an AMT. After ATRA, repealing the AMT might

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1 *The 1969 Economic Report of the President: Hearings before the Joint Economic Comm.*, 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury).

2 Tax Policy Center (TPC), *Distribution of Tax Units That Pay No Individual Income Tax; by Expanded Cash Income Level, Current Law, 2013*, T13-0230 (Aug. 29, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3989.

3 *See* TPC, *Characteristics of AMT Taxpayers, 2012–2014*, 2023, T13-0210 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3969 (projecting that about 18 percent of millionaires will owe AMT for 2013, as compared to about 64 percent of those earning between $500,000 and $1 million, and 29 percent of those earning between $200,000 and $500,000).

4 ATRA, Pub. L. No. 112-240, 126 Stat. 2317 (Jan. 2, 2013).

5 *See* TPC, *Reconciling AMTI and Taxable Income for AMT Taxpayers in 2008* (Dec. 21, 2010), http://taxpolicycenter.org/taxfacts/displayafact.cfm?DocID=468&Topic2id=30&Topic3id=36.

6 Studies suggest that unexpected tax liabilities reduce filing, payment, and reporting compliance. *See* National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, at 30-35 (summarizing various studies).

7 TPC, *Aggregate AMT Projections and Recent History, 1970-2023*, T13-0208 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3967&DocTypeID=7.

cost $384 billion over ten years (down from the pre-ATRA cost of about $1.3 trillion), an amount that could be replaced by changes to the regular tax system.[8]

EXAMPLES

Example 1: Wealthy investor not hit by the AMT. A single childless investor earns $100 million in 2012 from tax-exempt bonds. The investor does not owe any federal income tax and is not subject to the AMT.[9]

Example 2: Single parent living in a high tax state hit by the AMT. A single mother earns $100,000 in wages in 2012, which she uses to support her mother and three children. She deducts $22,000 in state and local property and income taxes and ineligible mortgage interest (*i.e.*, interest subject to AMT), and claims $19,000 in personal exemptions. In the absence of the AMT, she would owe $9,401 under the regular tax system (the tax on $59,000 in taxable income). She owes another $3,443 in AMT because she loses these deductions and exemptions under the AMT, bringing her total federal tax bill to $12,844.[10] Because she did not anticipate owing so much, she did not have enough withheld from her paycheck and cannot timely pay the full amount, triggering penalties and interest.

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RECOMMENDATION

Repeal the AMT.[11]

PRESENT LAW

The AMT is a separate system from the regular income tax, with unique rules governing the recognition of income and the timing of deductions and credits. Taxpayers are often required to maintain two sets of records — one for regular income tax purposes and one for AMT purposes.

As discussed in other reports, it is difficult for taxpayers to compute their AMT liability, if any.[12] The IRS has developed an online assistant to help taxpayers determine if they are *potentially* subject to the AMT, and must complete Form 6251, *Alternative Minimum Tax – Individuals*.[13] Some taxpayers complete Form 6251, only to find that they do not owe AMT.

Form 6251 requires the taxpayer to compute alternative minimum taxable income (AMTI) by giving up the benefit of tax preference items to which they are entitled under the regular tax system (*e.g.,* personal

8 TPC, *Aggregate AMT Projections and Recent History, 1970-2023*, T13-0208 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocId=3967&DocTypeID=7.

9 Assume the bonds are not private activity bonds, which are subject to the AMT. *See* IRC § 56(b)(1)(C)(iii) and 57(a)(5).

10 After subtracting her $50,600 AMT exemption, her AMT income is $49,400, and it is taxed at a flat 26 percent rate ($49,400 x 26% = $12,844). As noted below, the AMT contains a marriage penalty because the exemption amount for married persons is less than double that for singles. As this example illustrates, however, it may also be said to contain a head of household penalty because a head of household must claim the same exemption amount as a single filer. The computations for this example are before any applicable tax credits (*e.g.*, withholding, estimated tax payments, and potentially, $1,750 in child tax credits).

11 The AMT is codified at IRC § 55 *et. seq*.

12 *See, e.g.*, National Taxpayer Advocate 2003 Annual Report to Congress 5-19.

13 Instructions for Form 1040, *U.S. Individual Income Tax Return* 42 (2012). The assistant is at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Alternative-Minimum-Tax-(AMT)-Assistant-for-Individuals. Alternatively, a taxpayer may follow the instructions to Form 6251 regarding "Who Must File."

and dependency exemptions and itemized deductions for state and local taxes, employee business expenses, and legal fees).[14] On Form 6251, the AMT "exemption amount" replaces the standard deduction and personal exemptions for purposes of the AMT.[15] In addition, one rate applies to income taxed at AMT rates and another (lower) rate to income taxed as long term capital gains or qualified dividends.[16]

After these computations and others, the AMT is equal to the excess, if any, of the taxpayer's "tentative minimum tax" over his or her regular tax liability. For purposes of this comparison, however, the taxpayer must *recompute* his or her regular tax liability if he or she reported any tax from lump sum distributions (from Form 4972, *Tax on Lump Sum Distributions*), claimed a foreign tax credit, or used income averaging (on Form 1040, Schedule J).

A taxpayer who is subject to the AMT may accrue an AMT credit.[17] However, this credit is earned only for AMT liability attributable to timing items — not exclusion items.[18] Timing items are those that are accounted for in different tax years in the regular tax and AMT systems. For example, the AMT may require taxpayers to depreciate property over a longer period than under the regular tax system. Exclusion items are adjustments and tax preference items that result in the permanent disallowance of certain tax benefits, such as the standard deduction, personal exemptions, and certain itemized deductions. In addition, AMT credits can only be used in taxable years in which the taxpayer's regular tax liability, reduced by other nonrefundable credits, exceeds his or her tentative minimum tax.[19] To claim AMT credits, taxpayers must complete Form 8801 *Credit for Prior Year Minimum Tax – Individuals, Estates, and Trusts*, which the IRS estimates will take more than seven hours.[20]

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14 Required adjustments include: medical and dental expenses, state and local taxes, certain non-allowable home mortgage interest, miscellaneous itemized deductions, tax refunds, investment interest, depletion, certain net operating losses, interest from specified private activity bonds, qualified small business stock, the exercise of incentive stock options, estates and trusts, electing large partnerships, property dispositions, depreciation on certain assets, passive activities, loss limitations, circulation costs, long-term contracts, mining costs, research and experimental costs, income from pre-1987 installment sales, intangible drilling costs, certain other adjustments and alternative tax net operating loss deductions. *See* IRC § 56 and 57; Form 6251, *Alternative Minimum Tax – Individuals*, Part I (2012).

15 Instructions for Form 6251, *Alternative Minimum Tax – Individuals* 9 (2012); IRC § 55(d) and 56(b)(1)(E). The AMT exemption is phased out for married taxpayers and qualified widowers with AMTI exceeding $150,000, and single head of household taxpayers with AMTI exceeding $112,500. IRC § 55(d)(3); Instructions for Form 6251, *Alternative Minimum Tax – Individuals* 9 (2012). The AMT exemption amount may also be limited for certain people under age 24. *Id.*

16 Form 6251, *Alternative Minimum Tax – Individuals* (2012) (line 31 and part III). In general, the first $175,000 of income subject to AMT is taxed at a 26 percent rate and any excess is taxed at a 28 percent rate. IRC § 55(b)(1)(A). As noted above, capital gains and qualified dividend income are taxed at preferential AMT rates. IRC § 55(b)(3).

17 IRC § 53.

18 IRC § 53(d).

19 IRC § 53(c).

20 Instructions for Form 8801, *Credit for Prior Year Minimum Tax – Individuals, Estates, and Trusts* (2012) (2 hours 4 minutes for recordkeeping, 2 hours 19 minutes to learn about the law, 2 hours 3 minutes to complete the form, and 48 minutes to copy, assemble and send).

REASONS FOR CHANGE

In 1969, Congress enacted a minimum tax (the predecessor of the AMT) after hearing testimony that 155 taxpayers with adjusted gross incomes (AGI) above $200,000 (about $1,438,698 in 2013 dollars)[21] paid no federal income tax for the 1966 tax year, due to tax preferences or loopholes.[22] Today, the AMT fails to ensure that those with the highest incomes pay federal income tax.[23]

The AMT hits the "wrong" taxpayers.

Thousands of U.S. taxpayers with incomes of more than $200,000 paid no income tax anywhere in the world in 2010 (the most recent year for which complete data is available), and by one projection about 1,000 millionaires will pay no federal income tax in 2013.[24] Those with the highest incomes are actually less likely to be hit by the AMT than those just below them.[25] One reason for this is the exclusion of interest on certain tax-exempt bonds (and the allowance of certain deductions) under both regular tax and the AMT.[26] For example, wealthy individuals who invest in certain tax-exempt municipal bonds generally pay no federal income tax on the interest they receive.[27]

Even when high income taxpayers are subject to AMT, they can pay lower rates than moderate income taxpayers because preferential low rates apply to investment income under both the regular tax system and the AMT. In general, the AMT regime taxes upper-income taxpayers at a flat rate of 28 percent.[28] Before 1997, capital gains were considered a preference item and taxed at the same flat rate as other AMT income.[29] Under current law, however, long-term capital gains and qualified dividend income are subject

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21 *See* Bureau of Labor Statistics, *CPI Inflation Calculator, available at* http://www.bls.gov/data/inflation_calculator.htm (last visited Dec. 18, 2013).

22 *The 1969 Economic Report of the President: Hearings before the Joint Economic Comm.*, 91st Cong., pt. 1, p. 46 (1969) (statement of Joseph W. Barr, Secretary of the Treasury).

23 Perhaps because the AMT does not fulfill its original purpose, the administration has proposed (1) to cap, at 28 percent, the value of itemized deductions and specified exclusions, and (2) a new minimum tax, called the Fair Share Tax (FST) (a.k.a. the "Buffet rule"), on those making over $1 million ($500,000 in the case of a married individual filing a separate return). Treasury Department, *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals* 134-137 (Apr. 2013), http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf. In addition, ATRA recently reinstated the Pease limit that phases out itemized deductions for higher income taxpayers. *See* ATRA, Pub. L. No. 112-240, Title I, § 101(b)(2)(A)(ii), 126 Stat. 2317 (Jan. 2, 2013). ATRA also reinstated a personal exemption phase out (PEP). *Id*. The National Taxpayer Advocate has long opposed phase outs as unnecessarily complicated substitutes for increasing tax rates or eliminating tax preferences. *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 410-413 (Legislative Recommendation: *Eliminate (or Simplify) Phase-outs*).

24 Justin Bryan, *High-Income Tax Returns for 2010*, 32 SOI Bulletin 4, 11 (Spring 2013), http://www.irs.gov/uac/SOI-Tax-Stats-SOI-Bulletin-Spring-2013 (For 2010, "8,046 returns with no worldwide income tax had an AGI of $200,000 or more; 16,082 returns with no worldwide income tax had expanded income of $200,000 or more; and 4,782 returns with no worldwide income tax had both AGI and expanded income of $200,000 or more."); TPC, *Distribution of Tax Units That Pay No Individual Income Tax; by Expanded Cash Income Level, Current Law*, 2013, T13-0230 (Aug. 29, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3989 (number of millionaires).

25 *See* TPC, Characteristics of AMT Taxpayers, 2012-2014, 2023, T13-0210 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3969 (projecting that about 18 percent of millionaires will owe AMT for 2013, as compared to about 64 percent of those earning between $500,000 and $1 million, and 29 percent of those earning between $200,000 and $500,000).

26 Justin Bryan, *High-Income Tax Returns for 2009*, 31 SOI Bulletin 6, 15-17 (Spring 2012), http://www.irs.gov/pub/irs-soi/12soisprbul.pdf ("nontaxable returns under the expanded income concept, were much more likely to have tax-exempt interest than were taxable returns…. Similarly, nontaxable returns were much less likely to have any income from salaries and wages…. Because they do not generate AMT adjustments or preferences, tax-exempt bond interest, itemized deductions for interest expense, miscellaneous itemized deductions not subject to the 2-percent-of-AGI floor, casualty or theft losses, and medical expenses (exceeding 10 percent of AGI) could, by themselves, produce nontaxability.").

27 In theory, they are "taxed" in the sense that they receive a lower rate of interest than they might receive on bonds that produce taxable interest income. However, even if this rate reduction is considered a tax, it is probably not imposed at the investor's marginal income tax rate.

28 The 28 percent rate applies after a phase out of the exemption amount and a 26-percent rate that applies to the first $175,000 of income. *See generally* IRC § 55.

29 Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 311(b), 111 Stat. 788 (1997) (reducing the rate applicable to long-term capital gains under both the regular tax system and the AMT).

to a special low rate, which is generally 15 or 20 percent, under both the regular tax and the AMT.[30] Therefore, taxpayers who have sufficient resources to live off investment income pay tax at 20 percent (or perhaps less if they have tax-exempt bond income), which is less than the 25 percent marginal rate applicable to a single person who earns just $35,351 from wages.[31]

The AMT stealthily increases marginal rates for middle income taxpayers and reduces transparency.

In addition to eliminating tax preferences that taxpayers may expect to claim, the AMT exemption phase out stealthily increases marginal rates for those who are not in the highest tax bracket. Under the regular tax system, the highest marginal rate of 35 percent generally applies to those with taxable income of more than $388,350.[32] As described above, the AMT rules generally impose tax at a rate of 26 percent up to $175,000 and 28 percent on higher amounts. However, the AMT exemptions phase out, costing taxpayers $0.25 for every dollar their AMTI exceeds $150,000 for married filers (or $112,500 for non-married filers).[33] Therefore, the marginal tax rate for those in the AMT exemption phase-out range could exceed 35 percent (the highest regular marginal rate), even if they are subject to lower marginal rates under the regular tax system.[34]

The AMT penalizes families.

The AMT eliminates the tax "benefit" of children (dependency exemptions are lost under the AMT) and marriage (the AMT contains marriage penalties).[35] As a result, having two children is estimated to double a person's likelihood of being hit by AMT in tax year (TY) 2013.[36] Similarly, married taxpayers will be more than five times as likely as single ones to pay AMT in TY 2013.[37] While it is hard to imagine that the drafters of the original AMT provision would view incurring expenses to raise a family as a tax-avoidance loophole, that is essentially the way they are viewed under today's archaic AMT.

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30 IRC § 1(h) and 55(b)(3), as amended by ATRA, Pub. L. No. 112-240, § 102(b) (extending preferential rates that were set to expire, but increasing the long term capital gain rate from 15 to 20 percent for taxpayers in the 39.6 tax bracket). Upper middle income taxpayers who benefit from the AMT exemption face a higher marginal tax rate on long-term capital gains and dividend income because it decreases the value of the AMT exemption. *See, e.g.*, Benjamin H. Harris and Christopher Geissler, *Tax Rates on Capital Gains and Dividends Under the AMT*, 118 Tax Notes 1031 (Mar. 3, 2008). An IRS analysis of the 400 taxpayers reporting the highest income found that capital gains constituted between 46 and 72 percent of their total income in years 2009 to 2000. *See* IRS, SOI, *The 400 Individual Income Tax Returns Reporting the Largest Adjusted Gross Incomes Each Year*, 1992–2009 (2009) (Table 1 – Net capital gains less loss in AGI), http://www.irs.gov/pub/irs-soi/09intop400.pdf.

31 Instructions for Form 1040, *U.S. Individual Income Tax Return* 105 (2012).

32 IRC § 1(h); Instructions for Form 1040, *U.S. Individual Income Tax Return* 105 (2012). Those married, but filing separately hit the maximum marginal rate when they earn over $194,175. *Id.*

33 IRC § 55(d)(3); Instructions for Form 6251, *Alternative Minimum Tax – Individuals* 9 (2012). The phase out begins at $75,000 for those who are married, but filing separately. *Id*.

34 In the AMT exemption phase-out range an additional $1,000 of income could reduce the exemption amount by $250, increasing the amount subject to the 28 percent rate to $1,250, and increasing the AMT by $350 ($1,250*28%=$350) or 35 percent. If the same dollars of income also trigger other phase outs on the return, then the marginal rate could exceed 35 percent.

35 *See* IRC §§ 56 and 57; Form 6251, *Alternative Minimum Tax – Individuals* (2012).

36 *See* TPC, *Characteristics of AMT Taxpayers, 2012–2014*, 2023, T13-0210 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=3969 (projecting that 4.1 percent of those with two children will be hit by AMT, as compared to 2.1 percent with no children for TY 2013).

37 *See id.*, (projecting that 4.3 percent of married joint filers will be hit by AMT in TY 2013, as compared to 0.8 percent of single filers).

The AMT penalizes those with high expenses.

An individual taxpayer must add back certain itemized deductions when computing AMT.[38] This requirement affects taxpayers with large expenses such as legal fees in court settlements, state and local taxes, or employee business expenses. Thus, the AMT may hit those with relatively high expenses and a reduced ability to pay.

The AMT treats seemingly similar deductions differently.

The AMT does not treat itemized deductions uniformly. A married couple with three children living in a high tax area or incurring high employee business expenses is more likely to owe AMT than a similar family that has other itemized deductions, such as deductions for mortgage interest or charitable contributions, which are deductible for AMT purposes.

EXAMPLE 3: The AMT treats similar itemized deductions differently. In 2012, a married couple with six children had combined wages of $125,000 and paid $20,000 in state and local taxes. This couple was subject to $1,309 in AMT. If they had incurred $20,000 in employee business expenses or job-related legal fees instead, the couple would have been subject to AMT of $684.[39] However, if the $20,000 in itemized deductions were a combination of $10,000 of mortgage interest and $10,000 of local taxes, they would not owe AMT, as shown on Table 1 (below). Therefore, even though the couple had the same total income and itemized deductions under the regular tax rules, the difference in treatment of taxes and deductions under the AMT would produce different liabilities.

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TABLE 2.1.1, The AMT and Itemized Deductions

	Tax Year 2012: High Tax	Tax Year 2012: High EBE or Legal Fees	Tax Year 2012: Tax and Mortgage Interest Split
Filing Status	MFJ	MFJ	MFJ
Adjusted Gross Income (AGI)	$125,000	$125,000	$125,000
State and Local Taxes	$20,000		$10,000
Schedule A Miscellaneous		$20,000	
Mortgage Interest			$10,000
Tentative Minimum Tax	$12,025	$12,025	$9,425 [40]
Regular Tax	$10,716	$11,341	$10,716
AMT	$1,309	$684	$0
Total Tax	**$12,025**	**$12,025**	**$10,716**

38 IRC § 56(b) and (e). Common itemized deductions that must be added back to income include, but are not limited to: state and local taxes, real estate and personal property taxes, mortgage interest not used for the purchase or improvement of a personal residence, medical expenses exceeding 7.5 percent but less than 10 percent of adjusted gross income, and certain miscellaneous itemized deductions such as employee business expenses and legal fees. *Id*.

39 Unreimbursed employee business expenses are generally deductible under the regular tax system, but not deductible under the AMT. *See, e.g.*, Treas. Reg. § 1.62-1T(e)(3) (employee business expenses); *Alexander v. IRS*, 72 F.3d 938 (1st Cir. 1995) (legal fees); IRC §§ 55 and 56 (AMT).

40 The tentative minimum tax was computed by taking $125,000 of taxable income, minus the $10,000 mortgage interest deduction allowable under the AMT, minus the $78,750 AMT exemption, leaving a taxable excess of $36,250, which was multiplied by the 26 percent AMT rate.

The AMT is complicated and burdensome.

Although the IRS has not measured the compliance costs of the AMT, it estimates that taxpayers spent over 18 million hours in 2000 completing and filing AMT tax forms or determining whether they needed to do so — more than 12 hours for each person who actually paid the AMT.[41] Other research from TY 2000 suggested that those who filed a Form 6251, *Alternative Minimum Tax – Individuals,* spent nearly double the time on their returns (13.7 hours for individuals and 56.6 hours for self-employed filers) than those who did not (24.6 hours for individuals and 97.3 hours for self-employed filers).[42] Thus, the AMT nearly doubles the burden of filing a federal income tax return. The following points illustrate some of the complexity of the AMT.

The AMT multiplies complexity and recordkeeping for owning and selling property.

Taxpayers must claim depreciation over different periods under the AMT. For example, if a taxpayer placed an office building into service prior to 1999 and is claiming straight-line depreciation, the taxpayer would depreciate it over a 39-year period for regular tax purposes.[43] For AMT purposes, the taxpayer would have to depreciate the building over a 40-year period instead.[44] Thus, the taxpayer would have to compute depreciation under both tax systems.

The portion of AMT attributable to timing items (such as depreciation) reflects the difference between when certain deductions are allowable under the AMT and when the same deductions are allowable under the regular income tax. As noted above, a taxpayer can only claim an AMT credit with respect to timing items in subsequent years when the regular tax exceeds the tentative minimum tax. Accordingly, the taxpayer must track his or her AMT credits.[45]

In addition, because depreciation deductions (and other tax adjustments that affect basis) may be different under the AMT, an asset may have a different tax basis under the AMT than for regular tax purposes.[46] A taxpayer's gain on the sale of property is computed as the difference between the amount realized on the sale (*e.g.*, the sale price) and its adjusted tax basis (*e.g.*, the amount paid, as adjusted for tax purposes).[47] As a result, selling a single asset could produce a different gain under each system. Thus, a taxpayer must keep two sets of books to track each asset's basis under each tax system.

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41 Allen H. Lerman and Peter S. Lee, *Evaluating the Ability of the Individual Taxpayer Burden Model To Measure Components of Taxpayer Burden: The Alternative Minimum Tax as a Case Study*, 2004 IRS Research Conference 140, 151, 166 (Feb. 2005), http://www.irs.gov/file_source/pub/irs-soi/04lerman.pdf (estimating the AMT added 18.4 million hours in burden (including burden for those who did not owe AMT), and that between 1.4 and 1.5 million taxpayers actually had AMT liability or a reduced credit in TY 2000).

42 *See* John Guyton *et. al.*, *Estimating the Compliance Cost of the U.S. Individual Income Tax*, NTA Symposium (2003) (Table 6), www.irs.gov/pub/irs-soi/toder.pdf. By comparison, the IRS estimates that it takes 13 hours, on average, to fill out the entire Form 1040, U.S. Individual Income Tax Return. Instructions for Form 1040, U.S. Individual Income Tax Return 102 (2012).

43 IRC § 168(c).

44 IRC § 56(a)(1)(A)(i) (referencing IRC § 168(g)).

45 IRC § 53.

46 *See, e.g.*, IRC §§ 56(a)(6), 1011, and 1012.

47 *See generally* IRC § 1011.

The AMT multiplies complexity and recordkeeping for the foreign tax credit.

In order to prevent double taxation of foreign earned income, a taxpayer generally may claim a foreign tax credit (FTC) to offset U.S. income tax liability for income taxes paid to a foreign country or U.S. possession.[48] A taxpayer may be required to claim a different amount of FTC under the AMT than under the regular tax system.[49] Unused foreign tax credits generally may be carried back one year and forward ten years.[50] Thus, in addition to requiring two sets of FTC computations each year, the AMT requires a taxpayer to track FTC carryovers for purposes of both the AMT and the regular tax system.

The AMT multiplies complexity and recordkeeping for tax credits.

Some credits are allowed under the AMT and some are not. When a credit is disallowed under the AMT, it may sometimes be carried over and used in another tax year. When credits may be carried over to other years, the carryover periods vary from item to item. Because different credit limitations and carryover periods apply to the AMT, the AMT multiplies the complexity and burden of these already-complicated rules. For example, a taxpayer cannot carry over an unused credit for placing a qualified electric vehicle into service.[51] If the taxpayer cannot use the credit in the year the vehicle is placed into service, he or she loses the credit. On the other hand, when the AMT limits general business credits, it usually allows the taxpayer to carry them back one year and forward 20 years.[52] By contrast, when the home mortgage interest credit is limited, it may be carried forward three years but may not be carried back.[53] Similarly, when the adoption assistance credit is limited, it may be carried forward five years but may not be carried back.[54] Not only do these complicated credit carryover rules vary widely, but they require taxpayers to track multiple types of credit carryovers from year to year under both the AMT and the regular tax systems.

The AMT creates a trap for the unwary by taxing paper gains on incentive stock options.

A taxpayer's exercise of incentive stock options (ISOs) creates paper (phantom) gain in the year the stock is purchased (the option exercise). The gain is the difference between the option price and the market value of the stock on the date the option is exercised to purchase the shares. This gain is not taxed under the regular tax rules but is taxed for AMT purposes.[55] Because paper gains can disappear before the taxpayer sells the stock or pays the tax — as they often do in a sharp economic downturn — some taxpayers are subject to AMT on phantom gains that they cannot pay (*i.e.*, the so-called "ISO-AMT problem"). While a taxpayer who is subject to AMT on the exercise of an ISO receives AMT credits, he or she generally cannot recover these credits very fast.[56] Congress has partially addressed the ISO-AMT problem by

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48 IRC § 27 and 901.

49 *See* IRC § 59 and 904.

50 IRC § 904(c).

51 A credit may be carried to another taxable year only if the IRC expressly provides for it. In the case of the credit for placing a qualified electric vehicle into service, carryovers are not authorized. *See* IRC § 30(a).

52 IRC § 39(a).

53 *See* IRC § 26 and 25(e).

54 IRC § 23C.

55 *Compare* IRC § 422(c)(2) *with* IRC § 56(b)(3).

56 AMT credits generally can only be used in future years to the extent the taxpayer's regular tax liability exceeds his or her "tentative minimum tax" for the year. IRC § 53. Moreover, any AMT capital losses on a sale of the stock can only be offset against AMT capital gains plus $3,000 of ordinary AMT income per year. *See, e.g., Guzak v. U.S.*, 75 Fed. Cl. 304 (Feb. 15, 2007).

accelerating the availability of AMT credits taxpayers may claim in years before 2013, but the ISO-AMT problem remains a trap for the unwary.[57]

The AMT is less predictable than the regular tax system.

The complexity of the AMT makes it less predictable than the regular tax system. By one projection for tax year (TY) 2013, those who earn less than $200,000 and are hit by the AMT will be subject to an average effective marginal tax rate more than ten points higher, on average, than they would face under the regular tax system.[58] The AMT is so complicated that the IRS's wage withholding calculator does not even consider the AMT in determining how much taxpayers should withhold.[59] Many taxpayers first learn they are subject to the AMT only after preparing their returns, when it is too late to increase their withholding or estimated tax payments.

Taxpayers who do not withhold or pay enough estimated tax are subject to penalties. While we cannot determine how many taxpayers were subject to estimated tax penalties solely because of the AMT, IRS data show that for tax year 2012, about 18 percent of those subject to the AMT were liable for estimated tax penalties, as compared to four percent of individual taxpayers overall.[60] Some taxpayers cannot afford to pay their tax (or penalties) in one lump sum at the end of the year. Thus, the unpredictability of the AMT likely reduces voluntary compliance.[61]

EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate first recommended repeal of the AMT in her 2001 Annual Report to Congress and has consistently advocated for its repeal since then.[62] In 1999, Congress voted to repeal the individual AMT, but the legislation was vetoed.[63] The American Bar Association Section of Taxation, the American Institute of Certified Public Accountants Tax Division, and the Tax Executives Institute have

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57 Congress partially addressed the ISO-AMT problem by providing that for tax years beginning before January 1, 2013, taxpayers may generally recover the AMT credits associated with ISO exercises over a two-year period. IRC § 53(e). It followed up with the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 (2008), which abated any outstanding amounts attributable to unpaid ISO-AMT liabilities that remained unpaid as of October 3, 2008 — the date of enactment. IRC § 53(f). Although this legislation addressed the consequences of the ISO-AMT problem, it has expired.

58 *See* TPC, *Income Subject to Tax and Effective Marginal Tax Rates in the Regular Income Tax and the AMT among AMT Taxpayers, Current Law, 2012–2014*, T13-0214 (Aug. 26, 2013), http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=3973&DocTypeID=1.

59 The calculator refers taxpayers to Publication 505. *See* IRS Withholding Calculator (Apr. 4, 2013), http://www.irs.gov/individuals/article/0,,id=96196,00.html ("CAUTION: If you will be subject to alternative minimum tax, self-employment tax, or other taxes; you will probably achieve more accurate withholding by following the instructions in Pub 505: Tax Withholding and Estimated Tax."). Publication 505 instructs taxpayers to project their AMT liability by filling out Form 6251 or the Alternative Minimum Tax Worksheet in the Form 1040A instructions, a daunting task that few are likely to undertake before the end of the year.

60 IRS Compliance Data Warehouse, Individual Returns Transaction File (IRTF) and Individual Master File (IMF), TY 2012 (Sept. 2013). The National Taxpayer Advocate has recommended legislation to waive the estimated tax penalty for those who pay at least 100 percent of the amount due for the prior year, are subject to a *de minimis* penalty, or are first-time estimated tax payors and have reasonable cause for the violation. National Taxpayer Advocate 2008 Annual Report to Congress vol. 2 30-35.

61 Studies suggest that unexpected tax liabilities reduce filing, payment, and reporting compliance. *See* National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, at 30-35 (summarizing various studies).

62 *See, e.g.*, National Taxpayer Advocate 2001 Annual Report to Congress 56-58; National Taxpayer Advocate 2001 Annual Report to Congress 166-177; National Taxpayer Advocate 2003 Annual Report to Congress 5-19; National Taxpayer Advocate 2004 Annual Report to Congress 383-385; *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance*, 109th Cong. 367 (2005) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2006 Annual Report to Congress 3-5; *Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means*, 110th Cong. 43 (2007) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2008 Annual Report to Congress 356-362; National Taxpayer Advocate 2012 Annual Report to Congress 24-33.

63 Taxpayer Refund and Relief Act of 1999, H.R. 2488, 106th Cong. (1999).

jointly called for its repeal.[64] The National Association of Enrolled Agents also advocated outright repeal or substantial restructuring of the AMT for individuals.[65] Similarly, both the 2005 Tax Reform Panel and the 2010 National Commission on Fiscal Responsibility and Reform (the Simpson-Bowles Commission) recommended repealing the AMT.[66] Leaders of both parties in both the House and Senate have also proposed repealing it.[67] For all of the reasons stated above, the National Taxpayer Advocate continues to recommend permanent repeal of the individual AMT.

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64 American Bar Association Section of Taxation, American Institute of Certified Public Accountants Tax Division and Tax Executives Institute, *Tax Simplification Recommendations, reprinted at 2000 TNT 39-82* (Feb. 28, 2000).

65 *2003 Tax Return Filing Season and the IRS Budget for Fiscal Year 2004: Hearing before the House Ways and Means Subcommittee on Oversight*, 108th Cong. 94 (2003) (statement of Claudia Hill on behalf of the National Association of Enrolled Agents).

66 The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* xvii (Nov. 2005), http://govinfo.library.unt.edu/taxreformpanel/final-report/index.html; The National Commission on Fiscal Responsibility and Reform, *The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform*, 2010 TNT 231-35 sec. 2, fig. 7 (Dec. 3, 2010).

67 *See, e.g.*, Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. (2007) (sponsored by Rep. Charles Rangel, Chairman, House Committee on Ways and Means, though the bill limits the benefits of repeal to lower income taxpayers); Individual AMT Repeal Act of 2007, H.R. 1366, 110th Cong. (2007); Taxpayer Choice Act of 2007, H.R. 3818, 110th Cong. (2007); Individual AMT Repeal Act of 2009, H.R. 240, 111th Cong. (2009); End Tax Uncertainty Act of 2011, HR. 86, 112th Cong. (2011); Individual AMT Repeal Act of 2011, H.R. 547, 112th Cong. (2011); Jobs Through Growth Act, H.R. 3400, 112th Cong. (2011); American Opportunity and Freedom Act of 2012, H.R. 3804, 111th Cong. (2012); Individual Alternative Minimum Tax Repeal Act of 2007, S. 55, 110th Cong. (2007) (sponsored by Max Baucus and Chuck Grassley, Senate Finance Committee, Chairman and Ranking Minority member, respectively, among others); Invest in America Act, S. 14, 110th Cong. (2007); Individual Alternative Minimum Tax Repeal Act of 2007, S. 2293, 110th Cong. (2007); AMT Repeal and Tax Freedom Act, S. 2318, 110th Cong. (2007); Bipartisan Tax Fairness and Simplification Act of 2011, S. 727, 112th Cong. (2011).

LR #2 Broaden Relief from Timeframes for Filing a Claim for Refund for Taxpayers with Physical or Mental Impairments

PROBLEM

Congress has placed within the tax code a number of safeguards to ensure that taxpayers pay only the correct amount of tax. One of these safeguards is Internal Revenue Code (IRC) § 6511, which allows taxpayers to file a claim for a credit or refund of an overpayment. The taxpayer must file the claim within a specified time; if not, it is forgone.[1] Failure to file a timely claim for refund with the IRS also prevents a taxpayer from filing suit under IRC § 7422 to claim the refund in U.S. District Court or the Court of Federal Claims.[2]

Congress amended IRC § 6511 in 1998 by adding IRC § 6511(h), which suspends the running of the period for filing a claim for a refund where a taxpayer can show that he or she was financially disabled.[3] The provision was written in direct response to what many felt was an unfair outcome in the *Brockamp* case.[4]

The National Taxpayer Advocate understands the IRS's need for a legal standard that is practical in its application. However, the current, narrowly tailored provision fails to protect numerous taxpayers who lack the capacity to file a refund claim. The difficulties presented by the statute include requirements that:

- A qualifying taxpayer have a "medically determinable" physical or mental impairment. This limits other, potentially more valuable determinations from being considered, such as those of psychologists or clinical social workers.[5]
- The taxpayer be "unable" to manage his or her financial affairs as a result of a physical or mental impairment. This forces the individual making the determination to provide a global, "all or nothing," statement regarding the effect of the impairments, which is often contrary to how an impairment manifests itself.

These requirements have led the IRS to dismiss otherwise compelling evidence and have resulted in the denial of relief under IRC § 6511(h) to taxpayers who have lacked the capacity to file a refund claim. Such problems were intensified by the guidance issued under IRC § 6511(h), which further restricts

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1 Under IRC § 6511(a), a taxpayer must file a claim for credit or refund of an overpayment within 1) three years from the time the return was filed, or 2) two years from the time the tax was paid, whichever is later. If no return was ever filed by the taxpayer then the claim must be filed within two years of payment of the tax.

2 Under IRC § 6532, a refund suit cannot be brought before the earlier of six months after filing a refund claim or issuance of notice of disallowance of the claim.

3 Pub. L. No. 105-206, 112 Stat. 685 (July 22, 1998) amended IRC § 6511, adding (h) which provides that a person is financially disabled when he or she is "unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months." Additionally, the statute expressly authorizes the IRS to establish the "form and manner" of the proof a taxpayer must furnish to establish financial disability. The procedures for claiming financial disability are set forth in Rev. Proc. 99-21, 1999-1 C.B. 960, and require a taxpayer to submit a certification signed by a physician.

4 *U.S. v. Brockamp*, 519 U.S. 347 (1997).

5 *See, e.g.*, *Green v. Comm'r*, T.C. Memo. 2009-105. Rev. Proc. 99-21, 1999-1 C.B. 960, references 42 U.S.C. § 1395x(r), which defines physician, thereby excluding other medical professionals, such as nurse practitioners and physician assistants. *See also Henry v. United States*, 98 A.F.T.R.2d (RIA) 8359 (N.D. Tex. 2006).

what documentation the IRS can consider when evaluating the presence of a qualifying impairment, and according to some observers is not a clear reflection of Congress's intent.[6]

IRC § 6511(h) should be revised to clarify that the impairment can be determined by a health professional, and that a qualifying disability includes one that materially limits an individual's management of his or her financial affairs, rather than only one that leaves the individual "unable to manage" these affairs. Such revisions would protect more taxpayers who lack the capacity to file a refund claim, while balancing the IRS's need to administer requests for relief.

EXAMPLE

An unmarried taxpayer filed his return and paid his tax liability on April 15, 2009, then discovered he had overpaid. In May of 2011, the taxpayer began suffering from depression after a highly stressful period at work. The taxpayer found it difficult to get out of bed and found it overwhelming to complete normal day-to-day tasks. The taxpayer had his rent automatically withdrawn from his checking account, and could usually pay utilities and other monthly bills online, although the payments were often late and sometimes missed. However, he was unable to conduct more complex financial matters, such as managing his investments or submitting claims to his health insurance provider. The taxpayer's impairment also left him unable to complete a refund claim and collect and organize the supporting documents. The most severe phase of the depression lasted for about 16 months. During this time, no one was authorized to act on the taxpayer's behalf in financial matters.

After recovering from the depression, the taxpayer filed a refund claim in September of 2012. The taxpayer attached to the claim a letter from his clinical psychologist, stating that during the time of the depression, the taxpayer was materially limited from managing his financial affairs. It went on to specify that even though the taxpayer was occasionally able to perform simple and easy tasks, because of his clinical depression he gave up on more complicated and difficult tasks or avoided them altogether.

Under the current IRC § 6511(h), the taxpayer would not be considered financially disabled because the determination did not specify that he was unable to manage financial affairs. Further, the determination letter was written by a psychologist and would not be considered a medical determination. Therefore, the refund claim would be barred.

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RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6511(h)(2) to define a financially disabled individual as follows:

First, replace the existing requirement that the individual impairment be medically determinable with a provision that it be determined by a qualified medical or mental health professional. For this purpose, Congress should specify that a qualified medical or mental health professional is an individual who is

6 Rev. Proc. 99-21, 1999-1 C.B. 960. The National Taxpayer Advocate acknowledges that concerns raised in this legislative recommendation could also be at least partially alleviated by new guidance. *See* Bruce A. McGovern, *The New Provision for Tolling the Limitations Period for Seeking Tax Refund: Its History, Operation and Policy, and Suggestions for Reform*, 65 Mo. L. Rev. 797 (2000) (stating that "[a]lthough a physician's opinion is relevant to each of these issues, it should not be the sole evidence that the Service considers. Such exclusive reliance is contrary to congressional intent.").

licensed by the state in which he or she practices to provide direct medical or mental health treatment to another individual.

Second, replace the existing requirement that the impairment leaves the individual unable to manage his financial affairs with the requirement that the impairment materially limits the management of those affairs.

PRESENT LAW

Prior to 1998, IRC § 6511 made no allowance for late refund claims, and all claims for credit or refund of an overpayment had to be filed within 1) three years from the time the return was filed, or 2) two years from the time the tax was paid, whichever was later.[7] The harshness of this strict filing period was demonstrated by both the *Webb* and *Brockamp* cases, in which the taxpayers lacked the capacity to file refund claims within the proper period and argued that the statute of limitations should be equitably tolled.[8]

The Doctrine of Equitable Tolling

The equitable tolling doctrine prevents a statute of limitations from barring a claim if the claimant, despite diligent efforts, did not discover the injury or under the circumstances could not reasonably be expected to file the claim within the designated time period.[9] In *Irwin v. Dept. of Veterans Affairs*, 498 U.S. 1075 (1991), the Supreme Court held that when Congress has waived the government's sovereign immunity, thereby subjecting it to lawsuits, equitable tolling should be made applicable in the same way that it is applicable to private suits. Some speculated that equitable tolling might be expanded to situations such as those at issue in *Webb* and *Brockamp*. However, the Supreme Court in *Brockamp* and the Fourth Circuit Court of Appeals in *Webb* declined to toll IRC § 6511, despite the taxpayers' inability to comply with the statutory limitations period due to impairments. The rationale was that the requirements of IRC § 6511 were already set out with specificity.[10]

U.S. v. Brockamp

In *U.S. v. Brockamp*,[11] the taxpayer, who was 93 years old and demonstrating early signs of dementia, mailed a check to the IRS for $7,000, along with an application for an automatic extension of time to file his 1983 tax return. Despite his extension request, the taxpayer never filed a return for 1983. More than two years later, on July 15, 1986, the IRS transferred the $7,000 from the taxpayer's account into an "Excess Collection account."[12]

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7 IRC § 6511(a). If no return was ever filed by the taxpayer then the claim must be filed within two years of payment of the tax.

8 *U.S. v. Brockamp*, 519 U.S. 347 (1997), and *Webb v. U.S.*, 850 F. Supp. 489 (E.D. Va. 1994).

9 *Wolin v. Smith Barney, Inc.*, 83 F.3d 847, 852 (7th Cir. 1996).

10 *Webb v. U.S.*, 66 F.3d 691 (4th Cir. 1995), *cert. denied*, 519 U.S. 1148 (1997), and *U.S. v. Brockamp*, 519 U.S. 347 (1997), which was decided shortly after *Webb*, are discussed in more detail in the text. The Supreme Court recently restated its position taken in Brockamp, albeit not in a tax case, in *Sebelius v. Auburn Reg. Med. Ctr.*, 133 S. Ct. 817 (2013). Specifically, a provision of a Medicare statute that set a 180-day limit for health care providers to file administrative appeals was not subject to equitable tolling, because the regulation implementing the provision was a permissible interpretation of the law.

11 *U.S. v. Brockamp*, 519 U.S. 347 (1997).

12 National Taxpayer Advocate 2006 Annual Report to Congress at 157. The Excess Collections File (XSF) is a cumulative file that reflects payments that cannot be identified or applied to a specific taxpayer account. Internal Revenue Manual (IRM) 5.19.10.2 (Oct. 15, 2012). The National Taxpayer Advocate has expressed concern in the past that the IRS routinely moves funds into the XSF with very little research or attempts to contact the taxpayer to ascertain whether a taxable return should be filed, and if so, where such funds should be applied.

On November 7, 1988, the taxpayer died intestate. During the administration of his estate, his daughter discovered the $7,000 payment and requested a refund. In a letter to the IRS, she characterized her father as "senile" and stated that he had mistakenly sent the check for $7,000 rather than $700. On March 27, 1991, the daughter filed a return for the taxpayer's 1983 liability. The IRS assessed $427 in taxes, and refused the refund request, based on the statute of limitations in IRC § 6511.

The daughter, on behalf of the estate, filed suit against the United States seeking the return of the money her father had paid, arguing the refund claim was not barred because the statute of limitations imposed by IRC § 6511 was equitably tolled due to the taxpayer's mental incompetence. The case ultimately went before the Supreme Court.

The Court unanimously ruled that Congress did not intend the "equitable tolling" doctrine to apply to the Code's time limitations for filing tax refund claims because the limitations in IRC § 6511 were set out with an unusual degree of specificity, indicating that Congress would have specified whether to expand the statute's limitations periods under circumstances such as these. The Court went on to say that "[t]o read an 'equitable tolling' exception into § 6511 could create serious administrative problems by forcing the IRS to respond to, and perhaps litigate, large numbers of late claims, accompanied by requests for "equitable tolling" which, upon close inspection, might turn out to lack sufficient equitable justification." The Court considered the potential impact of this administrative burden on the IRS and observed that Congress accepted occasional unfairness in individual refund claim cases in an effort to maintain a more workable tax enforcement system.

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Webb v. U.S.

The taxpayer, a wealthy woman, entrusted the job of managing her financial affairs to her personal physician, a social acquaintance. Her physician retained an attorney to serve as his personal legal counsel. Over the next 14 years, they both physically and emotionally abused the taxpayer and confined her to bed under heavy sedation. During this period of abuse, the doctor and attorney induced the taxpayer to give them complete control of her day-to-day affairs. Each was granted power of attorney, which allowed them to further manipulate the taxpayer's financial affairs.[13]

After directing funds from the taxpayer to themselves, for their own personal benefit, both the physician and the attorney filed gift tax returns reporting the money as gifts from the taxpayer. In 1987, the fraudulent transfers were discovered after a friend intervened and helped the taxpayer break free. The taxpayer filed a refund claim seeking the return of the gift taxes paid. The IRS accepted the basis for the refund claim but denied claims made more than three years after the filing of the gift tax returns, since they were outside the statutory period for a claim. The taxpayer's estate brought suit, arguing that under the circumstances (*i.e.,* physical and emotional abuse and fraudulent transfers from the estate to the physician and attorney) the statute of limitations was equitably tolled. The District Court dismissed for lack of jurisdiction,[14] the Court of Appeals for the Fourth Circuit held that the *Irwin* case did not establish equitable tolling for tax refund suits,[15] and the Supreme Court denied certiorari. This left the taxpayer's estate with no way to retrieve the money wrongfully paid to the IRS.

13 *Webb v. U.S.*, 66 F.3d 691 (4th Cir. 1995).

14 *Webb v. U.S.*, 850 F. Supp. 489 (E.D. Va. 1994).

15 *Webb v. U.S.*, 66 F.3d 691 (4th Cir. 1995).

Congressional Response to the Webb and Brockamp Cases

In response to concerns in Congress and President Clinton's administration regarding the holding in *Brockamp*, Congress in 1998 carved out an exception to IRC § 6511(a) for taxpayers who are financially disabled. Specifically, the amendment suspended the running of the three- or two-year time period in IRC § 6511(a) during any period in which a taxpayer is financially disabled.[16] The amendment states that a person is financially disabled

> if such individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than [twelve] months.

Further, the amendment provides that a taxpayer must provide proof of such impairment in order for IRC § 6511(h) to apply.

The language in IRC § 6511(h) is similar to that used elsewhere in the tax code. For example, IRC § 22 (a credit for the elderly and permanently disabled) defines "permanent and total disability" as "any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than [twelve] months." It has been speculated that this definition was derived from the statute governing disability insurance payments.[17]

In April 1999, the IRS issued Revenue Procedure 99-21, providing guidance on what needs to be established to show that a taxpayer is financially disabled.[18] First, a taxpayer must provide a signed, written statement from a physician that sets forth:

- The name and a description of the taxpayer's physical or mental impairment;
- The physician's medical opinion that the impairment prevented the taxpayer from managing his or her financial affairs;
- The physician's medical opinion that the impairment either can be expected to result in death, or that it has lasted (or is expected to last) for a continuous time not less than 12 months; and
- To the best of the physician's knowledge, whether the taxpayer was prevented from managing his or her financial affairs during the specific time that the impairment persisted.

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16 Representative Jennifer Dunn, a member of the House Ways and Means Committee at that time, considered offering a legislative proposal as an amendment to the 1996 Taxpayer Bill of Rights. This proposal would have included circumstances other than financial disability in which the period for filing a refund claim should be tolled, and did not require that the disability be medically determinable. *See* Ways-Means Approves Taxpayer Rights 2 Measure, Adds Intermediate Sanctions, Daily Report for Executives, Mar. 22, 1996, at G56, available in LEXIS, Legis library, Drexec file. Representative Dunn never offered her proposal as a formal amendment.

17 Bruce A. McGovern, *The New Provision for Tolling the Limitations Period for Seeking Tax Refund: Its History, Operation and Policy, and Suggestions for Reform*, 65 Mo. L. Rev. 797 (2000) hypothesized that the origins of the language can be traced back to Social Security Disability Insurance definition of disabled. *See* Pub. L. No. 89-97, 79 Stat. 286. As originally enacted in 1956, the Social Security Disability Insurance definition of disabled required that the individual's physical or mental impairment "be expected to result in death or to be of long-continued and indefinite duration." *See* Social Security Amendments of 1956, Pub. L. No. 84-880, § 103(a), 70 Stat. 807, 815 (codified as amended at 42 U.S.C. § 423(d)(1)(A) (1994)). The 1965 amendment changed this language to require that the impairment be one that "can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months."

18 Rev. Proc. 99-21, 1999-1 C.B. 960.

The person signing the claim for credit or refund must also provide a written statement that no person, including the taxpayer's spouse, was authorized to act on behalf of the taxpayer in financial matters during the period of impairment.

REASONS FOR CHANGE

The National Taxpayer Advocate understands the need to set times in which certain actions must take place. These periods give a taxpayer an opportunity to act while providing finality to the tax system. However, ensuring that outcomes are fair, and that taxpayers truly have a genuine opportunity to take the critical action, is an essential component of a fair and just system. Ensuring that the taxpayer truly has an opportunity to file a refund claim is especially important, since filing a claim for refund is the taxpayer's very last opportunity to assert an overpayment. Once that period for claiming the refund has lapsed, the taxpayer can no longer retrieve the money and is barred from court.

Despite Congress's attempt to address the injustices illustrated by the *Webb* and *Brockamp* cases through IRC § 6511(h), the exception's narrowly tailored focus on a medically determinable impairment and the taxpayer's resulting inability to manage his or her financial affairs has failed to protect many taxpayers who lack the capacity to file a refund claim. The following cases illustrate the challenges imposed on taxpayers by this narrow provision, and its equally narrow interpretation by the IRS:

- *Pleconis v. IRS*:[19] The taxpayer sought to suspend the statute of limitations under IRC § 6511(h) for the time when he had undergone five back surgeries and two heart surgeries. In support of the request, the taxpayer submitted a physician statement that specifically said "[t]he surgeries, rehabilitation and pain medication could be expected to have an adverse effect on the patient's ability to carry about business and personal activities." The taxpayer's cardiologist also stated that, because of his medical condition, "there may be adverse effects on the patient's ability to carry out business and personal activities correctly." However, the district court held that these statements did not sufficiently satisfy the requirement that the taxpayer's injury actually prevented him from managing his financial affairs.
- *Redondo v. U.S.*:[20] The court found the evidence the taxpayer submitted failed to establish a "financial disability" under IRC § 6511(h) because the physician's statement failed to specifically state that Mr. Redondo was prevented from managing his financial affairs. Instead, the statement said that Meniere's disease and the taxpayer's clinical depression "made managing his daily living, finances, etc., extremely difficult."
- *Green v. Commissioner*:[21] The taxpayer was treated by a clinical psychologist, not a physician, and thus could not document a medically determinable impairment.

These cases illustrate the difficulties that the requirement of a medical determination from a physician can pose and the inappropriateness of requiring a physician to make a global, definitive statement that a taxpayer's impairment prevented him or her from managing financial affairs. The medically determinable

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19 *Pleconis v. IRS*, 108 A.F.T.R.2d (RIA) 5704 (D.N.J. 2011). The taxpayer filed a joint return with his wife, and the district court further held that his wife was not financially disabled from filing the claim for refund.

20 *Redondo v. U.S.*, 112 A.F.T.R.2d (RIA) 6092 (Fed. Cir. 2013). The court held that, even if the evidence did comply with the financially disabled requirements (*i.e.*, the impairment prevented him from managing his financial affairs) the claim for refund was nevertheless untimely as it was submitted more than three years after the date the disability ended..

21 *Green v. Comm'r*, T.C. Memo. 2009-105.

requirement precludes use of other types of documentation that can show a taxpayer's impairment, such as a letter from a psychologist or a clinical social worker. Additionally, the proposed revision would obviate the global "all or nothing" statement, which is generally not compatible with the reality of how a disability affects an individual's life.

In many cases a disability can materially limit particular aspects of an individual's conduct, while leaving other aspects, especially the ability to perform simple tasks, untouched or impaired to a lesser degree. This is especially true for individuals who suffer from mental illness. For instance, for an individual suffering from depression, a simple, routine task may pose little anxiety, while a more difficult and complex task (*e.g.*, filing a refund claim) may trigger severe anxiety and be avoided altogether.[22] Thus, a severely depressed person may be able to muster enough energy to pay utility bills after receiving a notice that the utilities will be disconnected if the bills are not paid, but would leave more complex financial obligations unattended.[23] The proposed legislative change will permit the professional making the determination to more fully consider whether the disability affects the individual's ability to perform financial tasks similar to filing a claim for refund. Such a revision will free the professional to provide a statement where simple tasks can be performed, instead of feeling compelled to provide a global statement that he or she fears cannot be fully supported.

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The IRS Is Administering Other Provisions Where It Has to Consider the Impact of a Physical or Mental Impairment.

Currently, various provisions require detailed analysis of how an impairment affects an individual's ability to perform and comply with tax obligations. For instance, penalties may be abated where a failure to act, such as failure to file a return or pay tax, was due to reasonable cause and not willful neglect.[24] Reasonable cause has been established in situations where the taxpayer was prevented from acting due to an impairment. For example, in *Wright v. Commissioner*, the court held that a stay in a hospital and a rehabilitation center for an injured leg during the time that the taxpayer's 2006 return was due, in conjunction with the fact that her financial documents were not easily accessible, was enough to establish reasonable cause.[25] The IRS argued that the taxpayer's ability to carry on negotiations with Nationwide Insurance during this time negated reasonable cause, but the court was not persuaded. Unlike the taxpayer showing financial disability under current IRC § 6511(h), this taxpayer did not have to show inability to manage his or her financial affairs due to a medical condition. Instead, the court considered whether the impairment affected the taxpayer's ability to comply with the filing requirement, and whether that failure was reasonable when accounting for the impairment.

Additionally, the IRS considers unique circumstances and weighs all the relevant facts of a case when considering a taxpayer's offer to compromise an outstanding liability on the basis of effective tax

22 Andrew M. Busch, Jonathan W. Kanter, Sara J. Landes, and Cristal E. Weeks, *The Nature of Clinical Depression: Symptoms, Syndromes, and Behavior Analysis*, Behav. Anal. 31(1): 1–21 (2008), *available at* http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2395346/ (stating that "[d]epression is characterized as much by increased escape and avoidance repertoires as by reduced positive repertoires.").

23 *Walter v. U.S.*, 104 A.F.T.R.2d (RIA) 7761 (W.D. Pa. 2009). The taxpayer in this case suffered from extreme clinical depression for at least seven years and diabetes. The taxpayer's depression prevented him from paying bills timely. Although he did pay some bills on time (*i.e.*, within a month of receipt), he normally paid his bills one to two months late. Further, taxpayer often delayed paying bills until receiving second or third notices or threats to shut off electricity.

24 Treas. Reg. § 301.6651-1(c)(1). Reasonable cause exists when the taxpayer exercises ordinary business care.

25 *Wright v. Comm'r*, T.C. Memo. 2013-129.

administration (an ETA offer).[26] In fact, one of the situations where IRS guidance instructs employees to consider an ETA offer is when a taxpayer is incapacitated and unable to comply with tax laws.[27]

Further, the IRS is obliged to accept information from a variety of sources when verifying an impairment to hire an individual with a disability.[28] For instance, the Office of Personnel and Management permits agencies to accept statements, records, or letters from a Federal Government agency that issues or provides disability benefits, from a state vocational rehabilitation agency counselor, or from a private vocational rehabilitation or other counselor that issues or provides disability benefits, in addition to statements, records, or letters from a medical professional.[29]

As with grants of penalty abatement on the basis of reasonable cause, settlement of tax liabilities on the basis of effective tax administration, which rests on consideration of all facts and circumstances, and as with the hiring process for IRS employees with a disability, which permits consideration of various sources, the proposed revisions to IRC § 6511(h) would allow the individual making a determination a broader framework within which to consider how a physical or mental condition materially limited the taxpayer's ability to manage his or her financial affairs, particularly those financial affairs that are akin to filing a refund claim.

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EXPLANATION OF RECOMMENDATION

The current, narrowly tailored exception has failed to protect some taxpayers who lack the capacity to file a refund claim. As has been acknowledged by legal scholars over the years, a better articulated exception with more breadth than the current one will better protect taxpayers.[30]

Replace the Medical Determination Requirement with a Requirement that the Impairment Be Determined by a Qualified Medical or Mental Health Professional.

Requiring that the determination as to the taxpayer's impairment be a medical one does not always result in IRS's receipt of the most accurate and useful information. For example, a taxpayer who is receiving regular counseling and treatment from a psychologist or a clinical social worker would be precluded from submitting a letter from either professional, because it would not be considered a medical determination under the law.[31] This means the taxpayer would have to obtain a letter from a physician who might be unfamiliar with his or her particular case. In all likelihood, the physician would have to base his or her opinion on the psychologist's or social worker's interactions with the taxpayer, rather than on first-hand knowledge. Since the physician would not be personally familiar with the case, the risk of a mischaracter-

26 IRC § 7122(a), and Treas. Reg. § 301.7122-1(b)(3)(ii). A liability may be compromised to promote effective tax administration (ETA) where compelling public policy or equity considerations provide a sufficient basis for compromising the liability. An ETA offer can only be considered where IRS has determined that the taxpayer does not qualify for an offer in compromise on the basis of doubt as to liability and doubt as to collectability.

27 IRM 5.8.11.2.2.1 (Sept. 23, 2008).

28 *Id.*

29 5 C.F.R. § 213.3102(u). For purposes of this regulation, a medical professional is an individual who is duly certified by a State, the District of Columbia, or a U.S. territory, to practice medicine. *See also* Office of Personnel and Management, Excepted Service — Appointment of Persons with Disabilities and Career And Career — conditional Employment Regulations, Question and Answers, *available at* http://archive.opm.gov/disability/appointment_disabilities.asp#3 (last visited Dec. 17, 2013).

30 *See, e.g.*, Keith Fogg, *Financial Disability for All*, Villanova Law/Public Policy Research Paper No. 2013-3009 (Nov. 30, 2012), *available at* http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=953107.

31 *Green v. Comm'r*, T.C. Memo. 2009-105. Rev. Proc. 99-21 references 42 U.S.C. § 1395x(r), which defines physician, thereby excluding other medical professionals, such as nurse practitioners and physician assistants. *See also Henry v. U.S.*, 98 A.F.T.R.2d (RIA) 8359 (N.D. Tex. 2006).

ization of the taxpayer's impairment increases, potentially resulting in an improper denial of relief. In this or similar situations, requiring a medical determination may prevent the IRS from having the most useful information on which to base its decision. The proposed change would permit the IRS to revise Revenue Procedure 99-21 to include professionals other than physicians, such as a licensed psychologist, a clinical social worker, or another trained mental health professional.

Replace the Unable to Manage Financial Affairs Requirement with a Requirement that Considers How the Impairment Materially Limited Management of Financial Affairs.

The current requirement that the taxpayer be "unable" to manage his or her financial affairs means that the supporting letter must make an "all or nothing" determination. Requiring such a statement places a large burden on the individual providing the determination letter, and may unnecessarily deter professionals from providing such a letter, since the letter could have unintended repercussions. Specifically, because the professional may know, or believe, that the individual is able to manage simple, easy financial tasks, he or she may feel barred from confidently stating that the taxpayer was unable to manage his or her financial affairs.[32] The proposed revision will allow the professional to more fully consider the nuances of the disability and how it affects management of financial affairs. This will allow the professional to consider the degree to which a taxpayer's ability to perform complex financial tasks (specifically, those tasks that are similar to filing a claim for refund) is impaired.

Replacing the requirement that the individual impairment be medically determinable with a provision that it be determined by a qualified medical or mental health professional and considering material limitations in place of inability will create an exception that more accurately reflects the circumstances and condition of taxpayers who are impaired from filing a refund claim.

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32 Although Revenue Procedure 99-21 does limit the physician's statement to "the best of your knowledge," an individual who is confident that the disability prevented the taxpayer from filing a refund claim but believes, or knows, that the taxpayer can undertake less significant financial tasks would be deterred from providing a determination letter.

LR #3 Allocate to the IRS the Burden of Proving it Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit

PROBLEM

Internal Revenue Code (IRC) § 32(k) authorizes the IRS to ban taxpayers from claiming the earned income tax credit (EITC) for two years if the IRS determines they claimed the credit improperly due to reckless or intentional disregard of rules and regulations. Neither section 32 nor its regulations define the terms "reckless or intentional disregard," nor is there any judicial interpretation of the provision. However, the requisite state of mind goes beyond mere negligence.[1] IRS Chief Counsel guidance provides that if the IRS disallowed the EITC because the taxpayer did not respond (or did not respond adequately) to a request for substantiation of claimed EITC, the ban should not be imposed.[2]

The IRS routinely imposes the ban on taxpayers with whom it had no interaction and where there was no occasion to ascertain anything about the taxpayer's state of mind. The IRS often ignores the statutory requirements for imposing the ban, contravenes its own Chief Counsel guidance, and bypasses its own procedural safeguards to impose the ban.[3] A taxpayer may petition the Tax Court for review of the IRS's determination to impose the two-year ban, but the taxpayer may have the burden of proving the IRS imposed the ban improperly.[4]

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EXAMPLE

M and F, an unmarried couple, lived together with their two children, ages 8 and 10, for all of 2011. M earned $30,000 in 2011 and F earned $35,000, but they did not share bank accounts and neither parent knew how much the other parent made. In 2012, the couple separated and F moved out of the family home. The children then resided equally with M and F, living alternate weeks with each parent. For tax purposes, the children were the "qualifying children" of both M and F in 2011, but F had the higher adjusted gross income and under the tie-breaker rules was entitled to the dependency deductions and EITC.[5] However, F told M that M could claim tax benefits, so M filed a separate 2011 return on which she claimed dependency deductions and approximately $4,000 of EITC, reducing her tax liability to zero. Unknown to M, F also claimed dependency deductions and EITC with respect to the children on his separate return for 2011.

The IRS audited M's return and disallowed the dependency deductions and EITC. M did not respond to the IRS's requests for documentation or participate in the audit because she inquired and learned that she was not entitled to benefits she claimed. She could not demonstrate that her adjusted gross income

1 See below for a discussion of IRC § 6662 and related regulations that define and distinguish "negligence," from a "reckless disregard" or "intentional disregard."

2 IRS SCA 200245051 (Nov. 8, 2002).

3 Most Serious Problem: *EITC: The IRS Inappropriately Bans Many Taxpayers From Claiming EITC, supra*.

4 Tax Court Rule of Practice and Procedure, 142(a); *Welch v. Helvering*, 290 U.S. 111, 115 (1933).

5 The applicable "tie breaker" rule of IRC § 152(c)(4)(B)(ii) provides that where more than one parent claims a qualifying child and the parents do not file a joint return together, if the child resides with both parents for the same amount of time during such taxable year, the child is the qualifying child of the parent with the highest adjusted gross income.

exceeded F's. The IRS asserted an accuracy-related penalty under IRC § 6662.[6] The IRS also imposed the two-year ban on M, so M cannot claim EITC in 2013 or 2014, even if her adjusted gross income exceeds F's in those years and she would otherwise be entitled to claim the credit.[7]

The maximum EITC for two qualifying children in 2012 was $5,236, and $5,372 for 2013.[8] If M petitions the Tax Court for review, the IRS will have the burden of showing that M negligently claimed the disallowed tax benefits and is liable for the section 6662 penalty. However, M may have the burden of proving the IRS erred in imposing the two-year ban, which if left in place potentially deprives her of more than $10,000 in tax benefits. She may be in a position of attempting to prove a negative — that her improper claim of EITC was not due to reckless or intentional disregard of rules and regulations.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 32(k) to provide that the IRS has the burden of proof as to whether it is appropriate to impose the two-year ban on claiming EITC.

CURRENT LAW

IRC § 32(k)(1)(B)(ii) disallows EITC claims for two taxable years if there has been a final determination that the taxpayer's claim of credit was due to "reckless or intentional disregard of rules and regulations."[9] There is no statutory, regulatory, or judicial interpretation of section 32(k)(1)(B)(ii), but section 6662(b)(1), which imposes an accuracy-related penalty on certain underpayments due to "negligence or disregard of rules or regulations," contains and defines the same terms, either in the statute or in the related regulations. Section 6662(c) provides that "negligence" includes "any failure to make a reasonable attempt to comply with any provision of this title." The regulations under section 6662 provide that "reckless disregard" means "the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances which demonstrate a substantial deviation from the standard of conduct that a reasonable person would observe."[10] "Intentional disregard" exists "if the taxpayer knows of the rule or regulation that is disregarded."[11]

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6 We note the dicta in *Rand v. Comm'r*, 141 T.C. No. 12, slip op. at 32 (Nov. 18, 2013), "it appears that Congress intended that the two-year bar be in lieu of any other monetary sanctions." Thus, while it is not clear that the Tax Court would sanction the imposition of the section 6662 penalty in addition to the two-year ban, the IRS is not explicitly prevented by statute from pursuing both.

7 F would also not be entitled to the credit under the tie-breaker rule of IRC § 152(c)(4)(A)(ii). IRC § 152(c)(4)(C), which permits another taxpayer to claim an individual as a qualifying child when the individual's parents may claim him or her but do not, does not apply. F and M's children would therefore not have the benefit of any EITC support.

8 EITC amounts for 2012 and 2013 are *available at* http://www.irs.gov/Individuals/Preview-of-2012-EITC-Income-Limits,-Maximum-Credit–Amounts-and-Tax-Law-Updates.

9 IRC § 32(k)(1)((B)(ii). IRC § 32(k) was enacted as part of the Tax Reform Act of 1997, Pub. L. No. 105-34, § 1085(a)(1), 111 Stat. 788, 956. IRC § 32(k(1)(B)(i) authorizes the IRS to impose a ten-year ban on taxpayers who fraudulently claim EITC, but the IRS imposes the ten-year ban infrequently (13 times, 27 times, and 17 times in 2009, 2010, and 2011 respectively). IRS Compliance Data Warehouse, *Individual Returns Transaction File* (Tax Years 2009, 2010, 2011).

10 Treas. Reg. § 1.6662-3(b)(2).

11 *Id*.

It is Not Clear Whether IRC § 7491 Shifts the Burden of Production to the IRS in Two-Year Ban Cases.

When the IRS audits a taxpayer's return and determines to disallow claimed EITC and impose the two-year ban, it issues a statutory notice of deficiency that includes notice of the IRS's determination to impose the ban.[12] The taxpayer may petition the Tax Court for review of the disallowed EITC as well as the determination to impose the ban.[13] Once in Tax Court, the taxpayer generally bears the burden of proof.[14] This "burden of proof" has two components. First, the taxpayer has the burden of coming forward with evidence (sometimes referred to as the burden of production). Second, the taxpayer must persuade the court that the evidence he or she submitted rises to the requisite level, such as the preponderance standard (sometimes referred to as the burden of persuasion).[15] Recognizing that "a taxpayer should not bear the burden of proving a negative (no unreported income) if the Commissioner can present no substantive evidence to support his deficiency claim," courts held that the burden of proof shifted to the IRS in some unreported income cases.[16] Consistent with this position, IRC § 7491, enacted as part of the IRS Restructuring and Reform Act of 1998, in subsection (b) shifts to the IRS the burden of proof in certain omitted income cases.[17] Additionally, subsection (c) of the statute shifts to the IRS the burden of production (and not the burden of persuasion) in penalty cases.[18] Thus, the IRS has the burden of producing evidence to show it properly imposed the IRC § 6662 accuracy-related penalty.

However, because the two-year ban on claiming EITC may not be a "penalty" for purposes of section 7491(c), it is not clear that the statute allocates to the IRS the burden of producing evidence that it was proper to impose the ban.[19] If section 7491(c) does not shift the burden to the IRS, the taxpayer contesting the ban will be required to produce evidence to prove a negative (that he or she did not claim the credit due to reckless or intentional disregard of rules and regulations), a requirement that is considered

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12 The statutory notice of deficiency, authorized by IRC § 6212, informs the taxpayer of the additional amount of tax the IRS believes he or she owes and advises of the right to petition the Tax Court for review of that determination. IRM 4.19.14.6.1(6), (11) (Jan. 1, 2013); IRM 4.13.3.18 (Sept. 30, 2010).

13 *See, e.g., Garcia v. Comm'r*, T.C. Summ. Op. 2013-28 (Apr. 3, 2013) for the facts contained therein; under IRC § 7463(b), the opinion is not precedent for any other case.

14 Tax Court Rule of Practice and Procedure, 142(a); *Welch v. Helvering*, 290 U.S. 111, 115 (1933).

15 Bittker and Lokken, *Tax Court Trial Practice* (Revised), par. 115.4.2, Thomson Reuters Tax and Accounting (2013).

16 *See, e.g., Gatlin v. Comm'r*, 754 F.2d 921, 923 (11th Cir.1985) and cases cited therein.

17 IRC § 7491(b) provides "In the case of an individual taxpayer, the Secretary shall have the burden of proof in any court proceeding with respect to any item of income which was reconstructed by the Secretary solely through the use of statistical information on unrelated taxpayers." IRC § 6201(d) contains a similar provision: "In any court proceeding, if a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information return filed with the Secretary under subpart B or C of part III of subchapter A of chapter 61 by a third party and the taxpayer has fully cooperated with the Secretary (including providing, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer as reasonably requested by the Secretary), the Secretary shall have the burden of producing reasonable and probative information concerning such deficiency in addition to such information return." IRC § 7491(a) also shifts the burden of proof to the IRS if, in a court proceeding, the taxpayer "introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B." However, in order for this provision to apply, IRC § 7491(a)(2)(A) requires that the taxpayer "complied with the requirements under this title to substantiate any item," which may not be possible where EITC was properly disallowed (although the ban was improperly imposed).

18 Pub. L. No. 105-206 § 3001, adding IRC § 7491. Subsection (c) provides "[n]otwithstanding any other provision of this title, the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title." Allocating the burden of production to the IRS means "the Commissioner must come forward with sufficient evidence indicating that it is appropriate to impose the relevant penalty." The burden of persuasion remains with the taxpayer, however, so that "once the Commissioner meets his burden of production, the taxpayer must come forward with evidence sufficient to persuade a Court that the Commissioner's determination is incorrect." *Higbee v. Comm'r*, 116 T.C. 438 at 446, 447 (2001).

19 As noted, IRC § 7491(c) shifts the burden for any "penalty, addition to tax, or additional amount imposed by this title" (i.e., Title 26). IRC § 32 is found in Title 26, in Subtitle A, Chapter 1. Title 26, Subtitle F, Chapter 68 is captioned "Additions to the Tax, Additional Amounts, and Assessable Penalties." *See also Rand v. Comm'r*, 141 T.C. No. 12, slip op. at 31-32 (Nov. 18, 2013), noting "[t]o the extent an erroneously claimed credit reduces a tax liability, it may be subject to an accuracy-related penalty under section 6662; to the extent that credit generates a refund, it may be subject to a penalty under section 6676" and "it appears that Congress intended that the two-year bar be in lieu of any other monetary sanctions."

unfair in certain unreported income cases.[20] Even if section 7491(c) does apply to two-year bans, the statute does not shift the burden of persuasion to the IRS, but only the burden of production. The IRS would have the burden of producing evidence to show it properly imposed the ban, but the taxpayer would bear the burden of persuading a court that the IRS's determination was incorrect. If the evidence on both sides were equal, the IRS would win.

Other Code Provisions and Tax Court Rules Shift the Burden of Proof to the IRS in Cases that May Be Analogous to Two-Year Ban Cases.

IRC § 7491 is not the only Code section that shifts the burden of proof to the IRS. For example, a taxpayer is generally entitled to innocent spouse relief under IRC § 6015(c) unless he or she had actual knowledge of an erroneous item allocable to the other spouse that gave rise to an understatement of tax on a joint return.[21] The IRS has the burden of proof with respect to such knowledge.[22] Another example is IRC § 7430, which provides for the award of reasonable costs for an administrative or court proceeding under certain circumstances when the taxpayer is the prevailing party. The taxpayer is not a "prevailing party" within the meaning of the statute if "the United States establishes that the position of the United States in the proceeding was substantially justified," and the government has the burden of proof to show its position was substantially justified.[23] Still other Code sections shift the burden of proof to the IRS with respect to various issues relating to a taxpayer's state of mind or the reasonableness of a position.[24] The Tax Court's Rules of Practice and Procedure reflect several statutory burden allocations in addition to containing other burden-shifting provisions not mandated by statute.[25]

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REASONS FOR CHANGE

The two-year ban authorized by IRC § 32 is unique in its temporal reach. A taxpayer who is subject to the ban but otherwise eligible for EITC is foreclosed from claiming it for two years following an audit in which EITC was disallowed. For this vulnerable population of low-income taxpayers, inappropriately being deprived of the credit for two years is a serious burden that may be difficult to relieve. These taxpayers

20 IRC §§ 7491(c), 6201(d).

21 IRC § 6015(c) provides "allocation" relief for understatements of tax for spouses who request relief when they are divorced, separated, widowed, or not living together, by allocating the liability between the spouses. IRC § 6015(c)(3)(C) provides that relief is not available where the spouse requesting relief had actual knowledge of the item that gave rise to the deficiency.

22 Treas. Reg. 1.6015-3(c)(2)(i) provides, "If, under section 6015(c)(3)(C), the Secretary demonstrates that, at the time the return was signed, the requesting spouse had actual knowledge of an erroneous item that is allocable to the nonrequesting spouse, the election to allocate the deficiency attributable to that item is invalid, and the requesting spouse remains liable for the portion of the deficiency attributable to that item. The Service, having both the burden of production and the burden of persuasion, must establish, by a preponderance of the evidence, that the requesting spouse had actual knowledge of the erroneous item in order to invalidate the election."

23 IRC § 7430(c)(4)(B)(i); *Center for Family Medicine v. U.S.*, 614 F.3d 937 (8th Cir. 2010). *See* H.R. Rep. 104-506 sec. 701(b) Burden of Proof on United States, accompanying Pub. L. No. 104-168, Taxpayer Bill of Rights 2, adding IRC § 7430(c). *See also* Joint Committee Print, Joint Committee on Taxation JCX -7-96, *Description of Amendment in the Nature of a Substitute to H.R. 2337 'Taxpayer Bill of Rights 2' Scheduled for Markup by the House Committee on Ways and Means on March 21,1996* (Mar. 20, 1996) explaining "The proposal would provide that, once a taxpayer substantially prevails over the IRS in a tax dispute, the IRS has the burden of proof to establish that it was substantially justified in maintaining its position against the taxpayer. This would switch the current procedure, which places the burden of proof on the taxpayer to establish that the IRS was not substantially justified in maintaining its position. Therefore, the successful taxpayer would receive an award of attorney's fees unless the IRS satisfies its burden of proof."

24 *See, e.g.*, I.R.C. § 7454(a) (providing "[i]n any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary."); IRC.§ 7429(g)(1)(in a judicial proceeding the IRS has the burden of proof as to whether certain levies, jeopardy assessments, or termination assessments were reasonable).

25 *See, e.g.*, Tax Court Rule of Practice and Procedure 142(b) (allocating to the IRS the burden of proof as to fraud and requiring a "clear and convincing" level of evidence); Rule 142(d) (allocating to the IRS the burden of proof as to transferee liability); Rule 232(e) (allocating to the IRS the burden of proof as set forth in IRC § 7430, including IRC § 7430(c)(4)(B). For circumstances in which the Tax Court places the burden of proof on the IRS other than in situations covered by statute, see Rule 142(a) (allocating the burden of proof to the IRS as to new matters not included in a notice of deficiency, increases in the asserted deficiency, and affirmative defenses).

may be intimidated and fearful of protesting the IRS's treatment of them. They may not understand they have been wronged when the IRS imposes the ban without following the statutory requirements, and consequently they may not seek assistance they need, such as from Low Income Taxpayer Clinics. The disallowance of the EITC in the audit year may also trigger other penalties, but the amount of foregone EITC in the later two years may far exceed those other penalties. Yet while it is clear that the IRS has the burden of production with respect to penalties, it is not clear whether the IRS has any burden of proof as to the two-year ban.

Actual experience with the two-year ban has demonstrated that the IRS imposes it inappropriately. Routinely and automatically, the IRS imposes the ban in cases where it has not interacted with the taxpayer and therefore no basis on which it could "determine," as the statute requires, that the taxpayer acted with "reckless or intentional disregard of rules and regulations." Clarifying that the IRS has the burden of proof in two-year ban cases is a logical remedial step.

EXPLANATION OF PROVISION

The proposal would amend IRC § 32(k) to clarify that the IRS has the burden of proof when proposing to impose the two-year ban on claiming EITC. Consequently, the IRS would be required to produce evidence of the taxpayer's reckless or intentional disregard of rules and regulations and persuade the court that imposition of the ban would be appropriate.

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LR #4 PREMIUM TAX CREDIT: Adjust the Affordability Threshold Based on Type of Coverage

PROBLEM

Under a Treasury Regulation implementing the Affordable Care Act (ACA),[1] an employee's family may be ineligible for the premium tax credit if the cost of health insurance to cover just the employee (self-only) is affordable, even though the employee must pay more to cover him- or herself and family members (family coverage).

EXAMPLE

An employer offers health insurance for an annual employee contribution of $999 to cover only the employee, or $4,565 to cover the employee's whole family. Even if the household's income is as little as $10,500, the rules deem this offer of employer coverage affordable. Family coverage could cost almost half of the household income, but a 9.5-percent affordability threshold refers to the cost of self-only coverage — regardless of which type of insurance the employee actually needs.[2] Assuming the employer health plan is affordable, the employee (and family) are ineligible for the premium tax credit, which otherwise subsidizes those who may be unable to afford health care.

RECOMMENDATION

Clarify that the 9.5-percent affordability threshold pertains to the type of insurance needed to cover the employee and, if applicable, the employee's spouse and dependents, whether self-only or family coverage.

PRESENT LAW

Generally, the ACA allows a refundable tax credit to low and moderate-income individuals to subsidize premiums at a legislatively-created health insurance marketplace "Exchange."[3] This premium tax credit creates affordable coverage for those who may otherwise go without insurance. If an employer offers health insurance coverage to its employees and the employees' family members, and the insurance meets certain minimum value standards, then employees and their family members are eligible for a premium tax credit only if the health plan offered by the employer is unaffordable.

In turn, the relevant statute states that an employer-sponsored plan is unaffordable "if the employee's required contribution (within the meaning of section 5000A(e)(1)(B)) with respect to the plan exceeds 9.5 percent of the applicable taxpayer's household income."[4] A Notice of Proposed Rule-making (NPRM) explained:

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1 *See* Patient Protection & Affordable Care Act of 2009, Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Educ'n Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010).

2 *See* Treas. Reg. § 1.36B-2(c)(3)(v)(C).

3 *See* Internal Revenue Code (IRC) § 36B.

4 IRC § 36B(c)(2)(C)(i)(II).

> The cross-referenced section 5000A(e)(1)(B) defines the term "required contribution" for this purpose as "the portion of the annual premium which would be paid by the individual * * * for self-only coverage." Thus, the statutory language specifies that for both employees and others (such as spouses or dependents) who are eligible to enroll in employer-sponsored coverage by reason of their relationship to an employee (related individuals), the coverage is unaffordable if the required contribution for "self-only" coverage (as opposed to family coverage or other coverage applicable to multiple individuals) exceeds 9.5 percent of household income. * * *
>
> Consistent with these statutory provisions, the proposed regulations provide that an employer-sponsored plan also is affordable for a related individual for purposes of section 36B if the employee's required contribution for self-only coverage under the plan does not exceed 9.5 percent of the applicable taxpayer's household income for the taxable year, even if the employee's required contribution for the family coverage does exceed 9.5 percent of the applicable taxpayer's household income for the year.[5]

To support this interpretation, the NPRM quoted a statement of the Joint Committee on Taxation (JCT): "Unaffordable is defined as coverage with a premium required to be paid by the employee that is more than 9.5 percent of the employee's household income, based on the self-only coverage."[6] The relevant substance of the NPRM was finalized by a Treasury Decision (TD).[7] As a result, an employee and his or her spouse and dependents may be ineligible for the premium tax credit because self-only coverage is affordable, even if the employee must pay more than 9.5 percent of household income to cover the him- or herself and family.

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REASONS FOR CHANGE

As a logical matter, the affordability threshold creates a disjunct between a stipulated amount and the actual cost of family coverage. Illogical provisions, which run contrary to intuitive behavior, make tax administration difficult. As a practical matter, disqualification from the premium tax credit makes it harder for families to obtain health insurance.

According to health-care industry analysts, average annual premiums for employer-sponsored plans in 2013 were $5,884 for self-only and $16,351 for family coverage.[8] The employee's share was on average $999 and $4,565, respectively.[9] Under the Treasury Regulation, $4,565 is affordable since $999 is less than 9.5 percent of household income. Researchers also stated that:

> there are about 3.9 million non-working dependents in families … in which the worker has access to affordable employer-sponsored coverage but the family does not. Under the draft regulation [now finalized], these family members would be excluded from getting federal tax

5 NPRM, 76 Fed. Reg. 50931, 50935 (Aug. 17, 2011).

6 JCT, *General Explanation of Tax Legislation Enacted in the 111th Cong.*, JCS–2–11 (Mar. 2011) at 265.

7 *See* TD 9590, 77 Fed. Reg. 30377 (May 23, 2012).

8 Kaiser Family Foundation, *Employer Health Benefits*, 2013 Ann'l Survey 12, available at http://kff.org/private-insurance/report/2013-employer-health-benefits/ (last visited Sept. 9, 2013).

9 *Employer Health Benefits*, 2013 Ann'l Survey 67; *see also* Rob't Pear, *Federal Rule Limits Aid to Families Who Can't Afford Employers' Health Coverage*, N.Y. Times (Jan. 30, 2013).

> credits to help them buy coverage in health insurance exchanges. On average they'd have to pay 14% of their income to opt into the employer coverage, substantially more than what they would pay in an exchange.[10]

Similarly, the Government Accountability Office (GAO) reported:

> The proposed affordability standard [now finalized] could potentially affect significantly more children than the approximately 460,000 uninsured children we estimated above under certain scenarios … we estimate that an additional 1.9 million children who would otherwise be eligible for C[hildren's] H[ealth] I[nsurance] P[rogram] would be considered to have access to affordable insurance under this [now finalized] proposed standard and would be ineligible for the premium tax credit.[11]

In sum, the threshold as written deems insurance affordable even if that is not the economic reality.

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EXPLANATION OF RECOMMENDATION

In view of the illogical and impractical affordability threshold, editorial writers have opined: "The ideal solution would be for Congress to clarify that the 9.5 percent calculation is based on a family plan, and that dependents can get subsidies on the exchanges if there is no affordable coverage at work."[12] Under the recommendation, the affordability threshold would refer to the level of coverage the employee needs.[13] If the employee purchases self-only coverage because he or she has no spouse or dependents, or they are eligible for coverage elsewhere, the affordability threshold would be based on the self-only premium. Otherwise, the threshold would be based on the cost of family coverage.

10 Larry Levitt & Gary Claxton, *Measuring the Affordability of Employer Health Coverage*, Kaiser Family Foundation (Aug. 24, 2011), *available at* http://kff.org/health-costs/perspective/measuring-the-affordability-of-employer-health-coverage/ (last visited Sept. 9, 2013).

11 GAO, *Children's Health Insurance: Opportunities Exist for Improved Access to Affordable Insurance*, GAO-12-648 (June 2012) 14.

12 *A Cruel Blow to American Families*, N.Y. Times (Feb. 2, 2013).

13 This would be consistent with an earlier explanation of the legislation. *See* JCT, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection And Affordable Care Act*," JCX-18-10 (Mar. 21, 2010) 14 ("Unaffordable is defined as coverage with a premium required to be paid by the employee that is 9.5 percent or more of the employee's household income, based on the type of coverage applicable (*e.g.*, individual or family coverage).").

LR #5 TUITION REPORTING: Allow TIN Matching By Colleges

PROBLEM

Although the tax code requires colleges and universities to file information returns with the IRS reflecting tuition from students,[1] the law does not permit these eligible educational institutions to verify Taxpayer Identification Numbers (TINs) with the IRS prior to filing.[2] Unlike other information return filers who can perfect TINs once the IRS advises them of any errors, colleges and universities must rely on student input while still facing penalties for errors. In tax year 2012, the IRS could not validate over 22,000 TINs on information returns for more than 24 million individuals on Form 1098-T, *Tuition Statement*.[3]

EXAMPLE

University X charges or receives tuition from 60,000 students, from whom the registrar solicits TINs. University X accepts this student information to prepare 60,000 Forms 1098-T, which it duly files with the IRS. Upon filing, the IRS finds that 15,000 of the TINs do not match the students' names, whether due to transposition errors, name changes, or otherwise. As a result, University X faces $1.5 million in penalties. If University X also includes the incorrect TINs on statements it furnished the students, it could potentially be liable for an additional $1.5 million in penalties.

RECOMMENDATION

Allow colleges and universities to verify TINs with the IRS prior to filing annual information returns on tuition payments.

PRESENT LAW

Generally, colleges and universities must file with the IRS annual information returns reflecting tuition paid or amounts billed.[4] These eligible educational institutions use Form 1098-T, *Tuition Statement*, which identifies the student by name, address, and TIN. These tuition statements facilitate the administration of education credits and deductions that depend on tuition paid.[5]

The penalty for failure to file a correct information return is generally $100, and the penalty for failure to furnish a correct payee statement is also generally $100.[6] The IRS will not impose the penalty if the filer shows the failure was due to reasonable cause and not willful neglect.[7] If a college reports an incorrect TIN on Form 1098-T due to inaccurate input from the student, the college may obtain a penalty waiver

1 Internal Revenue Code (IRC) § 6050S.

2 IRC § 6050S(e) defines "eligible educational institution" by cross-reference to IRC § 25A(f)(2), which in turn cross-references the Higher Education Act of 1965, 20 U.S.C. § 1088.

3 *See* IRS Compliance Data Warehouse, Info. Returns Master File.

4 *See* IRC § 6050S. The college must supply a copy to the student (payee statement).

5 *See* IRC §§ 25A, 222.

6 *See* IRC §§ 6721, 6722.

7 *See* IRC § 6724.

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upon proving reasonable cause. The college must establish that the failure to include a correct TIN was due to events beyond its control and that it acted in a responsible manner by soliciting a TIN from the student.[8]

In the case of an individual, a TIN generally is the Social Security number (SSN).[9] For an individual not eligible for an SSN who has a federal tax reporting requirement, the IRS assigns an Individual Taxpayer Identification Number (ITIN).[10]

Regarding information returns that report payments subject to backup withholding, such as dividends or other income, the tax law allows the payor, before filing the return, to verify with the IRS the TIN furnished by the payee.[11] As a mechanism, the payor transmits name/TIN combinations through the IRS online interactive or bulk TIN Matching Program, accessible 24 hours a day, seven days a week.[12] The IRS matching response is generally limited to notification of a match or mismatch.[13] If the IRS response indicates a TIN mismatch, the payor has the opportunity to resolve the inaccuracy with the payee, prior to filing an information return. Otherwise, the IRS generally may not disclose a taxpayer's name, TIN, or other return information.[14]

REASONS FOR CHANGE

Currently, the tax law authorizes the IRS TIN Matching program only for payors of reportable payments subject to backup withholding. Thus, it excludes colleges reporting tuition received (or billed), not making reportable payments subject to backup withholding (*i.e.* not paying income). Nevertheless, as a practical matter, colleges have an information reporting requirement for which they need to verify TINs. TINs may not match a student's name for various reasons, such as transposition errors or name changes. To allow the IRS to alert eligible educational institutions of mismatches to resolve with students prior to filing information returns, Congress should expand TIN Matching beyond the currently authorized program. This recommendation benefits the IRS, information return filers, and students by facilitating accurate reports.

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8 *See* Treas. Reg. §§ 1.6050S-1(e)(3); 301.6724-1.

9 *See* IRC § 6109.

10 *See* Treas. Reg. § 1.6109-1(d).

11 *See* IRC § 3406; Treas. Reg. § 31.3406(j)-1; Rev. Proc. 2003-9, 2003-8 I.R.B. 516.

12 *See* IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program*.

13 The TIN Matching Program provides a numerical response indicator for each match request. The potential responses include: '0' - Name/TIN combination matches IRS records; '1' - Missing TIN or TIN not 9-digit numeric; '2' - TIN not currently issued; '3' - Name/TIN combination does NOT match IRS records; '4' - Invalid request (*i.e.*, contains alphas, special characters); '5' - Duplicate request; '6' - (Matched on SSN), when the TIN type is (3), unknown, and a matching TIN and name control is found only on the NAP DM1 database; '7' - (Matched on EIN), when the TIN type is (3), unknown, and a matching TIN and name control is found only on the EIN N/C database; '8' - (Matched on SSN and EIN), when the TIN type is (3), unknown, and a matching TIN and name control is found on both the NAP DM1 and the EIN N/C databases. IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program* § 14, FAQ-9 at 9.

14 *See* IRC § 6103. *See also* National Taxpayer Advocate 2003 Annual Report to Congress 232 (Legislative Recommendation: *Confidentiality and Disclosure of Returns and Return Information*). Third-party payors and their authorized agents who participate in the TIN Matching Program must sign an on-line Terms of Agreement (TOA) clause stating they will attempt to match name/TIN combinations only for the types of reportable payments listed in Rev. Proc. 2003-9. IRS Pub. 2108A, *On-line Taxpayer Identification Number (TIN) Matching Program* § 4.3 at 4.

EXPLANATION OF RECOMMENDATION

In general, information returns allow the IRS to cross-check taxpayer claims against third-party reports. In the case of education credits and deductions that depend on tuition paid, Form 1098-T may facilitate tax administration.[15]

In 2011, the Treasury Inspector General for Tax Administration (TIGTA) published an audit report concerning Form 1098-T in the context of apparently erroneous education credits.[16] According to the report, based in part on analysis of Forms 1098-T, 2.1 million individuals received potentially erroneous education credits because they:

- Did not attend an eligible educational institution;
- Attended less than half time or were graduate students;
- Were dependents on another taxpayer's return; or
- Were incarcerated.[17]

In response to the report, the IRS observed that

> there are legitimate reasons why the information on the Form 1098-T could be different from the amount of credit allowed to the taxpayer. For example, timing differences can occur that will cause the reporting of all expenses on Form 1098-T in one year, when the student is required to claim the credit over two tax years. In addition, students whose tuition was fully paid through scholarships would not receive Form 1098-T, although they may have related expenses, such as course materials not purchased through the educational institution, which would qualify for the credit.[18]

Nevertheless, the IRS agreed with TIGTA's recommendation to "systemically identify and reject documents using incorrect coding on Form 1098-T for TY 2011" and to "identify educational institutions that are preparing inaccurate Forms 1098-T and then determine the appropriate treatment."[19]

Since enactment over the past decade and a half, the tax statutes have required a TIN on Form 1098-T, to match against claimed education credits and deductions.[20] Because the IRS TIN Matching program is not available for filers of Form 1098-T, colleges essentially must await a penalty notice to discover that a student has supplied an inaccurate number.[21] By extending TIN Matching to Form 1098-T, the recommendation reduces unnecessary burden and work for eligible educational institutions, the IRS, and taxpayers.

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15 As stated above, IRC § 6050S(b)(2)(B)(i) permits reporting either payments received or amounts billed. To the extent that Form 1098-T reports not tuition paid but amounts billed, its utility may be limited.

16 *See* TIGTA, Ref. No. 2011-41-083, *Recovery Act: Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 16, 2011).

17 *See id*. at 3 (relating to TY 2009 through May 28, 2010).

18 TIGTA, Ref. No. 2011-41-083, *Recovery Act: Billions of Dollars in Education Credits Appear to Be Erroneous* at 34 (IRS response).

19 *Id*. at 14.

20 *See* IRC §§ 25A(g) & 6050S(b), enacted by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, §§ 201 & 202, 111 Stat. 788, 799-809 (Aug. 5, 1997); IRC § 222, enacted by the Econ. Growth & Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 431, 115 Stat. 38, 66 (June 7, 2001).

21 On Dec. 17, 2013, the IRS stated that for "tax year 2011, the IRS introduced Forms … 1098-T … into the penalty notice program. * * * in the interest of providing good customer service and encouraging voluntary compliance, the IRS will waive penalties associated with Forms 1098-T … for this introductory year." Servicewide Electronic Research Program (SERP) Alert No. 13A0623.

MOST LITIGATED ISSUES: Introduction

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(X) requires the National Taxpayer Advocate to identify in her Annual Report to Congress (ARC) the ten tax issues most litigated in federal courts (Most Litigated Issues).[1] The National Taxpayer Advocate may analyze these issues to develop recommendations to mitigate the disputes resulting in litigation.

The Taxpayer Advocate Service (TAS) identified the Most Litigated Issues from June 1, 2012, through May 31, 2013, by using commercial legal research databases. For purposes of this section of the Annual Report, the term "litigated" means cases in which the court issued an opinion.[2] This year's Most Litigated Issues in descending order are:

- Accuracy-related penalty (IRC § 6662(b)(1) and (2));
- Trade or business expenses (IRC § 162(a) and related Code sections);
- Gross income (IRC § 61 and related Code sections);
- Summons enforcement (IRC §§ 7602(a), 7604(a), and § 7609(a));
- Collection due process (CDP) hearings (IRC §§ 6320 and 6330);
- Failure to file penalty (IRC § 6651(a)(1)), failure to pay penalty (IRC § 6651(a)(2), and estimated tax penalty (IRC § 6654);
- Charitable deductions (IRC §170);
- Frivolous issues penalty (IRC § 6673 and related appellate-level sanctions);
- Civil actions to enforce federal tax liens or to subject property to payment of tax (IRC § 7403); and
- Relief from joint and several liability for spouses (IRC § 6015).

The majority of these issues were identified as Most Litigated Issues last year, with the exception of charitable deductions.[3] Accuracy-related penalties became the top issue this year, continuing the trend from 2011 to 2012, which saw a 113 percent increase in cases, followed by a gain of another 52 percent in 2013.[4] The number of CDP cases fell slightly this year after a significant increase in 2012, dropping from 116 cases in 2012 to 105 in 2013.[5] Civil actions to enforce federal tax liens or to subject property to payment of tax saw the largest decrease in cases, with 48 cases in 2012 and 33 in 2013, a 31 percent decrease.[6]

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1 Federal tax cases are tried in the United States Tax Court, United States District Courts, the United States Court of Federal Claims, United States Bankruptcy Courts, United States Courts of Appeals, and the United States Supreme Court.

2 Many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers' cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Additionally, courts can issue less formal "bench opinions," which are not precedential. The more significant bench opinions are available through www.ustaxcourt.gov.

3 *See* National Taxpayer Advocate 2012 Annual Report to Congress 560.

4 *See id.* at 563, Table 3.0.1; National Taxpayer Advocate 2011 Annual Report to Congress 589.

5 *See id*.

6 *See id.*

Once TAS identified the Most Litigated Issues, it analyzed each one in four sections: summary of findings, description of present law, analysis of the litigated cases, and conclusion. Each case is listed in Appendix III, which categorizes the cases by type of taxpayer (*i.e.*, individual or business).[7] Appendix III also provides the citation for each case, indicates whether the taxpayer was represented at trial or argued the case *pro se* (*i.e.*, without representation), and lists the outcome.[8]

We have also included a "Significant Cases" section summarizing decisions that are not among the top ten issues but are important to tax administration.[9] This year, the Significant Cases discussion includes two decisions issued by the Supreme Court.[10]

AN OVERVIEW OF HOW TAX ISSUES ARE LITIGATED

Initially, taxpayers can generally litigate a tax matter in four different fora:

- The United States Tax Court;
- United States District Courts;
- The United States Court of Federal Claims; and
- United States Bankruptcy Courts.

With limited exceptions, taxpayers have an automatic right of appeal from final decisions of any of these courts.[11]

The Tax Court is generally a "prepayment" forum. In other words, taxpayers can access the Tax Court without first having to pay the disputed tax. The Tax Court has jurisdiction over a variety of issues, including deficiencies, certain declaratory judgment actions, appeals from collection due process hearings, relief from joint and several liability, and determination of employment status.[12]

The United States District Courts and the United States Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full,[13] and (2) the taxpayer has filed an administrative claim for refund.[14] The United States District Courts, along with the bankruptcy courts in very limited circumstances, provide the only fora in which a taxpayer can receive a jury

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7 Individuals filing Schedules C, E, or F are deemed business taxpayers for purposes of this discussion even if items reported on such schedules were not the subject of litigation.

8 "*Pro se*" means "for oneself; on one's own behalf; without a lawyer." *Black's Law Dictionary* (9th ed. 2009). For purposes of this analysis, we considered the outcome of the case with respect to the issue analyzed only. A "split" decision is defined as a partial allowance on the specific issue analyzed. The citations also indicate whether decisions were on appeal at the time this report went to print.

9 One of the cases discussed in the "Significant Cases" section of this report was decided outside the June 1, 2012, through May 31, 2013, period used to identify the ten most litigated issues, but we nonetheless have included it because of its impact on tax administration.

10 *United States v. Windsor*, 133 S. Ct. 2675 (2013), *aff'g* 699 F.3d 169 (2d Cir. 2012), *aff'g* 833 F. Supp. 2d 394 (S.D.N.Y. 2012) and *PPL Corp. v. Comm'r*, 133 S. Ct. 1897 (2013), *rev'g* 665 F.3d 60 (3d Cir. 2011), *rev'g* 135 T.C. 304 (2010).

11 *See* IRC § 7482, which provides that the United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) have jurisdiction to review the decisions of the Tax Court. There are exceptions to this general rule. For example, IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals $50,000 or less) for which appellate review is not available. *See also* 28 U.S.C. § 1294 (appeals from a United States District Court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court).

12 IRC §§ 6214; 7476-7479; 6330(d); 6015(e); 7436.

13 28 U.S.C. § 1346(a)(1). *See Flora v. United States*, 362 U.S. 145 (1960), *reh'g denied*, 362 U.S. 972 (1960).

14 IRC § 7422(a).

trial.[15] Bankruptcy courts can adjudicate tax matters that were not adjudicated prior to the initiation of a bankruptcy case.[16]

ANALYSIS OF *PRO SE* LITIGATION

As in previous years, many taxpayers appeared before the courts *pro se*. Table 3.0.1 lists the Most Litigated Issues for the review period of June 1, 2012, through May 31, 2013, and identifies the number of cases, broken down by issue, in which taxpayers appeared without representation. As the table illustrates, the issues with the highest rates of *pro se* appearance are summons enforcement and the frivolous issues penalty.

TABLE 3.0.1, *Pro Se* Cases by Issue

Most Litigated Issue	Litigated Cases Reviewed	*Pro Se* Litigation	Percentage of *Pro Se* Cases
Accuracy-Related Penalty	178	100	56%
Trade or Business Expenses	134	86	64%
Gross Income	117	71	61%
Summons Enforcement	117	91	78%
Collection Due Process	105	70	67%
Failure to File, Failure to Pay, and Estimated Tax Penalties	86	53	62%
Charitable Deductions	40	18	45%
Frivolous Issues Penalty (and related appellate-level sanctions)	36	35	97%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	33	18	55%
Joint and Several Liability	31	11	35%
Total	**877**	**553**	**63%**

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Table 3.0.2 affirms our contention that overall, taxpayers are more likely to prevail if they are represented. However, in cases involving relief from joint and several liability for spouses under IRC § 6015, it is interesting to note that taxpayers who appeared *pro se* were far more likely to prevail than taxpayers who were represented. The IRS and taxpayers would benefit from resolving these cases administratively rather than forcing taxpayers to seek relief through the courts.

15 The bankruptcy court may only conduct a jury trial if the right to a trial by jury applies, all parties expressly consent, and the district court specifically designates the bankruptcy judge to exercise such jurisdiction. 28 U.S.C. § 157(e).

16 *See* 11 U.S.C. § 505(a)(1) and (a)(2)(A).

TABLE 3.0.2, Outcomes For *Pro Se* and Represented Taxpayers

	Pro Se Taxpayers			Represented Taxpayers		
Most Litigated Issue	Total Cases	Taxpayer Prevailed in Whole or in Part	Percent	Total Cases	Taxpayer Prevailed in Whole or in Part	Percent
Accuracy-Related Penalty	100	20	20%	78	19	24%
Trade or Business Expenses	86	19	22%	48	16	33%
Gross Income	71	12	17%	46	5	11%
Summons Enforcement	91	1	1%	26	5	19%
Collection Due Process	70	7	10%	35	10	29%
Failure to File, Failure to Pay, and Estimated Tax Penalties	53	7	13%	32	8	25%
Charitable Deductions	18	1	6%	22	7	32%
Frivolous Issues Penalty (and related appellate-level sanctions)	35	12	34%	1	1	100%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	18	0	0%	15	3	20%
Joint and Several Liability	11	6	55%	20	5	25%
Total	**553**	**85**	**15%**	**323**	**79**	**24%**

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Significant Cases

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.[1] These decisions are summarized below.

In *United States v. Windsor*, the Supreme Court held unconstitutional the Defense of Marriage Act's denial of a spousal deduction to a same-sex couple in computing the federal estate tax.[2]

Edith Windsor and her same-sex spouse, Thea Spyer, long-time New York residents, were married in Canada in 2007. Spyer died in 2009, leaving her entire estate to Windsor. Because of the Defense of Marriage Act (DOMA),[3] which prevented them from being treated as married under federal law, Windsor did not qualify for the marital deduction under IRC § 2056(a). Windsor paid the estate tax (in her capacity as executor) and filed a claim for refund. The IRS denied the claim, concluding that under DOMA, Windsor was not a "surviving spouse." Windsor then filed suit, seeking a refund and a declaration that DOMA violates the Equal Protection Clause of the Fifth Amendment of the U.S. Constitution.

After concluding that the couple's marriage would be recognized under New York state law and that Windsor was entitled to a refund, the United States District Court for the Southern District of New York declared that section three of DOMA violated the Equal Protection Clause of the U.S. Constitution.[4] Both the U.S. Court of Appeals for the Second Circuit[5] and the Supreme Court[6] agreed that section three of DOMA is unconstitutional.

In support of its holding, the Supreme Court reasoned that by history and tradition, the regulation of marital relations is virtually within the exclusive providence of the states, necessarily diminishing federal authority in this area. It discussed how section three of DOMA has the impermissible principal purpose and effect of identifying and making unequal a subset of state-sanctioned marriages. Moreover, it observed that DOMA forces same-sex couples to live as married for the purpose of state law but unmarried for the purpose of federal law, thus diminishing the stability and predictability of basic personal relations that New York and other states found it proper to acknowledge and protect.

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1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2012, and ending on May 31, 2013. For purposes of this section of the report, we generally use the same time period.

2 *United States v. Windsor*, 133 S. Ct. 2675 (2013), *aff'g* 699 F.3d 169 (2d Cir. 2012), *aff'g* 833 F. Supp. 2d 394 (S.D.N.Y. 2012) [hereinafter *Windsor*]. The same issues arose in *Gill v. Office of Pers. Mgmt.*, 699 F. Supp. 2d 374 (D. Mass. 2010), *aff'd sub. nom. Massachusetts v. U.S. Dep't. of Health & Human Servs.*, 682 F.3d 1 (1st Cir. 2012) [hereinafter *Gill*]. For prior coverage of *Gill and Windsor*, see National Taxpayer Advocate 2010 Annual Report to Congress 418, 426-27 (discussing *Gill*) and National Taxpayer Advocate 2012 Annual Report to Congress 564, 567-70 (discussing *Gill* and *Windsor*).

3 For purposes of federal law, section three of DOMA defines "marriage" as "a legal union between one man and one woman as husband and wife," and "spouse" as "a person of the opposite sex who is a husband or a wife." Defense of Marriage Act, Pub. L. No. 104-199, § 3(a), 110 Stat. 2419 (1996) (codified at 1 U.S.C. § 7).

4 *Windsor*, 833 F. Supp. 2d at 406.

5 *Windsor*, 699 F.3d at 188.

6 *Windsor*, 133 S. Ct. at 2696.

This case is particularly significant for tax purposes because every federal statute (including the tax code) that refers to "marriage" or a "spouse" will no longer be tied to the unconstitutional definition provided by DOMA. As Justice Scalia observes in his dissent, this leaves many unanswered questions:[7]

> Imagine a pair of women who marry in Albany and then move to Alabama, which does not 'recognize as valid any marriage of parties of the same sex'… When the couple files their next federal tax return, may it be a joint one? Which State's law controls, for federal-law purposes: their State of celebration (which recognizes the marriage) or their State of domicile (which does not)? (Does the answer depend on whether they were just visiting in Albany?) Are these questions to be answered as a matter of federal common law, or perhaps by borrowing a State's choice-of-law rules? If so, *which* State's? And what about States where the status of an out-of-state same-sex marriage is an unsettled question under local law?[8]

The case will also have an immediate effect on the IRS because many same sex-couples are also likely to amend their returns to change their filing status.[9]

In *PPL Corp. v. Commissioner*, the Supreme Court held that a taxpayer was entitled to a foreign tax credit for the payment of a United Kingdom windfall tax because, in substance, it was a tax on income, notwithstanding its form as a tax on value.[10]

After the United Kingdom (U.K.) privatized 32 then-public utilities between 1984 and 1996, managers quickly cut costs, reaping higher-than-expected profits. In 1997, the U.K. enacted a one-time "windfall tax" to recoup excess profits.

PPL, part owner of a privatized U.K. company subject to the windfall tax, claimed a credit for its share of the windfall tax on its 1997 federal income tax return. PPL relied on IRC § 901(b)(1), which states that any "income, war profits, and excess profits taxes" paid overseas are creditable against U.S. income taxes. A foreign tax is creditable if its "predominant character" is that of an "income tax in the U.S. sense."[11] A foreign tax's predominant character is that of a U.S. income tax if it "is likely to reach net gain in the normal circumstances in which it applies."[12]

In form, the windfall tax was based on the difference between each company's "profit-making value" and "flotation value." It was computed using a complicated valuation formula that incorporated profits, but the tax was not directly imposed on income or profits. However, PPL reasoned that the tax formula could be algebraically recomputed as a tax on income or profits, and that it would reach net gain under normal circumstances. Thus, it argued the windfall tax was creditable.

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7 For further discussion of implementation issues, see Most Serious Problem: *Domestic Partners and Same-Sex Couples Need Federal Tax Guidance, supra*.

8 *Windsor*, 133 S. Ct. at 2675.

9 For a discussion of unanswered federal tax questions posed by state laws governing domestic partnerships, see National Taxpayer Advocate 2010 Annual Report to Congress 211 (Most Serious Problem: *State Domestic Partnership Laws Present Unanswered Federal Tax Questions*); National Taxpayer Advocate 2012 Annual Report to Congress 449 (Status Update: *Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses*). The government recently issued Notice 2013-61, and Revenue Ruling 2013-17, which address some of these questions.

10 *PPL Corp. v. Comm'r*, 133 S. Ct. 1897 (2013), *rev'g* 665 F.3d 60 (3d Cir. 2011), *rev'g* 135 T.C. 304 (2010) [hereinafter *PPL*].

11 Treas. Reg. § 1.901-2(a)(1)(ii) (as amended in 2013).

12 Treas. Reg. § 1.901-2(a)(3)(i) (as amended in 2013).

The IRS rejected PPL's claim. It reasoned that any algebraic rearrangement of the windfall tax was improper. The Tax Court disagreed with the IRS,[13] but the U.S. Court of Appeals for the Third Circuit reversed.[14] In a related case, the U.S. Court of Appeals for the Fifth Circuit held the U.K. windfall tax was creditable.[15] In holding in favor of PPL, the Supreme Court agreed with the Fifth Circuit's view that the tax was creditable.

The Supreme Court reasoned that foreign tax creditability depends not on the way a foreign government characterizes its tax, but on its economic substance. For most of the affected companies, the tax formula's substantive effect was to impose a tax on all profits above a threshold. Thus, the Supreme Court held the U.K. windfall tax was creditable against PPL's U.S. income tax.

This case is significant because the IRS argued that form should govern the result rather than substance. In other contexts, the IRS usually argues that economic substance controls tax treatment and vigorously opposes arguments that form should govern.[16]

In *Historic Boardwalk Hall, LLC v. Commissioner*, the U.S. Court of Appeals for the Third Circuit held that an investor was not a bona fide partner in a partnership and could not claim flow-through tax credits because the investor lacked a meaningful stake in the partnership's success or failure.[17]

The New Jersey Sports and Exposition Authority (NJSEA) and Pitney Bowes, Inc. (PB) formed Historic Boardwalk Hall, LLC (HBH), to renovate the East Hall, a popular convention center in Atlantic City, New Jersey. HBH allocated certain rehabilitation expenditures to PB, allowing PB to claim historic rehabilitation tax credits (HRTC) under IRC § 47.[18] Purchase and sale options limited the risk to PB and essentially guaranteed a three-percent return on its investment in addition to the tax credits.

The IRS disallowed PB's rehabilitation tax credits, arguing that the HBH partnership was a sham, lacked economic substance, and was not really a partnership, but rather a vehicle to allow NJSEA to impermissibly sell tax credits to PB.

The Tax Court disagreed, sustaining the allocation of the credits to PB.[19] In its view, the parties intended to form a partnership for a legitimate business purpose (*i.e.*, to rehabilitate the East Hall), and PB's motivation was not limited to the credits.[20] It also expected a three percent return. Moreover, PB's investment

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13 *PPL*, 135 T.C. 304 (2010).

14 *PPL*, 665 F.3d 60 (3d Cir. 2011), *rev'g* 135 T.C. 304 (2010).

15 *Entergy Corp. v. Comm'r*, 683 F.3d 233 (5th Cir. 2012), *aff'g* T.C. Memo. 2010-197. Entergy Corporation was an owner of one of the 32 companies that were privatized. This circuit split created the possibility that similarly situated competitors in the same industry could have received different federal income tax credits based solely on which circuit's precedent applied.

16 Substance over form arguments may take on even greater significance now that a taxpayer may be subject to a strict liability penalty of up to 40 percent of any underpayment (or refund claim) resulting from a transaction that lacks economic substance or fails to meet the requirements of "any similar rule of law." Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1409, 124 Stat. 1029, 1067 (codified at IRC § 7701(o), 6662(b)(6), 6662(i), and 6676(c) and applicable to transactions entered into after March 30, 2010, the date of enactment). *See also* IRC § 6664(d)(2) (no reasonable cause exception for transactions lacking economic substance).

17 *Historic Boardwalk, LCC v. Comm'r*, 694 F.3d 425 (3d Cir. 2012), *rev'g and remanding* 136 T.C. 1 (2011), *cert. denied*, 133 S. Ct. 2734 (2013) [hereinafter *Boardwalk*].

18 IRC § 47 allows a taxpayer to claim a tax credit equal to 20 percent of the qualified rehabilitation expenditures with respect to a certified historic structure.

19 *Boardwalk*, 136 T.C. 1 (2011).

20 *Boardwalk*, 136 T.C. 24 (2011).

had a potential for loss. Accordingly, it concluded that PB was a partner, HBH was a partnership, and the arrangement had economic substance.[21]

The U.S. Court of Appeals for the Third Circuit disagreed, reversing the Tax Court. The Third Circuit assumed that HBH had economic substance, but concluded that PB was not a bona fide partner.[22] It reasoned that PB's investment was more like debt than equity because PB had no meaningful downside risk or potential for gain in excess of its three percent return. NJSEA had even agreed to reimburse PB for any disallowed HRTCs. Moreover, NJSEA was financially secure and able to complete the project without PB, minimizing the risk the project would not be completed or that it would not be able to honor its obligations to PB.[23]

This decision is significant because it increases the cost and complexity of using partnerships to sell tax credits.[24] While hindering the sale of tax credits likely promotes respect for the tax system, it may also reduce the attractiveness of the credits. According to a consulting firm cited by the U.S. Court of Appeals for the Third Circuit, tax-exempt owners of historic properties (like NJSEA) could have expected an investor to pay $.80 to $.90 per dollar of HRTC.[25] This percentage has likely declined as a result of the court's decision, especially now that an additional penalty may apply to transactions deemed to lack economic substance.[26]

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In *Shockley v. Commissioner*, the U.S. Court of Appeals for the Eleventh Circuit held that a protective petition filed with the U.S. Tax Court by persons without actual or apparent authority to represent the taxpayer nonetheless suspended the taxpayer's period of limitations on assessment.[27]

After an audit of the Shockley Communications Corporation's (SCC) 2001 return, the IRS timely mailed a statutory notice of deficiency (SNOD) to SCC to the address shown on the return. SCC did not file a petition with the U.S. Tax Court to dispute the deficiency.

The IRS simultaneously mailed a duplicate SNOD to the Shockleys (SCC's former officers and shareholders), even though the Shockleys no longer had authority to act for SCC. During 2001, another company purchased all the shares of SCC and the Shockleys resigned from their positions. The Shockleys filed a protective petition, alleging that the SNOD they received, which identified both them and SCC as the taxpayer, was invalid because they were not the taxpayer. In addition, the Shockleys alleged that the

21 *Boardwalk*, 136 T.C. 29-30 (2011).

22 *Boardwalk*, 694 F.3d at 449-63. The court cited *TIFD III-E, Inc. v. United States*, 459 F.3d 220 (2d Cir. 2006) (concluding nontaxable foreign banks, which were allocated most of the partnership's taxable income but that did not share in its business risks, were not partners for tax purposes), and *Virginia Historic Tax Credit Fund 2001 LP v. Comm'r*, 639 F.3d 129 (4th Cir. 2011) (holding that those who invested in a partnership in exchange for an allocation of state tax credits without assuming meaningful business risks did not contribute funds to the partnership as partners, but rather paid to purchase tax credits).

23 Although "mindful of Congress's goal of encouraging rehabilitation of historic buildings," the court objected to the "prohibited sale of tax credits" presented by this case. *Boardwalk*, 694 F.3d at 462-63.

24 In light of the new penalty applicable to transactions that lack economic substance (cited above), the decision may also be significant because neither court adopted the IRS's argument that the transaction had no economic substance.

25 *Boardwalk*, 694 F.3d at 434.

26 If policymakers want to provide an incentive to rehabilitate historic properties, this may be an opportune time to reevaluate whether the HRTC is the most effective method for doing so. For a more in-depth discussion, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-119 (Research Study: *Evaluate the Administration of Tax Expenditures*) and National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (Research Study: *Running Social Programs Through the Tax System*).

27 *Shockley v. Comm'r*, 686 F.3d 1228 (11th Cir. 2012), *rev'g and remanding* T.C. Memo. 2011-96.

SNOD was invalid because it was sent to their personal residence and not the address of SCC. The Tax Court dismissed the case on the basis of the Shockleys' unopposed position that they lacked capacity to pursue it on SCC's behalf.

Next, the IRS assessed SCC's liability, issued notices of transferee liability to the Shockleys, and sought to secure payment from them. The Shockleys petitioned the Tax Court, arguing that the notices of transferee liability were not timely.[28]

The IRS generally has to issue a notice of transferee liability within one year after the end of the period of limitations on assessment (POL).[29] The POL generally ends three years after a return is filed.[30] However, the POL is suspended for the 90-day (or 150-day) period during which the taxpayer is permitted to file a petition in the Tax Court, plus 60 days.[31] This suspension is further extended if "a proceeding in respect of the deficiency is placed on the docket of the Tax Court."[32] Thus, the notice of transferee liability would not have been timely unless the Shockleys' earlier protective petition extended the POL with respect to SCC.

The Tax Court held that the Shockleys' petition did not extend the POL for SCC. It first concluded that the notice the IRS sent to the Shockleys was a nullity as to SCC because the IRS did not send it to SCC's last known address. Next, it concluded that the Shockleys' petition did not give rise to "a proceeding in respect of the deficiency." It reasoned that the petition was not filed on behalf of SCC, was not in respect of a valid deficiency notice, and did not prohibit assessment against SCC. Thus, it held the notice of transferee liability was not timely.[33]

The U.S. Court of Appeals for the Eleventh Circuit reversed the Tax Court. It did not disturb the Tax Court's holding that the SNOD the Shockleys received was invalid as to SCC. However, it concluded that the Shockleys' petition was "a proceeding in respect of the [SCC] deficiency" that extended the POL. It relied primarily on the plain language of the statute and the Supreme Court's admonition to construe statutes of limitation strictly in favor of the government.[34]

This case is significant because it may suggest that anyone who files a petition with respect to an IRS notice runs the risk of extending the POL for the taxpayer, even if the IRS knows the petitioner has no actual or apparent authority to represent the taxpayer and even if the notice at issue is not a valid SNOD.[35]

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28 The Shockleys' position was consistent with the IRS's published position. *See* Rev. Rul. 88-88, 1988-2 C.B. 354 (stating if an invalid SNOD is issued, "the filing of a Tax Court petition with respect to [that notice] does not stop the running of the period of limitations under section 6503(a)."). The IRS is generally bound by its published positions. *See Rauenhorst v. Comm'r*, 119 T.C. 157 (2002) (refusing to allow the IRS to take a position contrary to its own guidance); IRM 35.7.2.1.8(8) (Aug. 11, 2004) ("Respondent may not argue against his published position"). It is unclear if the parties were aware of the IRS's published position, as we did not locate any citations to Rev. Rul. 88-88 in any of the pleadings filed in the Tax Court.

29 IRC § 6901(c).

30 IRC § 6501(a).

31 IRC § 6213(a), 6503(a)(1). This 90-day (or 150-day) period commences on the date the IRS mails the SNOD to the taxpayer. IRC § 6213(a).

32 IRC § 6503(a)(1).

33 *Shockley v. Comm'r*, T.C. Memo. 2011-96.

34 *Shockley*, 686 F.3d at 1235-1238 (quotations omitted), *rev'g* T.C. Memo. 2011-96.

35 As of this writing, however, the case is still pending before the Tax Court on remand. For further commentary on this case, see Andy Roberson and Kevin Spencer, *11th Circuit Allows Invalid Notice to Suspend Assessment Period*, 2012 TNT 153-3 (July 24, 2012).

In *In re: Grand Jury Subpoena*, the U.S. Court of Appeals for the Fifth Circuit held that the Fifth Amendment privilege against self-incrimination does not apply to the disclosure of foreign bank accounts on Form TD F 90–22.1, Report of Foreign Bank and Financial Accounts (FBAR).[36]

The target of a grand-jury investigation (the "witness") refused to comply with a government subpoena seeking records of foreign bank accounts that he was required to keep and report on Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts*, pursuant to the Bank Secrecy Act (BSA). The witness cited his Fifth Amendment privilege against self-incrimination. The government moved to compel production of the records, arguing that the "Required Records Doctrine," which is in effect an exception to the privilege against self-incrimination, was applicable. The U.S. District Court for the Southern District of Texas denied the motion, and the government appealed.

The U.S. Court of Appeals for the Fifth Circuit reversed, concluding that the Required Records Doctrine applied. Under the doctrine, the government may require that certain records be kept and later produced without implicating the privilege against self-incrimination. The doctrine "does not empower the government to command every citizen to keep a diary of their crimes under the guise of regulation."[37] Rather, it permits the government to inspect records it requires an individual to keep as a condition of voluntarily participating in a regulated activity.[38] The doctrine may apply when (1) the purposes of the inquiry are "essentially regulatory" rather than criminal, (2) the information is of a kind which the regulated party has "customarily kept," and (3) the records are assumed to have "public aspects" that render them analogous to public documents.

The witness argued that because a primary purpose of the BSA is to fight crime, it fails the requirement to be "essentially regulatory." However, the court concluded that the BSA satisfies the requirement because another purpose of the BSA is to support regulatory investigations, as evidenced by the fact that BSA information is distributed to several civil and regulatory agencies.

The witness did not contest that bank account information is "customarily kept." However, he argued that because those subject to the BSA are not regulated and have not engaged in activities with the public or in the public sphere, their banking records lack "public aspects."[39] The court rejected this reasoning. It observed that under the witness's logic, Congress could only require those with foreign accounts to keep and produce records of the accounts if it first placed additional substantive regulatory restrictions on them to inject them with public aspects. Moreover, the court observed that records generally considered private (*e.g.*, medical records) can possess public aspects. It reiterated that the Treasury Department shares foreign bank account information with a number of different agencies, imbuing it with "public aspects." Thus, it concluded the privilege against self-incrimination was not a defense to the subpoena because the Required Records Doctrine was applicable.[40]

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36 *In re: Grand Jury Subpoena*, 696 F.3d 428 (5th Cir. 2012). Form TD F 90-22.1 was subsequently replaced by Form 114.

37 *Id*. at 433.

38 For example, the Supreme Court held that the government may require a wholesaler of fruit to keep and produce certain records to enable enforcement of the Emergency Price Control Act, which was passed following World War II to prevent inflation and price gouging. *Shapiro v. United States*, 335 U.S. 1 (1948).

39 *In re: Grand Jury Subpoena*, 696 F.3d at 435.

40 The court also mentioned that affirming the district court would have created a circuit split. *In re: Grand Jury Subpoena*, 696 F.3d at 431 (citing *In re: Special February 2011-1 Grand Jury Subpoena Dated September 12, 2011*, 691 F.3d 903 (7th Cir. 2012) and *In re: Grand Jury Investigation M.H. v. United States*, 648 F.3d 1067 (9th Cir. 2011)).

This case is significant because it suggest the Fifth Amendment privilege against self-incrimination does not apply to a wide range of private information that the IRS may require taxpayers to keep in connection with their tax returns.[41]

In *United States v. Quality Stores, Inc.*, the United States Court of Appeals for the Sixth Circuit held that supplemental unemployment benefit (SUB) payments to involuntarily terminated employees are not "wages" subject to Federal Insurance Contributions Act (FICA) taxes.[42]

Quality Stores made payments to employees who were involuntarily terminated in connection with its bankruptcy and discontinuance of operations, as required by its supplemental unemployment benefit (SUB) plans. It treated the payments as wages on Forms W-2, and withheld and paid employment taxes on them. Quality Stores and some of its employees sought a refund of the FICA tax, arguing that the payments were not wages, but rather SUB payments that were not taxable under FICA. The IRS denied the claim because in its view only certain SUB payments — not those at issue — qualify for a narrow exception to FICA described in a series of Revenue Rulings.[43] The bankruptcy court agreed with Quality Stores, as did the district court, and the United States Court of Appeals for the Sixth Circuit, concluding that the SUB payments were not wages for purposes of either FICA or federal income tax (FIT).

Under the court's analysis, Congress adopted a definition of "wages" for FIT purposes that is nearly identical to the definition of "wages" included in FICA. In its 1981 decision in *Rowan*, the Supreme Court confirmed that the term "wages" has the same meaning in both statutes.[44] IRC § 3402(o) states that for FIT purposes a SUB payment is "treated as if it were a payment of wages," and by implication, not actually wages.[45] Legislative history indicates that SUB payments "do not constitute wages."[46] According to the court, Congress allowed SUB payments to be treated as wages under IRC § 3402(o) to facilitate FIT withholding for taxpayers. Thus, the court held that SUB payments are not wages for either FIT or FICA purposes.

The IRS agreed that under IRC § 3402(o), SUB payments are not wages for purposes of FIT. However, it argued that they are wages for purposes of FICA. It reasoned that Congress legislatively superseded *Rowan* when it enacted the "decoupling amendment" in 1983. It cited legislative history and cases indicating that Congress intended the definition of wages to be more broadly construed under FICA.

According to the court, however, the text of the decoupling amendment simply authorized Treasury to promulgate regulations (not administrative guidance) to provide for different exclusions from wages under FICA than under the FIT withholding laws. But, the government has not issued any.

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41 However, some have argued that a person can still assert privilege with respect to certain line items on the FBAR form. *See* Edward M. Robbins, *The Fifth Amendment FBAR Lives!*, 2013 TNT 123-9 (June 26, 2013).

42 *United States v. Quality Stores, Inc.,* 693 F.3d 605 (6th Cir. 2012), *aff'g* 424 B.R. 237 (W.D. Mich. 2010), *aff'g* 383 B.R. 67 (Bankr. W.D. Mich. 2008), *cert. granted*, 82 U.S.L.W. 3177 (2013) [hereinafter *Quality Stores*].

43 *Quality Stores*, 693 F.3d at 619. *See, e.g.*, Rev. Rul. 56-249, 1956-1 C.B. 488 and Rev. Rul. 90-72, 1990-2 C.B. 211 (providing an exception for a stream of payments coordinated with the receipt of unemployment compensation, but not for a lump-sum payment).

44 *Quality Stores*, 693 F.3d at 613 (citing *Rowan Cos. v. United States*, 452 U.S. 247 (1981)).

45 If the SUB payments were actually wages, then some employees might lose the very state unemployment benefits that the SUB payments were intended to supplement. *Id*. at 617.

46 *Quality Stores*, 693 F.3d at 612 (quotations omitted).

The court also distinguished a holding by the Federal Circuit in *CSX* that reached a different conclusion as inconsistent with the Federal Circuit's own precedent.[47] This case is significant because it creates a split of authority, which the Supreme Court has agreed to review, regarding whether SUB payments are subject to FICA, even if they do not meet the exception described in the IRS's administrative guidance. It has also prompted those who made or received SUB payments to file claims to recover FICA taxes.[48]

In *Allcorn v. Commissioner*, the U.S. Tax Court held the IRS has discretionary authority to abate interest on an excessive refund even if the refund was caused, in part, by taxpayer error.[49]

Mr. Allcorn mistakenly reported $4,000 in estimated tax payments as withholding on line 62 (federal income tax withheld) rather than on line 63 (estimated tax payments) of his 2008 Form 1040, *U.S. Individual Income Tax Return*. He included a note with his return, which explained: "Additional $4,000 was sent with Form 1040-ES." He correctly reported his total payments on Line 71.

The IRS double-counted Mr. Allcorn's $4,000 payment and sent him a refund of $4,000 more than he requested. When the IRS discovered its error, it demanded $4,514 — the $4,000 plus a $300 late payment penalty and $214 in interest. The IRS abated the penalty, but declined to abate the interest.

Pursuant to IRC § 6602, when the IRS issues an erroneous refund, it must charge interest on the amount. Section 6404(e)(2), however, requires the IRS to abate interest on any "erroneous refund under section 6602," provided the refund did not exceed $50,000 and the taxpayer (or a related party) had not caused the refund. Mr. Allcorn believed he had not caused the $4,000 erroneous refund, and thus petitioned the Tax Court with respect to the IRS's determination not to abate the interest.

The IRS first argued that IRC § 6404(e)(2) did not apply because the payment was not an "erroneous refund under section 6602." IRC § 6602 only applies to refunds "recoverable by suit pursuant to section 7405."[50] Thus, the IRS asserted that because it could recover the refund using summary assessment procedures under IRC § 6201(a)(3) (*i.e.*, the IRS authority to make "math error" adjustments), the requirement to abate interest under IRC § 6404(e)(2) did not apply.[51] The court rejected this argument, reasoning that the IRS could have chosen to recover the erroneous refund by filing a civil suit under IRC § 7405.[52]

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47 *Id*. at 615-16 (citing *CSX Corp. v. United States*, 518 F.3d 1328 (Fed. Cir. 2008) [hereinafter *CSX*], as a decision contrary to the court's holding in *Anderson v. U.S.*, 929 F.2d 648 (Fed. Cir. 1991)). In *CSX*, the Federal Circuit concluded that "the text of section 3402(o) does not require that FICA be interpreted to exclude from 'wages' all payments that would satisfy the definition of SUB in section 3402(o)(2)(A)." *CSX*, 518 F.3d at 1342.

48 In the government's petition for a writ of certiorari, it indicated that the same issue is pending in 11 cases and more than 2,400 administrative refund claims, with a total amount at stake of more than $1 billion. *Quality Stores, petition for cert. filed*, 2013 WL 2390247 (May 31, 2013) (No. 12-1408). On October 1, 2013, the United States Supreme Court granted this petition, see 82 U.S.L.W. 3177 (2013).

49 *Allcorn v. Comm'r*, 139 T.C. 53 (2012).

50 Sections 7405(a) and (b) authorize the government to file a civil action to recover certain erroneous refunds. An erroneous refund suit is not, however, the sole means for the IRS to collect an erroneous refund. *See, e.g.*, CCDM 34.6.2.7(2)(a) (June 12, 2012) ("Assessable erroneous refunds may also be recovered by administrative action within the applicable period of limitation upon assessment and collection.").

51 *Allcorn*, 139 T.C. at 59.

52 *Id*. at 59-60.

Next, the IRS argued that IRC § 6404(e)(2) was inapplicable because Mr. Allcorn's error contributed to the erroneous refund. The court agreed that because of Mr. Allcorn's error, the IRS was not required to abate the interest.

However, the court went on to conclude that the IRS had discretionary authority to abate interest under IRC § 6404(e)(2), despite Mr. Allcorn's error. The court cited (1) cases applying IRC § 6404(e)(2) in situations where the taxpayer was somewhat at fault, (2) the legislative history of IRC § 6404(e)(2), which suggests Congress intended to increase the IRS's authority to abate interest, and (3) an Internal Revenue Manual provision that suggests the IRS has discretionary authority under IRC § 6404(e)(2) to abate interest on erroneous refunds in excess of the $50,000 amount provided by law.[53]

This case is significant because it clarifies the IRS's discretionary authority to abate interest on erroneous refunds under IRC § 6404(e)(2), even if taxpayer error contributes to the refund, the refund exceeds $50,000, and the IRS can recover it using summary assessment procedures (*i.e.*, math error authority).

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In *Loving v. Internal Revenue Service*, the District Court for the District of Columbia held the IRS lacked authority to issue regulations governing the conduct of registered tax return preparers, and enjoined the IRS from enforcing them.[54]

In June 2011, the Treasury Department issued regulations governing "registered tax return preparers," a previously unregulated group of 600,000 to 700,000 paid preparers.[55] In order to protect the consumers and the public fisc, the regulations require each preparer to obtain a valid preparer tax identification number (PTIN), pass a background check and an exam, pay an annual fee, and take fifteen hours of continuing education courses each year. Sabina Loving and two other preparers who had not previously been regulated by the IRS filed suit, claiming the regulations were not authorized by law and would cause them to increase prices or go out of business.

The IRS first argued that it did not need statutory authority to regulate preparers because each agency has inherent authority to regulate those who practice before it. However, the court concluded that this general authority does not apply because a specific statutory provision (*i.e.*, 31 U.S.C. § 330) defines the agency's authority.

Under the framework set forth in *Chevron*, agency regulations are entitled to deference unless they (1) contradict an unambiguous statute, or (2) adopt an unreasonable construction of it.[56] In this case, 31 U.S.C. § 330 authorizes Treasury to "regulate the practice of representatives," and to "require that the representative demonstrate…competency to advise and assist persons in presenting their cases," before

53 *Id*. at 63-66 (citing *Converse v. United States*, 839 F. Supp. 1274 (N.D. Ohio 1993); *Lindstedt v. United States*, 78 A.F.T.R.2d (RIA) 6211 (Fed. Cl. 1996); H.R. Rept. No. 99-426, at 844 (1985); and IRM 20.2.7.5(2) (Mar. 9, 2010)).

54 *Loving v. Comm'r*, 920 F. Supp. 2d 108 (D.D.C. 2013).

55 *See* T.D. 9527 (June 3, 2011), 76 Fed. Reg. ¶ 32,286, 32,299. These persons are sometimes referred to as "unenrolled" preparers. *See* Treas. Reg. § 601.502(b)(5)(iii); Rev. Proc. 81-38, 1981-2 C.B. 592. Attorneys, certified public accountants, enrolled agents and enrolled actuaries were already subject to IRS regulation under Circular 230. The National Taxpayer Advocate has long championed the regulation of return preparers as necessary to protect consumers. *See* National Taxpayer Advocate 2008 Annual Report to Congress 423 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*); National Taxpayer Advocate 2004 Annual Report to Congress 67 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270 (Legislative Recommendation: *Federal Tax Return Preparers Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*); Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31 (May 13, 2013).

56 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

admitting a "representative to practice."[57] In addition, 31 U.S.C. § 330(b) authorizes Treasury to suspend or disbar "a representative" from "practice" before the Treasury Department in certain circumstances, and also to impose a monetary penalty.

The IRS argued that the terms "practice" and "representative" are ambiguous and that it reasonably interpreted them as covering tax return preparers. Thus, the court should uphold the regulations under the second prong of *Chevron*.

The court disagreed, finding that the D.C. Circuit had previously "rejected the argument that a statute is ambiguous when it fails to define a broad term."[58] It concluded that the statute unambiguously fails to authorize the government to regulate tax return preparers — failing under the first prong of *Chevron*. According to the court, 31 U.S.C. § 330(a)(2)(D) equates "practice" with advising and assisting with the presentation of a "case," not the filing of a tax return.[59] Thus, the statutory definition of practice "makes sense only in connection with those who assist taxpayers in the examination and appeals stages of the process."[60]

Next, the court reasoned that because Congress has enacted at least ten penalties targeting specific misconduct by tax return preparers with specific sanctions, 31 U.S.C § 330(b) should not be interpreted to provide the IRS with overlapping discretion to penalize preparers for the same conduct.[61] It went on to observe that IRC § 6103(k) specifically authorizes the IRS to disclose information about violations triggering these specific penalties to state and local agencies that license, register or regulate preparers, but does not authorize the IRS to disclose violations of 31 U.S.C. § 330. One explanation for this omission, according to the court, is that 31 U.S.C. § 330 does not apply to preparers.[62]

Finally, the court observed that if the IRS's arguments were accepted, then the IRS could disbar a preparer pursuant to its authority under 31 U.S.C. § 330 for the same conduct that would enable it to seek an injunction against the preparer under IRC § 7407. Thus, an injunction would rarely be necessary. According to the court, this weighed against interpreting 31 U.S.C. § 330 as granting the IRS authority to regulate return preparers. Accordingly, the court granted Loving's motion for summary judgment, holding that the IRS lacked statutory authority to issue and enforce the regulations governing "registered tax return preparers," and enjoined the IRS from enforcing them.

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57 31 U.S.C. § 330(a)(1), (a)(2)(D).

58 *Loving*, 917 F. Supp. 2d 67, 74 (D.D.C. 2013) (citing *Goldstein v. SEC*, 451 F.3d 873, 878 (D.C. Cir. 2006)).

59 The court stated that because the law was enacted before the federal income tax, Congress could not have contemplated that it would authorize the regulation of income tax return preparers. For an alternative analysis and different conclusion, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31 (May 13, 2013). *See also* Lawrence B. Gibbs, *Loving v. IRS: Treasury's Authority to Regulate Tax Return Preparers*, 2013 TNT 203-50 (Oct. 21, 2013).

60 *Loving*, 917 F. Supp. 2d at 74. Unenrolled tax return preparers are generally authorized to represent a taxpayer before the IRS during the examination of a return that they prepared, but not before IRS appeals or collection functions. *See* 26 C.F.R. § 601.502(b)(5)(iii).

61 The court did not comment on the fact that the IRS did not have authority to impose a monetary penalty until 2004. *See* American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 822(a)(1), (b), 118 Stat. 1418, 1586-587.

62 Another explanation is that IRC § 6103 does not prevent the disclosure of sanctions under Title 31. Indeed, the IRS Office of Professional Responsibility (OPR) posts on its website sanctions imposed under Title 31, including censure, suspension or disbarment from practice before the IRS, as well as all final agency decisions following an appeal. *See, e.g.*, OPR, Announcement of Disciplinary Sanctions, http://www.irs.gov/Tax-Professionals/Enrolled-Agents/Announcements-of-Disciplinary-Sanctions. Thus, state and local agencies could simply check the OPR website on a regular basis.

The government filed a motion to suspend the injunction pending appeal. The court denied the motion but then modified the terms of the injunction.[63] On February 25, 2013, the government filed a motion for a stay pending appeal. On March 27, 2013, the U.S. District Court for the District of Columbia denied the motion for stay.[64] The government has appealed the district court's decision to the U.S. Court of Appeals for the District of Columbia Circuit. This case is significant because it will affect hundreds of thousands of tax return preparers and the taxpayers they serve.

In *Dorrance v. United States*, the United States District Court in Arizona held that a taxpayer must allocate basis between the life insurance policy and stock received when a mutual insurance carrier demutualizes.[65]

In 1995, a trust purchased policies from various mutual life insurance companies. As a policyholder it had certain ownership rights (mutual rights) normally held by stockholders, such as the right to vote and the right to receive the mutual company's "surplus" should it liquidate. Between 1998 and 2001, each of the insurance companies demutualized, distributing shares of stock (or cash in lieu of stock) to compensate for the loss of the mutual rights. The trust received stock valued at about $1.8 million, and in 2003, sold it for about $2.2 million. It reported the entire $2.2 million as gain, paid the resulting tax, and then filed for a refund, claiming that its basis should be allocated to the stock to offset the gain. The IRS did not pay the claim, and the trust filed suit.

The IRS argued that the trust did not meet its burden to prove it had paid for the mutual rights or that the stock had any basis at all. Accordingly, it should not be entitled to recover any basis in connection with the stock sale. The court rejected this argument because it concluded the trust had paid something for the mutual rights (and thus the stock) when it paid premiums for policies that included both the policy rights and mutual rights. It reasoned that if it is clear that a taxpayer is entitled to some deduction, but cannot establish the full amount claimed, it is improper to deny the deduction in its entirety.[66]

The trust argued it should recover its basis pursuant to the "open transaction" doctrine because it was impractical or impossible to allocate the basis in the mutual life insurance policy between the property it received in the demutualization transaction (*i.e.*, the stock and non-mutual policy).[67] If applicable, the doctrine would allow the trust to use its full basis in the policy to offset any gain on the stock sale before allocating any remaining basis to the non-mutual policy.

The court rejected this argument. While acknowledging that the Court of Federal Claims had concluded in the *Fisher* case that the open transaction doctrine applied to a demutualization transaction, it observed that neither of the parties in *Fisher* analyzed how much the taxpayer paid for the mutual rights — with the IRS arguing they paid nothing and the taxpayer arguing the amount could not be determined.[68]

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63 *See Loving*, 920 F. Supp. 2d 108 (D.D.C. 2013) (modifying the injunction to make clear that the IRS is not required to suspend the PTIN program and not required to shut down all of its testing and continuing-education centers).

64 *See Government Files Brief in D.C. Circuit Court in Return Preparer Oversight Case*, 2013 TNT 62-20 (Apr. 3, 2013).

65 *Dorrance v. United States*, 877 F. Supp. 2d 827 (D. Ariz. 2012).

66 *Id*. at 831 (citing *Cohan v. Comm'r*, 39 F.2d 540, 543 (2d Cir.1930)).

67 *See, e.g., Burnet v. Logan*, 283 U.S. 404 (1931); *Pierce v. United States*, 49 F. Supp. 324 (Ct. Cl. 1943).

68 *Fisher v. United States*, 82 Fed. Cl. 780 (2008), *aff'd without opinion*, 333 F. App'x 572 (Fed. Cir. 2009) [hereinafter *Fisher*]. For prior coverage of *Fisher*, see National Taxpayer Advocate 2008 Annual Report to Congress 468-469 (speculating: "We wonder if the [Fisher] court would have reached a different conclusion if the IRS's expert had valued the ownership components of the policy at an amount greater than zero.").

The court was also concerned that open transaction treatment would produce a windfall. In effect, all of the basis would be allocated to the stock — the asset that would be sold — while the asset that does not require basis — the policy — would have its basis reduced.[69]

Moreover, unlike the taxpayer in *Fisher* who had received cash at the time of the demutualization, the taxpayer in this case received stock that had appreciated before being sold. Thus, even gains on the stock following the demutualization could be offset by basis increases — increases resulting from post-demutualization payments on the policy – if it applied the open transaction doctrine.

Finally, the court reasoned that because the value of both the mutual rights and the policy itself could be determined at the time of the demutualization, there was no concern that the taxpayer might pay tax on a transaction that might later show a loss. Thus, it concluded that the parties must equitably apportion basis between the stock and the policy pursuant to Treasury Regulation § 1.61-6(a).

The district court later amended its opinion, holding the trust's basis was about $1 million, which represented the value of shares received to compensate for relinquishing voting rights and for past (but not future) contributions to surplus, as determined by the companies.[70]

This case is significant because it highlights how the tax treatment of stock or cash received in a demutualization transaction remains unsettled.[71] It suggests that taxpayers who receive stock (or cash) from mutual insurance companies in demutualization transactions must report taxable gains by allocating basis between the policy and the mutual rights (*i.e.*, stock or cash), rather than deferring gains under the open transaction doctrine.

In *United States v. McBride*, the United States District Court in Utah held that a taxpayer's failure to file Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, was willful because the government showed by a preponderance of the evidence that the taxpayer either knew or, deliberately or with reckless disregard, avoided learning of his filing requirement.[72]

Mr. McBride, a partner in a U.S. business, hired a financial management firm to move business profits offshore to avoid U.S. income tax. The firm's promotional materials informed Mr. McBride about the FBAR reporting requirements. When presented with the tax avoidance plan, Mr. McBride's first reaction was that "this is tax evasion." Yet, he did not obtain a second opinion or disclose his interest in the offshore accounts to his accountant or tax return preparer. He checked the box on Schedule B of his federal income tax returns "no" to indicate that he had no interests in foreign accounts exceeding the reporting threshold. The IRS imposed a civil penalty against Mr. McBride for willfully failing to file an FBAR, and ultimately sued in district court to collect the penalty.

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69 *Dorrance*, 877 F. Supp. 2d at 834 (quoting commentators).

70 *Dorrance*, 111 A.F.T.R.2d (RIA) 1280 (D. Ariz. 2013).

71 *See, e.g.*, Mark Persellin and Kent Royalty, *The Demutualized Stock Basis Conundrum: Update And Planning Implications*, Corporate Taxation, 39 WGL-CTAX 17 (Nov./Dec. 2012). Although the IRS has not issued an Action on Decision, it disagrees with *Fisher* and had been holding claims for refund pending a decision in *Dorrance*. *See Cadrecha v. United States*, 104 Fed. Cl. 296 (2012); Letter from IRS Associate Chief Counsel (Income Tax & Accounting) to Senator Harkin (May 23, 2011), *reprinted as*, IRS Will Not Refund Tax Paid on Sale of Life Insurance Company Stock, 2011 TNT 180-28 (Sept. 16, 2011); IMRS 11-0001391 (2011), http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Issues-Closed-in-Calendar-Year-2011-Sorted-by-Subject. It is now denying them. *See Reuben v. United States*, 111 A.F.T.R.2d (RIA) 620 (D. Cal. 2013).

72 *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012).

The court first decided that the U.S. has the burden to prove Mr. McBride's violation was willful by only a "preponderance of evidence," rather than by the higher "clear and convincing evidence" standard that applies to fraud.[73] The court also stated that the IRS could establish willfulness on the basis of reckless conduct, such as making a conscious effort to avoid learning about the FBAR reporting requirements — requirements explained on the face of a tax return (*i.e.*, willful blindness).

In this case, however, the IRS met is burden by showing that Mr. McBride had actual knowledge of the FBAR filing requirements because his financial management firm had informed him about them. Mr. McBride testified that the purpose of the scheme was to avoid disclosure and reporting the existence of the foreign interests, because "if you disclose the accounts on the form, then you pay tax on them,"[74] which went against the purpose of the scheme. The court also found that he deliberately withheld information about the accounts from his preparer and accountant. It reasoned that Mr. McBride either knew he was violating the FBAR reporting requirements or intentionally avoided learning whether he was violating the FBAR reporting requirements. Thus, the court held that Mr. McBride's violation was willful.

This case is significant because it confirms that the government has the burden to prove its case by a preponderance of the evidence when it seeks to impose the penalty applicable to willful FBAR violations. It may also suggest that the government can meet its burden if it can show that the taxpayer intentionally avoided learning about whether his or her actions violated the FBAR reporting requirements. Because the government established Mr. McBride *actually* knew about the FBAR reporting requirements and deliberately concealed the offshore accounts from his accountant and preparer, however, this conclusion might be characterized as dicta. Notably, this case does not stand for the proposition that if the government establishes a taxpayer signed a return, which failed to report the existence of an interest in a foreign account on Schedule B, then it has automatically met its burden to prove willfulness.[75]

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73 IRC § 7454(a); Tax Court Rule 142(b) ("In any case involving the issue of fraud with intent to evade tax, the burden of proof in respect of that issue is on the respondent, and that burden of proof is to be carried by clear and convincing evidence. See Code sec. 7454(a).").

74 *McBride*, 908 F. Supp. 2d at 1199.

75 Analysis in other cases may support that conclusion, however. *See, e.g., United States v. Sturman*, 951 F.2d 1466, 1477 (6th Cir. 1991) ("It is reasonable to assume that a person who has foreign bank accounts would read the information specified by the government in tax forms. Evidence of acts to conceal income and financial information, combined with the defendant's failure to pursue knowledge of further reporting requirements as suggested on Schedule B, provide a sufficient basis to establish willfulness on the part of the defendant."). *But see* IRM 4.26.16.4.5.3(6) (July 1, 2008) ("The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness.").

MLI #1 Accuracy-Related Penalty Under IRC §§ 6662(b)(1) and (2)

SUMMARY

Internal Revenue Code (IRC) §§ 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations caused an underpayment of tax, or if an underpayment exceeded a computational threshold called a substantial understatement, respectively. IRC § 6662(b) also authorizes the IRS to impose five other accuracy-related penalties.[1] We did not analyze these other accuracy-related penalties because during our review period of June 1, 2012, through May 31, 2013, taxpayers litigated these penalties less frequently than the negligence and substantial understatement penalties.[2]

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PRESENT LAW

The amount of an accuracy-related penalty equals 20 percent of the portion of the underpayment attributable to the taxpayer's negligence or disregard of rules or regulations or to a substantial understatement.[3] The IRS may assess penalties under both IRC § 6662(b)(1) and IRC § 6662(b)(2), but the total penalty rate cannot exceed 20 percent (*i.e.*, the penalties are not "stackable").[4] Generally, taxpayers are not subject to the accuracy-related penalty if they establish that they had reasonable cause for the underpayment and acted in good faith.[5] In addition, a taxpayer will be subject to the negligence component of the penalty only on the portion of the underpayment attributable to negligence. If a taxpayer wrongly reports multiple items of income, for example, some errors may be justifiable mistakes while others might be the result of negligence; the penalty applies only to the latter.

Negligence

The IRS may impose the IRC § 6662(b)(1) negligence penalty if it concludes that a taxpayer's negligence or disregard of the rules or regulations caused the underpayment. Negligence is defined to include "any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard."[6] Negligence includes a failure to keep adequate books and records or to substantiate items that gave rise to the underpayment.[7] Strong indicators of negligence include instances where a taxpayer failed to report income on a tax return that a payor reported on

1 IRC § 6662(b)(3) authorizes a penalty for any substantial valuation misstatement for income taxes; IRC § 6662(b)(4) authorizes a penalty for any substantial overstatement of pension liabilities; IRC § 6662(b)(5) authorizes a penalty for any substantial valuation understatement of estate or gift taxes; IRC § 6662(b)(6) authorizes a penalty when the IRS disallows the tax benefits claimed by the taxpayer when the transaction lacks economic substance; and IRC § 6662(b)(7) authorizes a penalty for any undisclosed foreign financial asset understatement.

2 Note, however, that there has been some recent significant litigation involving IRC § 6662(h) (the 40 percent penalty in the case of a gross valuation misstatement). *See, e.g., United States v. Woods*, 471 F. App'x 320 (5th Cir. 2012), *aff'g per curiam* 794 F. Supp. 2d 714 (W.D. Tex. 2011), *cert. granted*, 133 S. Ct. 1632 (Mar. 25, 2013); *Nevada Partners Fund L.L.C. v United States*, 111 A.F.T.R.2d (RIA) 2416 (5th Cir. 2013), *aff'g* 714 F. Supp. 2d 598 (S.D. Miss. 2010).

3 IRC § 6662(b)(1) (negligence/disregard of rules or regulations) and IRC § 6662(b)(2) (substantial understatement).

4 Treas. Reg. § 1.6662-2(c). The penalty rises to 40 percent if any portion of the underpayment is due to a "gross valuation misstatement." *See* IRC § 6662(h)(1).

5 IRC § 6664(c)(1).

6 IRC § 6662(c).

7 Treas. Reg. § 1.6662-3(b)(1).

an information return as defined in IRC § 6724(d)(1),[8] or failed to make a reasonable attempt to ascertain the correctness of a deduction, credit, or exclusion.[9] The IRS can also consider various other factors in determining whether the taxpayer's actions were negligent.[10]

Substantial Understatement

Generally, an "understatement" is the difference between (1) the correct amount of tax and (2) the tax reported on the return, reduced by any rebate.[11] Understatements are reduced by the portion attributable to (1) an item for which the taxpayer had substantial authority, or (2) any item for which the taxpayer, in the return or an attached statement, adequately disclosed the relevant facts affecting the item's tax treatment and the taxpayer had a reasonable basis for the tax treatment.[12] For individuals, the understatement of tax is substantial if it exceeds the greater of $5,000 or ten percent of the tax that must be shown on the return.[13] For corporations (other than S corporations or personal holding companies), an understatement is substantial if it exceeds the lesser of ten percent of the tax required to be shown on the return (or, if greater, $10,000), or $10,000,000.[14]

For example, if the correct amount of tax is $10,000 and an individual taxpayer reported $6,000, the substantial underpayment penalty under IRC § 6662(b)(2) would not apply because although the $4,000 shortfall is more than ten percent of the correct tax, it is less than the fixed $5,000 threshold. Conversely, if the same individual reported a tax of $4,000, the substantial understatement penalty would apply because the $6,000 shortfall is more than $5,000, which is the greater of the two thresholds.

Reasonable Cause

The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.[15] A reasonable cause determination takes into account all of the pertinent facts and circumstances.[16] Generally, the most important factor is the extent to which the taxpayer made an effort to determine the proper tax liability.[17]

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8 IRC § 6724(d)(1) defines an information return by cross-referencing various other sections of the Code that require information returns (*e.g.*, IRC § 6724(d)(1)(A)(ii) cross-references IRC § 6042(a)(1) for reporting of dividend payments).

9 Treas. Reg. § 1.6662-3(b)(1)(i)-(ii).

10 These factors include the taxpayer's history of noncompliance; the taxpayer's failure to maintain adequate books and records; actions taken by the taxpayer to ensure the tax was correct; and whether the taxpayer had an adequate explanation for underreported income. Internal Revenue Manual (IRM) 4.10.6.2.1, *Negligence* (May 14, 1999).

11 IRC § 6662(d)(2)(A)(i)-(ii).

12 IRC § 6662(d)(2)(B)(i)-(ii). No reduction is permitted, however, for any item attributable to a tax shelter. *See* IRC § 6662(d)(2)(C)(i).

13 IRC § 6662(d)(1)(A)(i)-(ii).

14 IRC § 6662(d)(1)(B)(i)-(ii).

15 IRC § 6664(c)(1).

16 Treas. Reg. § 1.6664-4(b)(1).

17 *Id*.

Penalty Assessment and the Litigation Process

In general, the IRS proposes the accuracy-related penalty as part of its examination process[18] and through its Automated Underreporter (AUR) computer system.[19] Before a taxpayer receives a notice of deficiency, he or she has opportunities to engage the IRS on the merits of the penalty.[20] Once the IRS concludes an accuracy-related penalty is warranted, it must follow deficiency procedures (*i.e.*, IRC § 6211-6213).[21] Thus, the IRS must send a notice of deficiency with the proposed adjustments and inform the taxpayer that he or she has 90 days to petition the United States Tax Court to challenge the assessment.[22] Alternatively, taxpayers may seek judicial review through refund litigation.[23] Under certain circumstances, a taxpayer can request an administrative review of IRS collection procedures (and the underlying liability) through a Collection Due Process (CDP) hearing.[24]

Burden of Proof

In court proceedings, the IRS bears the initial burden of production regarding the accuracy-related penalty.[25] The IRS must first present sufficient evidence to establish that the penalty is warranted. The burden of proof then shifts to the taxpayer to establish any exception to the penalty, such as reasonable cause.[26]

ANALYSIS OF LITIGATED CASES

We identified 178 opinions issued between June 1, 2012 and May 31, 2013 where taxpayers litigated the negligence/disregard of rules or regulations or substantial understatement components of the accuracy-related penalty. The IRS prevailed in full in 139 cases (78 percent), the taxpayers prevailed in full in 28

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18 IRM 4.10.6.2(1), *Recognizing Noncompliance* (May 14, 1999) ("assessment of penalties should be considered throughout the audit"). *See also* IRM 20.1.5.3(1)-(2), *Examination Penalty Assertion* (Jan. 24, 2012).

19 The AUR is an automated program that identifies discrepancies between the amounts that taxpayers reported on their returns and what payors reported via Form W-2, Form 1099, and other information returns. *See* IRM 4.19.2, *Liability Determination, IMF Automated Underreporter (AUR) Control* (Aug. 16, 2013). IRC § 6751(b)(1) provides the general rule that IRS employees must have written supervisory approval before assessing any penalty. However, IRC § 6751(b)(2)(B) allows an exception for situations where the IRS can calculate a penalty automatically "through electronic means." The IRS interprets this exception as allowing it to use its AUR system to propose the substantial understatement and negligence components of the accuracy-related penalty without human review. If a taxpayer responds to an AUR-proposed assessment, the IRS first involves its employees at that point to determine whether the penalty is appropriate. If the taxpayer does not respond timely to the notice, the computers automatically convert the proposed penalty to an assessment. *See* National Taxpayer Advocate 2007 Annual Report to Congress 259 ("Although automation has allowed the IRS to more efficiently identify and determine when such underreporting occurs, the IRS's over-reliance on automated systems rather than personal contact has led to insufficient levels of customer service for taxpayers subject to AUR. It has also resulted in audit reconsideration and tax abatement rates that are significantly higher than those of all other IRS examination programs.").

20 For example, when the IRS proposes to adjust a taxpayer's liability, including additions to tax such as the accuracy-related penalty, it typically sends a notice ("30-day letter") of proposed adjustments to the taxpayer. A taxpayer has 30 days to contest the proposed adjustments to the IRS Office of Appeals, during which time he or she may raise issues related to the deficiency, including any reasonable cause defense to a proposed penalty. If the issue is not resolved after the 30-day letter, the IRS sends a statutory notice of deficiency ("90-day letter") to the taxpayer. *See* IRS Pub. 5, *Your Appeal Rights and How to Prepare a Protest If You Don't Agree* (Jan. 1999); IRS Pub. 3498, *The Examination Process* (Nov. 2004).

21 IRC § 6665(a)(1).

22 IRC § 6213(a). A taxpayer has 150 days instead of 90 to petition the Tax Court if the notice of deficiency is addressed to the taxpayer outside the United States.

23 Taxpayers may litigate an accuracy-related penalty by paying the tax liability (including the penalty) in full, filing a timely claim for refund, and then timely instituting a refund suit in the appropriate United States District Court of the Court of Federal Claims. 28 U.S.C. § 1346(a)(1); IRC §§ 7422(a), 6532(a)(1); *Flora v. United States*, 362 U.S. 145 (1960) (requiring full payment of tax liabilities as a prerequisite for jurisdiction over refund litigation).

24 IRC §§ 6320 and 6330 provide for due process hearings in which a taxpayer may raise a variety of issues including the underlying liability, provided the taxpayer did not receive a statutory notice of deficiency or did not otherwise have an opportunity to dispute such liability. IRC §§ 6320(c), 6330(c)(2).

25 IRC § 7491(c) provides that "the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title."

26 IRC § 7491(a). *See also* Tax Court Rule 142(a).

cases (16 percent) and 11 cases (six percent) resulted in split decisions. Table 1 in Appendix III provides a detailed list of these cases.

Taxpayers appeared *pro se* (without representation) in 100 of the 178 cases (56 percent) and convinced the court to dismiss or reduce the penalty in 20 (20 percent) of those cases. Represented taxpayers fared slightly better, achieving full or partial relief from the penalty in 19 of their 78 cases (24 percent).

In some cases, the court found taxpayers liable for the accuracy-related penalty but failed to clarify whether it was for negligence under § 6662(b)(1), or a substantial understatement of tax under § 6662(b)(2), or both.[27] Regardless of the subsection at issue, the analysis of reasonable cause is the same. As such, we have combined our analyses of reasonable cause for the negligence and substantial understatement cases.

Adequacy of Records and Substantiation of Deductions to Show Reasonable Cause and as Proof of Taxpayer's Good Faith

Taxpayers are required to maintain records sufficient to establish the amount of gross income, deductions, and credits claimed on a return.[28] Taxpayers were most successful in establishing a defense for an asserted underpayment when they produced adequate records or proved they made a reasonable attempt to comply with the requirements of law. For example, in *Bauer v. Commissioner*,[29] the taxpayer engaged in a household goods transport business and sought to deduct contract labor expenses. Although a deduction is allowed for ordinary and necessary expenses paid or incurred by a taxpayer in carrying on a trade or business,[30] the IRS disallowed the contract labor expenses for failure to substantiate the deduction. In *Bauer*, the taxpayer kept a logbook of contract labor expenses that the court deemed inadequate to substantiate the deduction taken on Schedule C.[31] Pursuant to the *Cohan* rule,[32] however, the court was able to estimate the amount of deductible expense. The court did not uphold the accuracy-related penalty asserted against the taxpayer because his logbook demonstrated that he made a good faith effort to maintain a record of his contract labor expenses even though his attempt at recordkeeping fell short for substantiation purposes.[33]

While the Tax Court has been sympathetic to honest misunderstandings of a complex tax code,[34] it will still impose an accuracy-related penalty on taxpayers not demonstrating a good faith effort to comply with

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27 *See, e.g., Snow v. Comm'r*, T.C. Memo. 2013-114 (IRS proposed accuracy-related penalties against the taxpayer for both § 6662(b)(1) and (b)(2), but the Tax Court ultimately held him liable for "the accuracy-related penalty under section 6662(a)," without identifying which subsection applied). *Compare with Holmes v. Comm'r*, T.C. Memo. 2012-251 (IRS proposed accuracy-related penalties under both § 6662(b)(1) and (b)(2); however, once the IRS established that the taxpayer had substantially understated his income under § 6662(b)(2), the court declined to consider the negligence claim).

28 IRC § 6001; Treas. Reg. § 1.6001-1(a).

29 T.C. Memo. 2012-156.

30 IRC § 162(a).

31 *Bauer*, T.C. Memo. 2012-156.

32 *See Cohan v. Comm'r*, 39 F.2d 540, 544 (2d Cir. 1930) (holding that if a taxpayer establishes that he or she paid a deductible business expense but cannot substantiate the precise amount, the court may estimate the amount of the deductible expense, "bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making").

33 *Bauer*, T.C. Memo. 2012-156.

34 *See, e.g., Armstrong v. Comm'r*, 139 T.C. No. 18 (2012) (declining to impose an accuracy-related penalty on a taxpayer who improperly claimed a dependency exemption but was not sufficiently experienced in tax accounting and law to be found negligent); *Chien v. Comm'r*, T.C. Memo. 2012-277 (relieving from the accuracy-related penalty a taxpayer who failed to understand that she was liable for self-employment tax because of her inexperience and honest misunderstanding, after consulting instructions for Form 1040, of her employment status).

the law. For example, in *Striefel v. Commissioner*,[35] the taxpayer destroyed records because he was told he would die soon. Although the court acknowledges the taxpayer was understandably upset, it found the taxpayer's actions negligent and not justifiable pursuant to IRC § 6001, which requires the maintenance of tax records.[36] In *Fitch v. Commissioner*,[37] the taxpayers sought to deduct a net operating loss carried over from prior years pursuant to IRC § 172(a). The IRS disallowed the deduction for failure to substantiate, and the taxpayers were responsible for an accuracy-related penalty. Although the husband, who worked as a certified public accountant (CPA), suffered a brain aneurysm during the tax year, the deterioration of his health did not suffice to support a finding that the married couple acted with reasonable cause sufficient to avoid the accuracy-related penalty.[38] While the court sympathized with the taxpayer's health circumstances, it relied on Mr. Fitch's continued practice as a CPA to show that the illness alone did not support a reasonable cause or good faith defense sufficient to avoid the penalty.[39]

While expectations for compliance with the tax code are high, taxpayers avoided an accuracy-related penalty by adequately substantiating deductions to show reasonable cause and proof of good faith in connection with an unresolved legal issue. For example, in *Patel v. Commissioner*,[40] the taxpayers claimed a charitable contribution when they donated their house to the local fire department to conduct live fire training exercises on the property. The state of the law regarding the type of ownership interest in the house that the taxpayers transferred to the fire department was unsettled. The Tax Court denied the deduction but declined to impose the accuracy-related penalty. The IRS disagrees with the Tax Court's conclusion that the uncertain state of the law is a factor that supports a finding of reasonable cause when the taxpayers failed to obtain competent professional advice or do their own investigation of the state of the law.[41]

In *Olive v. Commissioner*,[42] the taxpayer was found negligent for failure to keep adequate books and records, and he substantially understated income in connection with his medical marijuana dispensary. The taxpayer deducted costs of goods sold and other business expenditures, some of which were properly substantiated while others were not. Accuracy-related penalties were imposed on the portion of the understatement that arose from unsubstantiated deductions, but not on the portion of the understatement stemming from properly substantiated deductions. Because the correct treatment of expenditures for the sale of marijuana was not resolved at the time the taxpayer filed the returns, the court focused the penalty application on whether the expenses had been properly substantiated as a sign of a good faith effort to comply with the tax code.[43]

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35 T.C. Memo. 2013-102.

36 *See supra*, note 28.

37 T.C. Memo. 2012-358.

38 *Id.*

39 *Id. See also Perry v. Comm'r*, T.C. Memo. 2012-237 (holding an accuracy-related penalty was appropriate where the taxpayer was a certified public accountant (CPA) and former IRS revenue agent and failed to substantiate deductions for travel expenses and depreciation on his home).

40 138 T.C. 395 (2012).

41 *See Patel*, 138 T.C. at 395, *action on dec.*, 2013-7 (Feb. 11, 2013).

42 139 T.C. 19 (2012).

43 139 T.C. 19 (2012).

Negligence by Creation of Artificial Capital Loss

We also reviewed several cases in which the taxpayer contested an accuracy-related penalty after creating an artificial capital loss by implementing a scheme called CARDS (Custom Adjustable Rate Debt Structure). In *Kerman v. Commissioner*,[44] the taxpayer was held liable for an accuracy-related penalty for a substantial understatement in tax resulting from the implementation of a CARDS scheme to generate tax losses to offset the capital gain realized from the sale of securities. A CARDS strategy begins with a foreign borrower taking a loan from a foreign bank in foreign currency. The taxpayer for whom the strategy is designed would then receive some of the funds from the company, agreeing to be jointly liable for the full amount of the loan. The taxpayer would then exchange the foreign currency for United States dollars. As the exchange of foreign currency is a taxable event, the taxpayer claims a basis in the foreign currency equal to the entire value of the loan taken from the foreign financial institution. The U.S. currency is then paid to the foreign company and the loan is paid off after a year, so as to avoid discharge of indebtedness income. This scheme lacks economic substance as it creates noneconomic losses to be used for tax benefits.[45]

The taxpayer in *Kerman* had been warned in the CARDS promotional materials "that tax losses from transactions similar to CARDS that are designed to produce noneconomic tax losses by artificially overstating basis are not allowable as deductions for Federal income tax purposes."[46] Relying in part on the copy of Notice 2000-44 the taxpayer received prior to engaging in the CARDS strategy, the court held that the taxpayer did not act with reasonable cause when entering into a transaction that lacked economic substance and was, therefore, a sham. Other courts besides the Tax Court have disallowed deductions resulting from this strategy and they impose accuracy-related penalties accordingly,[47] often times increasing the penalty to 40 percent for a gross misstatement penalty under IRC § 6662(h).[48]

Reliance on Advice of a Tax Professional as Reasonable Cause

Another commonly litigated question was whether reliance on a tax professional established reasonable cause. The taxpayer's education, sophistication, and business experience are relevant in determining whether his or her reliance on tax advice was reasonable.[49] To prevail, a taxpayer must establish that:

1. The adviser was a competent professional who had sufficient expertise to justify reliance;
2. The taxpayer provided necessary and accurate information to the adviser; and
3. The taxpayer actually relied in good faith on the adviser's judgment.[50]

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44 713 F.3d 849 (6th Cir. 2013), *aff'g* T.C. Memo. 2011-54.

45 *See* IRS Notice 2000-44, 2000-2 C.B. 255 ("Taxpayers and their representatives are alerted that the purported losses arising from certain types of transactions are not properly allowable for federal income tax purposes."); IRS Notice 2002-21, 2002-1 C.B. 730 (where CARDS transactions are listed).

46 *Kerman*, 713 F.3d at 870.

47 *See Crispin v. Comm'r*, 708 F.3d 507 (3d Cir. 2013), *aff'g* T.C. Memo. 2012-70; *Gustashaw v. Comm'r*, 696 F.3d 1124 (11th Cir. 2012), *aff'g* T.C. Memo. 2011-195.

48 IRC § 6662(h) (an overstatement in the basis of property by 400 percent or more will be treated as a gross valuation misstatement, thus doubling the penalty from 20 to 40 percent of the underpayment of income tax).

49 Treas. Reg. § 1.6664-4(c)(1). *See also* IRM 20.1.5.6.1(6), *Reasonable Cause* (Jan. 24, 2012).

50 *Neonatology Associates, P.A. v. Comm'r*, 115 T.C. 43, 99 (2000) (citations omitted), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

Taxpayers argued their good faith reliance on a competent tax professional in several cases this year,[51] including *Meinhardt v. Commissioner*.[52] In *Meinhardt*, the IRS imposed an accuracy-related penalty for a substantial understatement of income tax resulting from a failure to substantiate business expense deductions. The taxpayers, having recognized their relative unfamiliarity with tax law, hired a practicing attorney to help them prepare their returns. Their attorney regularly handled tax returns in the community, and the taxpayers gave him all of the materials they thought were relevant to their tax return. Having established good faith reliance on a competent tax professional, the court declined to uphold the accuracy-related penalty.

In *Romanowski v. Commissioner*,[53] the IRS imposed an accuracy-related penalty on the taxpayers for income tax deficiencies related to the improper deduction of expenses of their horse-breeding activity. The Tax Court found that the horse-breeding activity was not engaged in for profit, and therefore disallowed the deductions.[54] The taxpayers, however, presented credible evidence of good faith reliance on a competent tax professional. The taxpayers were unsophisticated in the field of tax and they hired a "very experienced and highly accomplished accountant" and an "accomplished lawyer familiar with tax law," upon whose advice they relied.[55] The taxpayers were able to establish the three criteria above, and the court held they were not liable for any accuracy-related penalties.

In several cases, the taxpayer could not establish all three of the above-mentioned criteria. For example, in *Mills v. Commissioner*,[56] the taxpayers hired their tax preparer to advise whether the LLC they had formed could amortize the value of the husband's time and expertise in real estate management. The tax preparer was an accountant, but he was not a lawyer or a CPA. He was an enrolled agent who had passed a written examination administered by the IRS Office of Professional Responsibility, but his status became inactive while working with the taxpayers. At the time of trial, the tax preparer resided in a Colorado Federal penitentiary after stealing from clients' individual retirement accounts using forged power of attorney forms. As the taxpayers were not able to establish the competence of the tax preparer, they failed to meet the *Neonatology* test and were liable for an accuracy-related penalty.

There are many more examples of taxpayers' failure to establish the competence of their tax preparers.[57] While some taxpayers choose to use tax software to prepare their tax returns, the Tax Court does not find reliance on tax preparation software justifiable to avoid an accuracy-related penalty. In this regard, the Tax

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51 *See, e.g., Cook v. Comm'r*, T.C. Memo. 2012-167 (finding the taxpayer reasonably relied on his CPA with respect to misplacement of commission expense on the wrong schedule for which the taxpayer provided proper documentation to his CPA; also finding the taxpayer failed to show that he had provided adequate documentation to his CPA for non-commission expenses and was, therefore, liable for an accuracy-related penalty for that portion of the underpayment in tax).

52 T.C. Memo. 2013-85.

53 T.C. Memo. 2013-55.

54 IRC § 183(a) ("In the case of an activity engaged in by an individual, … if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.").

55 *Romanowski*, T.C. Memo. 2013-55.

56 T.C. Memo. 2013-4.

57 *See, e.g., Yates v. Comm'r*, T.C. Memo. 2013-28, appeal filed (4th Cir. July 1, 2013) (holding taxpayers liable for an accuracy-related penalty because they offered no evidence concerning the expertise of their accountant); *Deutsch v. Comm'r*, T.C. Memo. 2012-318 (finding the taxpayer liable for an accuracy-related penalty because he failed to establish his CPA had adequate expertise). Taxpayers may have a difficult time demonstrating the competency of the majority of return preparers if the government is barred from regulating unenrolled preparers. *See Loving v. Internal Revenue Service*, 111 A.F.T.R.2d (RIA) 589 (D.D.C. 2013); Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31 (May 13, 2013).

Court has observed that "[t]he misuse of tax preparation software, even if unintentional or accidental, is no defense to accuracy-related penalties under section 6662."[58]

In *Bartlett v. Commissioner*,[59] the taxpayer admitted to underpayment of tax due to misreporting the amount of taxable pension benefits received. The taxpayer sought to avoid an accuracy-related penalty by claiming the underpayment was an "honest mistake" and that she believed that the tax preparation software would "catch any mistakes she otherwise might make."[60] The Tax Court found that the information the taxpayer had entered into the preparation software was incorrect, and the system was "only as good as the information entered into its software program."[61] The Tax Court found the taxpayer liable for an accuracy-related penalty as the mistakes were not made by the software, but by the taxpayer herself. Unless the taxpayer proves the software itself is flawed, the Tax Court is unlikely to accept reliance on tax preparation software as a justification to avoid an accuracy-related penalty.[62]

No Affirmative Defense Offered by the Taxpayer

Many litigants offered no affirmative defense for the understatement in tax, failing completely to claim the reasonable cause and good faith defense under IRC § 6664(c). In *Powers v. Commissioner*,[63] the taxpayers were negligent in keeping adequate books and records related to their telephone company. In addition, the taxpayers failed to report income and claimed deductions to which they were not entitled, which resulted in a substantial understatement of income tax. While the taxpayers claimed that their 44 years of tax compliance should be a significant factor in determining the existence of negligence, the court held that evidence of prior compliance with the Code was insufficient on its own to avoid the accuracy-related penalty.[64] The taxpayers failed to raise any affirmative defense and were, therefore, held liable for the penalty.

CONCLUSION

Of the 178 cases we reviewed, the courts upheld the underlying tax deficiency, or portions of the deficiency, determined by the IRS in all cases. In over a fifth of the cases, the courts abated the accuracy-related penalties, partially or in full, where the taxpayer showed a reasonable and good faith attempt to ascertain the correct amount of tax due. The courts most commonly found reasonable cause on the bases of maintenance of adequate records to substantiate deductions and reasonable reliance on a competent tax professional. Taxpayers should also be aware that they must raise an affirmative defense to the penalty in order to have a chance at avoiding liability for the penalty.

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58 *See Langley v. Comm'r*, T.C. Memo. 2013-22, 2013 Tax Ct. Memo. LEXIS 22 at *10 (citations omitted).

59 T.C. Memo. 2012-254.

60 *Id*.

61 *Id*.

62 *See Morales v. Comm'r*, T.C. 2012-341.

63 T.C. Memo. 2013-134.

64 *Id.*

MLI #2 Trade or Business Expenses Under IRC § 162 and Related Sections

SUMMARY

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues in the Annual Report. We identified 134 cases involving a trade or business expense issue that were litigated between June 1, 2012, and May 31, 2013. The courts affirmed the IRS position in the vast majority (approximately 74 percent) of cases, while taxpayers fully prevailed only about two percent of the time.[1] The remaining cases resulted in split decisions.

PRESENT LAW

Internal Revenue Code (IRC or the "Code") § 162 allows deductions for ordinary and necessary trade or business expenses paid or incurred during the course of a taxable year. Rules regarding the practical application of IRC § 162 have evolved largely from case law and administrative guidance. The IRS, the Department of the Treasury, Congress, and the courts continue to provide guidance about whether a taxpayer is entitled to claim certain deductions. The cases analyzed for this report illustrate that this process is ongoing and involves the analysis of facts and circumstances. When a taxpayer seeks judicial review of the IRS's determination of a tax liability stemming from the deductibility of a particular expense, the courts must often address a series of questions, including those discussed below.

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What is a trade or business expense under § 162?

Although "trade or business" is one of the most widely used terms in the IRC, neither the Code nor the Treasury Regulations provide a definition.[2] The definition of a "trade or business" comes from common law, where the concepts have been developed and refined by the courts.[3] The Supreme Court has interpreted "trade or business" for purposes of IRC § 162 to mean an activity conducted with "continuity and regularity" and with the primary purpose of earning income or making profit.[4]

What is an ordinary and necessary expense?

IRC § 162(a) requires a trade or business expense to be both "ordinary" and "necessary" in relation to the taxpayer's trade or business in order to be deductible. In *Welch v. Helvering*, the Supreme Court stated that the words "ordinary" and "necessary" have different meanings, both of which must be satisfied for the taxpayer to benefit from the deduction.[5] The Supreme Court describes an "ordinary" expense

1 The IRS prevailed in full in 99 out of 134 cases, while taxpayers prevailed in full in only three cases.

2 In 1986, the term "trade or business" appeared in at least 492 subsections of the Code and in over 664 Treasury Regulations. *See* F. Ladson Boyle, *What is a Trade or Business?* 39 Tax Law. 737 (Summer 1986).

3 Carol Duane Olson, *Toward a Neutral Definition of "Trade or Business" in the Internal Revenue Code*, 54 U. Cin. L. Rev. 1199 (1986).

4 *Comm'r v. Groetzinger*, 480 U.S. 23, 35 (1987).

5 290 U.S. 111, 113 (1933) (suggesting an examination of "life in all its fullness" will provide an answer to the issue of whether an expense is ordinary and necessary).

as customary or usual and of common or frequent occurrence in the taxpayer's trade or business.[6] The Court describes a "necessary" expense as one that is appropriate and helpful for development of the business.[7]

Common law also requires that in addition to being ordinary and necessary, the amount of the expense must be reasonable for the expense to be deductible. In *Commissioner v. Lincoln Electric Co.*, the Court of Appeals for the Sixth Circuit held "the element of reasonableness is inherent in the phrase 'ordinary and necessary.' Clearly it was not the intention of Congress to automatically allow as deductions operating expenses incurred or paid by the taxpayer in an unlimited amount."[8]

Is the expense a currently deductible expense or a capital expenditure?

A currently deductible expense is an ordinary and necessary expense paid or incurred during the taxable year in the course of carrying on a trade or business.[9] No deductions are allowed for the cost of acquisition, construction, improvement, or restoration of an asset expected to last more than one year.[10] Instead, capital expenditures may be subject to amortization, depletion, or depreciation over the useful life of the property.[11]

Whether an expenditure is deductible under IRC § 162(a) or is a capital expenditure under IRC § 263 is a question of fact. Courts have adopted a case-by-case approach to applying principles of capitalization and deductibility.[12]

When is an expense paid or incurred during the taxable year, and what proof is there that the expense was paid?

IRC § 162(a) requires an expense to be "paid or incurred during the taxable year" to be deductible. The Code also requires a taxpayer to maintain books and records that substantiate income, deductions, and credits — including adequate records to substantiate deductions claimed as trade or business expenses.[13] If a taxpayer cannot substantiate the exact amounts of deductions by documentary evidence (*e.g.*, invoice, paid bill, or canceled check), but can establish that he or she had some business expenditures, the courts may employ the *Cohan* rule to grant the taxpayer a reasonable amount of deductions.

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6 *Deputy v. du Pont*, 308 U.S. 488, 495 (1940) (citation omitted).

7 *Comm'r v. Tellier*, 383 U.S. 687, 689 (1966) (citations omitted).

8 176 F.2d 815, 817 (6th Cir. 1949), *cert. denied,* 338 U.S. 949 (1950).

9 IRC § 162(a).

10 IRC § 263. *See also INDOPCO, Inc. v. Comm'r*, 503 U.S. 79 (1950).

11 IRC § 167.

12 *See PNC Bancorp, Inc. v. Comm'r*, 212 F.3d 822 (3d Cir. 2000), *Norwest Corp. v. Comm'r*, 108 T.C. 265 (1997).

13 IRC § 6001. *See also* Treas. Reg. §§ 1.6001-1 and 1.446-1(a)(4).

The *Cohan* rule

The *Cohan* rule is one of "indulgence" established in 1930 by the Court of Appeals for the Second Circuit in *Cohan v. Commissioner*.[14] The court held that the taxpayer's business expense deductions were not adequately substantiated, but stated that "the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent."[15]

The *Cohan* rule cannot be used in situations where IRC § 274(d) applies. Section 274(d) provides that unless a taxpayer complies with strict substantiation rules, no deductions are allowable for:

1. Travel expenses;
2. Entertainment, amusement, or recreation expenses;
3. Gifts; and
4. Certain "listed property."[16]

A taxpayer must substantiate a claimed IRC § 274(d) expense with adequate records or sufficient evidence to establish the amount, time, place, and business purpose.[17]

Who has the burden of proof in a substantiation case?

Generally, the taxpayer bears the burden of proving that he or she is entitled to the business expense deductions and the IRS's proposed determination of tax liability is incorrect.[18] IRC § 7491(a) provides that the burden of proof shifts to the IRS when the taxpayer:

- Introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer's liability;
- Complies with the requirements to substantiate deductions;
- Maintains all records required under the Code; and
- Cooperates with reasonable requests by the IRS for witnesses, information, documents, meetings, and interviews.

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14 39 F.2d 540 (2d Cir. 1930). George M. Cohan was an actor, playwright, and producer who spent large sums travelling and entertaining actors, employees, and critics. Although Cohan did not keep a record of his spending on travel and entertainment, he estimated that he incurred $55,000 in expenses over several years. The Board of Tax Appeals, now the Tax Court, disallowed these deductions in full based on Cohan's lack of supporting documentation. Nevertheless, on appeal, the Second Circuit concluded that Cohan's testimony established that legitimate deductible expenses had been incurred. As a result, the Second Circuit remanded the case back to the Board of Tax Appeals with instructions to estimate the amount of deductible expenses.

15 *Id*. at 544 (2d Cir. 1930), *aff'g and remanding* 11 B.T.A. 743 (1928).

16 "Listed property" means any passenger automobile; any property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; any computer or peripheral equipment (except when used exclusively at a regular business establishment and owned or leased by the person operating such establishment); and any other property specified by regulations. IRC § 280F(d)(4)(A) and (B).

17 Treas. Reg. § 1.274-5T(b).

18 *See Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted) and U.S. Tax Court Rules of Practice and Procedure, Rule 142(a).

ANALYSIS OF LITIGATED CASES

The deductibility of trade or business expenses has been one of the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998.[19] This year, we reviewed 134 cases involving trade or business expenses issues that were litigated in federal courts from June 1, 2012, through May 31, 2013. Table 2 in Appendix III contains a list of the main issues in those cases. Table 3.2.1 categorizes the main issues raised by taxpayers. Cases involving more than one issue are included in more than one category.

FIGURE 3.2.1, Trade or Business Expense Issues in Cases Reviewed

Issue	Type of Taxpayer	
	Individual	Business (including sole proprietorships)
Substantiation of expenses, including application of the ***Cohan*** rule[1]	9	78
Profit objective[2]	0	19
Ordinary and necessary trade or business expenses[3]	0	34
Personal vs. business expenses[4]	4	26
Business expenses vs. capital expenditures[5]	0	1
Did the taxpayer establish the carrying on of a trade or business?	0	7
Gambling expenses[6]	1	0

Approximately 64 percent of the taxpayers litigating trade or business deduction issues represented themselves (*pro se*). However, those represented by counsel fared better than their *pro se* counterparts. Taxpayers with representation received full or partial relief in approximately 33 percent of cases (16 of 48). By contrast, *pro se* taxpayers received full or partial relief in just 22 percent of cases (19 of 86).

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19 *See* National Taxpayer Advocate 1998-2012 Annual Reports to Congress.

20 IRC § 6001 and Treas. Reg. § 1.6001-1 require a taxpayer to maintain books and records that substantiate income, deductions and credits. Treas. Reg. § 1.162-17 provides guidance regarding maintaining adequate records to substantiate deductions claimed as trade or business expenses in connection with the performance of services as an employee. The *Cohan* rule allows courts to estimate certain expenses not properly substantiated. *See Cohan*, 39 F.2d at 544.

21 IRC § 183(a) provides the general rule that no deduction attributable to an activity engaged in by an individual or an S corporation shall be allowed if such activity is not engaged in for profit. Treas. Reg. § 1.183-2(b) provides the following nonexhaustive list of nine factors to consider in determining whether an activity is conducted for profit: (1) manner in which the taxpayer carries on the activity; (2) expertise of the taxpayer or his advisors; (3) time and effort expended by the taxpayer in carrying on the activity; (4) expectation that assets used in the activity may appreciate in value; (5) success of the taxpayer in carrying on similar or dissimilar activities; (6) taxpayer's history of income or losses with respect to the activity; (7) amount of occasional profits, if any, which are earned; (8) financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

22 IRC § 162(a) allows deductions for ordinary and necessary trade or business expenses paid or incurred during the taxable year.

23 IRC § 262(a) provides that personal, living and family expenses are generally not deductible.

24 Under IRC § 263(a), generally no deduction is allowed for capital expenditures, where capital expenditures include any amount paid for permanent im¬provements made to increase the value of any property. Under IRC § 195(a), start-up expenditures generally cannot be deducted unless a taxpayer makes an expense/amortization election according to IRC § 195(b). Taxpayers who make the election may generally deduct up to $5,000 of start-up expenditures in the tax year in which an active trade or business begins and amortize any excess over 180 months. The $5,000 deduction is reduced by a dollar for every dollar that total start-up expenditures exceed $50,000. *See* IRC § 195(b)(1)(A), (B). (These amounts are increased to $10,000 and $60,000 for taxable years beginning in 2010. *See* IRC § 195(b)(3).)

25 IRC § 165(d) provides that "[l]osses from wagering transactions shall be allowed only to the extent of the gains from such transactions."

Individual Taxpayers

None of the 11 decisions involving individual taxpayers (where the term "individual" excludes a sole proprietorship) was issued as a regular opinion of the Tax Court.[26] Nine of the 11 individual taxpayers appeared *pro se*. No individual taxpayers received full relief, while only one earned a split decision; the court upheld the IRS position in ten of 11 cases (91 percent).

The most prevalent issue was the substantiation of claimed trade or business expense deductions, which appeared in nine cases. For example, in *Noz v. Commissioner*,[27] the Tax Court denied several claimed business expense deductions for failure to substantiate. The claimed deductions included travel expenses, meals and entertainment, and computer-related equipment. The taxpayers, two university professors, were unable to substantiate travel expenses for trips around the United States to give lectures in connection with their appointments as professors. The taxpayers provided no evidence as to the price of their plane tickets or the dates of their travel. As there was no evidence establishing the business purpose of the travel aside from the taxpayer's testimony, the court denied those deductions. It also denied expense deductions for meals and entertainment while traveling in the absence of evidence as to the cost, time and place of the meals, and the business purpose of the expenses. Deductions for computer equipment were also denied as there was no evidence indicating purchase price or purchase date.

The taxpayers, one of whom lived in Sweden while the other lived in New York, also sought to deduct travel expenses for trans-Atlantic travel. Because the court deemed this travel personal, rather than associated with a business purpose, it also denied those deductions. Because travel expenditures, meals and entertainment and listed property, such as computer equipment, are enumerated in IRC § 274(d), no deductions are allowed absent proper substantiation. As a result, the court could not invoke the *Cohan* rule.[28]

Business Taxpayers

We reviewed 123 cases involving business taxpayers, who had a far greater success rate than individual taxpayers. While individual taxpayers did not win a single case in full, splitting one case and losing ten of 11 others, business taxpayers received full or partial relief in approximately 28 percent of cases (34 of 123). Business taxpayers were represented by counsel in nearly half of the favorably decided cases (16 of 34) and in 34 percent of the cases that the IRS won (30 of 89).

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26 Tax Court decisions fall into three categories: regular decisions, memorandum decisions, and small tax case ("S") decisions. The regular decisions of the Tax Court include cases which have some new or novel point of law, or in which there may not be general agreement, and therefore have the most legal significance. In contrast, memorandum decisions generally involve fact patterns within previously settled legal principles and therefore are not as significant. Finally, "S" case decisions (for disputes involving $50,000 or less) are not appealable and, thus, have no precedential value. *See* IRC § 7463(b). *See also* U.S. Tax Court Rule of Practice and Procedure, Rules 170-175. With respect to the cases we reviewed this year, more than half the cases involving individual taxpayers (excluding sole proprietorships) were "S" cases.

27 T.C. Memo. 2012-272.

28 There were other examples of individual taxpayers who failed to substantiate claimed business expense deductions. *See, e.g., Harris v. Comm'r*, T.C. Memo. 2012-312 (holding deductions were improper for unreimbursed employee expenses related to lodging, meals and vehicle mileage for failure to substantiate).

As with the individual taxpayers, substantiation of expenses was by far the most prevalent issue,[29] and in most instances, the court denied the business taxpayers' deductions for failure to substantiate.[30] Courts did, however, allow some of these deductions when the taxpayer produced sufficient evidence.[31] Courts occasionally applied the *Cohan* rule where the taxpayer presented sufficient documentation to prove an expense was incurred but had limited documentation of the precise amount.[32] IRC § 274(d), however, makes the *Cohan* rule unavailable in certain circumstances in which the taxpayer must substantiate the deductions.

Another common difficulty was the failure to prove that expenses were ordinary and necessary to the taxpayer's business. For example, in *Curcio v. Commissioner*,[33] the taxpayers sought to deduct contributions to life insurance plans for employees, but because they failed to prove this was an ordinary and necessary business expense, the court denied the deduction. The court discussed the possibility that employee incentive programs, such as those involving contributions to life insurance plans, could be made primarily in furtherance of a profit objective, and, therefore, may be eligible as an ordinary and necessary business expense. In *Curcio*, however, the life insurance plans covered only four principal owners and the owner's stepson, and the court consequently ruled the payments were not "normal, useful, or helpful for the development of the taxpayer's business, and were not made in furtherance of a profit objective or for any viable business purpose, but rather, were a mechanism by which taxpayers could divert company profits." [34] As the expense was not ordinary and necessary to the taxpayer's business, it was not deductible as a trade or business expense pursuant to IRC § 162(a).[35]

In *Consolidated Edison Co. of NY, Inc. v. United States,*[36] the United States Court of Appeals for the Federal Circuit, reversing the Court of Federal Claims, disallowed certain business expense deductions that the taxpayer took in connection with a leasing arrangement. The taxpayer claimed on its tax return multiple deductions pertaining to a lease-in/lease-out ("LILO") tax shelter transaction in which it leased property from a foreign company, not subject to U.S. taxation, and subleased the property immediately back to the foreign entity. The tax scheme is designed to accelerate losses to the taxpayer and defer gains, thereby taking advantage of the time value of money by delaying tax payments.

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29 Substantiation of expenses was at issue in 78 out of 123 cases (63 percent) involving business taxpayers.

30 *See Schoppe v. Comm'r*, 711 F.3d 1190 (10th Cir. 2013), *aff'g* T.C. Memo 2012-153 (deduction denied for real estate practice expenses for failure to substantiate), *Christine v. Comm'r*, 475 F. App'x 259 (9th Cir. 2012), *aff'g* T.C. Memo 2010-144 (deduction denied for failure to substantiate), *MacGregor v. Comm'r*, 501 F. App'x 663 (9th Cir. 2012), *aff'g* T.C. Memo 2010-187 (deduction denied for marketing expenses for failure to substantiate expenses), *Natkunanathan v. Comm'r*, 479 F. App'x 775 (9th Cir. 2012), *aff'g* T.C. Memo 2010-15 (deduction for business expenses denied for failure to substantiate).

31 *See Striefel v. Comm'r*, T.C. Memo. 2013-102 (deduction allowed for lodging and meal expenses to the extent substantiated; deduction denied for failure to meet strict substantiation requirement for car and truck expenses), *Longino v. Comm'r*, T.C. Memo. 2013-80 (deduction allowed for utility and extermination expense in personal residence to extent substantiated as held exclusively for business purposes).

32 *See Bauer v. Comm'r*, T.C. Memo. 2012-156 (deduction allowed under *Cohan* for contract labor expenditures).

33 689 F.3d 217 (2d Cir. 2012), *aff'g* T.C. Memo. 2010-115.

34 *Id*. at 226.

35 *See* IRC § 162(a)(3) (There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including … rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property …"). For other examples of cases examined in which the court denied deductions for failure to prove the expense was ordinary and necessary in business, see *DiDonado v. Comm'r*, T.C. Memo. 2013-11 (deduction denied for firearm expense for failure to prove ordinary and necessary in business), *Abarca v. Comm'r*, T.C. Memo. 2012-245 (deduction denied for car and truck rental expenses for failure to prove ordinary and necessary in business).

36 703 F.3d 1367 (Fed. Cir. 2013), *rev'g* 90 Fed.Cl. 228 (2009).

Applying the substance-over-form doctrine,[37] the United States Court of Appeals for the Federal Circuit disallowed the deductions because "there was a reasonable likelihood that the tax-indifferent entity in the LILO Transaction (the lessor of the master lease) would exercise its purchase option at the conclusion of the ConEd sublease, thus rendering the master lease illusory."[38] Accordingly the court ruled the deductions were not properly allowable under IRC § 162(a)(3).

Taxpayers were also denied business expense deductions when the courts found the expenses related to personal, rather than business, activities[39] pursuant to § 262(a).[40] To illustrate, the taxpayers in *Robinson v. Commissioner*[41] sought to deduct expenses for vehicle use and travel, but the court held the expenses were personal and, therefore, not eligible for deduction under § 162. The taxpayers deducted expenditures for family trips to Disneyland and Disney World, hotel stays, airfare, and retail merchandise, claiming the family took trips and visited tourist sites for business purposes. The husband, a professor at Temple University, also claimed a deduction for the business use of his car in travel to and from the university. Although he taught for relatively few days at Temple, he deducted expenses corresponding to tens of thousands of miles traveled. The taxpayers also deducted expenses related to the personal use of their home office, including the use of a cellular phone and computer. As the taxpayers failed to present any evidence establishing the business use of any of these expenses, they were denied as business expense deductions. Additionally, the taxpayers failed to demonstrate that their expenses were related to a business purpose and were not primarily personal.

Courts generally upheld the IRS's determination that the business expense deductions were not attributable to an activity that was engaged in for profit within the meaning of § 183.[42] In *DKD Enterprises v. Commissioner*,[43] the taxpayers sought to deduct expenses related to a cat breeding activity. The taxpayers claimed that they intended to operate the activity for profit, and they entered their kittens in several national tournaments. The kittens were valued from $1,000-$5,000, and the owners won four national championships in two years. The taxpayers operated a website for marketing the kittens, and did earn some income from sales during the years in question. However, the Eighth Circuit Court of Appeals held the taxpayers had not engaged in cat breeding for profit. In doing so, the court noted that it "should find the trade or business venture lacked a genuine profit motive only if the court finds, as a factual matter, the taxpayer lacked a good-faith, subjective intention to make a profit and was engaged in the activity for wholly different reasons."[44] The expenses related to the activity, therefore, were not deductible.

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37 The Court of Appeals for the Federal Circuit followed the substance-over-form doctrine it articulated in *Wells Fargo & Co. v. U.S.*, 641 F.3d 1319 (Fed. Cir. 2011) (the tax consequences of a transaction are based on the substance of the transaction rather than its legal form).

38 *Consolidated Edison Co.*, 703 F.3d at 1369.

39 *See, e.g., Sernett v. Comm'r*, T.C. Memo. 2012-334 (deduction denied because expenses related to sprint car racing activity were personal), *Johnson v. Comm'r*, T.C. Memo. 2012-231 (deduction denied because expenses related to drag racing activity were personal).

40 *See supra*, note 23.

41 487 F. App'x 751 (3d Cir. 2012), *aff'g* T.C. Memo. 2011-99.

42 *See, e.g., Pederson v. Comm'r*, T.C. Memo. 2013-54 (deduction denied for horse breeding activity for failure to show engaged in for profit under § 183).

43 685 F.3d 730 (8th Cir. 2012), *aff'g* T.C. Memo. 2011-29.

44 *Id*.

The taxpayers in *Romanowski v. Commissioner*[45] sought to deduct expenses related to their horse breeding activity under IRC § 162(a), but the Tax Court denied the deduction because the activity was not engaged in for profit pursuant to § 183. In upholding the IRS's disallowance of the deductions, the court ultimately determined the enterprise was not conducted for profit under the nine factors of Treasury Regulation § 1.183-2(b).[46] Even though the married taxpayers were not motivated exclusively by recreational elements, the court still found the activity was not engaged in for profit since:

- The taxpayers did not conduct the activity in a businesslike manner;
- They lacked expertise in the industry;
- The activity was never profitable; and
- The taxpayers lacked reasonable belief that it would be profitable.

CONCLUSION

Taxpayers continue to challenge the IRS's denials of trade or business deductions. From June 1, 2012, through May 31, 2013, those represented by counsel fared better than those who represented themselves in these cases. Represented taxpayers prevailed in full or in part in 33 percent (16 of 48) of the cases while the IRS's denials were upheld in 78 percent (67 of 86) of cases in which the taxpayers appeared *pro se*. The courts generally favored the IRS's denial of business expense deductions, but specific facts and circumstances yielded some victories for taxpayers. The definition of an allowable business expense, therefore, remains open to interpretation and is highly fact-specific.

It appears that many individual taxpayers remain confused over the Code's requirements, especially with respect to IRC § 274(d) related to strict substantiation of listed items. Several additional cases dealt with whether an activity was engaged in for profit. The courts, relying on Treas. Reg. § 1.183-2(b) and the nine factors there provided, found that the activity was not engaged in for profit and sustained the IRS's position. Given the relative frequency of hobby loss litigation, we recommend that the IRS highlight the available hobby loss guidance on its website and undertake additional efforts to educate taxpayers and tax preparers through news releases and similar outreach. Through education, outreach, and collaboration with stakeholders, the IRS can help taxpayers understand what trade or business deductions are allowable and how best to substantiate them.

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45 T.C. Memo. 2013-55.

46 Those factors are (1) the manner in which the taxpayer carries on the activity; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in carrying on similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, which are earned; (8) the financial status of the taxpayer; and (9) elements of personal pleasure or recreation.

MLI #3 Gross Income Under IRC § 61 and Related Sections

SUMMARY

When preparing tax returns, taxpayers must report gross income for the taxable year to determine the tax they must pay. The reporting of gross income has been among the most litigated issues in each of the National Taxpayer Advocate's Annual Report to Congress.[1] For this report, we analyzed 117 cases decided between June 1, 2012, and May 31, 2013. The majority of cases this year involved taxpayers failing to report items of income, including some specifically mentioned in Internal Revenue Code (IRC) § 61 such as wages,[2] interest,[3] dividends,[4] and annuities.[5]

PRESENT LAW

IRC § 61 broadly defines gross income as "all income from whatever source derived."[6] The U.S. Supreme Court has defined gross income as any accession to wealth.[7] However, over time, Congress has carved out numerous exceptions to and exclusions from this broad definition and has based other elements of tax law on the definition.[8]

The Commissioner may identify particular items of unreported income or reconstruct a taxpayer's gross income using methods such as the bank deposits method.[9] If the Commissioner determines a tax deficiency, the IRS issues a Statutory Notice of Deficiency.[10] If the taxpayer challenges the deficiency, the Commissioner's notice is entitled to a presumption of correctness; the taxpayer bears the burden of proving that the determination is erroneous or inaccurate.[11]

ANALYSIS OF LITIGATED CASES

In the 117 opinions reviewed for this report, gross income issues most often fall into two categories: (1) what is included in gross income under IRC § 61, and (2) what can be excluded under other statutory provisions. A detailed list of all cases analyzed appears in Table 3 of Appendix III.

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1 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 637-642; National Taxpayer Advocate 2011 Annual Report to Congress 619-625.

2 Internal Revenue Code (IRC) § 61(a)(1). *See, e.g., Garber v. Comm'r*, 500 F. App'x 540 (7th Cir. 2013), *reh'g denied*, 2013 U.S. App. LEXIS 10454 (7th Cir. May 9, 2013), *aff'g* T.C. Memo. 2012-47.

3 IRC § 61(a)(4). *See, e.g., Cox v. Comm'r*, T.C. Memo. 2013-75.

4 IRC § 61(a)(7). *See, e.g., Clayton v. Comm'r*, T.C. Memo. 2012-188, *appeal docketed*, No. 12-73904 (9th Cir. Nov. 28, 2012).

5 IRC § 61(a)(9). *See, e.g., Buckardt v. Comm'r*, 474 F. App'x 612 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-145.

6 IRC § 61(a).

7 *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 431-33 (1955) (interpreting § 22 of the Internal Revenue Code of 1939, the predecessor to IRC § 61).

8 *See, e.g.*, IRC §§ 104 (compensation for injuries or sickness); 105 (amounts received under accident and health plans); 108 (income from discharge of indebtedness); 6501 (limits on assessment and collection, determination of "substantial omission" from gross income).

9 IRC § 6001. *See, e.g., DiLeo v. Comm'r*, 96 T.C. 858, 867 (1991).

10 Internal Revenue Manual (IRM) 4.8.9.2 (July 9, 2013).

11 *See* IRC § 7491(a) (burden shifts only where the taxpayer produces credible evidence contradicting the Commissioner's determination and satisfies other requirements). *See also Welch v. Helvering*, 290 U.S. 111, 115 (1933) (citations omitted).

In 46 cases (more than 39 percent), taxpayers were represented, while the rest appeared *pro se* (without representation). Five of the 46 represented taxpayers (about 11 percent) prevailed in full or in part in their cases. Twelve of the 71 *pro se* taxpayers (almost 17 percent) prevailed in full or in part. Overall, taxpayers prevailed in full or in part in 17 of 117 cases (almost 15 percent).

Drawing on the full list in Table 3 of Appendix III, we have chosen to discuss cases involving damage awards, retirement distributions, discharge of indebtedness, and partnership income, as those issues were some of the most commonly litigated.

Damage Awards

When a damage award is received, the nature of the claim that was the basis for the settlement determines whether the proceeds are excludible from gross income.[12] In six of the cases we reviewed, the taxpayers challenged the inclusion of damage awards in gross income, and the IRS won every case.

IRC § 104(a)(2) specifies that damage awards (and settlement proceeds[13]) for injuries or sickness are taxable as gross income unless the amount was received "on account of personal physical injuries or physical sickness."[14] Congress added the "physical injury or physical sickness" requirement in 1996.[15] The legislative history of the 1996 amendments to IRC §104(a)(2) states that "[if] an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness…[but] emotional distress is not considered a physical injury or physical sickness."[16]

Thus, a court cannot consider damage awards for emotional distress to be excludible from income, even if the emotional distress has resulted in "insomnia, headaches, [or] stomach disorders."[17] Note, however, that "[t]he injury need not be defined as a tort under state or common law."[18]

In five cases, the taxpayers argued that their damage awards compensated, in whole or in part, for personal physical injuries or personal sickness, and the IRS won every case. For example, in *Blackwood v. Commissioner*, the taxpayers (husband and wife) alleged the termination of the wife's employment exacerbated her depression, resulting in numerous symptoms, including insomnia, migraines, and nausea.[19] The wife alleged wrongful termination, which resulted in her former employer awarding her $100,000 in a settlement agreement. The taxpayers did not report the award on their joint return, relying on *Domeny v. Commissioner*[20] to argue that the flare-up of the wife's symptoms was a physical sickness under IRC § 104(a)(2).[21] In *Domeny*, the taxpayer's multiple sclerosis caused vertigo, shooting pain in her legs, and

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12 IRC § 104(a); *Comm'r v. Schleier*, 515 U.S. 323, 329-30 (1995).

13 *See* Treas. Reg. § 1.104-1(c)(1) (damages received, for purposes of IRC § 104(a)(2), "means an amount received (other than workers' compensation) through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution").

14 IRC § 104(a)(2).

15 Pub. L. No. 104-188, § 1605(a), 110 Stat. 1755, 1838 (1996).

16 H.R. Rep. No. 104-586, at 143-44 (1996).

17 H.R. Conf. Rep. No. 104-737, at 301 (1996). The exclusion does apply to damages received as reimbursement for amounts paid for medical care attributable to emotional distress for which deductions are allowed under IRC § 213. IRC § 104(a)(2)

18 Treas. Reg. § 1.104-1(c)(2).

19 T.C. Memo. 2012-190, *appeal filed* (4th Cir. Jan. 17, 2013).

20 T.C. Memo. 2010-9.

21 T.C. Memo. 2012-190.

difficulty walking due to numbness in her feet.[22] The Tax Court distinguished *Domeny* because Mrs. Blackwood's symptoms were not as severe as those Ms. Domeny suffered.[23]

Specifically, five of the eight symptoms that Mrs. Blackwood alleged at trial were very similar to the non-exclusive list of emotional distress symptoms in the legislative history of § 104(a).[24] In addition, unlike the facts at issue in *Domeny*, a medical doctor did not diagnose Mrs. Blackwood's illness. Consequently, the court concluded that Mrs. Blackwood's depression and corresponding physical symptoms were not physical injuries or sickness, and that the damage award was not excludible from gross income.[25]

Damage awards may also be excluded from gross income under common law doctrines. For instance, courts have ruled that settlement proceeds representing a return of capital, rather than lost profits, are excludible from gross income.[26] To determine whether a damage award is taxable, the court will ask, "[i]n lieu of what were the damages awarded?"[27]

In *Cung v. Commissioner,*[28] the taxpayer viewed an online advertisement, listing a vehicle for a discounted price. When the taxpayer attempted to purchase the vehicle, the dealer said it would not honor the advertised price.[29] The taxpayer filed suit alleging breach of contract and other various violations of statutory law. The taxpayer and the dealer reached a settlement, which he excluded from his gross income, claiming "the award represented compensation to offset a loss."[30] However, the taxpayer had sought specific performance, compensatory damages, and punitive damages, and the settlement agreement was silent as to the allocation of the award.[31] The court ruled that the taxpayer "failed to carry his burden of showing that the proceeds represent what he claims they represent, lost value."[32] Moreover, because the taxpayer never owned the vehicle, the court ruled that there was no sale or exchange from which to determine lost value.[33]

IRA Distributions

IRC § 61(a) defines gross income as "all income from whatever source derived, including (but not limited to)… (9) Annuities; … and (11) Pensions."[34] IRC § 408(d)(1) governs the tax treatment of distributions from individual retirement accounts (IRAs), and provides that they are included in gross income as amounts received as an annuity under IRC § 72.

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22 T.C. Memo. 2010-9.

23 T.C. Memo. 2012-190.

24 *Id*. (*citing* H.R. Conf. Rept. No. 104-737, at 301 n.56 (emotional distress includes symptoms such as "*e.g.*, insomnia, headaches, stomach disorders")).

25 T.C. Memo. 2012-190.

26 *See, e.g., Milenbach v. Comm'r*, 318 F.3d 924, 933 (9th Cir. 2003) (citations omitted), *aff'g* 106 T.C. 184 (1996).

27 *Milenbach v. Comm'r*, 318 F.3d 924, 932 (9th Cir. 2003) (quotations omitted), *aff'g* 106 T.C. 184 (1996).

28 T.C. Memo. 2013-81.

29 *Id*.

30 *Id*.

31 *Id*.

32 *Id*. (*citing* Milenbach, 318 F.3d at 933).

33 T.C. Memo. 2013-81.

34 IRC § 61(a).

Taxpayers in at least eight cases argued that a portion of their IRA distributions were excluded from gross income, and a taxpayer prevailed in part in only one case. For example, in *Bernard v. Commissioner*, the taxpayers (husband and wife) mischaracterized IRA distributions as proceeds of sale instead of ordinary income.[35] The taxpayers argued that because capital gains within their IRAs increased the cost basis in the accounts, they were entitled to report part of the distributions as return of capital not subject to tax, and part as long-term capital gains, which are taxed at a lower rate than ordinary income.[36] The court corrected the taxpayer by stating, "Gains within IRAs are not taxed, but accumulated income included in distributions is taxed in accordance with the provisions of section 408(d)."[37] In other words, the entire IRA distribution is generally taxable as ordinary income unless part of it represents a return of nondeductible contributions to the account, or the taxpayer transfers the funds into a qualified retirement account. Consequently, the taxpayers had to include their IRA distributions in gross income.

At least five taxpayers challenged the taxability of their IRA distributions arguing the "rollover provision" under § 408(d) applied. The "rollover provision" generally excludes from gross income IRA distributions that are transferred into an eligible retirement account within 60 days of receipt.[38] For example, in *Phillips v. Commissioner*, the taxpayer withdrew funds from an IRA, and elected to transfer the funds to a savings account rather than a qualified retirement account or IRA.[39] The taxpayer claimed the amount of the distribution was not includible in gross income because he merely made an error in rolling over the funds.[40] Because the taxpayer did not transfer the funds into a qualified retirement account once he discovered his mistake, he did not meet his burden of proving he took "every reasonable expected step" in making a rollover contribution to a qualified retirement account.[41]

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Discharge of Indebtedness

We reviewed eight cases in which taxpayers disputed the IRS's determination that a discharge of indebtedness was taxable income, and in four cases taxpayers prevailed in full or in part. A taxpayer's gross income generally includes income from any discharge of indebtedness.[42] Under certain circumstances, however, a taxpayer can exclude the amount of discharged indebtedness from gross income. In this regard, IRC § 108(a) provides, subject to limitation, that a taxpayer may exclude income from the discharge of indebtedness if the discharge occurs in bankruptcy, when the taxpayer is insolvent, if the indebtedness is qualified farm or business real estate debt, or if the indebtedness is qualified principal residence indebtedness discharged before January 1, 2014.[43] The creditor issues a Form 1099-C, *Cancellation of Debt*, to the taxpayer for cancelled debts of $600 or more.[44] If a creditor has discharged a debt the taxpayer owes, the taxpayer must include the discharged amount in gross income, even if it is less than $600, unless one of the exceptions in IRC § 108(a) applies. The issuance of a Form 1099-C is not dispositive of whether or

35 T.C. Memo. 2012-221.

36 *Id*.

37 *Id*.

38 IRC § 408(d)(3)(A)(i), (ii); *Schoof v. Comm'r*, 110 T.C. 1, 7 (1998).

39 T.C. Memo. 2013-42.

40 *Id*.

41 *Id*. (*citing Wood v. Comm'r*, 93 T.C. 114, 115-18 (1989)).

42 IRC § 61(a)(12).

43 IRC § 108(a)(1)(A)-(E).

44 IRS, Instruction for Forms 1099-A and 1099-C, *Acquisition or Abandonment of Secured Property and Cancellation of Debt* (2013).

when the debt is discharged.[45] A debt is deemed to have been discharged, and Form 1099-C is required, if (and only if) an "identifiable event" has occurred.[46]

In *Pinn v. Commissioner*, the taxpayers (brothers) each received loans from a trust secured by the cash values of their death benefits sufficient to cover the loans.[47] The taxpayers defaulted on the loans but the trust did not cancel the loans or consider them uncollectible.[48] The Commissioner argued the balances of the loans were discharged indebtedness because the taxpayers failed to pay the loans when due and the taxpayers' rights to the death benefit were too contingent to be a sufficient form of collateral.[49] While the court recognized that the death benefits were contingent on certain future events, their usefulness as collateral for the loans was still sufficient.[50] The court held the Commissioner was premature in asserting income from the discharged debts because future events to divest the collateral from the taxpayers had not occurred.[51] Therefore, the "identifiable event" had yet to occur, and the taxpayers' defaulted loans did not result in a discharge of indebtedness includible in their gross incomes.[52]

Another exception to the inclusion of discharge of indebtedness income is taxpayer insolvency at the time of the discharge.[53] The amount of gross income excluded cannot exceed the amount by which the taxpayer is insolvent.[54] The amount by which the taxpayer is insolvent is defined as the excess of liabilities over the fair market value of the taxpayer's assets immediately before the discharge.[55]

In *McAllister v. Commissioner*[56], the Commissioner argued that the amount shown on a Form 1099-MISC the taxpayer received from his former employer was fully includible in gross income as nonemployee compensation, rather than income from the cancellation of a loan extended by the employer. The court determined that the 1099-MISC memorialized the forgiveness of the debt, and analyzed whether the taxpayer's gross income should be reduced due to insolvency.[57] The court generally accepted the taxpayer's valuation of his assets and liabilities, except for the value of two real properties he owned in different states.[58] The taxpayer valued one of the properties based on a comparable sale in the same neighborhood, and another based on the local property tax assessment.[59] In both instances, the court held the taxpayer did not meet his burden of proving his valuation, and valued each property based on the taxpayer's purchase price.[60] Thus, the court's property values for insolvency purposes were greater than the amount

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45 *Kleber v. Comm'r*, T.C. Memo. 2011-233 (citation omitted).

46 Treas. Reg. § 1.6050P-1(a)(1), (b)(2)(i)(A)-(H) (describing different scenarios that signify when an "identifiable event" has occurred). *See also Friedman v. Comm'r*, 216 F.3d 537, 547-49 (6th Cir. 2000), *aff'g* T.C. Memo. 1998-196.

47 T.C. Memo. 2013-45.

48 T.C. Memo. 2013-45. The IRS learned of the default when the trust listed the loans as in default on an information return it filed with the IRS.

49 *Id*.

50 *Id*.

51 *Id*.

52 *Id*.

53 IRC § 108(a)(1)(B).

54 IRC § 108(a)(1)(3).

55 IRC § 108(d)(3).

56 T.C. Memo. 2013-96.

57 *Id*.

58 T.C. Memo. 2013-96.

59 *Id*.

60 *Id.*

the taxpayer claimed in his insolvency argument. Consequently, the taxpayer was only entitled to exclude from gross income a portion of the amount shown on the Form 1099-MISC.

Partnership Income

A partnership's income is not taxed at the entity level, but generally is reported on the partners' individual income tax returns.[61] Partners recognize "pass-through" income from the partnership equal to their distributive shares of the partnership items.[62] The partner's adjusted basis in his or her interest in the partnership equals the amount of his or her cash contributions plus the basis of other contributed property, and the basis is increased by the partners' distributive share of partnership income and decreased by distributions and losses.[63] Partners generally do not recognize gain or income on partnership distributions except to the extent that the distribution exceeds the partner's adjusted basis in the partnership interest immediately before the distribution.[64]

In *Cvancara v. Commissioner*, the taxpayers (husband and wife) formed a partnership to operate a private elementary school.[65] Two of the taxpayers' children were enrolled in the school,[66] and the taxpayers continuously made contributions to the partnership during the time their children were enrolled.[67] The Commissioner challenged certain of the Cvancaras' claimed deductions for partnership losses on the grounds that they had insufficient bases in their partnership interests.[68] The taxpayers argued that the amounts they contributed to the partnership were capital contributions and had properly increased their interests' bases. The Commissioner argued that the amounts should be recast as tuition payments and should not augment the partnership interests' bases. The court held that the taxpayers' payments constituted capital contributions because the school needed operating capital and the taxpayers did not make payments in anticipation of receiving a benefit from the school.[69] As a result, the payments increased the taxpayers' bases in their partnership interests and the court allowed the taxpayers' claimed losses.

Accounting Method

If the IRS determines that a method of accounting "does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income."[70] Under the cash receipts and disbursements method (cash method), all items that constitute gross income shall be reported in the taxable year in which they were actually or constructively received.[71] On the other hand, under the accrual method, income must be reported in the taxable year when all the events have occurred that fix the right to receive the income and the amount of income can be determined

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61 IRC § 701.
62 IRC § 702(a).
63 IRC §§ 705, 722.
64 IRC § 731(a)(1).
65 *Cvancara v. Comm'r*, T.C. Memo. 2013-20.
66 *Id*.
67 *Id*.
68 *See* IRC § 704(d) (partner's distributive share of a partnership loss allowed only to the extent of the partner's adjusted basis in the partnership).
69 T.C. Memo. 2013-20.
70 IRC § 446(b).
71 Treas. Reg. §1.446-1(c)(1)(i).

with reasonable accuracy.[72] Unlike the cash method, income realized under the accrual method may or may not be recognized in the year of receipt.

Another issue litigated in *Cvancara v. Commissioner, supra,* was whether the partnership employed the proper accounting method to reflect its income. The partnership received advance payments for tuition whose recognition it deferred until the subsequent year under the accrual method.[73] The Tax Court held that the partnership had properly elected the accrual method and properly deferred reporting the advance payments. The Commissioner contended that the partnership's use of the cash method for expenses showed the accrual method was not in fact in use. The court held that since the Commissioner had not exercised his discretion to require the partnership to change to the cash method, its finding that the partnership had adopted the accrual method was dispositive and that the partnership's "purported use of the cash method to calculate its expenses [did] not alter our conclusions."[74] Consequently, the partnership was entitled to use the accrual method of accounting and the taxpayers reported their share of the partnership income in the correct year.

CONCLUSION

Taxpayers litigate many of the same issues regarding gross income year after year, due to the complex nature of what constitutes gross income. Over the years, the courts have consistently interpreted gross income broadly and construed exclusions and exceptions narrowly. Most cases considering the inclusion of income under IRC § 61 were decided for the IRS. A major source of gross income litigation again this year was the inclusion of damage awards. However, the number declined from ten such cases litigated last year down to six this year. Notwithstanding this decrease, all taxpayers that challenged the inclusion of their damage award in gross income were overruled by the courts just as they were last year. The National Taxpayer Advocate has previously recommended a legislative change that would clarify the tax treatment of court awards and settlements by permitting taxpayers to exclude any payments received as a settlement or judgment for mental anguish, emotional distress, or pain and suffering.

Another source of litigation this year was disputes about the classification of IRA distributions. This litigated matter increased from only two cases last year to eight this year. Out of those cases, five taxpayers litigated the rollover provision of IRC § 408. The court upheld the Commissioner's determination, and ordered partial relief in one case.

Taxpayers litigated eight discharge of indebtedness income cases, and prevailed, in whole or in part, in half of those cases. We anticipate an increase in discharge of indebtedness cases particularly with respect to the insolvency exception in the future because of the expiration of qualified principal residence indebtedness exclusion under IRC § 108(a)(1) on January 1, 2014.

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72 Treas. Reg. §1.446-1(c)(1)(ii).

73 T.C. Memo. 2013-20. The payments were made in 2005 and 2006, but were tuition payments for 2006 and 2007, respectively.

74 *Id*.

MLI #4 Summons Enforcement Under IRC §§ 7602, 7604, and 7609

SUMMARY

Pursuant to IRC § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability.[1] To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information.[2] If a person summoned under section 7602 neglects or refuses to obey the summons, or to produce books, papers, records, or other data, or to give testimony, as required by the summons, the IRS may seek enforcement of the summons in a United States District Court.[3]

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it.[4] Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because often the government, rather than the taxpayer, initiates the litigation pertaining to summons enforcement. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons.[5] Generally, the burden on the taxpayer to establish the illegality of the summons is heavy.[6]

We identified 117 federal cases decided between June 1, 2012, and May 31, 2013, that included issues of IRS summons enforcement. In 80 cases, the government initiated the litigation by filing a petition to enforce the summons. In 37 cases, the taxpayer or a third party initiated the litigation by filing a motion to quash the summons. Of the 117 cases, the parties contesting the summonses prevailed fully in four cases, with two other cases resulting in split decisions. The IRS prevailed in full in the remaining 111 decisions. Of the 117 cases, 56 included a discussion of the law and interaction between the taxpayer and the government.[7] Of these 56 cases, the parties contesting the summonses prevailed fully in four cases, with two other cases resulting in split decisions. The IRS prevailed in the remaining 50 cases.

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PRESENT LAW

The IRS has broad authority under IRC § 7602 to issue a summons to examine a taxpayer's books and records or demand testimony under oath.[8] Further, the IRS may obtain information related to an investigation from a third party if, subject to the exceptions of IRC § 7609(c), it provides notice to the taxpayer

1 Internal Revenue Code (IRC) § 7602(a)(1); Treas. Reg. § 301.7602-1.

2 IRC § 7602(a).

3 IRC § 7604(b).

4 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

5 IRC § 7609(b).

6 *U.S. v. LaSalle Nat'l Bank*, 437 U.S. 298, 316 (1978).

7 These 56 cases do not include cases for which there was reported solely (1) an order to show why the case should not be decided on the basis of the government's allegations once the government established a *prima facie* case; (2) an order to obey a summons; or (3) a dismissal for failure to prosecute.

8 IRC § 7602(a). *See also LaMura v. U.S.*, 765 F.2d 974, 979 (11th Cir. 1985) (*citing U.S. v. Bisceglia*, 420 U.S. 141, 145-146 (1975)).

or other person identified in the summons.[9] In limited circumstances, the IRS can issue a summons even if the name of the taxpayer under investigation is unknown, *i.e.*, a "John Doe" summons.[10] However, the IRS cannot issue a summons after referring the matter to the Department of Justice (DOJ).[11]

If the recipient fails to comply with a summons, the United States may commence an action under IRC § 7604 in the appropriate U.S. District Court to compel document production or testimony.[12] If the United States files a petition to enforce the summons, the taxpayer may contest the validity of the summons in that proceeding.[13] Also, if the summons is served upon a third party, any person entitled to notice may petition to quash the summons in an appropriate district court, and may intervene in any proceeding regarding the enforceability of the summons.[14]

A taxpayer or other person named in a third-party summons is generally entitled to notice,[15] but exceptions may apply. For example, the IRS is not required to give notice if the summons is issued to aid in the collection of "an assessment made or judgment rendered against the person with respect to whose liability the summons is issued."[16] This exception reflects congressional recognition of a difference between a summons issued in an attempt to compute the taxpayer's taxable income, and a summons issued after the IRS has assessed tax or obtained a judgment. For example, notice to the taxpayer or person named in the summons is not required where the IRS is attempting to determine whether the taxpayer has an account in a certain bank with sufficient funds to pay an assessed tax because such notice might seriously impede the IRS's ability to collect the tax.[17] The courts have interpreted this "aid in collection" exception to apply only where the taxpayer owns a legally identifiable interest in the account or other property for which records are summoned.[18] Another situation in which notice is not required is when an IRS criminal investigator serves a summons, in connection with a criminal investigation, on any person who is not the third-party record-keeper.[19]

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9 IRC § 7602(c). Those entitled to notice of a third-party summons (other than the person summoned) must be given notice of the summons within three days of the day on which the summons is served to the third party but no later than the 23rd day before the day fixed on the summons on which the records will be reviewed. IRC § 7609(a).

10 IRC § 7609(f). The court must approve a "John Doe" summons prior to issuance. In order for the court to approve the summons, the United States commences an *ex parte* proceeding. The United States must establish during the proceeding that its investigation relates to an ascertainable class of persons; it has a reasonable basis for the belief that these unknown taxpayers may have failed to comply with the tax laws; and it cannot obtain the information from another readily available source. IRC § 7609(f).

11 IRC § 7602(d). This restriction applies to "any summons, with respect to any person if a [DOJ] referral is in effect with respect to such person." IRC § 7602(d)(1).

12 IRC § 7604.

13 *U.S. v. Powell*, 379 U.S. 48, 58 (1964).

14 IRC § 7609(b). The petition to quash must be filed not later than the 20th day after the date on which the notice was served. IRC § 7609(b)(2)(A).

15 IRC § 7609(a)(1); *Shaw v. U.S.*, 109 A.F.T.R.2d (RIA) 1333 (M.D. Fla. 2012), *adopted by* 109 A.F.T.R.2d (RIA) 2364 (M.D. Fla. 2012), *affirmed by* 111 A.F.T.R.2d (RIA) 1754 (11th Cir. 2013).

16 IRC § 7609(c)(2)(D)(i). The exception also applies to the collection of a liability of "any transferee or fiduciary of any person referred to in clause (i)." IRC § 7609(c)(2)(D)(ii).

17 H.R. Rep. No. 94-658 at 310, reprinted in 1976 U.S.C.C.A.N. at 3206. *See also* S. Rep. No. 94-938, pt. 1, at 371-371, *reprinted* in 1976 U.S.C.C.A.N. at 3800-01 (containing essentially the same language).

18 *Ip v. U.S.*, 205 F.3d 1168, 1172-76 (9th Cir. 2000).

19 IRC § 7609(c)(2)(E). A third-party record-keeper is broadly defined and includes banks, consumer reporting agencies, persons extending credit by credit cards, brokers, attorneys, accountants, enrolled agents, and owners or developers of computer source code but only when the summons "seeks the production of the source or the program or the data to which the source relates." IRC § 7603(b)(2).

Regardless of whether the taxpayer contests the summons in a motion to quash or in response to the United States' petition to enforce, the legal standard is the same.[20] In *United States v. Powell*, the Supreme Court set forth four threshold requirements (referred to as the *Powell* requirements) that must be satisfied to enforce an IRS summons:

- The investigation must be conducted for a legitimate purpose;
- The information sought must be relevant to that purpose;
- The IRS must not already possess the information; and
- All required administrative steps must have been taken.[21]

The IRS bears the initial burden of establishing that these requirements have been satisfied.[22] However, this burden is minimal, as the government need only introduce a sworn affidavit of the agent who issued the summons declaring that each of the *Powell* requirements has been satisfied.[23] The burden then shifts to the person contesting the summons to demonstrate that the IRS did not meet the requirements or that enforcement of the summons would be an abuse of process.[24]

A taxpayer may also allege that the information requested is protected by a statutory or common-law privilege, such as the

- Attorney-client privilege;[25]
- Tax practitioner privilege;[26] or
- Work product privilege.[27]

However, these privileges are limited. For example, the attorney-client privilege protects "tax advice," but not tax return preparation materials.[28] The "tax shelter" exception limits the tax practitioner privilege and permits discovery of communications between a practitioner and client that promote participation in any tax shelter.[29] Thus, the tax practitioner privilege does not apply to any written communication between a federally authorized tax practitioner and "any person, any director, officer, employee, agent, or representative of the person, or any other person holding a capital or profits interest in the person" that is "in

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20 *Villarreal v. U.S.*, 111 A.F.T.R.2d (RIA) 778 (D. Nev. 2013), *aff'g* 110 A.F.T.R.2d (RIA) 6777 (D. Colo. 2012).

21 *U.S. v. Powell*, 379 U.S. 48, 57-58 (1964).

22 *Fortney v. U.S.*, 59 F.3d 117, 119-20 (9th Cir. 1995).

23 *U.S. v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993).

24 *Id*.

25 The attorney-client privilege provides protection from discovery of information where:
(1) legal advice of any kind is sought, (2) from a professional legal advisor in his or her capacity as such, (3) the communication is related to this purpose, (4) made in confidence, (5) by the client, (6) and at the client's insistence protected, (7) from disclosure by the client or the legal advisor, (8) except where the privilege is waived. *U.S. v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997) (citing John Henry Wigmore, *Evidence in Trials at Common Law* § 2292 (John T. McNaughten rev. 1961)).

26 IRC § 7525 extends the protection of the common law attorney-client privilege to federally authorized tax practitioners in federal tax matters. Criminal tax matters and communications regarding tax shelters are exceptions to the privilege. IRC § 7525(a)(2), (b). The interpretation of the tax practitioner privilege is based on the common law rules of attorney-client privilege. *U.S. v. BDO Seidman, LLP*, 337 F.3d 802, 810-812 (7th Cir. 2003), *cert. denied, Roes v. U.S.*, 540 U.S. 1178 (2004).

27 The work product privilege protects against the discovery of documents and other tangible materials prepared in anticipation of litigation. Fed. R. Civ. P. 26(b)(3); *see also Hickman v. Taylor*, 329 U.S. 495 (1947).

28 *U.S. v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999), *cert. denied*, 528 U.S. 1154 (2000).

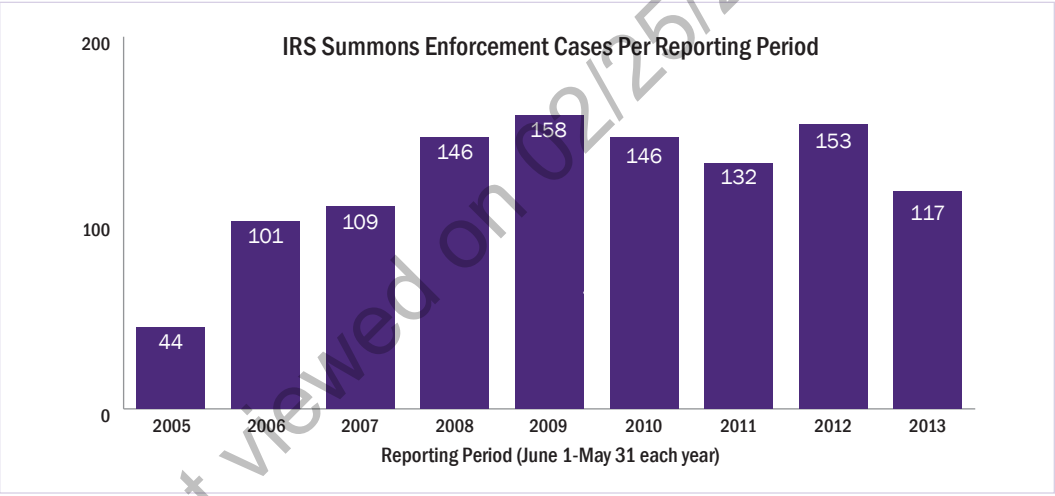
29 IRC § 7525(b); *Valero Energy Corp. v. U.S.*, 569 F.3d 626 (7th Cir. 2009).

connection with the promotion of the direct or indirect participation of the person in any tax shelter."[30] A tax shelter is defined as "a partnership or any other entity, any investment plan or arrangement, or any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax."[31]

ANALYSIS OF LITIGATED CASES

Summons enforcement has appeared as a Most Litigated Issue in the National Taxpayer Advocate's Annual Report to Congress every year since 2005. In 2005, we identified only 44 cases but predicted the number would rise as the IRS became more aggressive in its enforcement initiatives. The volume of identified cases rose to 101 during the reporting period ending on May 31, 2006, peaked at 158 cases for the reporting period ending on May 31, 2009, and stands at 117 during this year's reporting period as shown in Figure 3.1.1 below. A detailed list of these cases appears in Table 4 of Appendix III.

FIGURE 3.4.1, SUMMONS ENFORCEMENT CASES, 2005-2013



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The IRS recently issued guidance that requires examiners, when they do not receive information they request from a taxpayer, to issue delinquency notices followed by a pre-summons letter, and to then proceed to issue a summons.[32] The National Taxpayer Advocate is concerned about the increased use of summons the guidance is likely to trigger, and will scrutinize such use to determine whether it is appropriate and necessary.

Of the 117 cases we reviewed this year, the IRS prevailed in full in 111 cases. Taxpayers were represented in 26 cases and appeared *pro se (i.e.*, on their own behalf) in 91 cases. Eighty-eight cases involved individual taxpayers, while the remaining 29 involved business taxpayers, including sole proprietorships (16 of whom appeared through a representative). There were 56 cases where the taxpayer or a third party actually appeared in the proceeding, and the court issued an opinion discussing the law. Of these 56 cases, the IRS prevailed in full in 50 cases. The parties contesting the summonses prevailed fully in four

30 IRC § 7525(b).

31 IRC § 6662(d)(2)(C)(ii).

32 LB&I directive LB&I-04-1113-009, 2013 Tax Notes Today 214-19 (Nov. 5, 2013).

cases with two others ending in split decisions. Taxpayers were represented in 22 cases and appeared *pro se* in 34 cases. Thirty-six cases involved individual taxpayers, while the remaining 20 involved business taxpayers, including sole proprietorships (14 of whom appeared through a representative). The arguments the litigants raised against IRS summonses generally fell into the following categories:

***Powell* Requirements:** Taxpayers frequently argued that the IRS did not meet one or more of the *Powell* requirements, but such arguments met with little success. This outcome is due in large part to the substantial burden placed upon the taxpayers to rebut the IRS's *prima facie*[33] showing that the summons should be enforced. The U.S. Court of Appeals for the Eighth Circuit has described the IRS's burden here as slight, and the taxpayer's burden as heavy.[34]

Criminal Referral: The IRS may issue summonses for the purpose of investigating a possible criminal offense, so long as the matter has not yet been referred to the DOJ.[35] Many taxpayers argued that because the IRS issued a summons pursuant to a possible criminal investigation, it violated the IRC § 7602(d) restriction on issuing a summons after referring the matter to the DOJ. However, the courts are careful to distinguish between a *referral* to the DOJ, which prevents the IRS from issuing a summons, and a *criminal investigation* by the IRS, which does not.

Constitutional Arguments: Courts reiterated the longstanding rule that taxpayers cannot use the Fourth Amendment as a defense against a third-party summons.[36] Courts also continued to reject blanket assertions of the Fifth Amendment protection,[37] but noted that taxpayers may have valid Fifth Amendment claims regarding specific documents or testimony.[38] However, even if a taxpayer may assert the claim on behalf of himself or herself, he or she may not assert it on behalf of a business entity.[39]

Taxpayers may not be able to rely on the Fifth Amendment privilege to withhold self-incriminatory evidence of a testimonial or communicative nature if summoned documents fall within the "foregone conclusion" exception to the Fifth Amendment. The forgone conclusion exception applies where the government establishes its independent knowledge of three elements:

- The documents' existence;
- The documents' authenticity; and
- The possession or control of the documents by the person to whom the summons was issued.[40]

In *United States v. Sideman & Bancroft, LLP*,[41] the court considered the applicability of the foregone conclusion exception. In that case, the IRS executed a search warrant in connection with an ongoing criminal investigation of the taxpayer but failed to locate the relevant documents. During the investigation, the IRS learned that the taxpayer's tax return preparer had previously become very familiar with

33 *Prima facie* means "at first sight, on appearance but subject to further review or evidence." *Black's Law Dictionary* (9th Ed. 2009).

34 *U.S. v. Claes*, 747 F.2d 491, 494 (8th Cir. 1984).

35 IRC § 7602(d); *see, e.g., Peterson v. U.S.*, 110 A.F.T.R.2d (RIA) 6562 (D. Neb. 2012).

36 *See, e.g., Peterson v. U.S.*, 110 A.F.T.R.2d (RIA) 6562 (D. Neb. 2012).

37 *See, e.g., U.S. v. Amabile*, 109 A.F.T.R.2d (RIA) 2392 (E.D. Pa. 2012), *adopted by* 110 A.F.T.R.2d (RIA) 5017 (E.D. Pa. 2012).

38 *U.S. v. Amabile*, 109 A.F.T.R.2d (RIA) 2392 (E.D. Pa. 2012), *adopted by* 110 A.F.T.R.2d (RIA) 5017 (E.D. Pa. 2012).

39 *U.S. v. Christensen*, 110 A.F.T.R.2d (RIA) 5421 (D. Ariz. 2012).

40 *U.S. v. Sideman & Bancroft*, LLP, 107 A.F.T.R.2d (RIA) 1780 (N.D. Cal. 2011), *affirmed by* 111 A.F.T.R.2d (RIA) 460 (9th Cir. 2013).

41 *U.S. v. Sideman & Bancroft, LLP*, 107 A.F.T.R.2d (RIA) 1780 (N.D. Cal. 2011), *affirmed by* 111 A.F.T.R.2d (RIA) 460 (9th Cir. 2013).

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the sought-after documents and could identify numerous distinct features of those documents. The preparer later delivered the documents to the taxpayer's civil tax attorney, who delivered them to the taxpayer's counsel handling the IRS criminal investigation. The taxpayer's criminal tax counsel refused to comply with a subsequent IRS summons for the documents, arguing that producing the documents would be a communicative act that would tacitly concede the existence of the summoned documents and their possession or control by the taxpayer.[42] The court concluded that the IRS knew with "reasonable particularity" prior to issuing the summons, from the information provided by the taxpayer's tax return preparer, that those documents existed and were in the possession of the taxpayer's criminal tax counsel.[43] The court further noted that the information provided by the taxpayer's tax return preparer could sufficiently authenticate the summoned documents, thus satisfying each element of the foregone conclusion exception.[44]

One court held that a taxpayer is not precluded from invoking the Fifth Amendment privilege for the first time at a contempt proceeding for failure to comply with a summons. In *United States v. St. John*,[45] the IRS issued two summonses requesting that the taxpayer give testimony and produce records and documents for the purpose of determining his personal tax liability. The taxpayer appeared before the Revenue Officer named in the summons but refused to produce the records and refused to answer most questions on Fifth Amendment grounds.[46] Appearing *pro se* at a summons enforcement hearing, the taxpayer failed to assert his Fifth Amendment privilege. In a subsequent proceeding, however, when the taxpayer was ordered to show cause why he should not be held in contempt and appropriately sanctioned, he invoked the privilege.[47] The court rejected the argument that the taxpayer waived the Fifth Amendment privilege by failing to raise the defense at the enforcement stage of the proceedings and failing to object to the report and recommendation on the enforcement order.[48] The court stated that every reasonable presumption against waiver of the Fifth Amendment privilege, a fundamental constitutional right, should be indulged.[49] The taxpayer could invoke the privilege for the first time as late as a contempt hearing.

A court this year affirmed a lower court's rejection of a claim that IRS agents had attempted to "deter or chill" the right to speak out against "harassing agent conduct" in violation of the taxpayer's First Amendment rights.[50] Courts also rejected taxpayers' arguments that summons enforcement violated their rights under federal privacy laws.[51] Some taxpayers argued, without success, that summonses were unconstitutionally overbroad.[52]

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42 *U.S. v. Sideman & Bancroft, LLP*, 107 A.F.T.R.2d (RIA) 1780 (N.D. Cal. 2011), *affirmed by* 111 A.F.T.R.2d (RIA) 460 (9th Cir. 2013).

43 *Id*.

44 *Id*.

45 111 A.F.T.R.2d (RIA) 723 (M.D. Fla. 2013), *adopting in part* 111 A.F.T.R.2d (RIA) 719 (M.D. Fla. 2012).

46 *Id*.

47 *Id*.

48 *Id*.

49 *Id*.

50 *See, e.g., Canatella v. U.S.*, 108 A.F.T.R.2d (RIA) 5256 (N.D. Cal. 2011), *affirmed by* 111 A.F.T.R.2d (RIA) 1996 (9th Cir. 2013).

51 *See, e.g., U.S. v. Williams*, 111 A.F.T.R.2d (RIA) 850 (D. Or. 2013), *adopted by* 111 A.F.T.R.2d (RIA) 853 (D. Or. 2013).

52 *See, e.g., U.S. v. Lano Equipment, Inc.*, 2012 U.S. Dist. LEXIS 77900 (D. Minn. 2012), *adopted by* 2012 U.S. Dist. LEXIS 77392 (D. Minn. 2012).

Privilege: Courts generally reject claims of attorney-client privilege. In *Gjerde v. United States*,[53] the court rejected the taxpayer's argument that the attorney-client privilege protected his bank records from being summoned. The taxpayer, a licensed California attorney, argued that examination of his bank records, which included two of his client trust accounts, would contravene his duty under state law to preserve client confidences and would violate the attorney-client privilege.[54] The court concluded that the bank records were not communications made in the attorney's capacity as a legal adviser in the course of receiving or giving legal advice and therefore were not protected by the attorney-client privilege.[55]

In *United States v. Eaton Corp.*,[56] the taxpayer challenged multiple summonses, asserting various privileges including attorney-client privilege. In the first summons the court reviewed, a business failed to provide the IRS with a document-by-document privilege log but asserted that the information sought had been compiled in the course of seeking legal advice and provided a corroborating declaration from its vice president of federal tax strategy.[57] The court concluded that, pursuant to Federal Rule of Civil Procedure 26(b)(5),[58] the declaration was insufficient to establish the attorney-client privilege because it did not provide enough information about the documents withheld to enable the government to assess the claim of privilege.[59] In the second and third summonses it reviewed, the court found the privilege was sufficiently substantiated by the vice president's declaration in conjunction with logs that included the subject matter of the documents to which a privilege was asserted, the document type, the author, and the privilege claimed.[60] Accordingly, the court denied the government's petitions for enforcement of the second and third summonses.

International Treaty Obligations: Courts denied two taxpayer motions to quash summonses and granted one government motion to enforce a summons based on the government's compliance with international agreements. In *United States v. Villarreal*,[61] the court considered the enforceability of an IRS summons issued pursuant to the Agreement Between the United States of America and the United Mexican States for the Exchange of Information with Respect to Taxes ("TIEA"). In that case, an official of the taxing authority for Mexico, the Servicio de Administracion Tributaria ("SAT"), requested that the IRS obtain records from an American bank through which SAT believed the taxpayer's business transferred funds affecting the taxpayer's Mexican income tax liability.

The court noted that the same four-part *Powell* test applies where the IRS issues a summons at the request of a treaty partner.[62] The taxpayer asserted that the IRS summons was not issued for a legitimate purpose because it was being used to advance a "harassment campaign" by the SAT, and that the information

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53 110 A.F.T.R.2d (RIA) 5581 (E.D. Cal. 2012).

54 *Id*.

55 *Id.*

56 110 A.F.T.R.2d (RIA) 5638 (N.D. Ohio 2012).

57 *U.S. v. Eaton Corp.*, 110 A.F.T.R.2d (RIA) 5638 (N.D. Ohio 2012).

58 Federal Rule of Civil Procedure 26(b)(5) provides that a party withholding information based on a claim of privilege must: "expressly make the claims; and (ii) describe the nature of the documents, communications, or tangible things not produced or disclosed—and do so in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the claim." Fed. R. Civ. P. 26(b)(5).

59 *U.S. v. Eaton Corp*. 110 A.F.T.R.2d (RIA) 5638 (N.D. Ohio 2012).

60 *Id*. The court also found that the tax practitioner privilege applied to the information requested in the second and third summonses and the work product privilege applied to the information requested in the third summons.

61 *Villarreal v. U.S.*, 111 A.F.T.R.2d (RIA) 1713 (10th Cir. 2013), *aff'g* 109 A.F.T.R.2d (RIA) 1522 (D. Colo. 2012).

62 *Id*.

sought was irrelevant. The court held that the taxpayer's assertion of improper purpose was conclusory and therefore insufficient to meet his burden of proof. Moreover, relying on Supreme Court precedent, the court held that it is not the good faith of the foreign tax authority that is relevant in the analysis of proper purpose but rather the good faith of the IRS.[63] The court also held that the information requested by the summons need only be *potentially* relevant to an ongoing investigation; the information about the taxpayer's transferred funds satisfied this standard.[64]

The IRS prevailed in 33 cases involving motions to quash summonses, in part because the courts lacked jurisdiction to hear the cases. The courts dismissed these cases for lack of jurisdiction for the following reasons:

Lack of Jurisdiction Due to Procedural Requirements: The United States is immune from suit unless Congress has expressly waived its sovereign immunity.[65] Because a motion to quash service of an IRS summons is a suit against the United States, a court has jurisdiction only when Congress has expressly waived this immunity. When a taxpayer wishes to challenge an IRS summons issued to a third party, federal law sets forth the exclusive method by which the taxpayer can proceed. IRC § 7609(b) allows a taxpayer to initiate a proceeding in U.S. District Court for the district in which the third party resides, but the proceeding must be initiated no later than 20 days from the date the notice of summons was given. Courts have strictly construed the IRC § 7609(b) deadline when determining whether sovereign immunity has been waived. For example, a court dismissed a *pro se* taxpayer's motion to quash for lack of jurisdiction because the taxpayer filed the motion two days after the 20-day limit expired.[66] Another court held that it lacked subject matter jurisdiction over a petition to quash a third-party summons, where the third parties neither resided in nor were found within the jurisdiction of the district court.[67]

Lack of Jurisdiction Due to Notice Requirements: Courts denied multiple motions to quash because the parties contesting the summonses were not entitled to notice of the summonses due to one of the IRC § 7609(c) exceptions and therefore lacked standing to contest their validity.[68] In *Bybee v. United States*, the government served third-party summonses on the taxpayer's son and the son's business during an investigation into potential tax evasion by the taxpayer.[69] The taxpayer moved to quash the summonses, arguing that the IRS failed to give him proper statutory notice. The court rejected this argument because the summonses were not issued to third-party record-keepers and therefore the taxpayer had no right to notice of the summons.[70] The court held that sovereign immunity had not been waived and the court lacked subject matter jurisdiction.

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63 *U.S. v. Stuart*, 489 U.S. 353, 370 (1989).

64 *Villarreal v. U.S.*, 111 A.F.T.R.2d (RIA) 1713 (10th Cir. 2013), *aff'g* 109 A.F.T.R.2d (RIA) 1522 (D. Colo. 2012).

65 *U.S. v. Dalm*, 494 U.S. 596, 608 (1990).

66 *U.S. v. Chavira*, 111 A.F.T.R.2d (RIA) 1931 (C.D. Cal. 2013).

67 *Maxwell v. U.S.*, 876 F. Supp. 2d 22 (D.D.C. 2012).

68 IRC § 7609(c)(2)(E); *See, e.g., U.S. v. Bybee*, 110 A.F.T.R.2d (RIA) 6212 (D. Utah 2012), *adopted by* 110 A.F.T.R.2d (RIA) 6215 (D. Utah 2012).

69 110 A.F.T.R.2d (RIA) 6212 (D. Utah 2012), adopted by 110 A.F.T.R.2d (RIA) 6215 (D. Utah 2012).

70 IRC § 7609 does not apply to any summons served on any person who is not a third-party record-keeper (as defined in IRC § 7603(b)). IRC § 7609(c)(2)(E)(ii).

CONCLUSION

The IRS may issue a summons to obtain information needed to determine whether a tax return is correct or if a return should have been filed, to ascertain a taxpayer's tax liability, or to collect a liability.[71] Accordingly, the IRS may request documents and testimony from taxpayers who have failed to provide that information voluntarily. The IRS may also summon information from taxpayers at the request of a foreign taxing authority with which the United States is a treaty partner. Taxpayers and third parties rarely succeed in contesting IRS summonses due to the significant burden of proof and strict procedural requirements. Courts have justified broad readings of the summons enforcement statutes to ensure IRS investigatory powers are not unduly restricted.[72] Thus, taxpayers seldom challenge summons enforcement at the appellate level.[73] It appears that the IRS will continue to rely heavily on its summons enforcement power to effectively administer the IRC, and as a result, there will be challenges to these administrative actions that will be decided by the courts.

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71 IRC § 7602(a).

72 *Flight Vehicles Consulting, Inc. v. U.S.*, 110 A.F.T.R.2d (RIA) 5487 (N.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5484 (N.D. Cal. 2012).

73 Appeals were docketed in eight of the 117 cases reviewed herein.

MLI #5 Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

SUMMARY

Collection Due Process (CDP) hearings were created by the IRS Restructuring and Reform Act of 1998 (RRA 98).[1] CDP hearings provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.[2]

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court.[3] Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.[4]

Since 2003, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 105 opinions on CDP cases during the review period of June 1, 2012, through May 31, 2013.[5] Taxpayers prevailed in full in eight of these cases (nearly eight percent) and in part in nine others (nearly nine percent). Of the 17 opinions where taxpayers prevailed in whole or in part, seven taxpayers appeared *pro se* and ten were represented.

The cases discussed below demonstrate that CDP hearings serve an important function by providing taxpayers with a forum to raise legitimate issues before the IRS deprives them of property. Many of these decisions provide guidance on substantive issues. The Court imposed sanctions for inappropriate use of the CDP process in three of the 105 cases reviewed.[6]

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PRESENT LAW

Current law provides taxpayers an opportunity for independent review of an NFTL filed by the IRS or of a proposed levy action.[7] As noted above, the purpose of CDP rights is to give taxpayers adequate

1 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 Internal Revenue Code (IRC) §§ 6320(c) (lien) and 6330(c) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test.

3 Internal Revenue Code (IRC) § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

4 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax.). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review upon a showing of "good cause," if the underlying tax liability is not at issue.

5 For a list of all cases reviewed, see Table 4 in Appendix III, *infra*.

6 The Tax Court imposed penalties for frivolous proceedings under IRC § 6673 in the following three cases: *Klingenberg v. Comm'r*, T.C. Memo. 2012-292; *Mattson v. Comm'r*, 508 F. App'x 653 (9th Cir. 2013); and *Zook v. Comm'r*, T.C. Memo. 2013-128.

7 IRC §§ 6320 and 6330. *See* RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

notice of IRS collection activity and a meaningful hearing before the IRS deprives them of property.[8] The hearing allows taxpayers to raise issues relating to collection of the liability, including:

- The appropriateness of collection actions;[9]
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;[10]
- Appropriate spousal defenses;[11]
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a statutory notice of deficiency or have another opportunity to dispute the liability;[12] and
- Any other relevant issue relating to the unpaid tax, the NFTL, or the proposed levy.[13]

A taxpayer cannot raise an issue considered at a prior administrative or judicial hearing if the taxpayer participated meaningfully in that hearing or proceeding.[14]

Procedural Collection Due Process Requirements

The IRS must provide a CDP notice to the taxpayer after it has filed the first NFTL or generally before its first intended levy for the particular tax and tax period.[15] The IRS must provide the notice not more than five business days after the day of filing the NFTL, or at least 30 days before the day of the proposed levy.[16] If the IRS files a lien, the CDP lien notice must inform the taxpayer of the right to request a CDP hearing within a 30-day period, which begins on the day after the end of the five-business-day period after the filing of the NFTL.[17] In the case of a proposed levy, the CDP levy notice must inform the taxpayer of the right to request a hearing within the 30-day period beginning on the day after the date of the CDP notice.[18]

Requesting a CDP Hearing

Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing within the applicable period.[19] The Code and regulations require taxpayers to provide their reasons for requesting a hearing. Failure to provide the basis may result in denial of a face-to-face hear-

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8 Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. *See U.S. v. National Bank of Commerce*, 472 U.S. 713, 719-722 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

9 IRC § 6330(c)(2)(A)(ii).

10 IRC § 6330(c)(2)(A)(iii).

11 IRC § 6330(c)(2)(A)(i).

12 IRC § 6330(c)(2)(B).

13 IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

14 IRC §§ 6330(c)(4).

15 IRC § 6330(f) permits the IRS to levy without first giving a taxpayer a CDP notice in the following situations: the collection of tax is in jeopardy, a levy was served on a state to collect a state tax refund, the levy is a disqualified employment tax levy; or the levy was served on a federal contractor. A disqualified employment tax levy is any levy to collect employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h).

16 IRC § 6320(a)(2) and §§ 6330(a)(2). The CDP notice can be provided to the taxpayer in person, left at the taxpayer's residence or dwelling, or sent by certified or registered mail (return receipt requested) to the taxpayer's last known address.

17 IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

18 IRC § 6330(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

19 IRC §§ 6330(a)(3)(B) and 6320(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2)A-C1(ii) and 301.6330-1(c)(2)A-C1(ii).

ing.[20] Taxpayers who fail to timely request a CDP hearing will be afforded an "equivalent hearing," which is similar to a CDP hearing, but without judicial review.[21] Taxpayers must request an equivalent hearing within the one-year period beginning the day after the five-business-day period following the filing of the NFTL, or in levy cases, within the one-year period beginning the day after the date of the CDP notice.[22]

Conduct of a CDP Hearing

The IRS generally will suspend levy action throughout a CDP hearing involving a notice of intent to levy, unless it determines that:

- The collection of tax is in jeopardy;
- The collection resulted from a levy on a state tax refund;
- The IRS has served a disqualified employment tax levy; or
- The IRS has served a federal contractor levy.[23]

The IRS also suspends collection activity throughout any judicial review of Appeals' determination, except if an appeal is pending, the underlying tax liability is not at issue, and the IRS can demonstrate good cause to resume collection activity.[24]

CDP hearings are informal. When a taxpayer requests a hearing with respect to both a lien and a proposed levy, Appeals will attempt to conduct one hearing.[25] Courts have determined that a CDP hearing need not be face-to-face but can take place by telephone or correspondence,[26] and Appeals will conduct the hearing by telephone unless the taxpayer requests a face-to-face conference.[27] The CDP regula-

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20 IRC §§6320(b)(1) and 6330(b)(1); Treas. Reg. §§ 301.6320-1(c)(2)A-C1, 301.6330-1(c)(2) A-C1, 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2)A-D8. The regulations require the IRS to provide the taxpayer an opportunity to "cure" any defect in a timely filed hearing request, including providing a reason for the hearing. Form 12153 includes space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider, as well as examples of common reasons for requesting a hearing. *See* IRS Form 12153, *Requests for Collection Due Process or Equivalent Hearing* (Mar. 2011).

21 Treas. Reg. §§ 301.6320-1(i)(2) Q&A-I16 and 301.6330-1(2) Q&A-I16; *Business Integration Services, Inc. v. Comm'r*, T.C. Memo. 2012-342; *Moorhous v. Comm'r*, 116 T.C. 263 (2001). A taxpayer can request an Equivalent Hearing by checking a box on Form 12153, *Request for Collection Due Process or Equivalent Hearing*, by making a written request, or by confirming that he or she wants the untimely CDP hearing request to be treated as an Equivalent Hearing when notified by Collection of an untimely CDP hearing request. Internal Revenue Manual 5.19.8.4.3, *Equivalent Hearing (EH) Requests and timeliness of EH Requests* (Nov. 1, 2007).

22 Treas. Reg. §§ 301.6320-1(i)(2)A-17 and 301.6330-1(i)(2)A-17.

23 IRC § 6330(e)(1) provides the general rule for suspending collection activity. IRC § 6330(f) provides that if collection of the tax is deemed in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS served a disqualified employment tax levy or a federal contractor levy, IRC § 6330 does not apply, except to provide the opportunity for a CDP hearing within a reasonable time after the levy. *See Clark v. Comm'r*, 125 T.C. 108, 110 (2005) (citing *Dora v. Comm'r*, 119 T.C. 356 (2002)).

24 IRC § 6330(e)(1) and (e)(2).

25 IRC § 6320(b)(4).

26 *Katz v. Comm'r*, 115 T.C. 329, 337-38 (2000) (finding that telephone conversations between the taxpayer and the Appeals Officer constituted a hearing as provided in IRC § 6320(b)). Treas. Reg. §§ 301.6320-1(d)(2)A-D6, A-D8 and 301.6330-1(d)(2) A-D6, A-D8.

27 *See, e.g.*, Appeals Letter 4141 (rev. Aug. 2012) (acknowledging the taxpayer's request for a CDP hearing and providing information on the availability of face-to-face conference). The National Taxpayer Advocate has repeatedly raised concerns regarding the inadequacy of Appeals' communication to taxpayers on how to request a face-to-face hearing and where this information is included in the letter. *See* National Taxpayer Advocate 2005 Annual Report to Congress 136 (Most Serious Problem: *Appeals Campus Centralization*); National Taxpayer Advocate 2009 Annual Report to Congress 70 (Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Customer Satisfaction or Confidence in Appeals*); National Taxpayer Advocate 2010 Annual Report to Congress 128 (Most Serious Problem: *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered*). In response to taxpayers' and their representatives' dissatisfaction with the Appeals' CDP hearings, including the difficulty of receiving a face-to-face hearing, TAS worked with Appeals to test the use of "telepresence" or "virtual" face-to-face hearings. This test began in 2011 between two Low Income Taxpayer Clinics and two campus Appeals units and is ongoing. For a further discussion, see Status Update: *The IRS Has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance*, *supra*.

tions state that taxpayers who provide non-frivolous reasons for opposing the IRS collection action will generally be offered but not guaranteed face-to-face conferences.[28] Taxpayers making frivolous arguments are not entitled to face-to-face conferences.[29] A taxpayer will not be granted a face-to-face conference concerning a collection alternative, such as an installment agreement (IA) or offer in compromise (OIC), unless other taxpayers would be eligible for the alternative under similar circumstances.[30] For example, the IRS will not grant a face-to-face conference to a taxpayer who proposes an OIC as the only issue to be addressed but has failed to file all required returns and is therefore ineligible for an offer. Appeals may, however, at its discretion, grant a face-to-face conference to explain the eligibility requirements for a collection alternative.[31]

The CDP hearing is to be held by an impartial officer from Appeals, who is barred from engaging in *ex parte* communication with IRS employees about the substance of the case and who has had "no prior involvement" in the case.[32] In addition to addressing the issues raised by the taxpayer, the Appeals Officer must verify that the IRS has met the requirements of all applicable laws and administrative procedures.[33] In its determination, Appeals must weigh the issues raised by the taxpayer and decide whether the proposed collection action "balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be no more intrusive than necessary."[34]

Special rules apply to the IRS's handling of hearing requests that raise frivolous issues. IRC § 6330(g) provides that the IRS may disregard any portion of a hearing request based on a position the IRS has identified as frivolous, or that reflects a desire to delay or impede the administration of tax laws.[35] Similarly, IRC § 6330(c)(4) provides that a taxpayer cannot raise an issue if it is based on a position identified as frivolous or reflects a desire to delay or impede tax administration.

IRC § 6702(b) allows the IRS to impose a penalty for a specified frivolous submission, including a frivolous CDP hearing request.[36] A request is subject to the penalty if any part of it "(i) is based on a position which the Secretary has identified as frivolous…or (ii) reflects a desire to delay or impede the administration of the Federal tax laws."[37] In *Thornberry v. Commissioner*, the Tax Court held that if Appeals determines a request for an administrative hearing is based entirely on a frivolous position under IRC § 6702(c), and issues a notice stating that Appeals will disregard the request, the Tax Court does have jurisdiction to review Appeals' decision if the taxpayer timely petitions for review. The court found

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28 Treas. Reg. § 301.6320-1(d)(2) A-D8.

29 Treas. Reg. §§ 301.6320-1(d)(2) A-D7 and 301.6330-1(d)(2) A-D8.

30 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8.

31 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8.

32 IRC §§ 6320(b)(1), 6320(b)(3), 6330(b)(1) and 6330(b)(3). *See also* Rev. Proc. 2012-18, 2012-1 C.B. 455. *See, e.g., Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo. 2006-93, *action on dec.*, 2007-2 (Feb. 27, 2007); *Cox v. Comm'r*, 514 F.3d 1119, 1124-28 (10th Cir. 2008), *action on dec.*, 2009-22 (June 1, 2009).

33 IRC § 6330(c)(1); *Hoyle v. Comm'r*, 131 T.C. 197 (2008).

34 IRC § 6330(c)(3)(C).

35 IRC § 6330(g). Section 6330(g) is effective for submissions made and issues raised after the date on which the IRS first prescribed a list of frivolous positions. Notice 2007-30, 2007-1 C.B. 883, which was published on or about April 2, 2007, provided the first published list of frivolous positions. Notice 2010-33, 2010-17 C.B. 609, contains the current list.

36 The frivolous submission penalty applies to the following submissions: CDP hearing request, OIC, IA, and application for a Taxpayer Assistance Order.

37 IRC § 6702(b)(2)(a). Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous hearing request. The taxpayer then has 30 days to withdraw the submission to avoid the penalty.

Appeals' letter disregarding the hearing request was a determination conferring jurisdiction under IRC § 6330(d)(1) because it authorized the IRS to proceed with the disputed collection action.[38]

Judicial Review of CDP Determination

Within 30 days of Appeals' determination, the taxpayer may petition the Tax Court for judicial review.[39] The Tax Court will only consider issues, including challenges to the underlying liability, that were properly raised during the CDP hearing.[40] An issue is not properly raised if the taxpayer fails to request Appeals consideration of the issue or the taxpayer requests consideration but fails to present any evidence regarding that issue after being given a reasonable opportunity.[41] The Tax Court, however, may remand a case back to Appeals for more fact finding when the taxpayer's factual circumstances have materially changed between the hearing and the trial.[42] When the case is remanded, the Tax Court retains jurisdiction.[43] The resulting hearing on remand provides the parties with an opportunity to complete the initial hearing while preserving the taxpayer's right to receive judicial review of the ultimate administrative determination.[44]

Where the validity of the underlying tax liability is properly at issue in the hearing, the court will review the amount of the tax liability on a *de novo* basis.[45] Where the Tax Court is reviewing the appropriateness of the collection action or subsidiary factual and legal findings, the court will review these determinations under an abuse of discretion standard.[46]

ANALYSIS OF LITIGATED CASES

We identified and reviewed 105 CDP court opinions, a nine percent decrease from the 116 cases in last year's report. As shown in the chart below, litigation of CDP cases considered by the court has been averaging about 110 cases per year over the past four years since 2010. The 105 opinions identified this year do not reflect the full number of CDP cases because the court does not issue an opinion in all cases. Some are resolved through settlements, and in other cases taxpayers do not pursue litigation after filing a petition with the court. The Tax Court also disposes of some cases by issuing unpublished orders. Table 5 in Appendix III provides a detailed list of the CDP opinions, including specific information about the issues, the types of taxpayers involved, and the outcomes of the cases.

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38 *Thornberry v. Comm'r*, 136 T.C. 356 (2011). The Office of Chief Counsel disagrees with the *Thornberry* holding and will continue to file motions to dismiss for lack of jurisdiction if the taxpayer petitions for Tax Court review of a denial, under § 6330(g), of a CDP hearing request that was determined to be based on a frivolous position. *See* Chief Counsel Directives Manual (CCDM) 35.3.23.5.1, *Motion to Dismiss for Lack of Jurisdiction When CDP Hearing Request Denied Under Section 6330(g)* (July 25, 2012).

39 IRC § 6330(d)(1).

40 *Giamelli v. Commissioner*, 129 T.C. 107 (2007).

41 Treas. Reg. §§ 301.6320-1(f)(2) Q&A-F3, 301.6330-1(f)(2) Q&A-F3.

42 *Churchill v. Commissioner*, T.C. Memo. 2011-182; *see also* CCN-2013-002 (Nov. 30, 2012), which provides Counsel attorneys with instructions on when a remand based on changed circumstances might be appropriate.

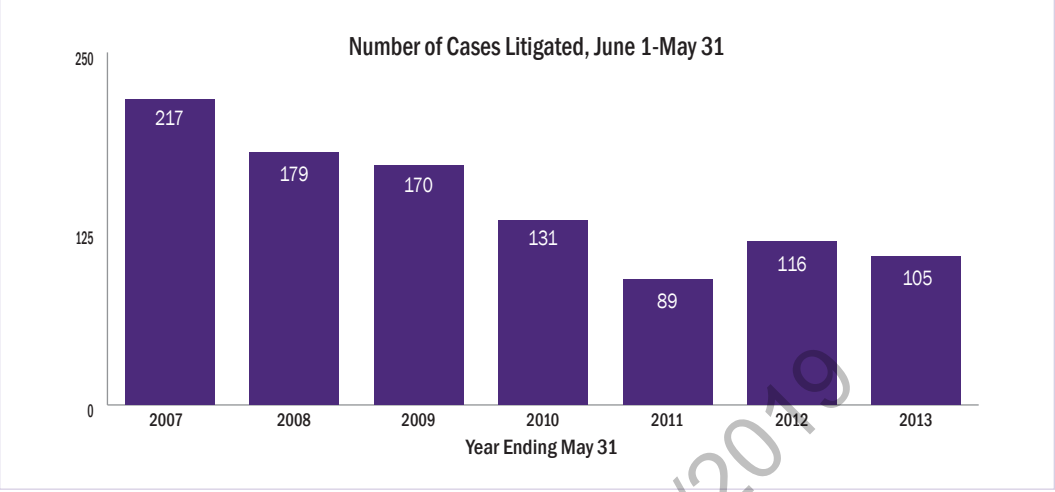
43 *Pomeroy v. Comm'r*, T.C. Memo 2013-26.

44 *Wadleigh v. Commissioner*, 134 T.C. 280, 299 (2010).

45 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. Rep. No. 1059-99, at 266 (Conf. Rep.). The term *de novo* means anew. *Black's Law Dictionary*, 447 (7th Ed. 1999).

46 *See, e.g., Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006); *Dalton v. Comm'r*, 682 F.3d 149 (1st Cir. 2012).

FIGURE 3.5.1, CDP Cases Litigated Between 2007 and 2013[47]



Litigation Success Rate

Taxpayers prevailed in full in eight of the 105 cases brought during the year ending May 31, 2013 (nearly eight percent).[48] Taxpayers prevailed in part in nine other cases (nearly nine percent). Of the cases in which the courts found for the taxpayer in whole or in part, the taxpayers appeared *pro se* in seven cases and were represented in ten others. The IRS prevailed fully in 84 percent of cases, the lowest percentage since 2003 when CDP first appeared as a Most Litigated Issue in the Annual Report to Congress.

FIGURE 3.5.2, Success Rates in CDP Cases[49]

Court Decision	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Decided for IRS	96%	95%	89%	90%	92%	90%	92%	89%	92%	86%	84%
Decided for Taxpayer	1%	4%	8%	8%	5%	8%	4%	10%	3%	7%	8%
Split Decision	3%	1%	3%	2%	3%	2%	4%	2%	3%	6%	9%
Neither	N/A	N/A	N/A	N/A	Less than 1%	N/A	N/A	N/A	1%	Less than 1%	N/A

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47 National Taxpayer Advocate 2007 Annual Report to Congress 569; National Taxpayer Advocate 2008 Annual Report to Congress 476; National Taxpayer Advocate 2009 Annual Report to Congress 418; National Taxpayer Advocate 2010 Annual Report to Congress 436; National Taxpayer Advocate 2011 Annual Report to Congress 619; National Taxpayer Advocate 2012 Annual Report to Congress 595.

48 *Antioco v. Comm'r*, T.C. Memo. 2013-35; *ENSYC Technologies v. Comm'r*, T.C. Summ. Op. 2012-55; *Fielder v. Comm'r*, T.C. Memo. 2012-284; *JAG Brokerage v. Comm'r*, T.C. Memo. 2012-315; *Jones v. Comm'r*, T.C. Memo. 2012-274; *Lane v. Comm'r*, T.C. Memo. 2013-121; *Lepore v. Comm'r*, T.C. Memo. 2013-135; *Moore v. Comm'r*, T.C. Summ. Op. 2012-116; *Pomeroy v. Comm'r* T.C. Memo. 2013-26.

49 Numbers have been rounded to nearest percentage and may not add to 100% due to rounding. A "split" decision refers to a case with multiple issues where both the IRS and the taxpayer prevail on one or more substantive issues. A "neither" decision refers to a case where the court's decision was not in favor of either party.

Issues Litigated

The cases discussed below are those the National Taxpayer Advocate considers significant or noteworthy. Their outcomes can provide important information to Congress, the IRS, and taxpayers about the rules and operation of CDP hearings. Equally important, all of the cases offer the IRS an opportunity to improve the CDP process, and collection practices in general, in both application and execution.

Dalton v. Commissioner

In *Dalton v. Commissioner*,[50] the United States Court of Appeals for the First Circuit decided the proper standard of review with respect to subsidiary legal and factual findings made by Appeals during the CDP process. In this case, the taxpayers (husband and wife) owned and operated a construction business that failed to pay its payroll taxes. The business went bankrupt, and the IRS assessed trust fund recovery penalties (TFRPs) under IRC § 6672 against the taxpayers for the unpaid taxes, which with interest exceeded $400,000. When the IRS sent the taxpayers a CDP levy notice, they requested a CDP hearing, at which they requested an OIC based on doubt as to collectibility and proposed to pay $10,000 to fully settle the liabilities.[51] The Appeals Officer (AO) rejected the offer because it did not include the value of property held by a trust. The AO included the trust property when calculating an acceptable offer amount because the AO concluded the trust was the nominee of the taxpayer. The taxpayers argued they held no legal interest in the trust property and appealed to the Tax Court.

The Tax Court initially remanded the case to Appeals with the instruction that the nominee question be reconsidered under state law principles.[52] On remand, Appeals issued a supplemental Notice of Determination (NOD) concluding again that the trust was the nominee of the taxpayers, as a Maine court would likely borrow nominee principles from federal law, and again rejected the taxpayers' OIC. The Tax Court reviewed the AO's supplemental determination to include the trust property when evaluating the OIC under a *de novo* standard. It found in analyzing the state law that the taxpayers were not the owners of the trust property and thus held that the AO's supplemental determination to proceed with the levy was an abuse of discretion.[53]

The IRS appealed the Tax Court's decision to the First Circuit, which reversed the Tax Court's decision, holding that the proper standard of review with respect to subsidiary factual and legal determinations made by Appeals during the CDP process is abuse of discretion, not *de novo*. The First Circuit reasoned that the Tax Court should not review Appeals' factual and legal determinations anew under the *de novo* standard but should instead should just analyze whether Appeals' subsidiary determinations are reasonable.

Under this more deferential standard of review, the Court found that Appeals did not abuse its discretion when it rejected the OIC based on its legal finding that the trust property was the property of the taxpayer. It found the IRS's determination that the trust was a nominee was reasonable based on the

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50 682 F.3d 149 (1st Cir. 2012).

51 An OIC is an agreement between a taxpayer and the government that settles a tax liability for payment of less that the full amount the IRS believes is owed. IRC § 7122. There are several grounds for an OIC, doubt as to collectibility, doubt as to liability, and effective tax administration. Doubt as to collectibility exists when the taxpayer's assets and income are less than the liability. Treas. Reg. § 301.7122-1(b).

52 *Dalton v. Comm'r*, T.C. Memo 2008-165.

53 *Dalton v. Comm'r*, 135 T.C. 393 (2010).

facts known by Appeals at the time of the hearing. Significant facts cited by the IRS that supported the nominee finding included the following:

- The taxpayers received only one dollar at the property's sale to the grantor of the trust;
- The taxpayers continued to maintain sole possession without payments of rent;
- The trust beneficiaries were the taxpayers' children; and
- The taxpayers paid the mortgage and property taxes.

Finally, the First Circuit reiterated that Congress intended CDP hearings to be informal, including the investigation of facts. In light of the informalities of the CDP hearings, the First Circuit held that a reviewing court's objective should be to evaluate the reasonableness of Appeals' subsidiary determination. As long as Appeals has reached a reasonable conclusion on questions of fact and law during the CDP process, Appeals has not abused its discretion.[54]

Antioco v. Commissioner

In *Antioco v. Commissioner*,[55] a 71-year-old taxpayer sold her primary residence, which doubled as a bed and breakfast, to pay marital debts following a divorce. The taxpayer received her portion of the sale proceeds, which were substantial, and used these proceeds (believing the sale of the residence was exempt from tax) as a down payment to purchase a five-unit apartment building. The taxpayer lived in one unit, used a second unit to house her 96-year-old mother, and rented the three others. Learning later that she was obliged to report the income, she did so in August 2008, but without remitting payment.

In response to the CDP levy notice, the taxpayer requested a CDP hearing and offered to pay $1,000 a month until she could refinance the building to satisfy the tax. The taxpayer was experiencing difficulty in securing an agreement to refinance because her income was too low. Since her elderly mother was suffering from health issues and the taxpayer relied on rental income to survive, she argued that the levy would create an "economic hardship" for them both. Nevertheless, Appeals issued an NOD sustaining the proposed levy action and rejecting the taxpayer's proposal for an installment agreement due to failure to submit a new financial information statement. The taxpayer sought Tax Court review of the NOD.

Prior to trial, the Commissioner requested, and was granted, a motion to remand the case. At that time, the Commissioner conceded the AO had abused her discretion by not asking for revised financial forms and by not addressing the taxpayer's "economic hardship" argument.[56]

On remand, a new AO issued a supplemental NOD sustaining the proposed levy on the basis that the taxpayer could afford to pay her tax liabilities. The AO alleged the taxpayer committed fraud when she subsequently put her mother's name on the apartment building's deed to meet the terms of a refinancing agreement. The AO also alleged the taxpayer had deliberately transferred all her equity in the building to

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54 As of the writing of this report, *Dalton* has been cited in ten decisions as well as two amicus briefs. Reactions to the *Dalton* decision are mixed. *See* Susan Simmons, *First Circuit Uses New Standard in CDP Case*, 136 Tax Notes 159 (July 9, 2012) ("The First Circuit appears to have broken new ground in applying a reasonableness standard to findings of law in CDP determinations. Whether that's helpful or reasonable remains to be seen."). *See also* Adam Cole, *Student Case Note: A Preference for Deference: The Benefits of the First Circuit's Customized Standard of Review for Collection Due Process Appeals in Dalton v. Commissioner*, 58 Vill. L. Rev. 239 (2013) (arguing that the First Circuit reached the correct result because the Dalton standard of review increases efficiency and fairness, and is consistent with the purpose of CDP).

55 T.C. Memo. 2013-35.

56 T.C. Memo. 2013-35 at 3.

her ailing mother by including her on the deed. Additionally, the AO refused to consider the taxpayer's "economic hardship" argument, labeling the issue of her 96-year-old mother a "diversionary argument."[57]

The Tax Court could not uphold the supplemental NOD on any of the stated grounds and found the AO had abused his discretion in sustaining the proposed levy. The court found the AO's determination was not supported by the administrative record and the AO drew conclusions of fraud without performing an insolvency analysis. The Tax Court found an abuse of discretion in that the AO failed to consider the economic hardship argument and failed to ask the taxpayer to submit revised financial forms, which the court had ordered. The court remanded the case for a second time and instructed the AO to consider the taxpayer's revised financial information, proposed installment agreement, special circumstances, and "economic hardship" claims.

Pomeroy v. Commissioner

In *Pomeroy v. Commissioner*,[58] the taxpayers (husband and wife) timely requested a CDP hearing in response to the CDP lien notice. In their hearing request, the taxpayers stated they planned to submit an offer in compromise to settle their tax liabilities. The taxpayers then submitted an OIC based on doubt as to collectibility offering to settle the debt for $25,000. After the OIC was sent to the centralized offer unit (COIC), the taxpayers notified the offer examiner that the husband had suffered a severe stroke and was on his deathbed. The examiner responded by asking the taxpayers to provide more information, including a doctor's written prognosis, if they wanted the medical condition to be considered in the OIC review. The taxpayers submitted additional documentation stating a doctor's prognosis was forthcoming. However, because the examiner did not receive the documentation within ten days of the request, she determined that the taxpayers could fully pay and returned the case to Appeals. Upon receiving the new documentation, Appeals assigned a Settlement Officer (SO) to review the OIC. The SO issued a NOD approving the examiner's calculations, rejecting the OIC, and sustaining the NFTL filing.

The taxpayers appealed to the Tax Court and argued, among other things, that the husband's medical condition qualified them for an OIC based on effective tax administration (ETA) even though the taxpayers had submitted the OIC based on doubt as to collectibility.[59] In particular, the taxpayers argued that Appeals did not properly consider Mr. Pomeroy's stroke when determining whether the taxpayers could full pay. The court found that because the administrative record was incomplete with regard to the husband's medical condition, it could not determine whether Appeals abused its discretion when it rejected the OIC and remanded the case so the record could be supplemented. The Tax Court also noted that the SO did not make adequate efforts to ascertain the current status of the taxpayer husband's health or his prognosis. The case was remanded to the Appeals Office to supplement the record accordingly.

Brombach v. Commissioner

In *Brombach v. Commissioner*,[60] the IRS filed an NFTL and sent the taxpayer a CDP lien notice. The taxpayer timely requested a CDP hearing and proposed an OIC in which he would pay $28,000 in full

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57 T.C. Memo. 2013-35 at 4.

58 T.C. Memo. 2013-26.

59 An ETA offer may be entered into when the IRS determines that although collection in full is possible, it would cause the taxpayer economic hardship or where public policy or equity considerations support compromise. Treas. Reg. § 301.7122-1(b).

60 T.C. Memo. 2012-265.

settlement of his tax liabilities, which exceeded $150,000. The taxpayer explained in a letter submitted with the OIC that his monthly expenses exceeded the national standards the IRS adopted, pointing to a number of "special circumstances." The AO rejected this offer, finding no special circumstances making the offer acceptable.

The Tax Court, in determining whether the IRS abused its discretion in rejecting the taxpayer's OIC, considered the IRS's "reasonable collection potential" (RCP) calculations. The court held that the IRS did not abuse its discretion in determining that taxpayer's interest in motorcycles, which he jointly owned with his wife, was half the motorcycles' realizable value; in allowing housing expenses less than the taxpayer claimed; or in determining that no special circumstances existed to require acceptance of the OIC. The Tax Court agreed in part that the IRS abused its discretion in estimating the taxpayer's monthly tax expenses, using an unusually short payout period. Despite this mistake, the Tax Court held the proposed offer of $28,000 was still lower than the taxpayer's RCP and therefore Appeals did not abuse its discretion in rejecting the OIC.

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Cantrell v. Commissioner

In *Cantrell v. Commissioner*,[61] the taxpayer requested a CDP hearing after receiving a CDP lien and levy notice relating to tax year 2001. After requesting the hearing, the taxpayer filed an amended 2001 tax return. The AO provided the taxpayer with a payoff amount to settle his tax liabilities based on the amended return. The taxpayer provided the AO with a check for that amount, but the AO forwarded the amended return to a Revenue Agent who then informed the taxpayer that the return was under examination. Ultimately, the Revenue Agent sent the amended return back to the AO with the recommendation that it be rejected. The AO then issued a notice of determination sustaining the NFTL filing and the proposed levy. In response, the taxpayer filed a petition with the Tax Court, arguing that his prior payment by check, which he presented to the AO, should have settled his entire liabilities for 2001.

The Tax Court noted that only authorized agents or officials representing the Commissioner are empowered to enter into settlement agreements, and AOs are not authorized agents for these purposes. Thus, the court determined the AO's acceptance of the check did not settle the taxpayer's liability. The court reviewed the underlying liability *de novo*, since the taxpayer did not receive a notice of deficiency or otherwise have an opportunity to contest the liability. The court found the petitioner failed to provide documentation to support the deductions claimed on the amended return. Thus, the IRS did not abuse its discretion in deciding to proceed with the proposed collection actions.

Hinerfeld v. Commissioner

In *Hinerfeld v. Commissioner*,[62] the taxpayer sought Tax Court review of Appeals' determination to sustain a proposed levy. The taxpayer, a corporate officer, owed TFRPs stemming from various unpaid quarterly employment tax periods for Thermacon Industries, Inc. (Thermacon).[63] During the CDP hearing, the SO indicated she would accept the taxpayer's amended OIC, because it proposed to pay the amount that the SO calculated as the taxpayer's RCP. However, the OIC was subject to review by Area Counsel as

61 T.C. Memo. 2012-257.

62 139 T.C. 277 (2012).

63 The taxpayer did not dispute the liability. The quarterly periods owed were for the quarters ending September 30 and December 31, 2002; March 31, September 30, and December 31, 2003; and June 30, 2004.

prescribed in IRC § 7122(b) for OICs made in cases with tax assessments of $50,000 or more.[64] Area Counsel's review discovered the taxpayer was involved in pending litigation over asset transfers from Thermacon to corporations owned by the taxpayer's immediate family. The complaint filed in this litigation alleged the taxpayer and his wife made fraudulent conveyances that left Thermacon unable to pay its creditors.[65] Since the assets transferred were valued at $2.2 million, the taxpayer made conflicting statements, and since the wife was suspected of serving as the taxpayer's nominee, Area Counsel recommended the SO reject the taxpayer's amended OIC. The SO's manager agreed and notified the taxpayer that his account could be placed in "currently not collectible" (CNC) status until the litigation was resolved. The taxpayer disagreed with Appeals' determination to reject the OIC and petitioned the Tax Court.

The taxpayer argued that Appeals participated in prohibited *ex parte* communications with Area Counsel. The court analyzed administrative guidelines prohibiting certain *ex parte* communications and found in favor of the IRS. First, the court determined that the *ex parte* communications did not fall within the limitations prescribed in Rev. Proc. 2000-43,[66] because there was some evidence the Appeals manager had exercised independent judgment in rejecting the offer. Second, the court found the Area Counsel's *ex parte* communications were mandated by statute under IRC § 7122(b). The court reviewed original legislative intent to reconcile IRC § 1001(a)(4)[67] and IRC § 7122(b). It concluded the *ex parte* communications in this instance fulfilled supervisory responsibilities and were therefore not prohibited. Finally, the court found no abuse of discretion because it concluded no undue influence was exerted by Area Counsel over Appeals during its independent review of the case and found all procedures were properly followed.

Imposition of Sanctions

IRC § 6673(a)(1) authorizes the Tax Court to impose sanctions when it appears the taxpayer instituted or maintained proceedings primarily for delay or when the taxpayer's position is frivolous or groundless.[68] As we found in last year's analysis, the court imposed these penalties in only a few CDP cases. Of the 105 cases reviewed this year, the court imposed sanctions in only three, or approximately three percent.[69] Last year, with 116 CDP cases decided, the court imposed sanctions in eight cases, or seven percent.[70] This low number may be attributable to IRC § 6330(g), which allows the IRS to disregard a frivolous hearing request.

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64 Section 7122(b) provides that if the Secretary makes a compromise in a civil case in which the unpaid amount of the tax assessed is $50,000 or more, an opinion of the General Counsel for the Department of the Treasury, or his delegate, shall be placed on file in the office of the Secretary. *See also* Treas. Reg. 301.7122-1(e)(6); CCDM 33.3.2.1(2), *Authority to Compromise* (Nov. 4, 2010).

65 Area Counsel discovered that the taxpayer and his wife were named as codefendants in a lawsuit filed in the U.S. District Court for the District of New Jersey on Oct. 2, 2007. The pending lawsuit, *Multi-Glass Atlantic, Inc. v. Alnor Assocs., LLC*, No. 1:07-cv-04760 (D.N.J. filed Oct. 2, 2007), concerned the sale of substantially all of Thermacon's assets pursuant to an asset purchase agreement the taxpayer signed on Thermacon's behalf on September 13, 2004, to Reelan Industries, Inc., a corporation wholly owned by the taxpayer's children and RJTL, Inc., a corporation wholly owned by Ruth Hinerfeld and the taxpayer's children.

66 The taxpayer cited Rev. Proc. 2000-43, 2000-2 C.B. 404 (superseded by Rev. Proc. 2012-12, 2012-10 I.R.B. 455, effective after May 15, 2012.) Rev. Proc. 2000-43, Q&A-11, 2000-2 C.B. at 406, specifically addresses communications between Appeals and the Office of Chief Counsel, A-11 provides three limitations on communications between Appeals employees and Office of Chief Counsel attorneys: (1) Appeals employees must not communicate with Chief Counsel attorneys who have previously provided advice to the IRS employees who made the determination Appeals is reviewing; (2) requests for legal advice where the answer is uncertain should be referred to the Chief Counsel's National Office and handled as requests for field service advice or technical advice; and (3) although Appeals employees may obtain legal advice from the Office of Chief Counsel, they remain responsible for making independent evaluations and judgments concerning the cases appealed to them, and Counsel attorneys are prohibited from offering advice that includes settlement ranges for any issues in an appealed case.

67 RRA 98, Pub. L. No. 105-206, § 1001(a)(4), 112 Stat. 685, 689 (1998). RRA 98 § 1001(a)(4) states, "ensure an independent appeals function within the Internal Revenue Service, including the prohibition in the plan of ex parte communications between appeals officers and other Internal Revenue Service employees to the extent that such communications appear to compromise the independence of the appeals officers."

68 *See* Most Litigated Issue: *Frivolous Issues Penalty Under IRC § 6673 and Related Appellate Level Sanctions*, *infra*

69 *Klingberg v. Comm'r*, T.C. Memo. 2012-292; *Mattson v. Comm'r*, 508 F. App'x 653 (9th Cir. 2013); *Zook v. Comm'r*, T.C. Memo. 2013-128.

70 National Taxpayer Advocate 2012 Annual Report to Congress 608.

Pro Se *Analysis*

Pro se taxpayers (those without the benefit of counsel) litigated 70 (or 67 percent) of the 105 cases brought before the Tax Court, a decrease from the previous year. Table 3.5.3 shows the breakdown of *pro se* and represented cases and the decisions rendered by the court indicating that 17 taxpayers, represented or unrepresented (or about 16 percent of the 105 cases), received some relief on judicial review.

FIGURE 3.5.3, *Pro Se* and Represented Taxpayer Cases and Decisions[71]

Court Decisions	*Pro Se* Taxpayers		Represented Taxpayers	
	Volume	Percentage of Total	Volume	Percentage of Total
Decided for IRS	63	90%	25	71%
Decided for Taxpayer	2	3%	6	17%
Split Decisions	5	7%	4	11%
Totals	**70**		**35**	

CONCLUSION

CDP hearings provide an invaluable opportunity for taxpayers to meaningfully address the appropriateness of IRS collection actions. Given the important protection that CDP hearings offer, it is unsurprising that CDP remains one of the most frequently litigated issues.

The opinions reviewed this year suggest the communication process between the taxpayer and the Appeals Officers occasionally breaks down. For example, in one case, the taxpayer did not provide the requested documentation.[72] In another, the taxpayer provided the documentation but it was not timely, and once associated with the case was not fully considered.[73] In a third case, the AO did not request the documentation needed, including revised financial documentation.[74] As illustrated by these cases, when the facts of the case are not sufficiently developed, the taxpayer may not obtain the collection alternative or liability determination that he or she would be eligible for if all the facts were known.

The First Circuit set forth a new standard for Tax Court review of Hearing Officers' determinations of law, ruling that they can only be reversed for abuse of discretion.[75] In *Dalton v. Commissioner*, the court found no abuse of discretion where the Hearing Officer made a "reasonable" conclusion based on the facts known, regardless of whether that conclusion was legally correct.

As discussed in the Most Serious Problem on Collection Due Process, communication improvements need to be made in the collection process from its inception.[76] Taxpayers should have an opportunity to work with Collection employees and provide documentation to support their ability to pay before the IRS sends a CDP lien or levy notice, because it is better for both the taxpayer and the government to resolve

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71 Due to rounding, the percentages may not add up to exactly 100 percent.

72 *See, e.g., Cantrell v. Comm'r*, T.C. Memo 2012-257.

73 *See, e.g., Pomeroy v. Comm'r*, T.C. Memo. 2013-26.

74 *See, e.g., Antioco v. Comm'r*, T.C. Memo 2013-35.

75 682 F.3d 149 (1st Cir. 2012).

76 See Most Serious Problem: *Collection Due Process Hearings: Current Procedures Allow Undue Deference to Collection Decisions and Fail to Give the Taxpayer a Fair and Impartial Hearing*, *supra*.

the tax debt as early as possible. Some cases, however, will not be resolved before CDP rights are provided. Thus, to make CDP hearings more valuable for taxpayers, Appeals Officers and Settlement Officers may need to make special efforts to ensure that taxpayers know what documentation to provide, are given an opportunity to provide the documentation, and are encouraged to do so.

Virtual CDP hearings might also improve the process. Appeals conducts CDP hearings by telephone as a default if the taxpayer does not request a face-to-face meeting. However, a single telephone conversation may not be the best way for Appeals employees to communicate to taxpayers what documentation they need and to ensure taxpayers understand what the IRS is asking of them. The use of virtual face-to-face (VFTF) service should be explored in greater depth. Expansion of VFTF service could give taxpayers visual interaction with an AO in CDP hearings and break down some of the current communication barriers, so taxpayers fully understand what Appeals has asked for and can provide all applicable information. In addition, the increased interaction between the taxpayer and Appeals employee during a virtual meeting could encourage the employee to ask for further information based on the issues raised and documents viewed during the conversation. In several cases this year, Appeals denied a collection alternative because the taxpayer did not provide the information requested. Virtual hearings may enable Appeals to gather more relevant information that would not otherwise be presented if the hearing was conducted by telephone.

In sum, changes are needed both before the IRS sends a CDP notice and while a case is open. If taxpayers provide the full documentation to prove their cases, the IRS can make determinations on collection cases that better take into account the taxpayer's facts and circumstances.

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MLI #6 Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654

SUMMARY

We reviewed 86 decisions issued by federal courts from June 1, 2012, to May 31, 2013, regarding the additions to tax for:

- Failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1);
- Failure to pay an amount shown as tax on a return under IRC § 6651(a)(2);
- Failure to pay estimated tax under IRC § 6654; or
- Some combination of the three.[1]

The phrase "addition to tax" is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Nineteen cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties, 14 involved both the failure to file and failure to pay penalties, one case involved only the estimated tax penalty, three cases involved only the failure to pay penalty, and 39 cases involved only the failure to file penalty.

The failure to file and failure to pay penalties are imposed unless the taxpayer can demonstrate that the failure is due to reasonable cause and not willful neglect.[2] The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions.[3] In 71 out of the 86 cases, taxpayers were unable to avoid a penalty.

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PRESENT LAW

Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before its due date (including extensions) will be subject to a penalty of five percent of the tax due (minus any credit the taxpayer is entitled to receive and payments made by the due date) for each month or partial month the return is late, up to a maximum of 25 percent, unless the failure is due to reasonable cause and not willful neglect.[4] To establish reasonable cause, the taxpayer must show that he or she exercised ordinary business care and prudence but was still unable to file by the due date.[5] The failure to file penalty applies to income, estate, gift, employment and self-employment, and certain excise tax returns.[6]

1 IRC § 6651(a)(3) imposes an addition to tax for failure to pay a tax liability not shown on a return. However, because only a small number of cases involved this penalty, we did not include it in our analysis.

2 IRC § 6651(a)(1), (a)(2).

3 IRC § 6654(e).

4 IRC § 6651(a)(1), (b)(1). The penalty increases to 15 percent per month up to a maximum of 75 percent if the failure to file is fraudulent. IRC § 6651(f).

5 Treas. Reg. § 301.6651-1(c)(1).

6 IRC § 6651(a)(1).

The failure to pay penalty applies to a taxpayer who fails to pay an amount shown as tax on his or her return. The penalty accrues at a rate of 0.5 percent per month on the unpaid balance for as long as the balance due remains unpaid, up to a maximum of 25 percent of the amount due.[7] When both the failure to file and failure to pay penalties are imposed for the same month, the amount of the failure to pay penalty reduces the amount of the failure to file penalty by 0.5 percent for each month.[8]

The failure to pay penalty applies to income, estate, gift, employment and self-employment, and certain excise tax returns.[9] The taxpayer will not be held liable if he or she can establish reasonable cause, *i.e.*, the taxpayer must show that he or she exercised ordinary business care and prudence but still could not pay by the due date, or that payment on the due date would have caused undue hardship.[10] Courts will consider "all the facts and circumstances of the taxpayer's financial situation" to determine whether the taxpayer exercised ordinary business care and prudence.[11] In addition, "consideration will be given to the nature of the tax which the taxpayer has failed to pay."[12]

IRC § 6654 imposes a penalty on any underpayment of estimated tax by an individual or by certain estates or trusts.[13] The law requires four installments per taxable year, each generally 25 percent of the annual payment.[14] The required annual payment is generally the lesser of 90 percent of the tax shown on the return for the current taxable year or 100 percent of the tax shown on the return for the previous year.[15] The IRS will determine the amount of the penalty by applying the underpayment rate according to IRC § 6621 to the amount of the underpayment for the applicable period.[16]

To avoid the penalty, the taxpayer has the burden of proving that one of the following exceptions applies:

- The tax due (after taking into account any federal income tax withheld) is less than $1,000;[17]
- The preceding taxable year was a full 12 months, the taxpayer had no liability for the preceding taxable year, and the taxpayer was a U.S. citizen or resident throughout that year;[18]
- The IRS determines that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience;[19] or

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7 IRC § 6651(a)(2). Note that if the taxpayer timely files the return (including extensions) but an installment agreement is in place, the penalty will continue accruing at the lower rate of 0.25 percent rather than 0.5 percent of the tax shown. IRC § 6651(h).

8 IRC § 6651(c)(1). When both the failure to file and failure to pay penalties are accruing simultaneously, the failure to file will max out at 22.5 percent and the failure to pay will max out at 2.5 percent, thereby abiding by the 25 percent limitation.

9 IRC § 6651(a)(2).

10 Treas. Reg. § 301.6651-1(c)(1). Even when a taxpayer shows undue hardship, the regulations require him or her to prove reasonable cause.

11 Treas. Reg. § 301.6651-1(c)(1). *See, e.g., East Wind Indus., Inc. v. U.S.*, 196 F.3d 499, 507 (3d Cir. 1999).

12 Treas. Reg. § 301.6651-1(c)(2).

13 IRC § 6654(a), (l).

14 IRC § 6654(c)(1), (d)(1)(A).

15 IRC § 6654(d)(1)(B).

16 IRC § 6654(a).

17 IRC § 6654(e)(1).

18 IRC § 6654(e)(2).

19 IRC § 6654(e)(3)(A).

- The taxpayer retired after reaching age 62 or became disabled in the taxable year for which estimated payments were required or in the taxable year preceding that year, and the underpayment was due to reasonable cause and not willful neglect.[20]

In any court proceeding, the IRS has the burden of producing sufficient evidence that it appropriately imposed the failure to file, failure to pay, or estimated tax penalties.[21]

ANALYSIS OF LITIGATED CASES

We analyzed 86 opinions issued between June 1, 2012, and May 31, 2013, where the failure to file penalty, failure to pay penalty, or estimated tax penalty was in dispute. All but seven of these cases were litigated in the United States Tax Court. A detailed list appears in Table 6 in Appendix III. Fifty-one cases involved individual taxpayers and 35 involved businesses (including individuals engaged in self-employment or partnerships). Of the 53 cases in which taxpayers appeared *pro se* (without counsel), taxpayers prevailed in full in one case, and six resulted in split decisions. Of the 32 cases in which taxpayers appeared with representation, taxpayers prevailed in full in two cases, and six were split decisions.[22]

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Failure to File Penalty

A common basis for the courts' ruling against taxpayers on the failure to file penalty was that the taxpayer could not establish that the failure was due to reasonable cause. Among the 63 cases where the court considered whether there was evidence to establish reasonable cause, taxpayers showed reasonable cause in only four cases. The most common arguments raised by taxpayers for reasonable cause included the following.

Medical Illness

Depending on the facts and circumstances, a medical illness may establish reasonable cause for failing to file, if the taxpayer can show incapacitation to such a degree that he or she could not file a return on time.[23] When considering whether the severity of the illness suffices to establish reasonable cause, the court will analyze a taxpayer's management of his or her business affairs during the period of illness.[24] In *Hardin v. Commissioner*, the taxpayer's mental disorders (attention deficit and hyperactive disorder, bipolar disorder, and post-traumatic stress disorder) did not rise to the level of reasonable cause because the taxpayer was able to continue his business affairs.[25] Specifically, during the time the return was due, the taxpayer managed two rental properties and worked full time for the Department of Defense as an engineer, performing complex analyses of military equipment. In light of the taxpayer's management of

20 IRC § 6654(e)(3)(B).

21 *Higbee v. Comm'r*, 116 T.C. 438, 446 (2001) (quoting IRC § 7491(c)). An exception to this rule relieves the IRS of this burden where the taxpayer's petition fails to state a claim for relief from the penalty (and therefore is deemed to concede the penalty), such as where the taxpayer only makes frivolous arguments. *Funk v. Comm'r*, 123 T.C. 213 (2004).

22 In *Cryer v. Comm'r*, T.C. Memo. 2013-69, the taxpayer died before the court hearing and no substitution of any personal representative was ever made; therefore, this case is neither marked as *pro se* or not *pro se* and constitutes the 86th case in our total case review.

23 *Williams v. Comm'r*, 16 T.C. 893, 905-06 (1951) (interpreting § 291 of the 1939 Code, a predecessor to IRC § 6651), *acq.*, 1951-2 C.B. 1. *See, e.g., Harbour v. Comm'r*, T.C. Memo. 1991-532 (finding reasonable cause for failing to timely file because the taxpayer was in a coma the month before the due date of his tax return).

24 *Judge v. Comm'r*, 88 T.C. 1175, 1189–1191, 1987 WL 49322 (1987).

25 T.C. Memo. 2012-162.

these activities, the court held the disorders were not severe enough to establish reasonable cause and the penalty was properly assessed.

Conversely, in *Wright v. Commissioner*, the court held that a stay in a hospital and a rehabilitation center for an injured leg during the time that the taxpayer's 2006 return was due, in conjunction with the fact that her financial documents were not easily accessible, was enough to establish reasonable cause.[26] The IRS argued that the taxpayer's ability to carry on negotiations with her insurance company[27] during this time negated reasonable cause, but the court was not persuaded. These cases illustrate how a reasonable cause determination can easily turn on the specific facts of the taxpayer's situation.

Reliance on Agent

The U.S. Supreme Court, in *United States v. Boyle*,[28] held that taxpayers have a nondelegable duty to file a return on time, and a taxpayer's reliance on an agent to file that return does not excuse a failure to comply with a known filing requirement. In *Tesoriero v. Commissioner*,[29] the taxpayer relied on his accountant to file a request for an extension, but the IRS never received it. The court held that filing an extension request is tantamount to filing a return and a taxpayer's reliance on an agent to file the request does not establish reasonable cause for the delay.[30]

A taxpayer may establish reasonable cause for a failure to file if he or she can prove reasonable reliance on a professional tax advisor's advice or that the taxpayer made a good-faith effort to ascertain return filing requirements.[31] In order to reasonably rely on the advice of a tax professional, the taxpayer must present evidence of the professional's expertise and show that he or she provided the practitioner with all necessary and accurate information.[32] In *Thousand Oaks Residential Care Home I, Inc. v. Commissioner*,[33] the court held the taxpayer reasonably relied on advice from its accountant regarding the reasonableness of certain compensation payments, making the payments deductible, and rendering the filing of Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans,* and the payment of the amount due unnecessary.[34] Since the advisor was an accountant, the court determined that reliance on the accountant's advice after consultation was reasonable and the taxpayer was not liable for IRC § 6651(a)(1) or (2) penalties for failure to file Form 5330 and pay the associated tax.

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26 T.C. Memo. 2013-129.

27 The taxpayer had filed a claim for reimbursement from her insurance company due to water damage to her apartment and personal belongings.

28 469 U.S. 241 (1985).

29 T.C. Memo. 2012-261.

30 *Tesoriero v. Comm'r*, T.C. Memo. 2012-261.

31 *Estate of La Meres v. Comm'r*, 98 T.C. 294, 315-17 (1992) (citations omitted).

32 *Id*.

33 T.C. Memo. 2013-10.

34 IRC § 162(a)(1) permits a deduction for ordinary and necessary business expenses, including "a reasonable allowance for salaries or other compensation for personal services actually rendered." The deductibility of compensation is determined through a two-prong test: the amount of compensation must be reasonable, and the payment must be purely for services rendered. In *Thousand Oaks Residential Care Home I, Inc. v. Comm'r*, the court held that the compensation payments were not reasonable and, therefore, not deductible.

"Zero Return" Filers and Other Frivolous Arguments

Under the longstanding four-part test articulated in *Beard v. Commissioner*,[35] a valid return must:

1. Contain sufficient data to calculate the tax liability;
2. Purport to be a return;
3. Represent an honest and reasonable attempt to satisfy the requirements of the tax laws; and
4. Be signed under penalties of perjury.

Each year, some taxpayers claim they have no obligation to pay taxes by filing returns reporting zero income when they have earned substantial wages accurately reported on a Form W-2.[36] A "zero" return does not constitute a tax return under the *Beard* test because it is devoid of financial data and does not provide sufficient information to calculate the tax liability.[37] Thus, when the taxpayer in *Nelson v. Commissioner* filed returns containing zeros for taxable income, the Tax Court sustained the failure to file penalty.[38]

Failure to Pay an Amount Shown Penalty

A taxpayer can file his or her return by the applicable due date and still be liable for a penalty if the amount shown on the return is not paid. In cases where taxpayers disputed that they were subject to the failure to pay penalty, many of the justifications were similar to those used for the failure to file penalty under IRC § 6651(a)(1). To refute the failure to pay penalty, individual taxpayers often unsuccessfully argued medical illness or reliance on an agent.[39]

However, taxpayers succeeded in disputing the penalty when the IRS was unable to meet its burden of production under IRC § 7491(c).[40] Specifically, the IRC § 6651(a)(2) penalty applies only when the return filed by the taxpayer shows the amount due.[41] If the taxpayer did not file a return, the IRS can only assess the penalty if it has prepared a substitute for return (SFR) that satisfies the requirements of IRC § 6020(b). If the IRS cannot produce the SFR, it falls short of satisfying its burden of production under IRC § 7491.[42] For example, in *Gardner v. Commissioner*, the IRS stated it prepared a valid SFR for the taxpayers for each year in issue. However, no SFRs were introduced into evidence, and the parties did not stipulate that valid SFRs were prepared.[43] Instead, the IRS relied upon account transcripts, which stated "substitute tax return prepared by IRS" and listed a corresponding date. Despite the transcripts, the court held that the IRS did not meet its burden of production under IRC § 7491(c), because the transcripts did not adequately prove the SFRs had been created.

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35 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

36 *See, e.g., Parker v. Comm'r*, T.C. Memo. 2012-66 (concluding that there was no evidence of reasonable cause presented when the taxpayer reported all "zeros" on his return and offered only frivolous arguments).

37 *See Turner v. Comm'r*, T.C. Memo. 2004-251, and the numerous cases cited therein.

38 *Nelson v. Comm'r*, T.C. Memo. 2012-232.

39 *See, e.g., Kuretski v. Comm'r*, T.C. Memo. 2012-262 (illness); *Knappe v. U.S.*, 713 F.3d 1164 (9th Cir. 2013), *petition for cert. filed*, *aff'g* 2013-1 U.S.T.C. (CCH) ¶ 60,662 (C.D. Cal. 2010) (agent).

40 *See, e.g., Arroyo v. Comm'r*, T.C. Memo. 2013-112; *Jenkins v. Comm'r*, T.C. Memo. 2012-181.

41 IRC § 6651(a)(2), (g)(2).

42 *See Wheeler v. Comm'r*, 127 T.C. 200, 210, (2006), *aff'd*, 521 F.3d 1289 (10th Cir. 2008).

43 *Gardner v. Comm'r*, T.C. Memo. 2013-67.

Estimated Tax Penalty

Courts routinely found taxpayers liable for the IRC § 6654 estimated tax penalty when the IRS proved the taxpayer had a tax liability, had no withholding credits, and made no estimated tax payments for that year, and the taxpayer offered no evidence to refute the IRS.[44]

The IRS has the burden of production under IRC § 7491(c) to produce evidence that a taxpayer was required to make an annual payment under IRC § 6654(d)(1)(B). We found six cases where the taxpayer prevailed regarding the estimated tax penalty because of the IRS's failure to put forth evidence that the penalty was appropriate. In *Kuretski v. Commissioner*, the IRS did not produce any evidence the taxpayers (husband and wife) did not file a return or that they had a tax liability for 2006.[45] Without the 2006 return, and without knowing if the taxpayers had a liability for that year, the court was unable to calculate the taxpayers' estimated annual payment for 2007, if any. Therefore, the IRS did not meet its burden of production of information showing that the taxpayers had a required payment under IRC § 6654.

Penalty for Raising Frivolous Arguments

In three cases where the IRS had asserted either the failure to file penalty, failure to pay penalty, estimated tax penalty, or some combination, the courts also imposed the IRC § 6673 penalty for making frivolous arguments.[46] Among the frivolous argument cases is one where the taxpayer failed to file a return because he believed neither compensation nor dividends were taxable income.[47] The Tax Court held the taxpayer liable for the failure to file and failure to pay penalties, and imposed a $2,500 penalty under IRC § 6673.

CONCLUSION

The IRS failed to prevail in full in 15 of 86 (or 17 percent) of the failure to file penalty, failure to pay penalty, and the estimated tax penalty cases analyzed in this report. This unsuccessful litigation represents a significant waste of IRS resources, as well as a burden on taxpayers. Typically, the IRS did not meet its burden of production in these cases.

The IRS's incorrect assessment of penalties in these 15 cases, and its failure to appropriately resolve them during the administrative process, may reflect a trend in litigation results because of the IRS's heavy reliance on automatic application of penalties, and its use of the Reasonable Cause Assistant (RCA).[48] The RCA software is designed to help IRS employees make fair and consistent abatement determinations.[49]

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44 *See, e.g., Haury v. Comm'r*, T.C. Memo. 2012-215.

45 T.C. Memo. 2012-262.

46 See Most Litigated Issue: *Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions*, *infra*.

47 *Winslow v. Comm'r*, 139 T.C. 270 (2012).

48 See Most Serious Problem: *Accuracy-Related Penalties: The IRS Assessed Penalties Improperly, Refused to Abate Them, and Continues to Assess Them Automatically, Violating Taxpayer Rights and Reducing Respect for the Law*, *supra*.

49 The Reasonable Cause Assistant can only consider Failure to File or Failure to Pay penalties on certain individual tax returns, and the Failure to Deposit penalty only on certain business returns.

However, as discussed in the National Taxpayer Advocate's 2010 Annual Report to Congress,[50] the IRS's reliance on the RCA has actually eroded the accuracy of abatements.[51]

Further, the cases illustrate how establishing reasonable cause can turn on the very specific facts of the individual case. The cases once again illuminate the importance of the IRS looking closely and thoroughly at the case facts, rather than solely relying on the RCA when assessing reasonable cause claims. A close consideration of the relevant facts for each reasonable cause claim is essential to ensure that the penalty is appropriate. To promote voluntary compliance, it is crucial that taxpayers believe the facts of their individual case have been carefully considered.

As another way to promote voluntary compliance, the National Taxpayer Advocate reiterates her recommendation that Congress implement a one-time abatement of the failure to file penalty for taxpayers who comply with their filing obligations, but in an untimely manner.[52] Further, she urges a repeal of the failure to pay penalty, which could be replaced by a market rate of interest equal to the rate on an unsecured loan.[53]

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50 National Taxpayer Advocate 2010 Annual Report to Congress 198 (Most Serious Problem: *The IRS's Over-Reliance on Its "Reasonable Cause Assistant" Leads to Inaccurate Penalty Abatement Determinations*).

51 IRS, Reasonable Cause Assistant (RCA) Usability Test Final Report Summary 4 (May 28, 2010). The test showed that employees using the RCA determined penalty abatement requests correctly in only 45 percent of the cases. An even more disturbing finding was that all of the employees in the study believed they were making correct legal determinations based on reasonable cause.

52 *See* National Taxpayer Advocate 2001 Annual Report to Congress 188. A provision to waive the failure to file penalty for first-time, unintentional, minor errors was included in the House-passed Taxpayer Protection and IRS Accountability Act of 2003. *See* H.R. 1528, 108th Cong. § 106 (2003). Although the IRS has provided for a one-time administrative waiver of the failure to file penalty in IRM 20.1.1.3.6.1 (Nov. 25, 2011), the National Taxpayer Advocate continues to recommend a statutory waiver similar to IRC § 6656(c).

53 *See* National Taxpayer Advocate 2001 Annual Report to Congress 182.

MLI #7 Charitable Deductions Under IRC §170

SUMMARY

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes for contributions of cash or other property to or for the use of charitable organizations.[1] In order to take a charitable deduction, taxpayers must contribute to a qualifying organization[2] and must substantiate contributions of $250 or more. Litigation generally arises over one or more of these four issues:

- Whether the organization to which a donation is made is charitable;
- Whether contributed property qualifies as a charitable contribution;
- Whether the amount taken as a charitable deduction equals the fair market value of the property contributed; and
- Whether the taxpayer has substantiated the contribution.

We reviewed 40 cases decided between June 1, 2012, and May 31, 2013, with charitable deductions as a contested issue. The IRS prevailed in 32 cases, with taxpayers prevailing in five cases and with the remaining three cases resulting in split decisions. Taxpayers represented themselves (appearing *pro se*) in 18 of the 40 cases (45 percent), with one of these *pro se* cases resulting in a split decision and the IRS prevailing in the remaining 17 cases.

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PRESENT LAW

Taxpayers must itemize in order to claim any charitable contribution deduction[3] and generally are able to take a deduction for charitable contributions made within the taxable year. Transfers to charitable organizations are deductible only if they are contributions or gifts[4] and not if they are payments for goods or services.[5] A contribution or gift will be allowed as a deduction under IRC § 170 only if it is made "to" or "for the use of" a qualifying organization.[6]

For individuals, charitable contribution deductions are generally limited to 50 percent of the taxpayer's contribution base (adjusted gross income computed without regard to any net operating loss carryback to the taxable year under IRC § 172).[7] However, subject to certain limitations, individual taxpayers can carry forward unused charitable contributions in excess of the 50 percent contribution base for up to

1 Internal Revenue Code (IRC) § 170.

2 To claim a charitable contribution deduction, a taxpayer must establish that a gift was made to a qualified entity organized and operated exclusively for an exempt purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual. IRC § 170(c)(2).

3 IRC §§ 63(d) and (e); 161; 170(a).

4 The Supreme Court of the United States has defined "gift" as a transfer proceeding from a "detached and disinterested generosity." *Comm'r v. Duberstein*, 363 U.S. 278, 285 (1960).

5 Treas. Reg. § 1.170A-1(g) (no deduction for contribution of services).

6 IRC § 170(c).

7 IRC §§ 170(b)(1)(A), (G).

five years.[8] Corporate charitable deductions are generally limited to ten percent of the taxpayer's taxable income.[9] Taxpayers cannot deduct services that they offer to charitable organizations; however, incidental expenditures incurred while serving a charitable organization and not reimbursed may constitute a deductible contribution.[10]

Substantiation

For cash contributions, taxpayers must maintain receipts from the charitable organization, copies of cancelled checks, or other reliable records showing the name of the organization, the date, and the amount contributed.[11] Deductions for single charitable contributions of $250 or more are disallowed in the absence of a contemporaneous written acknowledgement from the charitable organization.[12] The donor is generally required to obtain the contemporaneous written acknowledgment no later than the date he or she files the return for the year in which the contribution is made, and it must include:

- The name of the charitable organization;
- The amount of the cash contribution;
- A description (but not the value) of any non-cash contribution;
- A statement that no goods or services were provided by the organization in return for the contribution, if that was the case;
- A description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution; and
- A statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits, if that was the case.[13]

For each contribution of property other than money, taxpayers generally must maintain a receipt showing the name of the recipient, the date and location of the contribution, and a description of the property.[14] When property other than money is contributed, the amount of the allowable deduction is the fair market value of the property at the time of the contribution.[15] This general rule is subject to certain exceptions that in some cases limit the deduction to the taxpayer's cost basis in the property.[16] Moreover, for claimed contributions exceeding $5,000, a qualified appraisal prepared by a qualified appraiser is required.[17]

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8 IRC § 170(d)(1).

9 IRC § 170(b)(2).

10 Treas. Reg. § 1.170A-1(g). Meal expenditures in conjunction with offering services to qualifying organizations are not deductible unless the expenditures are away from the taxpayer's home. *Id*. Likewise, travel expenses associated with contributions are not deductible if there is a significant element of personal pleasure involved with the travel. IRC § 170(j).

11 Treas. Reg. § 1.170A-13(a)(1).

12 IRC § 170(f)(8); *see also* Treas. Reg. § 1.170A-13(f).

13 IRS Pub. 1771, *Charitable Contributions Substantiation and Disclosure Requirements* (Rev. 7-2013).

14 Treas. Reg. § 1.170A-13(b)(1)(i)-(iii).

15 Treas. Reg. § 1.170A-1(c)(1).

16 *Id*. Note that the deduction is reduced for certain contributions of ordinary income and capital gain property. *See* IRC § 170(e).

17 IRC § 170(f)(11)(C). A qualified appraisal is defined in IRC § 170(f)(11)(E)(i), and a qualified appraiser is defined in IRC § 170(f)(11)(E)(ii).

ANALYSIS OF LITIGATED CASES

We reviewed 40 decisions entered between June 1, 2012, and May 31, 2013, involving charitable contribution deductions claimed by taxpayers. Table 7 in Appendix III contains a detailed list of those cases. Of the 40 cases, 25 cases involved the taxpayers' substantiation (or lack thereof) of the claimed contribution, 14 cases involved a dispute over the valuation of property contributed, and four cases involved the issue of whether the recipient was a qualified charitable organization. Various other challenges were raised by the IRS primarily involving claimed qualified conservation contribution deductions.

Qualifying Charitable Organization

A gift will qualify as a deductible contribution under IRC § 170 only if it is made "to" or "for the use of" a qualifying organization.[18] Courts rejected claimed charitable deductions in four cases for taxpayer failure to establish that the donee organization qualified as a charitable organization under IRC § 170(c). In *Gunkle v. Commissioner*,[19] the taxpayers deducted amounts for claimed charitable contributions to a church that they had operated. The taxpayer husband dissolved the church three years prior to the year for which the charitable deduction was claimed, and the IRS issued notification to the taxpayers at the time of dissolution that the church's charitable status had been terminated.[20] The court noted that for a church to be characterized as a qualifying organization under IRC § 170(c), it must meet organizational and operational tests in IRC § 501(c)(3).[21] The court held that the deductions were inappropriate because the taxpayers did not provide evidence that the organization qualified as a charitable organization under IRC § 501(c)(3).[22]

Qualified Contribution

For a gift to constitute a qualified contribution under IRC § 170, the donor-taxpayer must possess a transferrable interest in the property and intend to irrevocably relinquish all rights, title, and interest to the property without any expectation of some benefit in return.[23] For example, in *Patel v. Commissioner*,[24] the taxpayers claimed a charitable deduction contribution for donating their existing house to the local fire department but maintained possession of the real property on which the house stood. The fire department subsequently burned the house down in a training exercise. The IRS disallowed the deduction, believing that the taxpayers donated merely a right for the fire department to use the property, and therefore the taxpayers only contributed a partial interest in the property. The court noted that "[w]here a taxpayer contributes to a charity an interest in a building that is part of the land under State law but retains all title to and interest in the remaining land, the taxpayer has donated less than his entire interest

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18 IRC § 170(c).

19 T.C. Memo. 2012-305, *appeal filed* (5th Cir. Apr. 5, 2013).

20 *Id*.

21 *Id*.

22 *Id*.

23 IRC § 170(f)(3)(A) generally requires that taxpayers relinquish all rights, title, and interest in property contributed.

24 138 T.C. 395 (2012).

in the land."[25] The court disallowed the deduction concluding that the taxpayers donated only a partial interest in their property, namely the right to use the existing house for training purposes.[26]

As exemplified in the *Patel* holding, taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayers' entire interest in that property.[27] Nevertheless, taxpayers may deduct the value of a contribution of a partial interest in property that constitutes a "qualified conservation contribution,"[28] known more colloquially as a conservation easement. A contribution will constitute a qualified conservation contribution only if it is of a "qualified real property interest" made to a "qualified organization" "exclusively for conservation purposes."[29]

In *Belk v. Commissioner*,[30] the Tax Court addressed for the first time what constitutes a "qualified real property interest."[31] In that case, the taxpayers (a husband and wife) executed a conservation easement in favor of a qualifying organization prohibiting the taxpayers' entire golf course from being used for "residential, commercial, institutional, industrial, or agricultural purposes."[32] The conservation easement agreement, however, permitted the taxpayers and donee to change what property would be subject to the easement, presumably to allow the taxpayers to reconfigure the golf course.[33] As a result, the court determined that the contribution comprised neither the entire interest of the donor nor a remainder interest. The court then examined whether the contribution qualified as a use restriction granted in perpetuity, which is a permitted type of qualified real property interest described in IRC § 170(h)(2)(C).[34] Nevertheless, the court concluded that there was no agreement that the golf course would not be developed in the future because the taxpayers had the ability to remove portions of the golf course and replace them with property currently not subject to the conservation easement.[35] Accordingly, the substitution provision disqualified the conservation easement from characterization as a qualified real property interest and by extension as a qualified conservation contribution.[36]

A conservation easement subject to a mortgage will not qualify as a qualified conservation contribution unless the taxpayer obtains consent from the mortgagee to subordinate its interest in the property to the easement.[37] In *Minnick v. Commissioner*,[38] the taxpayer donated a conservation easement to a qualified

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25 138 T.C. 406 (2012).

26 As support for its holding, the Tax Court looked to similar cases, explaining "As with this case, taxpayers usually grant a fire department license to destroy a building on their land because they wish to have it removed from the land, either to increase the value of the land (*Scharf*) or so that they may construct a new building on the land (*Rolfs*)." *Patel*, 138 T.C. at 415 (citing *Scharf v. Comm'r*, T.C. Memo. 1973-265, and *Rolfs v. Comm'r*, 135 T.C. 471 (2010)). For a further discussion of *Rolfs*, see also National Taxpayer Advocate 2011 Annual Report to Congress 673-674.

27 IRC § 170(f)(3).

28 IRC § 170(b)(1)(E).

29 IRC § 170(h)(1)(A)-(C).

30 140 T.C. 1 (2013), *reconsideration denied*, T.C. Memo. 2013-154.

31 A "qualified real property interest" is defined as any of the following interests in real property: (A) the entire interest of the donor other than a qualified mineral interest, (B) a remainder interest, and (C) a restriction (granted in perpetuity) on the use which may be made of the real property. IRC § 170(h)(2)(A)-(C).

32 *Belk*, 140 T.C. at 3.

33 *Id*.

34 *See also* Treas. Reg. § 1.170A-14(b)(2).

35 *Belk*, 140 T.C. at 10-11.

36 *Id*. at 14-15.

37 Treas. Reg. § 1.170A-14(g)(2).

38 T.C. Memo. 2012-345.

donee but did not execute an agreement under which the mortgagee of the subject property subordinated its interest in the property to the easement until after the conservation easement was granted. The court held that the taxpayer was not entitled to a charitable contribution deduction for the conservation easement donation because a subordination agreement was not in place at the time that the conservation easement was granted. Consequently, during the period when no subordination agreement existed, the mortgagee had the ability to seize the easement in the event of default on the mortgage, thus owning the land free of the conservation easement.[39] The court also noted that the intent of the taxpayer to seek subordination of the mortgagee's interest in the property at the time the conservation easement was granted was irrelevant.[40]

Valuation

In order to receive a deduction for most contributions of property in excess of $5,000, taxpayers must provide a qualified appraisal of the property that is donated.[41] In *Estate of Evenchik v. Commissioner*,[42] the taxpayers donated shares in a corporation to a charity and reported a charitable contribution deduction exceeding $5,000. The taxpayers provided a qualified appraisal of the corporation's two assets for which the stock was issued, rather than a valuation of the donated stock itself.[43] In addition to other shortcomings in the qualified appraisal,[44] the court concluded that not valuing the property actually donated is a defect that "goes to the essence of the information required" because without knowing the specific property contributed, the Commissioner is unable to determine whether the contributed property interest was overvalued by the taxpayers.[45] Thus, the court denied the deductions claimed with respect to the charitable contributions of stock.

Although charitable contribution deductions are generally disallowed when the taxpayer receives a benefit for a donation, a taxpayer who receives goods or services in exchange for a contribution of property may still be entitled to a charitable contribution deduction if he or she makes a contribution that exceeds the fair market value of the benefit received and makes the excess payment with the intention of making a gift.[46] In *Boone Operations Co., L.L.C. v. Commissioner*,[47] the taxpayer sold fill dirt to the City of Tucson at what the taxpayer claimed to be a price below fair market value. After finding that the taxpayer did not provide a contemporaneous written acknowledgement from the city as required by IRC § 170(f)(8), the court noted that the taxpayer failed to prove that the fair market value of the fill dirt exceeded the amount received by the taxpayer.[48] The court focused particularly on defects in the taxpayer's expert's appraisals of the fill dirt including, *inter alia*, inconsistent valuation methodologies applied to different orders of dirt delivered to the city, the inclusion of labor and delivery costs in the valuation calculation, and failure

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39 T.C. Memo. 2012-345.

40 *Id*.

41 IRC § 170(f)(11)(C).

42 T.C. Memo. 2013-34.

43 *Id*.

44 Treas. Reg. § 1.170A-13(c)(3)(ii) contains a detailed set of requirements that a qualified appraisal must contain. The two appraisals that the taxpayers provided failed to meet all of those requirements.

45 *Estate of Evenchik*, T.C. Memo. 2013-34.

46 Treas. Reg. § 1.170A-1(h).

47 T.C. Memo. 2013-101.

48 *Id*.

to introduce evidence of the claimed highest and best use of the fill dirt.[49] Consequently, the Tax Court sustained the IRS's determination to disallow the claimed charitable contribution deductions.

Substantiation

Twenty-five cases involved the substantiation of deductions for charitable contributions. When determining whether or not a claimed charitable contribution deduction is adequately substantiated, courts tend to follow a strict interpretation of IRC § 170. For example, in *Longino v. Commissioner*,[50] the taxpayer alleged that he made a cash contribution of $25,000 to a qualifying organization and claimed a deduction for the donation. The court denied the deduction because the taxpayer failed to provide a contemporaneous written acknowledgement from the donee indicating whether or not it furnished any goods or services in exchange for the cash as required under IRC § 170(f)(8)(B)(ii).[51]

Further, in *Riether v. United States*,[52] the taxpayers donated Chevrolet vans to religious organizations and claimed charitable contribution deductions for the donations. The court denied the deductions because the taxpayers did not submit a "qualified appraisal" meeting each of the requirements as described in Treasury Regulation § 1.170A-13(c)(3)(ii).[53]

Although gifts of charitable contributions of $250 or more must be substantiated by a contemporaneous written acknowledgement from the donee organization, that acknowledgement need not take any particular form. For example, in *Averyt v. Commissioner*,[54] the court addressed the question of whether a conservation easement deed can function as a contemporaneous written acknowledgment. In that case, the taxpayers conveyed a conservation easement to a charitable organization so as to protect the land as a wildlife habitat.[55] The IRS challenged the taxpayers' charitable contribution deduction, arguing that the taxpayers' contemporaneous written acknowledgment did not comply with the requirements under IRC § 170(f)(8).[56] Among other things, the taxpayers contended that the conservation deed constituted a satisfactory contemporaneous acknowledgment. The court observed that the conservation deed contained a signature from a representative of the qualifying donee, provided a detailed description of the donated property, and was executed contemporaneously with the contribution.[57] Moreover, the court observed that the conservation deed stated the property was an unconditional gift for which no consideration was received. The court held that, taken as a whole, the conservation deed met all requirements under IRC § 170(f)(8) and served as a satisfactory contemporaneous written acknowledgement to support the charitable contribution deduction.[58]

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49 T.C. Memo. 2013-101.

50 T.C. Memo. 2013-80.

51 *Id*.

52 *Riether v. Comm'r*, 919 F. Supp. 2d 1140 (D.N.M. 2012).

53 A "qualified appraisal" requires the following: a detailed description of the property, the physical condition of the property, the date of contribution, the terms of any agreement by the donor or donee relating to the use, sale, or disposition of the property, the name, address, and identification number of the appraiser, the appraiser's qualifications, a statement that the appraiser prepared the appraisal for income tax purposes, the date on which the appraiser appraised the property, the appraised fair market value of the property, the method of valuation used, and the specific basis for the valuation. Treas. Reg. § 1.170A-13(c).

54 T.C. Memo. 2012-198.

55 *Id*.

56 *Id*.

57 *Id*.

58 T.C. Memo. 2012-198.

Charitable Contribution Deduction Limitations: Fair Market Value v. Cost Basis

The manner in which a taxpayer holds his or her donated property prior to donation may limit a charitable contribution to the donated property's cost basis.[59] In *Flood v. Commissioner*,[60] the taxpayers operated a real estate business, which included purchasing and selling vacant lots. The taxpayers donated 11 of the lots to charity and claimed charitable contributions consistent with the fair market value of the lots.[61] The court, however, determined that the charitable contributions were inappropriate because the donated lots had been purchased as part of the taxpayers' business venture and only a cost-basis deduction is allowable when property held primarily for sale to customers in the ordinary course of business is later donated.[62]

A charitable deduction is also allowable for the appreciated portion of long-term capital gain[63] property. Nevertheless, if the property is not held as a capital asset for more than one year, the deduction is limited to the taxpayer's basis in the property at the time of the property's contribution.[64] In *Williams v. Commissioner*,[65] the court was required to determine whether execution by the taxpayer of an Art Purchase Agreement triggered the holding period required for long-term capital gain. In that case, the taxpayer signed an agreement to purchase unidentified artwork that was to be donated to charitable organizations.[66] Upon execution of the agreement, the taxpayer did not obtain title to the unidentified artwork, paid only five percent of the purchase price with the remainder being due when the taxpayer took physical possession of the artwork, had no obligation to honor the contract, and bore none of the expenses and risk in the transaction.[67] The court held that the Art Purchase Agreement was not a contract for sale but rather an option contract and that the date on which the taxpayer actually paid for and acquired a present interest in the art was the date that must be used to calculate the holding period for purposes of determining if the property was long-term capital gain property.[68] The holding period when measured from this date was less than one year; consequently, the taxpayer's charitable contribution deduction for donating the art was limited to his basis in the property.[69]

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59 IRC § 170(e).

60 T.C. Memo. 2012-243.

61 *Id*.

62 *Id*.

63 "Long-term capital gain" means "gain from the sale or exchange of a capital asset held for more than one year, if and to the extent such gain is taken into account in computing gross income." IRC § 1222(3).

64 IRC § 170(e)(1)(A).

65 498 F. App'x 284 (4th Cir. 2012), *aff'g* T.C. Memo. 2011-89.

66 *Id*.

67 *Id*.

68 *Id*.

69 *Id*.

CONCLUSION

IRC § 170 and the accompanying Treasury Regulations provide detailed requirements which must be complied with strictly and become more stringent as deductions increase in size. As one court has observed, the "hoops become longer and tighter as the value of donated property rises."[70] Taxpayers must be careful to include every statutorily required item of information in any mandated agreement and ensure the integrity of any necessary valuations of donated property. Taxpayers donating conservation easements would be advised to pay particular attention to the technicalities of qualified conservation contributions, especially where mortgages are attached to the donated easement and where easement deeds may be ambiguous as to whether use restrictions are truly granted in perpetuity to the donee.

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70 *Estate of Evenchik v. Comm'r*, T.C. Memo. 2013-34.

MLI #8 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

SUMMARY

From June 1, 2012, through May 31, 2013, the federal courts issued decisions in at least 34 cases involving the Internal Revenue Code (IRC) § 6673 "frivolous issues" penalty and at least four cases involving an analogous penalty at the appellate level.[1] These penalties may be imposed when a taxpayer maintains a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.[2] In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future.[3] Nonetheless, we include these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

PRESENT LAW

The U.S. Tax Court is authorized to impose a penalty against a taxpayer if the taxpayer institutes or maintains a proceeding primarily for delay, takes a frivolous position in a proceeding, or unreasonably fails to pursue available administrative remedies.[4] The maximum penalty is $25,000.[5] In some cases, the IRS requests that the Tax Court impose the penalty;[6] in other cases, the Tax Court exercises its discretion, *sua sponte*,[7] to do so.

Taxpayers who institute actions under IRC § 7433[8] for certain unauthorized collection actions can be subject to a maximum penalty of $10,000 if the court determines the taxpayer's position in the proceeding is frivolous or groundless.[9] In addition, IRC § 7482(c)(4),[10] §§ 1912 and 1927 of title 28 of the U.S.

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1 Two of the four appellate cases involved taxpayers appealing the Tax Court's decision regarding the IRC § 6673 penalty, but also involved an analogous appellate level penalty. Thus, we reviewed a total of 36 cases this year.

2 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts impose the penalty under IRC § 6673(b). The United States Courts of Appeals generally impose sanctions under IRC §7482(c)(4), 28 U.S.C. §1927, or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.

3 *See, e.g., Good v. Comm'r*, T.C. Memo. 2012-323; *Flint v. Comm'r*, T.C. Memo. 2012-287.

4 IRC § 6673(a)(1)(A), (B), and (C).

5 IRC § 6673(a)(1).

6 The standards for the IRS's decision to seek sanctions under IRC § 6673(a)(1) are found in the Chief Counsel Directives Manual (CCDM). *See* CCDM 35.10.2, *Special Procedures When Attorneys' Fees and Sanctions Are Sought, Penalties and Sanctions* (Aug. 11, 2004). For sanctions under IRC § 6673(a)(2) of attorneys or other persons admitted to practice before the Tax Court, all requests for sanctions are reviewed by the designated agency sanctions officer (currently the Associate Chief Counsel (Procedure & Administration)). This review ensures uniformity on a national basis. *See* CCDM 35.10.2.2.3, *Sanctions Requiring National Office Review* (Aug. 11, 2004).

7 "*Sua sponte*" means without prompting or suggesting; on its own motion. *Black's Law Dictionary* (9th ed. 2009). In other words, if the Tax Court finds conduct particularly offensive, it can impose a § 6673 penalty even if the IRS has not requested such penalty. See, e.g., *Burt v. Comm'r*, T.C. Memo. 2013-58, *appeal filed* (6th Cir. July 5, 2013).

8 IRC § 7433(a) allows a taxpayer a civil cause of action against the United States if an IRS employee intentionally or recklessly, or by reason of negligence, disregards any IRC provision or Treasury regulation in connection with collecting the taxpayer's federal tax.

9 IRC § 6673(b)(1).

10 IRC § 7482(c)(4) provides that the United States Courts of Appeals and the Supreme Court have the authority to impose a penalty in any case where the Tax Court's decision is affirmed and the appeal was instituted or maintained primarily for delay or the taxpayer's position in the appeal was frivolous or groundless.

Code,[11] and Rule 38[12] of the Federal Rules of Appellate Procedure authorize federal courts to impose penalties against a taxpayer for raising frivolous arguments or litigating cases primarily to delay the collection process. Because the sources of authority for imposing appellate-level sanctions are numerous and some of these sanctions may be imposed in nontax cases, the report focuses primarily on the IRC § 6673 penalty.

ANALYSIS OF LITIGATED CASES

We analyzed 34 opinions issued between June 1, 2012, and May 31, 2013, that addressed the IRC § 6673 penalty. Thirty of these opinions were issued by the U.S. Tax Court and four were issued by U.S. Courts of Appeals in cases brought by taxpayers who sought review of the Tax Court's imposition of the penalty. The Courts of Appeals sustained the Tax Court's position in all four cases.[13]

In ten cases, the Tax Court imposed penalties under IRC § 6673, ranging from $2,000 to the maximum of $25,000. In 11 cases, taxpayers prevailed when the IRS asked the court to impose a penalty, but in each case the court warned that they would be issued a penalty if they brought the same arguments in a subsequent proceeding.[14] One taxpayer went to court with representation; all 33 others appeared *pro se* (represented themselves). The taxpayers in these cases presented a wide variety of arguments that the courts have generally rejected on numerous occasions. Upon encountering these arguments, the courts almost invariably cited the language set forth in *Crain v. Commissioner*:

> We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system — including the role played within that system by the Internal Revenue Service and the Tax Court — has long been established.[15]

In the cases we reviewed, taxpayers raised the following issues that the court deemed frivolous. Consequently, the taxpayers were subject to a penalty under IRC § 6673(a)(1) (or in some cases, the court warned that such arguments were frivolous and could lead to a penalty in the future if the taxpayers maintained the same position in a subsequent case):

- **Taxpayers who claim that broadly applicable Internal Revenue Code terms do not apply to their circumstances:** Taxpayers in at least ten cases argued that, in some way or another, they fell

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11 28 U.S.C. § 1912 provides that when the Supreme Court or a United States Court of Appeals affirms a judgment, the court has the discretion to award to the prevailing party just damages for the delay, and single or double costs. 28 U.S.C. § 1927 authorizes federal courts to sanction an attorney or any other person admitted to practice before any court of the United States or any territory thereof for unreasonably and vexatiously multiplying proceedings; such person may be required to personally pay the excess costs, expenses, and attorneys' fees reasonably incurred because of his or her conduct.

12 Federal Rule of Appellate Procedure 38 provides that if a United States Court of Appeals determines an appeal is frivolous, the court may award damages and single or double costs to the appellee.

13 In every appellate case we have reviewed since June 1, 2005, the Courts of Appeals have not reversed the imposition of the Tax Court's IRC § 6673 penalty in any case brought before them. *See* National Taxpayer Advocate 2012 Annual Report to Congress 640-642; National Taxpayer Advocate 2011 Annual Report to Congress 666-669; National Taxpayer Advocate 2010 Annual Report to Congress 479-482; National Taxpayer Advocate 2009 Annual Report to Congress 461-464; National Taxpayer Advocate 2008 Annual Report to Congress 533-536; National Taxpayer Advocate 2007 Annual Report to Congress 599-603; National Taxpayer Advocate 2006 Annual Report to Congress 2006 602-606.

14 *See, e.g., Weatherly v. Comm'r*, T.C. Memo. 2012-320; *Trescott v. Comm'r*, T.C. Memo. 2012-321.

15 737 F.2d 1417, 1417-18 (5th Cir. 1984).

outside the parameters of the IRC and, therefore, were not obligated to pay federal income taxes.[16] Five of those taxpayers argued they did not earn "wages" as defined in the IRC.[17] One taxpayer argued he was not a "person" as defined in the IRC.[18] Most of these taxpayers avoided penalties, but the court warned them that further similar conduct could lead to a penalty.

- **Taxpayers who claim the IRS lacked authority to issue a notice of deficiency:** In at least five cases, taxpayers argued the IRS did not have authority to determine deficiencies or assess tax against them.[19] In three out of five cases, the court imposed the § 6673 sanction on the taxpayer.[20] In one case, the taxpayer argued that both the person certifying his substitutes for returns and the person issuing the notices of deficiency lacked authority to do so.[21]
- **Taxpayers who object to the admission of their IRS form W-2 as hearsay:** Taxpayers (husband and wife) in at least one case[22] argued the information returns filed by their employers were hearsay under Federal Rule of Evidence 802, and therefore, not admissible to show they received unreported income. The court declined to impose the § 6673 penalty but warned the taxpayers that continuing to advance frivolous or groundless arguments could result in a penalty in the future.

CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated year after year.[23] When the taxpayer is asserting a frivolous argument for the first time or, in raising the frivolous argument, has at least one other valid claim, then the court appears reluctant to impose a penalty on the taxpayer.[24] However, when the taxpayer is only asserting frivolous and groundless claims and has previously been warned about bringing such claims, the court will almost invariably impose a penalty.[25] If the court has already imposed a penalty in an earlier case against the taxpayer (or has admonished the taxpayer about his or her behavior in an earlier proceeding), the court is more likely to impose the maximum (or close to the maximum) penalty.[26] Where the IRS has not requested a penalty, the court may nonetheless raise the issue *sua sponte,* and in many cases imposes the penalty or at least cautions the taxpayer that

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16 *See, e.g., Snow v. Comm'r*, T.C. Memo. 2013-114 (taxpayer argued his activities were not taxable because his employers were not "Subtitle C statutory employers"); *Flint v. Comm'r*, T.C. Memo. 2012-287 (taxpayer argued he did not have income as he was not a federal employee or corporate officer).

17 *See, e.g., Grandy v. Comm'r*, T.C. Memo. 2012-196; *Nix v. Comm'r*, T.C. Memo. 2012-304, *appeal filed* (11th Cir. May 20, 2013).

18 *Crites v. Comm'r*, T.C. Memo. 2012-267.

19 *See, e.g., Rice v. Comm'r*, T.C. Memo. 2012-301 (taxpayer argued that the IRS was merely a debt collector and therefore not a part of the U.S. government); *Roye v. Comm'r*, T.C. Memo. 2012-246 (taxpayer argued that the IRS lacked the authority under section 6020(b) to prepare substitutes for returns).

20 The court imposed the penalty in *Roye v. Comm'r*, T.C. Memo. 2012-246 and *Winslow v. Comm'r*, 139 T.C. 270 (2012), but declined to impose the penalty in *Leyshon v. Comm'r*, T.C. Memo. 2012-248, and *Rice v. Comm'r*, T.C. Memo. 2012-301 and instead strongly warned the taxpayers that future similar conduct in court would result in the imposition of the penalty. In *Palmer v. Comm'r*, 503 F. App'x 596 (10th Cir. 2012), *aff'g* T.C. Docket No. 1398-10 (Feb. 6, 2012), the Court of Appeals affirmed the Tax Court's imposition of the penalty.

21 *Winslow v. Comm'r*, 139 T.C. 270.

22 *Davenport v. Comm'r*, T.C. Memo. 2013-41.

23 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress 640-642.

24 *See, e.g., Crites v. Comm'r*, T.C. Memo. 2012-267.

25 *See, e.g., Roye v. Comm'r*, T.C. Memo. 2012-246.

26 *See, e.g., Curtis v. Comm'r*, T.C. Memo. 2013-12 ($25,000 penalty when the court had imposed $15,000 in an earlier case); *Burt v. Comm'r*, T.C. Memo. 2013-58, *appeal filed* (6th Cir. July 5, 2013) ($20,000 penalty when the court had admonished the taxpayer in an order in an earlier case that the court would impose the penalty if the taxpayer continued to advance frivolous arguments).

similar future behavior will result in a penalty.[27] Finally, the U.S. Courts of Appeals have shown their willingness to uphold the penalties imposed by the Tax Court without fail in the cases analyzed since June 1, 2005.

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27 *See, e.g., Davenport v. Comm'r*, T.C. Memo. 2013-41 (court raised the penalty *sua sponte* and imposed sanctions of $4,000).

MLI #9 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

SUMMARY

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or subject any of the delinquent taxpayer's property to the payment of tax. We identified 33 opinions issued between June 1, 2012, and May 31, 2013, that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 30 of these cases. The number of cases represents a 31 percent decrease from the previous year.[1]

PRESENT LAW

IRC § 7403 authorizes the United States to enforce a federal tax lien with respect to a taxpayer's delinquent tax liability, or to subject any property, right, title or interest in property of the delinquent taxpayer to the payment of a liability, by initiating a civil action against the taxpayer in the appropriate United States District Court.[2] All parties having liens on or otherwise claiming interest in the relevant property shall be made parties to the action.[3] The law of the state where the property is located determines the nature of a taxpayer's legal interest in the property.[4] However, if it is determined that the taxpayer has an interest in the property, federal law controls whether the property is exempt from attachment of the lien.[5]

The court may order that the property be sold by an officer of the court and the proceeds applied to the delinquent tax liability.[6] However, based on the Supreme Court case *United States v. Rodgers*, the court is not required to authorize a forced sale and may exercise limited equitable discretion.[7] When a forced sale involves the interests of a non-delinquent third party, the court should consider four factors from *Rodgers* when determining whether the property should be sold:

1. The extent to which the government's financial interests would be prejudiced if they were relegated to a forced sale of the partial interest of the delinquent taxpayer;
2. Whether the innocent third party with a separate interest in the property, in the normal course of events, has a legally recognized expectation that the property would not be subject to a forced sale by the delinquent taxpayer or taxpayer's creditors;
3. The likely prejudice to the third party in personal dislocation costs and inadequate compensation; and
4. The relative character and value of the non-liable and liable interests held in the property.[8]

1 National Taxpayer Advocate 2012 Annual Report to Congress 634-639.
2 IRC § 7403(a); Treas. Reg. § 301.7403-1(a).
3 IRC § 7403(b).
4 *U.S. v. National Bank of Commerce*, 472 U.S. 713, 722 (1985).
5 *U.S. v. Rodgers*, 466 U.S. 677 (1983).
6 IRC § 7403(c).
7 466 U.S. 677 (1983).
8 *Rodgers*, 461 U.S. at 709-11.

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At the sale of the property in which it holds a first lien, the United States may bid an amount equal to or less than the amount of the lien, plus selling expenses.[9] Additionally, the United States may intervene in foreclosure actions initiated by other creditors, to assert any lien on the property that is the subject of such action.[10] The United States may also remove the case to a U.S. District Court if the case was initiated in a state court.[11] However, junior federal tax liens may be effectively extinguished in a foreclosure and sale under state law, even if the United States is not a party to the proceeding.[12] The IRC also specifically authorizes the court to appoint a receiver to enforce the lien and, upon the government's certification that it is in the public interest, may appoint a receiver with all powers of a receiver in equity to preserve and operate the property prior to the sale.[13]

Recently, the IRS clarified its procedures for referring cases to the Department of Justice (DOJ) when seeking to recommend a suit to foreclose on a taxpayer's principal residence.[14] When a tax lien attaches to the principal residence of a taxpayer or a residence owned by the taxpayer but occupied by the taxpayer's spouse, former spouse, or minor child, the IRS can use two methods to enforce the tax lien. The IRS can request that the DOJ:

- File suit to foreclose the federal tax lien against the principal residence under IRC § 7403; or
- Commence a proceeding to obtain a court order allowing administrative seizure of a principal residence under IRC § 6334(e)(1).[15]

In explaining what steps the IRS must take prior to requesting that the DOJ obtain a court order allowing administrative seizure of a principal residence under IRC § 6334(e)(1), the Treasury Regulations clearly state that among other things, the IRS must consider who is living in the residence.[16] The Treasury Regulation on requesting the commencement of a foreclosure action of a principal residence under § 7403 is not as clear about the considerations the IRS should make prior to referring a case to the DOJ for potential foreclosure on a principal residence.[17] Thus, the IRS recently issued interim guidance to employees to explain that the procedures for developing suit referral recommendations under IRC § 6334(e) apply to such recommendations under IRC § 7403 as well.[18] The guidance also emphasizes that the IRS

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9 IRC § 7403(c).

10 28 U.S.C. § 1444. However, if the application of the United States to intervene is denied, the adjudication will have no effect upon the federal tax lien on the property. IRC § 7424.

11 28 U.S.C. § 1444.

12 *U.S. v. Brosnan*, 363 U.S. 237 (1960).

13 IRC §§ 7403(d) and 7402(a).

14 Interim Guidance Memorandum (IGM), *Principal Residence Suit Foreclosure Recommendations*, SBSE-05-0413-035 (Apr. 30, 2013). This guidance is the result of action by TAS leadership. In 2012, TAS Systemic Advocacy developed and issued to the IRS an Advocacy Proposal recommending that the IRS consider the negative impact on the taxpayer of a suit to foreclose on a principal residence prior to forwarding the case to the Department of Justice. TAS, *Memorandum for Director, Collection Policy*, Aug. 20, 2012. The National Taxpayer Advocate followed this advocacy proposal with a legislative recommendation that Congress amend IRC § 7403 to require that the IRS, before recommending that the Attorney General file a suit to foreclose, first determine that the taxpayer's other property or rights to property, if sold, are insufficient to pay the amount due, and that the foreclosure and sale of the residence will not create an economic hardship due to the financial condition of the taxpayer. National Taxpayer Advocate 2012 Annual Report to Congress 537-543 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*). Following this recommendation, Systemic Advocacy consulted extensively with the IRS to develop the IGM, which adopted the recommendations set forth by the National Taxpayer Advocate.

15 IRC § 6334(e)(1) requires that the IRS obtain court approval prior to administratively seizing a principal residence.

16 Treas. Reg. § 301.6334-1(d)(1).

17 Treas. Reg. § 301-7403-1.

18 The IGM follows the legislative recommendation made by the National Taxpayer Advocate in 2012. National Taxpayer Advocate 2012 Annual Report to Congress, 537-543 (Legislative Recommendation: *Amend IRC § 7403 to Provide Taxpayer Protections Before Lien Foreclosure Suits on Principal Residences*).

should pursue a suit to foreclose a lien on a residence only when it has considered hardship issues and there are no reasonable administrative remedies.

ANALYSIS OF LITIGATED CASES

We reviewed 33 opinions issued between June 1, 2012 and May 31, 2013 that involved civil actions to enforce federal tax liens. Table 9 in Appendix III contains a detailed list of those cases. Fifty-five percent of the taxpayers appeared *pro se* and 45 percent were represented. Taxpayers with representation received full relief in two cases and partial relief in one case. No *pro se* taxpayer received relief in any of the opinions reviewed.

In *United States v. Marciello*, the IRS had referred the suit to foreclose to the DOJ under IRC § 7403. The court applied the *Rodgers* factors to deny the government's motion for summary judgment with respect to property owned by the taxpayer and his estranged wife.[19] The court noted that the forced sale of the taxpayer's marital home could foreseeably cause the taxpayer's 65-year-old wife significant emotional distress and detriment stemming from dislocation. Although the court felt some of the factors might weigh in favor of the government, it concluded the taxpayer's wife raised a genuine factual issue regarding the proper evaluation of the remaining *Rodgers* factors, and denied the government's motion for summary judgment with respect to the marital home.

In determining the appropriateness of foreclosure, the courts frequently consider whether a transfer of the property to another party extinguished the federal tax lien. For example, in *United States v. Dickert*, the taxpayer failed to file an income tax return for the 1999 tax year.[20] Based on information provided by third parties, the IRS computed the taxpayer's tax liability and sent the taxpayer a statutory notice of deficiency (SNOD) proposing an assessment. The taxpayer did not file a Tax Court petition or otherwise respond to the SNOD; thus, the liabilities proposed in the SNOD were assessed. After the assessment, but before a notice of federal tax lien (NFTL) was filed, the taxpayer transferred real property to a third party who did not pay full or give adequate consideration. Based on these facts, the court determined that the government had demonstrated it properly assessed the liabilities after notice and demand for payment, these liabilities remained unpaid, and a federal lien tax arose upon assessment that attached to all the taxpayer's property, including the property transferred to the third party.[21] The court found that because the third party did not qualify as a "purchaser" under 26 U.S.C. § 6323(h)(6), the tax lien remained on the property and thus was subject to foreclosure.[22]

In *United States v. Aiello*,[23] the court considered whether it was appropriate to foreclose on property transferred to the taxpayer's wife after the IRC § 6321 tax lien arose and the IRS filed an NFTL. The court looked at whether the tax liabilities were assessed prior to or after transfer of title. Once it determined the

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19 2013 U.S. Dist. LEXIS 43582 (D. Mass. 2013) *adopting* 2013 U.S. Dist. LEXIS 43589 (D. Mass. 2013). For an explanation of the *Rodgers* factors, see footnote 8, *supra*.

20 2012 U.S. Dist. LEXIS 187223 (N.D. Fla. 2012).

21 IRC § 6321. This lien that arises upon assessment and notice and demand for payment is known as the "secret lien" because its existence is generally known only by the IRS and the taxpayer.

22 If a taxpayer transfers property subject to a federal tax lien to a purchaser before the government files an NFTL, the lien no longer attaches and the purchaser acquires the property free of the lien. IRC § 6323(a). A purchaser is defined in the Code as a person who for adequate consideration acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice. IRC § 6323(h)(6).

23 2013 U.S. Dist. LEXIS 77854 (E.D.N.Y. 2013).

liabilities were assessed prior to the transfer of property to the wife, the court found the tax lien remained on the property, notwithstanding the transfer.[24] Applying similar reasoning, the court in *United States v. Johnson* found that because the taxpayer transferred properties to his daughter after the IRC § 6321 lien arose and an NFTL was filed, the federal tax liens remained on the properties.[25]

A number of the opinions involved foreclosure of federal tax liens against property titled in the name of a taxpayer's nominee or alter ego. A nominee is "one who holds bare legal title to property for the benefit of another."[26] Courts typically look at a number of factors to determine whether an entity is a nominee of a taxpayer, such as whether:

- The nominee paid no or inadequate consideration;
- The property was placed in the name of the nominee in anticipation of the tax debt or litigation;
- There is a close relationship between the transferor and the nominee;
- The parties to the transfer never recorded the conveyance;
- The transferor retained control; and
- The transferor continues to enjoy the benefits of property.[27]

In *United States v. Smith*, the court held the revocable living trust set up by the taxpayer was the alter-ego/nominee of the taxpayer.[28] The court based this conclusion on the fact that the taxpayer admitted he owned the property held by the trust, had exclusive use of the subject properties, and personally paid the property expenses.

In *United States v. Zaccardi*, the taxpayer transferred title of his house to Grace Christian Fellowship, an entity that the government argued was not functionally a church but was simply the taxpayer's nominee.[29] The court agreed with the government, noting that the transfers of the home were made without exchange of money or other items of value.[30]

The court in *United States v. Hopkins* reached a similar decision.[31] The taxpayers established two trusts and a corporation and the husband, an emergency room physician, instructed his employers to send his compensation to one of these entities. After the taxes were assessed, the taxpayers transferred their residence and adjoining real property to one of these entities and acquired new properties in the name of one of these entities. After noting that the taxpayers themselves were the chief officers of these entities, the court held that these trusts and corporations were the nominees of the taxpayers and thus ordered the foreclosure of the tax liens on the properties held by the nominee entities.[32]

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24 2013 U.S. Dist. LEXIS 77854 (E.D.N.Y. 2013).

25 111 A.F.T.R.2d (RIA) 1551 (S.D. Tex. 2013).

26 *U.S. v. Smith*, 109 A.F.T.R.2d (RIA) 2359 (W.D. Wash. 2012) quoting *Scoville v. U.S.*, 250 F.3d 1198, 1202 (8th Cir. 2001).

27 *Id*.

28 *Id*.

29 110 A.F.T.R.2d (RIA) 6679 (D. Utah 2012).

30 *Id*.

31 2013-1 U.S.T.C (CCH) ¶ 50,218 (D.N.M. 2013).

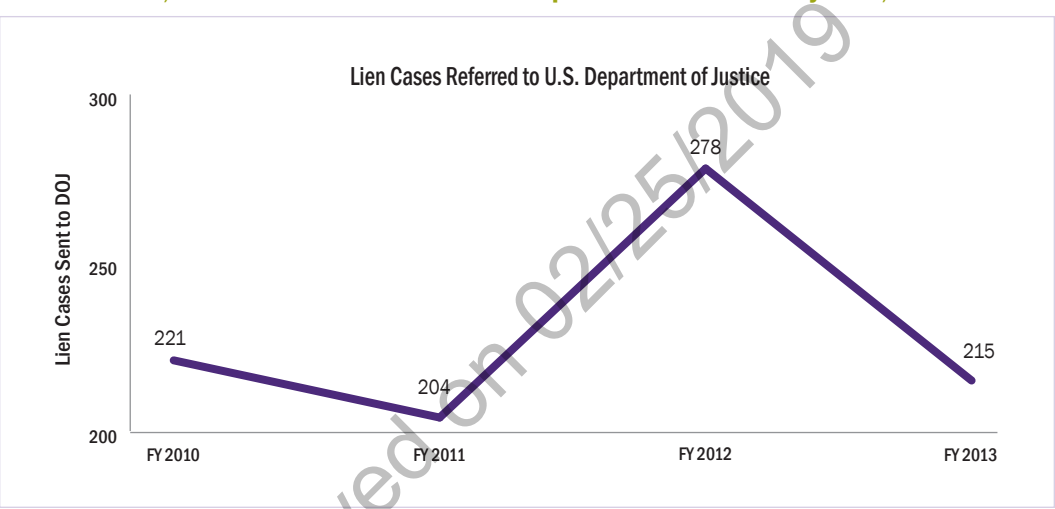
32 2013-1 U.S.T.C (CCH) ¶ 50,218 (D.N.M. 2013).

CONCLUSION

In the 2012 Annual Report to Congress, we predicted that we might see more court opinions involving lien enforcement in the coming years due to an increase of cases referred to the Department of Justice by the IRS.[33] While we did not find that outcome this year, factors such as delays in litigation or settlement prior to trial may have contributed to the smaller number of court opinions this year and a spike in cases may be seen in coming years.

Figure 3.9.1 below shows the number of cases referred to the DOJ by fiscal year.[34]

FIGURE 3.9.1, Lien Cases Referred to U.S. Department of Justice by Year, FY 2010–2013



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More importantly, the National Taxpayer Advocate and her staff raised concerns about inadequate protections for taxpayers in lien enforcement mechanisms, as evidenced in specific cases open in the Taxpayer Advocate Service. With the issuance of interim guidance clarifying when the IRS should seek to refer a foreclosure case to the Department of Justice, referrals of cases may decrease in coming years and we may then see a further decline in court opinions on lien enforcement.

33 National Taxpayer Advocate 2012 Annual Report to Congress 639.

34 Department of Justice (DOJ), Tax Division, *Suits to Foreclose Tax Lien - Summary by Fiscal Year of Case Receipt* (Oct. 3, 2012) and Department of Justice (DOJ), Tax Division, *Suits to Foreclose Tax Lien - Summary by Fiscal Year of Case Receipt* (Oct. 18, 2013).

MLI #10 Relief from Joint and Several Liability Under IRC § 6015

SUMMARY

Married couples may elect to file their federal income tax returns jointly or separately. Spouses filing joint returns are jointly and severally liable for any deficiency or tax due.[1] Joint and several liability permits the IRS to collect the entire amount due from either taxpayer.[2]

Internal Revenue Code (IRC) § 6015 provides three avenues for relief from joint and several liability. Section 6015(b) provides "traditional" relief for deficiencies. Section 6015(c) also provides relief for deficiencies for certain spouses who are divorced, separated, widowed, or not living together, by allocating the liability between the spouses. Section 6015(f) provides "equitable" relief from both deficiencies and underpayments, but only applies if a taxpayer is not eligible for relief under IRC § 6015(b) or (c).

We reviewed 31 federal court opinions involving relief under IRC § 6015 that were issued between June 1, 2012, and May 31, 2013. The most significant issues the courts addressed this year are the Tax Court's scope and standard of review of claims for relief under IRC § 6015(f) and whether district courts have jurisdiction to decide innocent spouse claims raised as a defense in a collection suit or in an interpleader suit.[3] The Tax Court also noted how proposed guidance, if applicable, would have affected its analysis of claims for relief under IRC § 6015(f).

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PRESENT LAW

Three Avenues for Relief from Joint and Several Liability

Traditional Innocent Spouse Relief Under IRC § 6015(b)

IRC § 6015(b) provides that a requesting spouse shall be partially or fully relieved from joint and several liability, pursuant to procedures established by the Secretary, if the requesting spouse can demonstrate that:

1. A joint return was filed;
2. There was an understatement of tax attributable to erroneous items of the nonrequesting spouse;[4]
3. Upon signing the return, the requesting spouse did not know or have reason to know of the understatement;

1 IRC § 6013(d)(3). We use the terms "deficiency" and "understatement" interchangeably for purposes of this discussion and the case table in Appendix 3, even though IRC § 6015(b)(1)(D) and IRC § 6015(f) expressly use the term "deficiency" and IRC § 6015(b)(1)(B) refers to an "understatement of tax."

2 The National Taxpayer Advocate, in the 2005 Annual Report to Congress, proposed legislation that would eliminate joint and several liability for joint filers. *See* National Taxpayer Advocate 2005 Annual Report to Congress 407.

3 Rule 22 of the Federal Rules of Civil Procedure permits a party to a lawsuit to join others to the suit — to interplead them — when the party may otherwise be exposed to double or multiple liability. For example, a party may hold property to which more than one other person claims an interest, and honoring one claim may expose the party to liability to other claimants. By joining interested parties in an interpleader suit, the claimants litigate among themselves to resolve the competing claims.

4 An erroneous item is any income, deduction, credit, or basis that is omitted from or incorrectly reported on the joint return. *See* Treas. Reg. § 1.6015-1(h)(4).

4. Taking into account all the facts and circumstances, it is inequitable to hold the requesting spouse liable; and
5. The requesting spouse elected relief within two years after the IRS began collection activities against him or her.[5]

A requesting spouse is eligible for a refund under this subsection so long as the requesting spouse made the payment and the requirements of IRC § 6511 have been met.[6]

Allocation of Liability Under IRC § 6015(c)

IRC § 6015(c) provides that the requesting spouse shall be relieved from liability for deficiencies allocable to the nonrequesting spouse, pursuant to procedures established by the Secretary. To obtain relief under this section, the requesting spouse must demonstrate that:

1. A joint return was filed;
2. At the time relief was elected, the joint filers were unmarried, legally separated, widowed, or had not lived in the same household for the 12 months immediately preceding the election; and
3. The election was made within two years after the IRS began collection activities with respect to the requesting spouse.

This election allocates to each joint filer the portion of the deficiency attributable to each filer as calculated under the allocation provisions of IRC § 6015(d). A taxpayer is ineligible to make an election under IRC § 6015(c) if the IRS demonstrates that, at the time he or she signed the return, the requesting taxpayer had "actual knowledge" of any item giving rise to the deficiency.[7] Relief is not available for amounts attributable to fraud, fraudulent schemes, or certain transfers of disqualified assets.[8] Finally, no credit or refund is allowed as a result of relief granted under IRC § 6015(c).[9]

Equitable Relief Under IRC § 6015(f)

IRC § 6015(f) provides that the Secretary may relieve a taxpayer from liability for both deficiencies and underpayments[10] where the taxpayer demonstrates that:

1. Relief under IRC § 6015(b) or (c) is unavailable; and
2. Taking into account all the facts and circumstances, it would be inequitable to hold the taxpayer liable for the underpayment or deficiency.

Previously, the IRS incorporated the statutory two-year deadline found in IRC § 6015 (b)(1)(E) and (c)(3)(B) into the § 6015 regulations and thereby imposed the two-year rule on requests for equitable

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5 Not all actions that involve collection will trigger the two-year period of limitations. Under the regulations, only the following four events constitute "collection activity" that will start the two-year period: (1) an IRC § 6330 notice; (2) an offset of an overpayment of the requesting spouse against the joint income tax liability under IRC § 6402; (3) the filing of a suit by the United States against the requesting spouse for the collection of the joint tax liability; and (4) the filing of a claim by the United States to collect the joint tax liability in a court proceeding in which the requesting spouse is a party or which involves property of the requesting spouse. Treas. Reg. § 1.6015-5(b)(2).

6 IRC § 6015(g)(1). See note 19 for an explanation of the general time period for filing refund claims under IRC § 6511.

7 IRC § 6015(c)(3)(C).

8 IRC § 6015(c)(4),(d)(3)(C).

9 IRC § 6015(g)(3).

10 An underpayment of tax occurs when the tax is properly shown on the return but is not paid. *Washington v. Comm'r*, 120 T.C. 137, 158-59 (2003).

relief under IRC § 6015(f).[11] In 2009, the Tax Court, in *Lantz v. Commissioner*, held the regulation imposing the two-year rule invalid.[12] The IRS appealed *Lantz* and similar decisions, and three U.S. Courts of Appeal ultimately held that the regulation was valid.[13] In the meantime, the Tax Court continued, where permitted, to hold the regulation invalid, and the issue was appealed to other U.S. Courts of Appeal.[14] The National Taxpayer Advocate consistently advocated for removal of the two-year rule that prevented taxpayers from obtaining equitable relief.[15] In July 2011, the IRS changed its position and now considers requests for equitable relief under IRC § 6015(f) submitted after July 25, 2011, without regard to when the first collection activity was taken.[16] Proposed Treasury regulations to reflect the change in the two-year rule were published on August 13, 2013.[17] Requests for equitable relief may be filed within the period of limitation on collection in IRC § 6502[18] or, for any credit or refund of tax, within the period of limitation in IRC § 6511.[19]

Revenue Procedure 2003-61 lists some of the factors the IRS has considered in determining whether equitable relief is appropriate.[20] In January 2012, the IRS issued a proposed revenue procedure to supersede Revenue Procedure 2003-61.[21] IRS Chief Counsel attorneys immediately applied the provisions of the proposed revenue procedure in docketed Tax Court cases.[22] However, taxpayers were advised to notify the IRS in their applications for relief (or supplement existing applications) if they would receive more favorable treatment under one or more of the factors provided in Revenue Procedure 2003-61. The IRS

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11 Treas. Reg. § 1.6015-5(b)(1).

12 132 T.C. 131 (2009).

13 *Mannella v. Comm'r*, 631 F.3d 115 (3d Cir. 2011) *rev'g and remanding* 132 T.C. 196 (2009); *Jones v. Comm'r*, 642 F.3d 459 (4th Cir. 2011), *rev'g and remanding* T.C. Docket No. 17359-08 (May 28, 2010); *Lantz v. Comm'r*, 607 F.3d 479 (7th Cir. 2010) *rev'g and remanding* 132 T. C. 131 (2009).

14 Adhering to the rule in *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd* 445 F.2d 985 (10th Cir. 1971), that the Tax Court will defer to a U.S. Court of Appeals decision which is squarely on point where appeal from the Tax Court decision lies to that U.S. Court of Appeal, the Tax Court continued to hold the regulation invalid in cases appealable to other circuits. *See, e.g., Young v. Comm'r*, T.C. Docket No. 12718-09 (May 12, 2011); *Pullins v. Comm'r*, 136 T.C. 432 (2011); *Stephenson v. Comm'r*, T.C. Memo. 2011-16; *Hall v. Comm'r*, 135 T.C. 374, *appeal dismissed* (6th Cir. Aug. 2, 2011); *Buckner v. Comm'r*, T.C. Docket No. 12153-09, *appeal dismissed* (6th Cir. July 27, 2011); *Carlile v. Comm'r*, T.C. Docket No. 11567-09, *appeal dismissed* (9th Cir. Dec. 8, 2010); *Payne v. Comm'r*, T.C. Docket No. 10768-09, *appeal dismissed* (9th Cir. July 25, 2011); *Coulter v. Comm'r*, T.C. Docket No. 1003-09, *appeal dismissed* (2d Cir. Aug. 4, 2011).

15 National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*); vol. 2 at 1-12 (*Unlimit Innocent Spouse Equitable Relief*); National Taxpayer Advocate 2006 Annual Report to Congress 540 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief under IRC § 6015 or 66*).

16 Notice 2011-70, 2011-2 C.B. 135 (July 25, 2011), *available at* http://www.irs.gov/pub/irs-drop/n-11-70.pdf. The Notice provides transitional rules and provides that pending litigation will be managed consistently with the removal of the two-year rule. *See also* CC-Notice 2011-017 (July 25, 2011) (providing direction for Chief Counsel attorneys handling cases docketed with the Tax Court that involve the two-year deadline).

17 78 Fed. Reg. 49,242 (Aug. 13, 2013). Written or electronic comments were invited. Comments and requests for a public hearing were to be received by Nov. 12, 2013.

18 The statutory period of limitations on collection is generally ten years after the date the tax is assessed. IRC § 6502(a). However, a variety of statutory provisions may extend or suspend the collection period. For example, if a court proceeding to collect the tax is brought, such as a suit to reduce a tax liability to judgment, the period of limitations on collection is extended. Therefore, the period of limitations on collection could exceed ten years, and a claim for innocent spouse relief would be valid at any point during that time.

19 Generally, taxpayers must request a refund within three years from the date their return was filed, or two years from the time the tax was paid, whichever occurs later, or, if no return was filed, within two years from the time the tax was paid. IRC § 6511(a). If taxpayers meet the three-year requirement, they can recover payments made during the three-year period that precedes the date of the refund request, plus the period of any extension of time for filing the return. However, taxpayers who do not meet the three-year requirement can recover only payments made during the two-year period preceding the date of the refund request. IRC § 6511(b)(2).

20 Rev. Proc. 2003-61, 2003-2 C.B. 296.

21 Notice 2012-8 (Jan. 5, 2012), 2012-4 C.B. 309, *available at* http://www.irs.gov/irb/2012-04_IRB/ar09.html. The Department of Treasury and the IRS invited public comment on the proposed guidance and on the administration of the IRS's innocent spouse program by Feb. 21, 2012.

22 Notice CC-2012-004 (Jan. 5, 2012).

would then apply those factors until the proposed revenue procedure was finalized. The proposed revenue procedure was finalized as Revenue Procedure 2013-34 and became effective for requests for equitable relief pending on September 16, 2013.[23] As discussed below, the Tax Court continued to apply Revenue Procedure 2003-61 pending finalization of the new revenue procedure. However, it occasionally considered whether the revenue procedure as proposed would change its analysis.[24]

Factors common to Revenue Procedure 2003-61, the proposed revenue procedure, and Revenue Procedure 2013-34 include

- Marital status;
- Economic hardship;
- Knowledge or reason to know of the understatement or that the tax would not be paid;
- Legal obligations of the nonrequesting spouse;
- Significant benefit to the requesting spouse; and
- Compliance with income tax laws.

Abuse was an additional factor under Revenue Procedure 2003-61; the new guidance removed abuse as a separate factor, but clarified the effect abuse has on the analysis generally and on the knowledge factor and significant benefit factors specifically.[25]

Rights of Nonrequesting Spouse

The individual with whom the requesting spouse filed the joint return is generally referred to as a "nonrequesting spouse" and is granted certain rights by IRC § 6015. The nonrequesting spouse must be notified and given an opportunity to participate in any administrative proceedings concerning a claim under IRC § 6015.[26] Further, if during the administrative process full or partial relief is granted to the requesting spouse, the nonrequesting spouse can file a protest and receive an administrative conference in the IRS Appeals function.[27] The nonrequesting spouse does not have the right to petition the Tax Court in response to the IRS's administrative determination regarding IRC § 6015 relief.[28]

If the requesting spouse files a Tax Court petition, the nonrequesting spouse must receive notice of the Tax Court proceeding and has an unconditional right to intervene in the proceeding to dispute or support the requesting spouse's claim for relief.[29] However, an intervening spouse has no standing to appeal the Tax Court's decision to the United States Court of Appeals.[30]

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23 2013-42 I.R.B. 1.

24 *Sriram v. Comm'r*, T.C. Memo. 2012-91, was the first case in which the Tax Court analyzed the IRC § 6015(f) claim under the provisions of both Rev. Proc. 2003-61 and Notice 2012-8. More recent examples of this approach are discussed below.

25 Notice 2012-8 and Rev. Proc 2013-34, §§ 4.01(5), (7)(d); 4.02(3); 4.03(2)(c)(iv), (e).

26 IRC § 6015(h)(2).

27 Rev. Proc. 2003-19, 2003-5 C.B. 371.

28 *Maier v. Comm'r*, 119 T.C. 267 (2002), *aff'd*, 360 F.3d 361 (2d Cir. 2004) (holding that there are no provisions in IRC § 6015 that allow the nonrequesting spouse to petition the Tax Court from a notice of determination).

29 *Van Arsdalen v. Comm'r*, 123 T.C. 135 (2004).

30 *Baranowicz v. Comm'r*, 432 F.3d 972 (9th Cir. 2005).

Judicial Review

Taxpayers seeking relief under IRC § 6015 generally file Form 8857, *Request for Innocent Spouse Relief*.[31] After reviewing the request, the IRS issues a final notice of determination granting or denying relief in whole or in part. The taxpayer has 90 days from the date the IRS mails the notice to file a petition with the Tax Court.[32] The Tax Relief and Health Care Act of 2006 amended IRC § 6015(e) to expressly provide that the Tax Court has jurisdiction in "stand-alone" cases to review IRC § 6015(f) determinations, even where no deficiency has been asserted.[33]

ANALYSIS OF LITIGATED CASES

We analyzed 31 opinions issued between June 1, 2012, and May 31, 2013, including 21 Tax Court opinions, one each from the United States Courts of Appeals for the First, Fifth, Ninth, Eleventh, and Federal Circuits, two from the Court of Appeals for the Sixth Circuit, and three from U.S. District Courts. Sixty-five percent of the cases (20 of 31) were decided in favor of the IRS and 32 percent (10 of 31) in favor of the requesting spouse (including two cases in which only the intervenor opposed granting relief). One case (three percent) ended in a split decision. In 35 percent (11 of 31) of the cases, the taxpayers appeared *pro se* (*i.e.*, they represented themselves). Taxpayers who proceeded *pro se* prevailed in spite of opposition from the IRS in three cases out of 11 (27 percent).[34] One *pro se* taxpayer obtained a split decision. The nonrequesting spouse intervened in 23 percent of the cases (seven of 31).

Seventy-one percent of the cases (22 of 31) involved an analysis of whether to grant relief. Twenty-nine percent of the cases (nine of 31) involved procedural issues, with 78 percent (seven of nine) of these cases decided in favor of the IRS, and 22 percent (two of nine) in favor of the taxpayer.

Of the 22 cases decided on the merits, 59 percent (13 of 22) were decided in favor of the IRS, and 36 percent (eight of 22) in favor of the taxpayer. In five percent (one case) the court split its decision. See Table 10 in Appendix 3 for a detailed breakdown of the cases.

Procedural Issues

The Court of Appeals for the Ninth Circuit affirmed the Tax Court's holding in *Wilson v. Commissioner*, discussed in the National Taxpayer Advocate's 2011 Annual Report to Congress, that the Tax Court provides *de novo* review of claims for relief under IRC § 6015(f).[35] Additionally, two district courts

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31 *See* IRS Form 8857, *Request for Innocent Spouse Relief, Instructions* (Sept. 2010).

32 IRC § 6015(e)(1)(A)(ii).

33 Pub. L. No. 109-432, Div. C, § 408(a), (c), 120 Stat. 2922, 3061-62 (2006). Prior to amendment, IRC § 6015(e) provided for Tax Court review of determinations under IRC 6015(b) or (c), but it was not clear that the Tax Court had jurisdiction to review requests for relief made only under IRC § 6015(f) when no deficiency had been asserted. The 2006 amendment followed the National Taxpayer Advocate's recommendation that IRC § 6015(e) be amended to clarify that taxpayers have the right to petition the Tax Court for review of determinations made only under IRC § 6015(f). *See* National Taxpayer Advocate 2001 Annual Report to Congress 159-65 (Key Legislative Recommendation: *Joint and Several Liability Final Determination Rights*). The filing of a Tax Court petition in response to the final notice of determination or after the IRC § 6015 claim is pending for six months is often referred to as a "stand-alone" proceeding, because jurisdiction is predicated on IRC § 6015(e) and not deficiency jurisdiction under IRC § 6213.

34 Taxpayers who proceeded *pro se* prevailed in an additional two cases in which only the intervenor (and not the IRS) opposed relief.

35 *Wilson v. Comm'r*, 705 F.3d 980 (9th Cir. 2013) *aff'g* T.C. Memo. 2010-134; National Taxpayer Advocate 2011 Annual Report to Congress 655 (Most Litigated Issue: *Relief from Joint and Several Liability under IRC § 6015*) at 661.

continued the disturbing trend of holding that a taxpayer was not entitled to raise innocent spouse relief as a defense in a collection suit.[36] A third district court refused to allow the defense in an interpleader suit.[37]

Wilson v. Commissioner

In *Wilson v. Commissioner*,[38] Mr. Wilson, an insurance salesman, generated additional income by steering people into a Ponzi scheme. Mrs. Wilson was aware of the additional income but believed it derived from legitimate business operations. The additional income, which arose in 1997-1999, was not reported on the joint returns the couple filed for 1997 or 1998. The couple later filed amended 1997 and 1998 returns that reported the income, and included the additional income on their 1999 joint return. The resulting $540,000 tax debt from the returns for the three years remained unpaid. In 2002, Mrs. Wilson requested innocent spouse relief under IRC § 6015(f) in a stand-alone petition.[39]

In the Tax Court proceeding, pursuant to *Porter v. Commissioner* (*Porter I*),[40] the Tax Court's scope of review was *de novo*, which means that the court could and did consider evidence introduced at trial that was not part of the administrative record. The Tax Court's decision in *Porter I* was in turn based on its earlier holding in *Ewing v. Commissioner*,[41] in which the Tax Court found that the Administrative Procedure Act (APA),[42] which limits the scope of judicial review to the administrative record, was not applicable to Tax Court proceedings, including IRC § 6015 proceedings. Further, the Tax Court found that the use of the word "determine" in IRC § 6015 is similar to the use of the word "redetermination" in IRC § 6213(a) under which it is unquestioned that the scope of its review is *de novo*. The Tax Court concluded that the use of this term meant that Congress intended the court to have *de novo* review authority for IRC § 6015 cases. The Court of Appeals for the Eleventh Circuit had also held that *de novo* review is appropriate for Tax Court review of stand-alone claims under IRC § 6015(f).[43] However, the IRS did not agree with the decision in *Porter I*, and instructed Chief Counsel attorneys to, among other things, continue to raise the scope of review argument whenever appropriate.[44]

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36 *U.S. v. Popowski*, 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012); *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012). The National Taxpayer Advocate has recommended that Congress address this problem in three Annual Reports to Congress. National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*); National Taxpayer Advocate 2009 Annual Report to Congress 378 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*); National Taxpayer Advocate 2007 Annual Report to Congress 549 (Legislative Recommendation: *Allow Taxpayers to Raise Relief Under Internal Revenue Code Sections 6015 and 66 as a Defense in Collection Actions*).

37 *Simmons Perrine Moyer Bergman, PLC v. Coleman*, 1111 A.F.T.R.2d (RIA) 1237 (N.D. Iowa 2013).

38 T.C. Memo. 2010-134, *aff'd by* 705 F.3d 980 (9th Cir. 2013).

39 The trial began in 2005, but the Tax Court suspended the case due to the questioned jurisdiction of the Tax Court over stand-alone innocent spouse cases. *See Comm'r v. Ewing*, 439 F.3d 1009 (9th Cir. 2006), *rev'g* 118 T.C. 494 (2002) and vacating 122 T.C. 32 (2004). As discussed *supra*, the Tax Relief and Health Care Act of 2006 amended IRC § 6015(e) to expressly provide that the Tax Court has jurisdiction to review IRC § 6015(f) determinations even when no deficiency has been asserted, permitting Mrs. Wilson's case to go forward.

40 130 T.C. 115 (2008) (*Porter I*). In *Porter I*, the Tax Court denied the IRS's motion *in limine* (*i.e.*, as a preliminary matter), which sought to preclude the taxpayer from offering evidence not already contained in the administrative record.

41 118 T.C. 494 (2002), vacated on other grounds sub nom. *Comm'r v. Ewing*, 439 F.3d 1009 (9th Cir. 2006).

42 5 U.S.C. §§ 551-559, 701-706 (2000).

43 *Neal v. Comm'r*, 557 F.3d 1262 (11th Cir. 2009), *aff'g* T.C. Memo. 2005-201.

44 Notice CC-2009-021 (June 30, 2009) supplementing Notice CC-2004-26 (July 12, 2004).

Pursuant to its decision in *Porter v. Commissioner (Porter II)*,[45] the Tax Court used the *de novo* standard of review, rather than an abuse of discretion standard of review. Under a *de novo* standard, the court considers the facts of the case anew and determines whether it is inequitable to hold the requesting spouse liable for the unpaid tax or deficiency. Under an abuse of discretion standard, the court reviews the IRS's denial of relief and overturns that determination only where it is shown to be arbitrary, capricious, or without sound basis in fact, and the requesting spouse bears the burden of proving that the Commissioner abused his discretion in denying relief.[46] The IRS also did not agree with the decision in *Porter II*, and instructed Chief Counsel attorneys to, among other things, continue to raise the standard of review argument whenever appropriate.[47]

The Tax Court held that Mrs. Wilson was entitled to relief under IRC § 6015(f), and articulated the ways in which its conclusions, based on *de novo* review, differed from the IRS's conclusions that were based solely on the administrative record.[48] The IRS appealed the Tax Court's decision to the Court of Appeals for the Ninth Circuit. While the appeal was pending, the National Taxpayer Advocate recommended that Congress clarify that the scope and standard of Tax Court determinations under IRC § 6015(f) is *de novo*.[49]

The Court of Appeals for the Ninth Circuit affirmed the Tax Court's decision. The court noted that the statutory mandate in IRC § 6015(e) that the Tax Court "determine" the appropriate relief "in light of all the facts and circumstances" suggests a *de novo* scope of evidentiary review; the Court of Appeals for the Eleventh Circuit had arrived at this conclusion; and a different approach would produce inconsistencies in different types of IRC § 6015(f) claims.[50] The court did not decide whether the APA applies to Tax Court proceedings (although it acknowledged that there is "considerable doubt" on this point).[51] However, it noted that even if the APA applies, an exception to the general rule that review is limited to the agency record permits a reviewing court to require supplementation of an incomplete administrative record, and that "[t]he ability to supplement the administrative record is particularly important in equitable relief cases, which require a fact-intensive inquiry of sensitive issues that may not come to light during the administrative phase of review."[52] Supplementing the administrative record was critical to determining whether the IRS had properly considered Mrs. Wilson's claim, and the Tax Court properly considered the additional evidence.[53]

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45 132 T.C. 203 (2009); *Porter II* is a continuation of the same case that produced the 2008 holding (*Porter I, see supra* note 40) that Tax Court review of denials of relief under IRC § 6015(f) is not limited to the administrative record.

46 *Jonson v. Comm'r*, 118 T.C. 106, 125, *aff'd* by 353 F.3d 1181 (10th Cir. 2003).

47 Notice CC-2009-021 (June 30, 2009), supplementing Notice CC-2004-26 (July 12, 2004).

48 For a complete discussion of the Tax Court's analysis of the relevant factors, see National Taxpayer Advocate 2011 Annual Report to Congress (Most Litigated Issue: *Relief from Joint and Several Liability Under IRC § 6015*) at 661.

49 National Taxpayer Advocate 2011 Annual Report to Congress 531 (Legislative Recommendation: *Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is De Novo*).

50 705 F.3d 980, 988-989. For example, if a taxpayer petitions the Tax Court after the request for relief has been pending for six months, as permitted by IRC § 6015(e)(1)(A)(i)(II), there may be no administrative record. As another example, a taxpayer may, in a deficiency proceeding, raise IRC § 6015(f) as an affirmative defense. Again, there would be no administrative record to consult, and the scope of review would be *de novo*. Moreover, Congress provided for intervention by nonrequesting spouses, which suggests it intended trials *de novo* under IRC § 6015(f) to permit the other spouse to offer evidence.

51 705 F.3d 980, 990, n. 16.

52 705 F.3d 980, 991, citing the National Taxpayer Advocate 2011 Annual Report to Congress (Most Serious Problem: *The IRS Does Not Sufficiently Recognize and Address Domestic Violence and Abuse and its Effects on Tax Administration*).

53 The court noted that many taxpayers claiming innocent spouse relief like Mrs. Wilson proceed *pro se*, citing the National Taxpayer Advocate 2011 Annual Report to Congress 589 (Most Litigated Issues: *Introduction, Analysis of Pro Se Litigation*).

The court also held that the Tax Court properly reviewed Wilson's claim anew, rather than for an abuse of discretion. Because the Tax Court may consider a claim in which there is no administrative record at all, it would be illogical to require review only for abuse of discretion. The IRS agreed that a *de novo* scope of review is incompatible with review for abuse of discretion because such an approach may result in the Tax Court finding the IRS abused its discretion in denying relief based on evidence not before the IRS. The court noted that it would be pointless for the Tax Court to compile a *de novo* record by considering evidence not in the administrative record if the court could then only review the claim for an abuse of discretion.[54] "Finally," the court noted, "the nature of equitable relief also favors de novo review. … The award of equitable spouse relief often turns on credibility, which is best tested in the crucible of trial rather than in a bureaucratic office in which the officer is unlikely even to meet the claimant. In this unique context, de novo review of the agency decision is particularly appropriate."[55]

On June 17, 2013, the IRS announced its acquiescence in the *Wilson* decision, stating that "[a]lthough the Service disagrees that section 6015(e)(1) provides both a *de novo* standard and a *de novo* scope of review, the Service will no longer argue that the Tax Court should review section 6015(f) cases for an abuse of discretion or that the court should limit its review to the administrative record."[56] Chief Counsel attorneys were instructed to proceed accordingly.[57]

U.S. v. Popowsi, U.S. v. Elman, and Simmons v. Coleman

The *Popowski* and *Elman* cases[58] further illustrate the need for legislative clarification to counter the judicial view, identified by the National Taxpayer Advocate in past Annual Reports to Congress, that a taxpayer may not raise IRC § 6015 as a defense in district court proceedings.[59] IRC § 6015 (e)(1)(A) provides that an individual who seeks relief from joint liability may, "in addition to any other remedy provided by law," petition the Tax Court to determine the appropriate relief available. At least one district court has considered the defense in a suit to reduce joint federal tax assessments to judgment and to foreclose federal tax liens.[60] Other statutory provisions and judicial precedent support the conclusion that taxpayers may raise IRC § 6015 in a variety of contexts.[61] However, in the *Popowski* and *Elman* cases, two district courts, one in South Carolina and one in Illinois, held that they do not have jurisdiction over IRC

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54 705 F.3d 980, 992-993.

55 705 F.3d 980 at 993. The court added that the IRC § 6015(e) jurisdictional grant to the Tax Court to "determine" whether relief is appropriate buttressed its conclusion that *de novo* review is appropriate. The Tax Court had always reviewed claims under IRC § 6015 (b) and (c) *de novo*, and the 2006 statutory direction that the Tax Court determine the appropriate relief available under subsections (b), (c), and (f), indicated that uniformity in the standard of review was intended for all claims under IRC § 6015.

56 Action on Dec., 2012-07 (June 17, 2013).

57 Notice CC-2013-11 (June 7, 2013), obsoleting Notice CC-2009-021 (June 30, 2009), and Notice CC-2004-26 (July 12, 2004), *supra* notes 44 and 47.

58 *U.S. v. Popowski*, 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012); *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012).

59 *See* National Taxpayer Advocate 2012 Annual Report to Congress 648; National Taxpayer Advocate 2010 Annual Report to Congress 504; National Taxpayer Advocate 2009 Annual Report to Congress 487; National Taxpayer Advocate 2008 Annual Report to Congress 524; National Taxpayer Advocate 2007 Annual Report to Congress 631. Moreover, the National Taxpayer Advocate three times recommended that legislation clarify that taxpayers may raise relief under IRC §§ 6015 and 66 as a defense in collection actions. *See* National Taxpayer Advocate 2010 Annual Report to Congress 377; National Taxpayer Advocate 2009 Annual Report to Congress 378; National Taxpayer Advocate 2007 Annual Report to Congress 549.

60 *U.S. v. Melot*, 109 A.F.T.R.2d (RIA) 1568 (D.N.M. 2012), *appeal dismissed* (10th Cir. Aug. 1, 2012) (holding that relief under IRC § 6015 was not available because the taxpayer requesting relief had not filed a joint return, and that relief under IRC § 66 was not available because the taxpayer did not establish that she did not know, and had no reason to know, of the item of community income giving rise to the unpaid tax).

61 *See* IRC §§ 6320(c) and 6330(c)(2)(A)(i) (pertaining to collection due process proceedings); IRC § 6213 and *Corson v. Comm'r*, 114 T.C. 354, 363 (2000) (pertaining to deficiency proceedings); 11 U.S.C.A.§ 505(a) (pertaining to bankruptcy proceedings); and IRC § 7422 (pertaining to refund suits).

§ 6015 claims raised as a defense in an action to reduce joint federal tax assessments to judgment or in a lien foreclosure suit.

In *Popowski*, Mrs. Popowski alleged that she had sought innocent spouse relief from the IRS, which was denied.[62] Mrs. Popowski did not petition the Tax Court for review of the determination. When Mrs. Popowski sought to raise a claim for innocent spouse relief as a defense in a suit to reduce joint tax liabilities to judgment, the court found that she had not made any evidentiary showing that she qualified for innocent spouse relief. The court held that even if Mrs. Popowski had submitted such evidence, "the Court has no authority to hear it. The defendant essentially concedes and the plaintiff amply demonstrates that the 'innocent spouse' defense may only be heard by the Tax Court."[63] Mrs. Popowski was not permitted to raise her innocent spouse claim as a defense, and the court granted the government's motion for summary judgment.

In *Elman*, Mrs. Elman sought innocent spouse relief as a defense in a suit to reduce to judgment joint tax liabilities from tax years 1996, 1998, and 1999 and to enforce federal tax liens on her home.[64] The IRS had rejected Mrs. Elman's request for relief under IRC § 6015(b), (c), and (f) because she did not request relief within two years of August 4, 2003, the date the IRS commenced its first collection activity against her.[65] In addition, the IRS rejected the claim under IRC § 6015(f), because, it said, Mrs. Elman had not shown that at the time the returns were filed, she had reason to believe Mr. Elman (who died in 2005) would pay the tax, and she had not proven her claim of economic hardship. The IRS Office of Appeals agreed with the denial of relief, and Mrs. Elman did not petition the Tax Court for review. The court, citing *U.S. v. Boynton*, noted "[a]lthough the statute itself does not address whether the Tax Court's jurisdiction is exclusive, courts interpreting the statute have concluded that it is."[66] The court held that exclusive jurisdiction over Mrs. Elman's innocent spouse claim lies with the Tax Court and that it lacked jurisdiction to entertain the innocent spouse defense. It therefore granted the government's motion for summary judgment to reduce the tax liabilities to judgment.[67]

As the National Taxpayer Advocate has pointed out, these district court decisions are inconsistent with the statutory language of IRC § 6015, which does not give the Tax Court exclusive jurisdiction to determine innocent spouse claims, but rather confers Tax Court jurisdiction "in addition to any other remedy

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62 *U.S. v. Popowski*, 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012).

63 *Popowski*, 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012), slip op. at 7.

64 *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012).

65 Mrs. Elman requested relief on May 18, 2006. As discussed above, claims for relief under IRC § 6015(b) or (c) must be made within this two-year timeframe, and at the time Mrs. Elman requested relief, the IRS adhered to Treas. Reg. 1.6015-5(b)(1), which imposed the same two-year deadline on requests for relief under IRC § 6015(f). As described above, the IRS no longer applies the two-year deadline to requests for relief under IRC § 6015(f).

66 *U.S. v. Elman*, 110 A.F.T.R.2d (RIA) 6993, slip op. at 8, citing *U.S. v. Boynton*, 99 A.F.T.R.2d (RIA) 920 (S.D. Cal. 2007) (holding that the district court has no jurisdiction to consider the innocent spouse defense when the taxpayer has not first sought such relief with the IRS, reasoning that otherwise a district court and the Tax Court would have concurrent jurisdiction over the claim and might be placed in the position of adjudicating the same issues at the same time). District courts in California have continued to refuse the defense in collection suits, and district courts in other jurisdictions have also not permitted the defense. *See U.S. v. LeBeau*,109 A.F.T.R.2d (RIA)1369 (S.D. Cal. 2012) (relying on *Boynton*); *U.S. v. Miles*, 109 A.F.T.R.2d (RIA) 1602 (N.D. Cal. 2012) (relying on *Boynton*); *U.S. v. Wallace*, 105 A.F.T.R.2d 2827 (S.D. Ohio 2010), *adopted by* 105 A.F.T.R.2d (RIA) 2831 (S.D. Ohio 2010) (relying on *Boynton*); *U.S. v. Bucy*, 100 A.F.T.R.2d (RIA) 6666 (S.D. W. Va. 2007); *U.S. v. Feda*, 97 A.F.T.R.2d (RIA) 1985, 1989 (N.D. Ill. 2006) (taxpayer could not raise IRC § 6015 as a defense in a suit to reduce joint federal tax assessments to judgment); *U.S. v. Cawog*, 97 A.F.T.R.2d (RIA) 3069 (W.D. Pa. 2006), *appeal dismissed* (3d Cir. July 5, 2007) (taxpayer could not raise IRC § 6015 as a defense in a suit to foreclose tax liens).

67 Because the government anticipated that proceeds from the sale of Mrs. Elman's home would be insufficient to pay her tax liabilities, it had invited Mrs. Elman to enter into a compromise of the liability. The court therefore denied without prejudice the government's motion for summary judgment to foreclose on the liens on Mrs. Elman's home and strongly urged the parties to settle the dispute.

provided by law." Nothing in IRC § 6015 prevents a district court from determining, in a collection suit, whether innocent spouse relief is available. As noted above, another district court actually did so last year.[68] Moreover, the refusal to allow a taxpayer to raise IRC § 6015 as a defense in a collection suit may create hardship because a taxpayer may be left without a forum in which to raise IRC § 6015 as a defense before losing her home to foreclosure by the IRS.

This year, a district court also refused to allow a taxpayer to raise innocent spouse relief as a defense in an interpleader suit. In *Simmons v. Coleman*,[69] Mr. Coleman had been injured in a motor vehicle accident, and he and Mrs. Coleman settled a suit for damages for Mr. Coleman's personal injuries and for Mrs. Coleman's loss of consortium.[70] The settlement proceeds had been deposited with the Clerk of the Court. Mr. Coleman's automobile insurance company had paid medical bills resulting from the accident and claimed it was entitled to a portion of the settlement proceeds. The United States also claimed that it was entitled to apply the proceeds to the Colemans' unpaid joint tax liabilities and to taxes owed by Mr. Coleman separately.[71] The state of Iowa also claimed it was entitled to a portion of the settlement proceeds to satisfy unpaid taxes. Mrs. Coleman claimed she was not liable for the unpaid taxes because she was an innocent spouse under IRC § 6015(f) and that because 40-50 percent of the settlement proceeds were attributable to her loss of consortium claim, she was entitled to those amounts free of any claim for unpaid taxes. The court, citing the *Elman* case, agreed with the government that it did not have jurisdiction to hear Mrs. Coleman's innocent spouse claim in the interpleader action before it and that she therefore remained jointly and severally liable for unpaid taxes.[72] Even if some of the settlement proceeds were Mrs. Coleman's separate property, they would still be subject to the government's tax lien. The court therefore granted the government's motion for summary judgment on the innocent spouse issue, but noted that its decision did not prevent Mrs. Coleman from seeking a refund by pursuing her innocent spouse claim with the IRS.[73]

Although not addressed by the court in *Simmons*, unlike a suit to reduce an assessment to judgment or to foreclose a tax lien where a taxpayer can challenge the merits of the assessment as part of the proceeding, normally when an interpleader is brought and the Government's sovereign immunity is waived under 28 U.S.C. § 2410, a taxpayer can only challenge the procedural validity of the federal tax lien, not the merits of the assessment.[74] Because seeking relief under section 6015 would be a challenge to the underlying assessment, prohibiting a taxpayer from raising innocent spouse in an interpleader action seems to be consistent with the existing statutory scheme. Thus, the "in addition to any other remedy provided by law" language found in section 6015 would not provide a basis for raising section 6015 as a defense in

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68 *U.S. v. Melot*, 109 A.F.T.R.2d (RIA) 1568 (D.N.M. 2012), *appeal dismissed* (10th Cir. Aug. 1, 2012) (holding, in a suit to reduce joint federal tax assessments to judgment and to foreclose federal tax liens, that relief under IRC § 6015 was not available because the taxpayer requesting relief had not filed a joint return, and that relief under IRC § 66 was not available because the taxpayer did not establish that she did not know, and had no reason to know, of the item of community income giving rise to the unpaid tax).

69 *Simmons Perrine Moyer Bergman, PLC v. Coleman*,111 A.F.T.R.2d (RIA) 1237 (N.D. Iowa 2013).

70 The Restatement (Second) of Torts § 693 describes the elements of a claim for loss of consortium: "One who by reason of his tortious conduct is liable to one spouse for illness or other bodily harm is subject to liability to the other spouse for the resulting loss of the society and services of the first spouse, including impairment of capacity for sexual intercourse, and for reasonable expense incurred by the second spouse in providing medical treatment." *See also* Iowa Code § 613.15. *Injury or Death of Spouse—Measure of Recovery*.

71 In pertinent part, 28 U.S.C. § 2410(a) provides: "[T]he United States may be named a party in any civil action or suit in any district court, or in any State court having jurisdiction of the subject matter—…5) of interpleader or in the nature of interpleader with respect to, real or personal property on which the United States has or claims a mortgage or other lien."

72 *Simmons Perrine Moyer Bergman, PLC v. Coleman*,111 A.F.T.R.2d (RIA) 1237, slip op. at 22-24.

73 *Simmons Perrine Moyer Bergman, PLC v. Coleman*,111 A.F.T.R.2d (RIA) 1237, slip op. at 30, n. 20.

74 *Elias v. Connett*, 908 F.2d 521, 527 (9th Cir. 1990).

an interpleader action. However, as the court points out, the taxpayer in this situation is not without recourse, as he or she can file a refund claim.

Relief on the Merits

While the courts considered many factors in determining the appropriateness of relief on the merits under IRC § 6015, the most significant factor was whether the requesting taxpayer had actual or constructive knowledge that there was a deficiency or that the nonrequesting spouse would not pay the tax. All three avenues for relief contain a knowledge element or factor, making it the linchpin in most of the courts' analyses.[75] Actual or constructive knowledge was a factor in 21 of the 22 cases decided on the merits. These cases suggest that determining what a taxpayer knew or should have known will continue to generate a significant amount of controversy as long as joint filers are taxed on their combined incomes and remain jointly and severally liable for the tax that must be shown on the return.

In addition, five Tax Court cases considered the effect that Notice 2012-8, if final, would have had on the analysis of a claim for relief under IRC § 6015(f). In three of the cases, the court noted that the factors taken into account in evaluating the claim would have weighed the same way (in favor of or against relief) under both Revenue Procedure 2003- 61 and the proposed guidance in Notice 2012-8.[76] In two cases, the court noted that a factor would have weighed differently under Notice 2012-8 than under Revenue Procedure 2003-61.

In *Cutler v. Commissioner*,[77] the court found that Mrs. Cutler, who obtained relief from underpayments, did not significantly benefit (beyond normal support) from the unpaid tax liabilities. Revenue Procedure 2003-61 identifies significant benefit as a "relevant" factor, but does not specify whether the absence of significant benefit should weigh in favor of relief.[78] Relying on its own precedent, the Tax Court found this factor weighed in favor of granting relief.[79] In contrast, Notice 2012-8 provides that "[i]f the amount of unpaid tax or understated tax was small such that neither spouse received a significant benefit, then this factor is neutral."[80] The Tax Court found that neither spouse received a significant benefit from the unpaid liabilities, so this factor would change from favorable to neutral if Notice 2012-8 applied.

In *Hudgins v. Commissioner*,[81] the court found that Mrs. Hudgins did not show that she would suffer economic hardship if denied relief under IRC § 6015(f), a factor Revenue Procedure 2003-61 also identifies as "relevant" without specifying how the absence of the factor should be treated.[82] The Tax Court applied its own precedent and held the absence of economic hardship weighed against granting relief.[83] In contrast, Notice 2012-8 provides that the absence of economic hardship would be considered neutral.[84]

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75 *See* IRC § 6015(b)(1)(C); § 6015(c)(3)(C); Rev. Proc. 2003-61, 2003-2 C.B. 296 §§ 4.02(1)(b) and 4.03(2)(a)(iii); *see also* Notice 2012-8, §§ 4.02(3) and 4.03(2)(c), 2012-4 C.B. 309.

76 *Henson v. Comm'r*, T.C. Memo. 2012-288; *Stanwyck v. Comm'r*, T.C. Memo. 2012-180, *appeal docketed*, No. 12-73136 (9th Cir. Oct. 1, 2012); *Deihl v. Comm'r*, T.C. Memo. 2012-176, *appeal docketed*, No. 12-74169 (9th Cir. Dec. 21, 2012).

77 T.C. Memo. 2013-119.

78 *See* Rev. Proc. 2003-61, 2003-2 C.B. 296 § 4.03(2)(a)(v).

79 *Cutler v. Comm'r*, T.C. Memo. 2013-119, 19-21.

80 Notice 2012-8, § 4.03(2)(e).

81 T.C. Memo. 2012-260.

82 Rev. Proc. 2003-61, 2003-2 C.B. 296 § 4.03(2)(a)(ii).

83 *Hudgins v. Comm'r*, T.C. Memo. 2012-260 at 34.

84 Notice 2012-8, § 4.03(2)(b).

The court noted this difference, but also noted it would have denied relief even if the proposed guidance applied.[85]

CONCLUSION

This year, the Tax Court's holding that its review of IRC § 6015(f) claims is *de novo* was affirmed by a court of appeals and the IRS acquiesced to that position. District courts continued the troubling trend of not permitting the innocent spouse defense in collection actions before them. For this reason, the National Taxpayer Advocate again urges Congress to state definitively that innocent spouse claims can be raised as a defense in collection actions. The Tax Court, in evaluating claims for innocent spouse relief under IRC § 6015(f), indicated in two cases how its analysis would change if the proposed guidance in Notice 2012-8 had applied. The proposed guidance has now been finalized as Revenue Procedure 2013–34. We expect future cases to provide additional insight on how the new guidance affects innocent spouse cases.

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85 *Hudgins v. Comm'r*, T.C. Memo. 2012-260 at 40, n. 18.

TAS CASE ADVOCACY

FUNCTIONS OF THE OFFICE OF THE TAXPAYER ADVOCATE

The National Taxpayer Advocate leads TAS in all aspects of its statutory mission. Under Internal Revenue Code (IRC) § 7803(c)(2)(A), the Office of the Taxpayer Advocate has four principal functions:

- Assist taxpayers in resolving problems with the IRS;
- Identify areas in which taxpayers are experiencing problems with the IRS;
- Propose changes in the administrative practices of the IRS to mitigate problems taxpayers are experiencing with the IRS; and
- Identify potential legislative changes that may be appropriate to mitigate such problems.

The first function described in the statute relates to TAS's Case Advocacy, which involves assisting taxpayers with their cases. The next three functions are associated with identifying and correcting systemic problems impacting taxpayers. In addition to helping taxpayers resolve specific cases and individual problems, TAS employees advocate systemically by identifying IRS procedures that adversely affect taxpayer rights or create taxpayer burden and recommending solutions to improve tax administration.[1]

TAS serves as the voice of the taxpayer within the IRS by providing the taxpayer's viewpoint on new policies, procedures, or programs. While systemic advocacy is the responsibility of everyone in TAS, primary oversight of systemic advocacy efforts belongs to the Office of Systemic Advocacy. Additionally, TAS administers the Low Income Taxpayer Clinic (LITC) grant program[2] and oversees the Taxpayer Advocacy Panel (TAP).[3]

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TAS ANALYZES ECONOMIC AND SYSTEMIC BURDEN CASE RECEIPTS TO IMPROVE IRS PROCESSES

Taxpayers seek TAS assistance with specific issues when:

- They have experienced a tax problem that causes financial difficulty;
- They have been unable to resolve their issues directly with the IRS; or
- An IRS action or inaction has caused or will cause them to suffer a long-term adverse impact, including a violation of taxpayer rights.

1 Taxpayers and practitioners can use the Systemic Advocacy Management System (SAMS) to submit a systemic issue to TAS at www.irs.gov/SAMS.

2 The LITC program provides matching grants to qualifying organizations to operate clinics that represent low income taxpayers in disputes with the IRS, or educate taxpayers for whom English is a second language about their tax rights and responsibilities. LITCs provide services to eligible taxpayers for free or for no more than a nominal fee. *See* IRC § 7526.

3 TAP is a Federal Advisory Committee established by the Department of the Treasury to provide a taxpayer perspective on improving IRS service to taxpayers. TAS provides oversight and support to the TAP program. The Federal Advisory Committee Act (5 U.S.C. Appendix) prescribes standards for establishing advisory committees when those committees will furnish advice, ideas, and opinions to the federal government. *See also* 41 C.F.R. Part 102-3.

TAS generally accepts cases in four categories.

1. *Economic Burden* – Four categories of cases are classified as economic burden cases:
   a) A taxpayer is experiencing economic harm or is about to suffer economic harm;
   b) A taxpayer is facing an immediate threat of adverse action;
   c) A taxpayer will incur significant costs if relief is not granted; and
   d) A taxpayer will suffer irreparable injury or long term adverse impact if relief is not granted.

In many of these cases, time is of the essence, and if the IRS does not act quickly (*e.g.*, to remove a levy or release a lien), the taxpayer will experience even more economic harm.[4]

2. *Systemic Burden* – Systemic burden cases involve situations where the taxpayer has experienced a delay of more than 30 days to resolve a tax account problem, where the taxpayer has not received a response by the date promised, or where a system or procedure has either failed to operate as intended or failed to resolve the taxpayer's problem or dispute within the IRS.[5]
3. *Best Interest of the Taxpayer* – Best interest of the taxpayer cases involve situations where the manner in which the tax laws are being administered raises considerations of equity, or has impaired or will impair the taxpayer's rights. For example, this criterion would be met if the taxpayer disagrees with a proposed tax assessment and the IRS issued a notice of deficiency without giving the taxpayer his or her appeal rights.[6]
4. *Public Policy* – Public policy cases are those where the National Taxpayer Advocate has determined that compelling public policy warrants assistance to an individual or group of taxpayers. The National Taxpayer Advocate has the sole authority to determine which issues are included in this criterion and will so designate by memo.[7]

In fiscal year (FY) 2010, TAS received the highest number of cases in its history (298,933).[8] In FY 2011, a hiring freeze was imposed on the federal government. To ensure that the resources necessary to advocate effectively are commensurate with TAS's growing inventory, TAS identified certain types of systemic burden cases that the IRS ultimately resolves without the need for TAS engagement. In FY 2011, TAS suspended acceptance of four issue codes in systemic burden cases: original return processing, amended return processing, injured spouse claims and unpostable/reject cases. This guidance remains in effect so TAS can provide effective service to taxpayers who are in most need of assistance and timely resolve their cases.[9]

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4 IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.1 (Aug. 24. 2007).

5 IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.2 (July 23, 2007).

6 *Id*.

7 IRC § 7803(c)(2)(A)(i); IRM 13.1.7.2.4 (Apr. 26. 2011).

8 Data obtained from TAMIS (October 1, 2011) compared to TAMIS data on October 1 of each year since TAS was formed in 2000 through the present.

9 In September 2012, TAS reissued the memorandum to reiterate the changes to TAS case-acceptance criteria - 16M TAS-13-0912-019 (Sept. 25, 2012). In September 2013, TAS again reissued the guidance – 16M TAS-13-0913-009 (Sept. 27, 2013).

TAS continues to accept cases involving the four categories listed above if the taxpayer:

- Is suffering an economic burden;
- Has related issues (*e.g.*, needs an amended return processed quickly, because the IRS has created a substitute for return and is trying to collect, and the amended return will eliminate or minimize the tax liability);[10]
- Is referred by a congressional office; or
- Specifically requested TAS assistance.

The change in case acceptance criteria was the first step in a long-term strategy to continue to focus on our primary mission and serve the most vulnerable taxpayers. TAS must continually adjust to conditions of limited resources, growing case complexity, an increase in economic burden cases, and the IRS's inability, on occasion, to address taxpayer issues timely and effectively. The next phase of TAS's strategy is exploring new approaches and alternative services on certain issues, to allow TAS to keep its focus on providing vital service to those suffering economic burden and preventing negative consequences to the most vulnerable taxpayer population. This strategy will involve:

- Identifying and testing self-help tools for taxpayers in resolving requests for expedited refunds, returned or stopped refunds, and requests for copies of certain documents, (returns, reports, determination letters, etc.). This includes producing short videos with downloadable forms and simple guidelines for taxpayers.
- Identifying issues where intake advocates (employees who handle the initial contact with the taxpayer) can take full and complete action(s) to resolve all issues without assigning the case to a case advocate, and with no negative impact on customer satisfaction.

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TAS RECEIPT TRENDS

Increasing Cases, Complexity, and Urgency in TAS Casework

In FY 2013, TAS received 244,956 cases of all types, a nearly 12 percent increase from FY 2012. TAS provided relief to taxpayers in approximately 79 percent of cases closed in FY 2013, which was an increase of about 2.1 percent from FY 2012.[11] Figure 4.1 below compares FY 2011, FY 2012, and FY 2013 receipts and relief rates by case acceptance category.

10 A substitute for return is a return prepared for a taxpayer by the IRS when it has no record of receiving a return and has not been able to obtain one from someone who was expected to file. IRC § 6020(b) allows the IRS to prepare a return on behalf of the taxpayer based on available information, and assess the tax after providing a statutory notice of deficiency to the taxpayer.

11 TAS determines relief rates based upon whether TAS can provide full or partial relief or assistance on the issue initially identified by the taxpayer. Because TAS frequently provides relief on issues that differ from the ones initially identified, the relief rate as calculated is understated. Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Oct. 1, 2013). TAS uses TAMIS to record, control, and process cases, and analyze the issues that bring taxpayers to TAS.

FIGURE 4.1, TAS Case Receipts and Relief Rates, FY 2011–2013[12]

Case Categories	Receipts FY 2011	Receipts FY 2012	Receipts FY 2013	Relief Rate FY 2011	Relief Rate FY 2012	Relief Rate FY 2013
Economic Burden	131,482	133,082	156,130	72.7%	74.6%	77.1%
Systemic Burden	164,173	85,671	88,598	78.0%	80.1%	81.3%
Best Interest of Taxpayers	216	167	160	73.0%	75.7%	70.6%
Public Policy	33	746	68	79.2%	29.2%	70.8%
Total Cases	**295,904**	**219,666**	**244,956**	**75.7%**	**76.9%**	**78.5%**

Below, we explore some of the reasons for continued increases in cases, complexity, and urgency in TAS casework.

Increasing Complexity

TAS measures complexity in its cases in a number of ways, including whether a case involves multiple issues or multiple tax periods and whether technical advice is needed, thus increasing the resources required to resolve the matter.[13] Whether the issues are linked or separate, the Case Advocate must resolve all issues before closing the case.[14] Case Advocates must identify primary and secondary issues on cases, which they record in TAS's case management system, TAMIS.[15] In addition to cases that required expedited actions, more than 63 percent of all closed cases in FY 2013 involved two or more issues, as shown in Figure 4.2.[16]

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12 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2012).

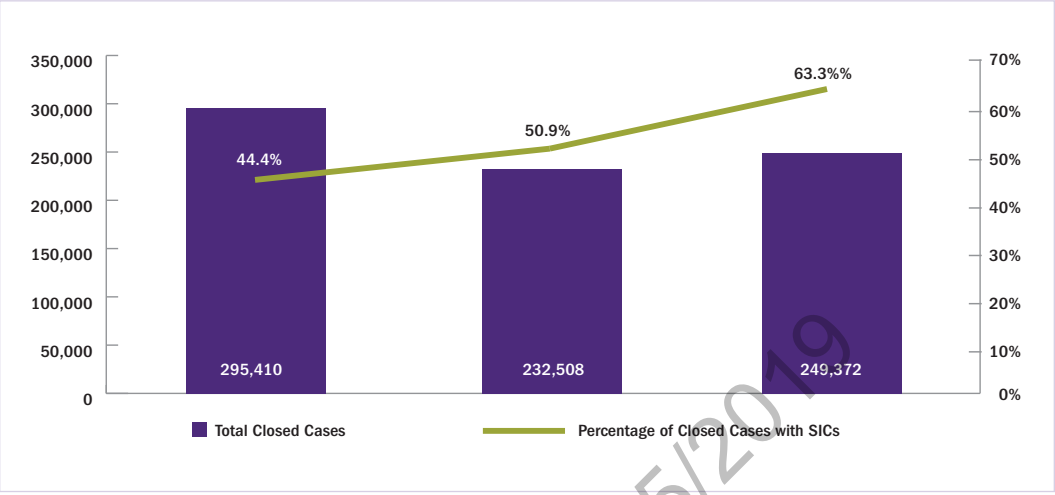
13 In 2010, TAS implemented a complexity factor screen to its case management system containing 24 factors whose presence in a case tends to make the case more complex. For example, one of the complexity factors is whether the case requires statutory analysis. TAS is using this data for purposes of developing its new case management system, Taxpayer Advocate Service Integrated System (TASIS), and the factors will be used in the process of assigning cases to Case Advocates. See National Taxpayer Advocate FY 2014 Objectives Report to Congress, Section VII for a full discussion of TASIS.

14 IRM 13.1.21.1.1 (Aug. 24, 2012).

15 IRM 13.1.16.13.1 (June 22, 2012). The Primary Core Issue Code (PCIC) is a three-digit code that defines the most significant issue, policy or process within the IRS that needs to be resolved. The Secondary Core Issue (SCIC) is a three-digit code that is used to identify secondary issues involved in the case. The SCIC is used when a case has multiple issues to resolve.

16 Data obtained from TAMIS (Oct. 1, 2013).

FIGURE 4.2, TAS Closed Cases and Percent of Closures with Secondary Issue Codes (SICs), FY 2011 through FY 2013[17]



There are a number of reasons for the increasing complexity of TAS cases. Identity theft cases, discussed as a Most Serious Problem in this report and more briefly below, are inherently complex.[18] Erroneous information can affect a victim's account for multiple tax periods and cause multiple issues, impacting accounts management, examination, and collection. Because identity theft cases are growing and now account for more than a quarter of all TAS cases, this issue significantly impacts complexity.[19]

Increasing Economic Burden Cases

For the second consecutive fiscal year, more than half of TAS receipts involved taxpayers experiencing economic burden as shown by Figure 4.3 below. Because of the dire financial situations facing these taxpayers, TAS requires that the cases be worked within enhanced timeframes.[20] TAS receipts reflect a higher percentage of cases where the outcome will have profound consequences on taxpayers' lives, as well as an increased workload for TAS employees. Economic Burden cases often occur where IRS processes are not functioning smoothly or experience other systemic problems.

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17 Data obtained from TAMIS (Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013).

18 For a detailed discussion of the identity theft problem see Most Serious Problem: Identity Theft: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance That Minimizes Burden and Anxiety for Such Taxpayers*, *supra*.

19 Data obtained from TAMIS (Oct.1, 2013).

20 IRM 13.1.16.12(1) (Upon acceptance into the TAS program, cases are ready for assignment to Case Advocates. Assign cases to Case Advocates within 2 workdays of the Taxpayer Advocate Received Date (TARD) for Criteria 1–4 cases and 3 workdays of the TARD for Criteria 5-9 cases.) IRM 13.1.18.3(1) (Contact the taxpayer or representative by telephone within 3 workdays of the TARD for criteria 1–4 cases, and within 5 workdays of the TARD for criteria 5–9 cases to notify of TAS's involvement and independence from the IRS.)

FIGURE 4.3, TAS Economic Burden and Systemic Burden Receipts, FY 2010 Through FY 2013[21]

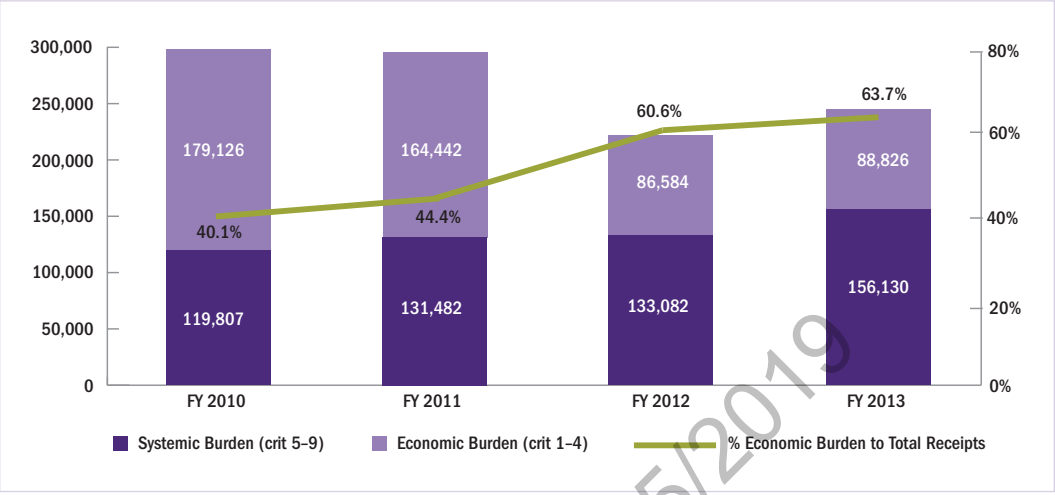

FIGURE 4.4, Top 10 Issues for Cases Received in TAS, FY 2012 and FY 2013, Cumulative[22]

Rank	Issue Description	FY 2012	FY 2013	FY 2013 Percent of Total	Percent Change FY 2012 to FY 2013
1	Identity Theft	54,748	57,929	23.6%	5.8%
2	Pre-Refund Wage Verification Hold	18,012	26,136	10.7%	45.1%
3	Unpostable and Rejected Returns	5,286	17,045	7.0%	222.5%
4	Earned Income Tax Credit (EITC)	7,441	11,980	4.9%	61.0%
5	Processing Amended Return	8,783	10,441	4.3%	18.9%
6	Levies (including Federal Payment Levy Program)	11,419	8,829	3.6%	-22.7%
7	Processing Original Return	6,250	8,714	3.6%	39.4%
8	Injured Spouse Claim	4,115	8,021	3.3%	94.9%
9	Reconsideration of Audits and Substitute for Return under IRC 6020(b)	9,344	7,527	3.1%	-19.4%
10	Open Audit (Not EITC)	8,885	6,734	2.7%	-24.2%
	Other TAS Receipts	85,383	81,600	33.3%	-4.4%
Total TAS Receipts		**219,666**	**244,956**		**11.5%**

Figure 4.5 below shows the top five issues driving the economic burden receipts in TAS casework. TAS's percentage of economic burden case receipts to total receipts increased from 40.1 percent in FY 2010 to 63.7 percent in FY 2013, a 58.8 percent increase.[23] These five issue codes represent the majority of the increase in economic burden cases and overall caseloads.

21 Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013). TAS retrieved the data on the first day of the month following the end of each fiscal year.

22 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013).

23 *Id*.

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FIGURE 4.5, Top Five Increasing Economic Burden (EB) Case Issues, FY 2012 and 2013[24]

Issue Description	EB FY 2012	EB Receipts as % Total Receipts for Issue FY 2012	EB FY 2013	EB Receipts as % Total Receipts for Issue FY 2013	EB Percent Change FY 2012 to FY 2013
Identity Theft	42,300	77.3%	43,695	75.4%	3.3%
Pre-Refund Wage Verification Hold	12,649	70.2%	18,200	69.6%	43.9%
Unpostable and Rejected Returns [25]	4,358	82.4%	14,866	87.2%	241.1%
Earned Income Tax Credit (EITC)	4,915	66.1%	9,968	83.2%	103%
Injured Spouse Claim	3,598	87.4%	7,015	87.5%	95%

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TAS has undertaken strategic efforts to have other IRS functions address problems where no economic burden exists. This strategy allows TAS to focus on taxpayers whose issues require the expertise of TAS employees for expeditious resolution to allay economic harm and rests responsibility with the IRS to address case problems that arise from its own operations. TAS also dedicates significant resources to resolving the systemic causes of these issues, as discussed in the Most Serious Problems section of this report. Of the top ten issue codes listed in Figure 4.4, TAS has taken steps to limit acceptance of cases where no economic burden exists in five categories.[26] In identity theft cases, unless certain exceptions are met, the Wage and Investment (W&I) division's Identity Protection Specialized Unit (IPSU) will retain and work the cases rather than refer them to TAS.[27] Additionally, as described above, TAS has modified case acceptance criteria in certain issue codes where there is no economic harm to the taxpayer. With these efforts to limit systemic case receipts in some of TAS's highest volume issue codes, it is natural that the percentage of economic burden cases would increase.

IDENTITY THEFT

Identity theft continues to be the number one reason that taxpayers seek TAS assistance — comprising 23.6 percent of all case receipts for FY 2013. The National Taxpayer Advocate first addressed the issue as a Most Serious Problem affecting taxpayers beginning in 2005, and it is again addressed in this report.[28] Typically, a taxpayer's name, Social Security number (SSN), and other information is misused by another to file a false return and obtain a fraudulent refund. Unless the IRS catches the fraudulent return in its filters, the IRS issues the refund to the perpetrator, and the false information will appear on the taxpayer's account. When the victim attempts to file an electronic tax return, the IRS will not process it because a

24 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013). TAS computed the top five economic burden issue codes that are increasing using only Primary Issue Codes (PIC). Often TAS cases involve more than one issue and TAS tracks these data; however, these are not included within this computation to avoid counting a case more than once.

25 In FY 2013, TAS actually had 31,368 cases with unpostable returns as an issue; however, 16,502 of these returns were identity theft returns and are counted under the identity theft PIC.

26 The five issues where TAS has taken steps to limit the acceptance of systemic burden cases are: identity theft thru a Memorandum of Understanding with the Identity Protection Specialized Unit dated December 9, 2010 through which TAS only accepts identity theft cases with economic burden or at the taxpayer's insistence and, unpostable/reject returns, injured spouse, original return processing, and amended return processing as stated in the previously mentioned IGM 16M TAS-13-0913-009 (Sept. 27, 2013).

27 Memorandum of Understanding between the National Taxpayer Advocate and the Commissioner, Wage and Investment, Transition TAS Criteria 5-7 ID Theft Cases to W&I, Identity Protection Specialized Unit (IPSU) (effective April 30, 2010).

28 For a detailed discussion of the identity theft problem, see Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance That Minimizes Burden and Anxiety for Such Taxpayers*, *supra*.

return with the same name and SSN has already been processed. If the victim files a paper return, the IRS posts it as a "duplicate" return, but the victim will not receive any refund claimed, because the false refund was previously issued, which causes the victim to seek TAS assistance. The IRS procedures for verifying the identity of the innocent taxpayer, moving the incorrect tax information off the account, and processing the innocent taxpayer's tax return take an inordinate amount of time. In addition, identity theft cases often involve related collection and examination issues, as well as multiple years. Thus, victims often come to TAS for faster resolution.

TAS obtains relief for a significant majority of taxpayers in identity theft cases. In FY 2013, taxpayers received relief in over 87 percent of cases with an average timeframe of 87 days to resolution. On September 23, 2013, Treasury Inspector General for Tax Administration (TIGTA) reported that the IRS averaged 312 days to resolve identity theft cases, with 277 of those days showing no activity. In response to TIGTA, the IRS stated "for cases received in filing season 2013 we are currently achieving a 120 day resolution timeframe.[29] While the IRS's published time for completing identity theft cases has improved,[30] it is still significantly (33 days) longer than the average time it takes TAS to resolve an identity theft case. In addition, TIGTA reported an average of ten different IRS assistors reviewed and reassigned the case prior to case resolution resulting in case processing delays.[31] As Figures 4.6 and 4.7 below demonstrate, despite increasing identity theft inventories since FY 2009, TAS timeframes for completing identity theft cases and relief rates have improved over time.

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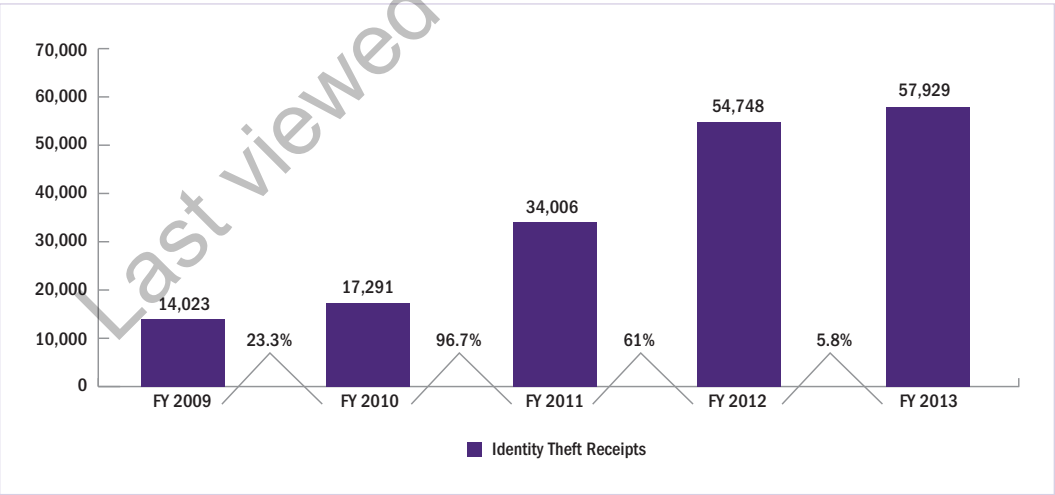
FIGURE 4.6, TAS Identity Theft Case Receipts and Percentage Increases, FY 2009 Through FY 2013[32]



As Figure 4.6 above reflects, over the last five years, TAS has helped over 175,000 identity theft victims to resolve their account problems.

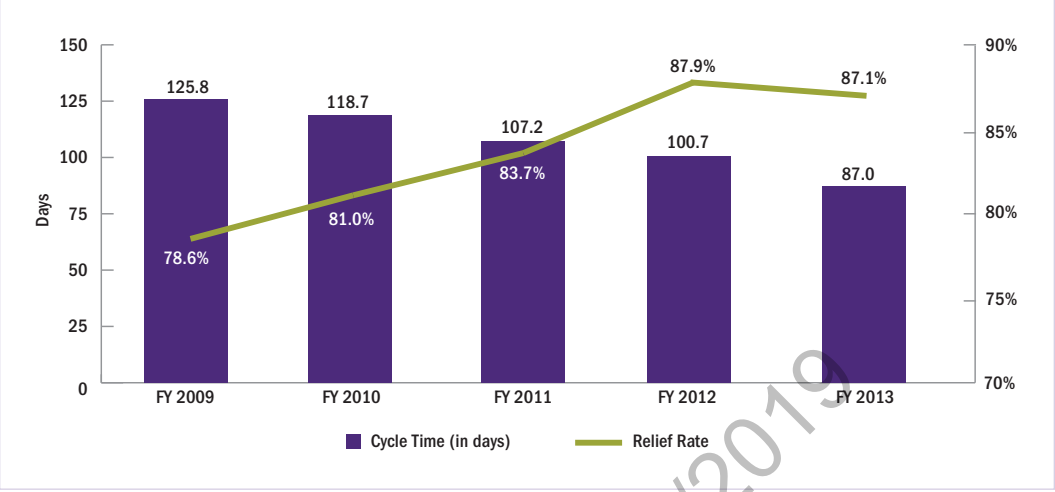
29 TIGTA Ref. No. 2013 40-129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

30 In a May 2012 report, the Treasury Inspector General for Tax Administration found the average cycle time for the identity theft cases it reviewed to be **414 days**. TIGTA, Ref. No. 2012-40-050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Receive Quality Customer Service* (May 3, 2012).

31 TIGTA Ref. No. 2013 40-129, *Case Processing Delays and Tax Account errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

32 Data obtained from TAMIS (Oct. 1, 2009; Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013).

FIGURE 4.7, Identity Theft Relief Rate and Cycle Time, FY 2009 through FY 2013[33]



In part, these improvements are a tribute to the TAS Case Advocates who communicate with their taxpayers directly over the span of the case's resolution and work to resolve all problems. Additionally, TAS continues to make process improvements that reduce time spent on these cases. For example, Case Advocates now have access to the Integrated Automation Technologies (IAT) Identity Theft tool that consolidates information from multiple IRS systems, allowing Case Advocates to quickly gather needed information to expedite correction of identity theft-related issues and to promptly secure refunds, as applicable.[34]

PRE-REFUND WAGE VERIFICATION HOLDS — QUESTIONABLE REFUND PROGRAM

The IRS employs various filters to attempt to prevent fraudulent returns from being processed and refunds issued, but which also stop a certain percentage of innocent taxpayers' returns. When the IRS stops more returns than it has resources to evaluate, it places holds on the refunds to keep them from going out. These efforts in the past have raised significant taxpayer rights issues, and increasing numbers of impacted taxpayers come to TAS for assistance.[35]

Originally, the Questionable Refund Program (QRP) was managed by the Criminal Investigation division but was transferred to the W&I Accounts Management Taxpayer Assurance Program (AMTAP) in 2006 due to significant problems in the QRP process.[36] After the 2011 Annual Report to Congress identified program management problems, AMTAP was transferred to the new Return Integrity and Correspondence Services function in W&I and renamed the Integrity Verification Office.[37] The QRP is again a Most Serious Problem impacting taxpayers, and is the subject of a TAS Research study.[38]

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33 Data obtained from TAMIS (Oct. 1, 2009; Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013).

34 IAT supplies automated tools to IRS employees that simplify research, reduce keystrokes, and increase accuracy. IAT is working with TAS Business Systems Planning to provide automated tools for TAS employees that meet TAS requirements and are compatible with TAS work processes and delegations of authority: http://tas.web.irs.gov/tech/iat/default.aspx.

35 See National Taxpayer Advocate 2005 Annual Report to Congress 25, addressing the IRS's Questionable Refund Program that failed to provide taxpayer's adequate due process protections and failed to maintain an adequate system to vet IRS concerns about taxpayer refund claims.

36 National Taxpayer Advocate 2005 Annual Report to Congress 25.

37 National Taxpayer Advocate 2011 Annual Report to Congress 28.

38 For a detailed discussion of the identity theft problem see Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance That Minimizes Burden and Anxiety for Such Taxpayers*, *supra*.

Pre-refund wage verification holds under the QRP constitute the second most frequent reason that taxpayers come to TAS for assistance.

FIGURE 4.8, Pre-Refund Wage Verification Hold, QRP Receipts, FY 2010 through FY 2013

	FY 2010	FY 2011	FY 2012	FY 2013
TAS QRP Receipts	3,171	21,286	18,012	26,136
Total TAS Receipts	298,933	295,904	219,666	244,956
QRP Receipts as a Percentage of TAS Receipts	1.1%	7.2%	8.2%	10.7%

Generally, TAS achieves over a 70 percent relief rate in these cases.[39] TAS also achieved an 86 percent customer satisfaction rate in these cases.[40] Inventories of pre-refund wage verification QRP cases in FY 2013 have almost climbed back to their 2005 levels.[41]

UNPOSTABLE AND REJECTED RETURNS

In 2013, TAS receipts involving unpostable and rejected returns totaled 17,045, an increase of nearly 223 percent from FY 2012.[42] An unpostable return is one that has been accepted onto the taxpayer's account, but fails to completely post to the account because it contains a condition that requires IRS employee intervention to correct.[43] A rejected return is not processable and will not be accepted onto the taxpayer's tax account because a math error must be corrected, or additional research is required due to missing or incomplete information.[44] An IRS employee must determine why the return was rejected and request the appropriate information from the taxpayer or another IRS function.[45]

TAS has significantly more unpostable cases than the 14,866 economic burden cases described in Figure 4.5.[46] In addition to the economic burden unpostable cases, TAS received 2,179 systemic burden unpostable cases and 16,500 identity theft cases involving an unpostable return in FY 2013.[47] When factoring in the identity theft receipts, unpostable return related cases in TAS totaled 31,368 in FY 2013 for economic burden.[48] The increase in unpostable receipts resulted from:

- A replacement Identity Protection PIN process designed to cause unpostable conditions;

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39 Data obtained from TAMIS (Oct. 1, 2013).

40 TAS customer satisfaction is determined using a survey administered by a contractor. Customer satisfaction is the percent of taxpayers who indicate they are very satisfied or somewhat satisfied with the service provided by TAS. The FY 2013 results through June 30, 3013 are from the Taxpayer Advocate Service National Report, Sept. 2013.

41 In FY 2005, TAS had over 28,000 cases involving CI frozen refunds, while for FY 2013 TAS has almost 27,000 pre-refund wage verification QRP cases. See National Taxpayer Advocate 2006 Annual Report to Congress 408 for information on the restructuring of the QRP.

42 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013).

43 IRM 21.5.5.2 (A transaction is termed unpostable when it fails to pass any of the validity checks and is then returned to the campus for follow up action(s).)

44 IRM 21.4.1.3.1.2.2 (1) Rejects are returns or documents that cannot be processed, usually due to missing or incomplete information. ERS is the computer tracking system used by the Submission Processing Centers Reject/Suspense Unit to categorize and resolve rejects.

45 IRM 3.12.3.2.4.

46 Data obtained from TAMIS (Oct. 1, 2013) for FY 2013 Receipts with PIC 315.

47 *Id*. See footnote 15 for an explanation of primary and secondary issue codes for tracking cases. Because of the importance of tracking and identifying identity theft, the identity theft code is always treated as the primary issue in a case. Where there is another issue on a case, such as "unpostable tax return," it retains the secondary code.

48 See footnote 20.

- Issues with the recapture of the 2008 First-Time Homebuyer Credit (FTHBC) used the unpostable process;
- A vendor's return preparation software programming issue involving Form 8863, *Education Credit*, placed returns into the reject inventory;[49] and
- Returns with missing Forms 8867, *Paid Preparer's Earned Income Credit Checklist*, were rejected.

Replacement Identity Protection Personal Identification Numbers (IP PINS)

IRS decision-making plays a significant role in which returns "go unpostable," because the IRS sets the validity checks.[50] One such policy decision involves IP PINs. An IP PIN is a single-use six-digit identification number the IRS sends to a taxpayer who has previously reported to the IRS that he or she has been the victim of identity theft and has provided information sufficient for the IRS to validate his or her identity.[51] The IRS issues IP PINs to identity theft victims so that they can file their tax returns with the assurance that an identity thief is not able to file first. If the innocent taxpayer loses the IP PIN and requests a replacement, the IRS does not give the taxpayer a unique IP PIN. Previously, the IRS gave the taxpayers a universal replacement IP PIN and made all returns belonging to taxpayers who received replacement IP PINs go unpostable.[52] The IRS plans to initiate a new process enabling taxpayers who have lost, misplaced, or never received their IP PIN to retrieve their original IP PIN with an online application. Only taxpayers who are unwilling or unable to authenticate their identity will be issued a replacement IP PIN. We will provide more information about this new process as it becomes available.

2008 First-Time Homebuyer Credit (FTHBC) Recapture Payments

Problems with repayments of the FTHBC again plagued some taxpayers in the 2013 filing season.[53] Taxpayers who claimed and received the FTHBC in 2008 must repay it over a 15-year "recapture period," beginning with the second tax year after the credit was received.[54] When taxpayers began repaying the credit in the 2011 filing season, numerous conditions caused their returns not to post, including when taxpayers failed to repay the precise amount that IRS data showed as due (even if the taxpayers overpaid).[55]

In FY 2013, TAS received 1,456 FTHBC unpostable cases.[56] These cases resulted from the indicator that the IRS sets on accounts of taxpayers subject to the recapture period:

- Tax returns went unpostable if the full credit was repaid prior to 2012, but the indicator was not removed from the account.

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49 SERP Alert 13A0205 IRS Announcement, *IRS Statement on Form 8863, Education Credit*, dated March 12, 2013.

50 Validity checks are specific items built into any system for which information exists in the system that is compared to correlating information being input to the system to assure return accuracy before it is accepted. The IRS validity checks are sensitive information that cannot be shared. A non-tax example would be security questions to access financial accounts.

51 *See* IRM 10.5.3.2.16 (Jan. 11, 2013).

52 IRM 10.5.3.

53 See 2012 National Taxpayer Advocate Objectives Report to Congress 28, where the National Taxpayer Advocate described problems associated with the FTHBC following the 2011 first filing season when taxpayers began repaying the FTHBC.

54 IRC § 36(f)(1). The tax shall be increased by 6 2/3 percent of the amount of the total FTHBC for each taxable year in the recapture period. IRC § 36(f)(7) defines the recapture period as 15 years beginning with the second taxable year after the year in which the home was purchased.

55 2012 National Taxpayer Advocate Objectives Report to Congress 28.

56 Data obtained from TAMIS (Oct. 1, 2013).

- Accounts went unpostable that correctly showed a 2008 FTHBC recapture indicator, but no recapture amount was included on the 2012 return, or a repayment had to be divided between two taxpayers.[57]
- When identity theft in 2008 involved FTHBC claims, the FTHBC indicator was placed on the victim's account. The 2012 accounts then went unpostable when the victim filed a return that did not include a FTHBC recapture amount.

The IRS has permanent procedures for FTHBC recapture in place, so this problem should not repeat in the upcoming filing season.

Problems with Return Preparers' Software Created Problems for Some Taxpayers Claiming Education Credits

In 2013, some electronically filed 2012 tax returns with Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits),* were rejected because the software of certain return preparers failed to transmit the education credit information into the IRS's filing system.[58] The IRS and TAS worked together to correct all of these returns. The IRS worked directly with the software companies, so that returns filed after February 22 would not be affected. Despite the IRS's efforts, TAS's unpostable receipts due to this issue continued to increase. In an effort to resolve these cases expeditiously, TAS negotiated with the IRS to address all of the accounts at once, rather than TAS having to make an individual request on each case. The IRS successfully corrected 844 taxpayers' accounts. Moreover, TAS continued to communicate with the IRS on behalf of taxpayers whose 2012 tax returns were unpostable and were being held until the IRS established procedures to deal with the non-IRS software glitch.

Form 8867, Paid Preparer's Earned Income Credit Checklist

In 2013, TAS also observed an increase in unpostable receipts due to 2012 tax returns filed prior to February 19, 2013, which included Earned Income Credit (EIC) claims, but failed to include a completed Form 8867, *Paid Preparer's Earned Income Credit Checklist*. The IRS made an initial decision not to allow these returns to post via the reject process, unless all of the information on the form was provided. In these cases, the 2012 tax returns went unpostable until the IRS reviewed the tax return and issued the taxpayer a Letter 12C, requesting that the taxpayer substantiate eligibility for the EIC.[59] In these cases, TAS used the OAR process to have the taxpayer's refund released or collect the missing information. The IRS subsequently reversed its decision allowing returns without a complete Form 8867 to post and addressing missing information after processing.[60]

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57 SERP Alert 13A0208 (March 14, 2013).

58 SERP Alert 13A0132.

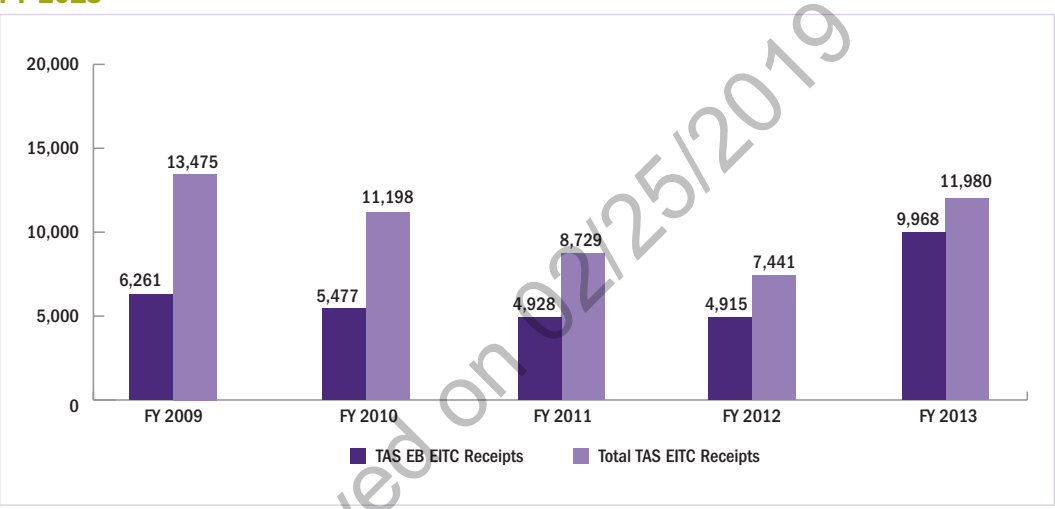
59 SERP Alert 13A0168 (Feb. 25, 2013).

60 *Id.*

EARNED INCOME TAX CREDIT CASES

The EITC is an important economic benefit for low income taxpayers who have earned income.[61] TAS's FY 2013 EITC receipts increased by 61 percent compared to FY 2012.[62] Over 83 percent of the 2013 cases involved taxpayers who were experiencing an economic burden, with the number of economic burden cases increasing by 102.8 percent from FY 2012.[63]

FIGURE 4.9, TAS EITC Economic Burden and Total Case Receipts, FY 2009 through FY 2013[64]



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Under the IRS examination plan for FY 2013, the increase in TAS EITC cases does not appear to be caused by a corresponding increase in EITC audits. For example, the W&I plan for FY 2013 was to conduct 338,656 EITC audits, while the total EITC audits for W&I in FY 2012 was 339,322.[65] Rather, the most significant trend we have identified as causing more EITC claimants to come to TAS in FY 2013 is that W&I experienced almost a 76,780 percent increase in overaged mail during FY 2013.[66] In FY 2012, W&I had approximately 46 overaged EITC responses, while in FY 2013, inventory exceeded 35,565.[67] W&I could not timely handle the taxpayer correspondence to the EITC examination function, reporting 79.9 percent of total mail was overaged.[68] Additionally, W&I's level of service, the number of taxpayer calls involving EITC initially handled by an assistor as opposed to calls received, declined by

61 The benefit is available for low income taxpayers without children, but is more significant for those with children. The maximum benefit for 2012 was $5,891 with three or more qualifying children and $475 with no qualifying children. IRS Publication 596, EIC Table.

62 Data obtained from TAMIS (Oct. 1, 2013).

63 Data from TAMIS (Oct. 1, 2009; Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013).

64 *Id*.

65 EITC PAC 7F Report – W&I through September 2013.

66 W&I, *Reporting Compliance PAC 7E & PAC 7F reports*, Sept. 2013, at 22.

67 *Id*. at 20.

68 IRS should initiate a response to incoming mail from taxpayers within 30 calendar days from the received date. In IRM 4.19.13.10, *Monitoring Overaged Replies*, if the IRS does not send a reply within 70 to 115 days, Exam updates the Audit Information Management System (AIMS) to Status 55 and if more than 115 days, to Status 57.

seven percent.[69] The extensive delays in responding to EITC claimants do not appear to be caused by reductions in staffing. EITC full-time equivalents, *i.e.*, W&I employees working EITC cases, declined from FY 2012 to FY 2013, but only by 2.3 percent.[70]

While the cause of the overaged correspondence is uncertain, the impact of delayed and ineffective communication on taxpayers claiming EITC is more certain. The EITC is a complex tax provision, yet the taxpayers navigating its provisions tend to be in the lower economic stratum and least able to navigate complex processes. TAS taxpayers experience issues relating to the EITC's residency and relationship requirements.[71] Taxpayers with the most difficulty navigating the EITC requirement are those with non-traditional family relationships (where the child is not the biological child of the taxpayer claiming the EITC) for whom the documentation requirements can be daunting (such as the need to obtain numerous birth certificates to establish the required relationship for a niece, nephew or other extended relative).[72]

Studies performed by TAS demonstrate the importance of timely and clear communications to enable taxpayers to obtain the EITC to which they are entitled.[73] TAS is improving its own EITC casework through a number of initiatives, as well as engaging W&I on the backlog of aged EITC correspondence, and more effective ways to administer EITC examinations.[74] One such TAS effort involves advocating to the IRS that it accept TAS's comprehensive list of alternative documentation that taxpayers can use in lieu of the more restrictive approach taken by the IRS.[75]

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INJURED SPOUSE

When a married couple files a return claiming a refund, the IRS may offset the refund to satisfy certain outstanding tax and non-tax debts belonging to one of the spouses. The non-liable spouse has a right to have a portion of the refund returned.[76]

69 W&I, *Reporting Compliance PAC 7E & PAC 7F reports*, Sept. 2013, at 20.

70 *Id*.

71 For the relationship test, the child must be the taxpayer's child (including an adopted child, stepchild, or eligible foster child), brother, sister, half-brother, half-sister, stepbrother, stepsister, or descendant of one of these relatives. An adopted child includes a child lawfully placed with a taxpayer for legal adoption even if the adoption is not final. An eligible foster child is any child placed with a taxpayer by an authorized placement agency or by judgment, decree, or other order of any court of competent jurisdiction. IRC §§ 152(c)(1)(A);152(c)(2);152(f)(1). For the residency test, the child must live with the taxpayer for more than half of the tax year. Exceptions apply for temporary absences for special circumstances such as illness, school attendance, business, vacation, and military service. There are also exceptions for children who were born or died during the year, children of divorced or separated parents, and kidnapped children. IRC §§ 152(c)(1)(B); 152(f)(6); Treas. Reg. § 1.152-2(a)(2)(ii).

72 National Taxpayer Advocate 2005 Annual Report to Congress, MSP: *Earned Income Credit Exam Issues*, Taxpayer Advocate Service, *Challenges for Taxpayers Claiming the Earned Income Tax Credit (EITC), From Interviews with Low Income Tax Clinics* (Sept. 2005). The Low Income Taxpayer Clinic (LITC) Program is a grant program under IRC § 7526 where qualified organizations receive matching federal grants to represent taxpayers in controversies before the IRS or provide tax outreach and education to English as a second language taxpayers.

73 National Taxpayer Advocate 2004 Annual Report to Congress, Vol. II, EITC Audit Reconsideration Study. In the study of EITC audit reconsideration cases by TAS Research, it was found that in cases originally closed as "no response," but where taxpayers were provided additional communication approximately 43 percent of the taxpayers had some or all of their EITC restored. They received on average about 96 percent of what they originally claimed on their returns.

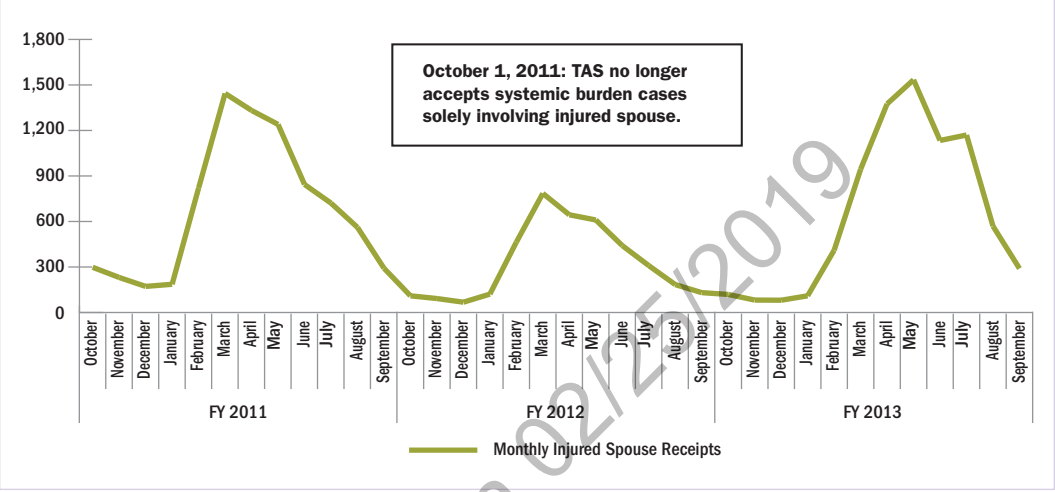
74 EITC cases present TAS leadership with an improvement opportunity. For years, TAS offices on average only achieved relief rates on average of around 50 percent while generally TAS achieves relief for approximately 79 percent of TAS taxpayers. TAS has taken a number of steps to improve its service to these taxpayers, including: EITC training for field employees led by the National Taxpayer Advocate, decentralization of all EITC casework so that EITC cases can be worked in local offices; and EITC case reviews by TAS leadership to identify which offices need additional training on EITC issues.

75 Attachment 1 to the TAS Interim Guidance Memorandum TAS-13-1213-011, Reissuance of *Interim Guidance on Advocating for Taxpayers Claiming Earned Income Tax Credit (EITC) with Respect to a Qualifying Child* (Dec 23, 2013). This document was re-issued, pending incorporation into the IRM.

76 IRC § 6402.

Gathering enough facts to show that a spouse qualifies for the relief and assisting the spouse in completing Form 8379, *Injured Spouse Allocations*, are important advocacy opportunities in these cases. Taxpayers mainly seek TAS assistance in injured spouse cases due to lengthy delays in processing times and economic burden. Figure 4.10 shows injured spouse claim receipts for the past two years.

FIGURE 4.10, TAS Monthly Injured Spouse Receipts, FY 2011 through FY 2013[77]



While TAS changed its case acceptance criteria for injured spouse cases on October 1, 2011, to exclude injured spouse cases involving solely systemic burden, TAS still accepts economic burden injured spouse cases and injured spouse cases involving other issues (*e.g.,* where one spouse needs TAS to advocate for an audit reconsideration of the IRS debt subject to offset absent the injured spouse claim).

FIGURE 4.11, IRS Injured Spouse Inventory, FY 2012 and 2013[78]

Selected FY 2012 Dates				Selected FY 2013 Dates			
As of	Open Inventory	Overage Inventory	Percent Overage	As of	Open Inventory	Overage Inventory	Percent Overage
3/17/2012	75,088	2,996	4.0%	3/16/2013	110,254	2,965	2.7%
4/14/2012	72,408	11,959	16.5%	4/13/2013	138,213	52,302	37.8%
5/12/2012	75,648	15,115	20.0%	5/11/2013	140,539	59,414	42.3%
6/9/2012	47,967	22,959	47.9%	6/8/2013	101,352	71,804	70.8%
7/7/2012	18,678	9,562	51.2%	7/6/2013	59,809	46,615	77.9%
8/4/2012	10,198	4,476	43.9%	8/3/2013	38,332	29,229	76.3%
9/8/2012	7,477	2,783	37.2%	9/7/2013	16,464	10,434	63.4%

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77 Data obtained from TAMIS. TAS retrieved the data on the first day of the month following the end of the month for each fiscal year for FY 2011 through FY 2013.

78 Joint Operations Center CIS Inventory reports.

On July 25, 2013, the IRS alerted employees that the Accounts Management function was receiving a higher than normal volume of refund calls or inquiries on Form 8379 due to a delay in processing.[79] The Alert further instructed employees that "if a taxpayer states he or she called in previously and was informed to allow up to 45 days for processing, apologize for the delay in processing and inform the taxpayer it could take an additional four weeks to complete the processing."[80]

Overall, TAS received 8,021 injured spouse cases in FY 2013, compared to 4,115 in FY 2012, an increase of 95 percent.[81] Ninety-two percent of the cases from the week ending March 16, 2013 to the week ending July 6, 2013 (the heart of the filing and processing season) consisted of economic burden cases.[82] In addition, over 96 percent of the FY 2013 injured spouse receipts involved claims for the current tax year.

COLLECTION CASES

While still a source of a substantial number of cases, collection issues continued to decline between FY 2012 and FY 2013. In FY 2013, collection issues accounted for nearly 11 percent of all economic burden receipts and nearly ten percent of TAS's total caseload.[83] These issues are vitally important to the affected taxpayers, because IRS collection tools (bank levies, wage levies, personal residence seizures, and the filing of Notices of Federal Tax Lien) significantly affect all taxpayers, but can have a devastating impact on low income taxpayers.

Collection cases also present an improvement opportunity for TAS leadership, as TAS provided relief in 69 percent of these cases in FY 2013, while providing relief on other issues approximately 79 percent of the time.[84] TAS continuously strives to improve advocacy in collection cases through enhanced guidance and detailed training for employees.[85]

In FY 2013, TAS issued 24 Taxpayer Assistance Orders (TAOs) in collection cases where the IRS did not agree with TAS's case-specific recommendations. The IRS complied with 19 of these (including one where TAS modified the TAO), and five are still in process.[86]

TAS OPERATIONS ASSISTANCE REQUEST TRENDS FOR FY 2013

To serve taxpayers more efficiently, the Commissioner delegated to the National Taxpayer Advocate certain tax administration authorities that do not conflict with or undermine TAS's unique statutory mission of advocating for taxpayers, but allow TAS to take actions to resolve routine problems.[87] When TAS lacks the statutory or delegated authority to directly resolve a taxpayer's problem, TAS works with the responsible IRS operating division (OD) or function to resolve the issue, a process necessary in 66 percent

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79 IRS, SERP Alert 13A0446.

80 *Id*.

81 Data obtained from TAMIS (Oct. 1, 2012 through Oct. 1, 2013).

82 *Id.*

83 Data obtained from TAMIS (Oct. 1, 2013).

84 *Id*.

85 In FY 2012, the National Taxpayer Advocate developed and led the course *Roadmap to a Tax Controversy*, which addressed the collection stage of the process. Additional courses were also developed to provide advanced training on more complex collection related topics.

86 For a detailed discussion of TAOs, see *TAS Uses Taxpayer Assistance Orders to Advocate Effectively in Taxpayer Cases, infra*. TAO compliance data is as of Oct. 1, 2013.

87 IRM 1.2.50.3(1) Delegation Order 13-2 (Rev. 1) Authority of the National Taxpayer Advocate to Perform Certain Tax Administration Functions.

of all TAS cases closed in FY 2012 and 66 percent in FY 2013.[88] After independently reviewing the facts and circumstances of the case and communicating with the taxpayer, TAS uses Form 12412, *Operations Assistance Request* (OAR), to transmit documentation to the IRS and convey a recommendation or requested action to resolve the issue. The OAR also serves as an advocacy tool by:

- Giving the IRS a second chance to resolve the issue;
- Opening discussions between TAS and the IRS in an effort to resolve the issue without having to elevate it; and
- Documenting trends that could lead to improvements in IRS processes.

Each IRS function has agreed to work TAS cases as priority and expedite the process for taxpayers whose circumstances warrant immediate handling. Negotiated Service Level Agreements (SLAs) require the ODs and functions to direct resources to process OARs and alert them to the number of taxpayers who seek TAS assistance because they have not been able to resolve their problems through regular IRS channels. Form 12412 also includes an "expedite" box that TAS case advocates can check when the OD needs to act immediately to relieve the taxpayer's hardship.

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FIGURE 4.12, Expedited OARs and Non-Expedited OARs Issued by BOD for FY 2013[89]

Business Operating Division	FY 2013 OARs Issued Requesting Expedited Action	FY 2013 OARs Issued Without Expedited Request	FY 2013 Total OARs
Appeals	247	530	777
Criminal Investigation	83	107	190
LB&I	61	241	302
SB/SE	19,190	28,399	47,589
TE/GE	1,134	1,581	2,715
W&I	111,099	98,026	209,125
Totals	**131,814**	**128,884**	**260,698**

TAS generally completes an OAR on each case it sends to the IRS, but as previously described, a single OAR may be used to handle multiple taxpayers with the same issue by agreement with the IRS.

Additionally, in FY 2013, TAS and the IRS made strides in implementing several recommendations from a joint study of the OAR process.[90] The recommendations included:

- Simplifying and automating OAR routing;
- Improving timeliness and reducing cycle time;
- Setting joint goals and process monitoring; and
- Leveraging workflow technology for TAS's integrated system of the future.

88 In FY 2012, TAS closed 152,775 cases requiring an OAR. During FY 2013, TAS closed 165,003 cases with OARs. Data obtained from TAMIS (Oct. 18, 2013).

89 Data obtained from TAMIS (Oct. 1, 2013).

90 MITRE Report, *Case Advocacy Review Phase 2: Operations Assistance Request Process Review – Exploring Future State Opportunities in the Operation Assistance Request Process* (Mar. 10, 2011).

The actions implemented in FY 2013 flowing from these recommendations included:

- Using aggressive, informed Requested Completion Dates (RCDs) for frequently worked OAR issue codes. This improves timeliness and reduces cycle time, speeding up resolutions for taxpayers facing hardships.
- Developing a high-level measure related to the use of consistent OAR document requirements.
- Aligning TAS area offices to IRS campuses based on certain OAR issues, to simplify routing and resolve problems more efficiently.

These steps will help TAS achieve its long-term goal of resolving taxpayer problems accurately and timely. TAS surpassed its FY 2013 goal of reducing OAR rejects to 3.6 percent.[91] A properly routed OAR, which includes an advocacy-focused narrative along with an informed RCD, promotes efficient tax administration by directing the appropriate IRS function to provide prompt relief to the taxpayer.

As Figure 4.13 reflects, TAS is already making significant strides in reducing its OAR rejection rate with the percentage of rejected OARs decreasing from FY 2012 to FY 2013 in each operating division and function.

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FIGURE 4.13, OARs Issued, Rejected, and Reject Rate, FY 2012 and FY 2013[92]

OD / Function	FY 2012			FY 2013			Change in OAR Reject Rate
	OARs Issued	OARs Rejected	OAR Reject Rate	OARs Issued	OARs Rejected	OAR Reject Rate	
Appeals	830	26	3.1%	777	14	1.8%	- 42.5%
CI	309	28	9.1%	190	7	3.7%	- 59.3%
LB&I	209	12	5.7%	302	12	4.0%	- 30.8%
SB/SE	54,620	2,451	4.5%	47,589	1,918	4.0%	- 10.2%
TE/GE	1,416	21	1.5%	2,715	16	0.6%	- 60.3%
W&I	198,248	6,767	3.4%	209,125	5,970	2.9%	- 16.4%
Total	**255,632**	**9,305**	**3.6%**	**260,698**	**7,937**	**3.0%**	**- 16.4%**

TAS USES TAXPAYER ASSISTANCE ORDERS TO ADVOCATE EFFECTIVELY

The TAO is a powerful statutory tool delegated by the National Taxpayer Advocate to the Local Taxpayer Advocates (LTAs) and others to resolve taxpayer cases.[93] An LTA may issue a TAO to order the IRS to take an action, cease an action, or refrain from taking an action (*e.g.*, to release a levy).[94] A TAO may order the IRS to expedite consideration of a taxpayer's case, reconsider its determination in a case, or review the case at a higher level.[95] When a taxpayer faces significant hardship and the facts support relief,

91 OAR reject rate is the percent of rejected requests for action to be taken by the IRS. The corporate OAR reject goal for TAS in FY 2013 is 3.6 percent.

92 Data obtained from TAMIS (Oct. 1, 2012; Oct. 1, 2013).

93 IRC § 7811. IRC § 7811(f) states that for purposes of this section, the term "National Taxpayer Advocate" includes any designee of the National Taxpayer Advocate.

94 IRC § 7811(b); Treas. Reg. § 301.7811-1(c)(3); IRM 13.1.20.3 (Dec. 15, 2007).

95 Treas. Reg. § 301.7811-1(c)(3): IRM 13.1.20.3 (Dec. 15, 2007).

an LTA should issue a TAO when the IRS refuses to take the action TAS has requested to resolve the case.[96] Once TAS issues a TAO, the IRS can comply with the request or appeal the issue for resolution at higher levels.[97]

In FY 2013, TAS issued 353 TAOs.[98] TAS issued 74 TAOs because the IRS failed to respond to an OAR. Of these 74 TAOs, the IRS complied with 72 in an average of eight days.[99] This indicates that had the IRS responded timely to TAS's initial requests through the OAR process, which was clearly within its power, TAS could have resolved the taxpayers' issues sooner.

Figure 4.14 reflects the results of the TAOs. Figure 4.15 shows the TAOs issued by fiscal year.

FIGURE 4.14, Actions Taken on FY 2013 TAOs Issued[100]

Action	Total
IRS Complied with TAO	231
IRS Complied after TAO Modified	12
TAS Rescinded TAO	16
TAO Pending In Process	94
Total	**353**

FIGURE 4.15, TAOs Issued to the IRS, FY 2010–FY 2013[101]

Fiscal Year	TAOs Issued
2010	95
2011	422
2012	434
2013	353

The following examples illustrate the use of TAOs to obtain taxpayer relief. To comply with IRC § 6103, which generally requires the IRS to keep taxpayers' returns and return information confidential, the identifying details of the fact patterns have been modified or redacted.

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96 IRC § 7811(a)(1); Treas. Reg. § 301.7811-1(a)(1) and (c).
97 IRM 13.1.20.5(2) (Dec 15, 2007).
98 Data obtained from TAMIS (Oct. 1, 2013).
99 *Id*.
100 *Id*.
101 *Id*.

TAOs Involving Account Resolution

As discussed throughout this report, identity theft harms our tax system in many ways.[102] More than 75 percent of individual taxpayers filing returns claim refunds, averaging about $3,000.[103] In an identity theft situation, where the IRS has processed a false return before the "true" taxpayer's return, refunds are not paid to the SSN owner until the IRS fully resolves the SSN ownership, which can take 180 days.[104] In FY 2013, TAS issued 39 TAOs involving identity theft, 23 of which were issued because the IRS failed to respond to OARs by the negotiated completion date.[105] The IRS complied with all 23 of these TAOs within an average of five days.[106] Of the original 39 TAOs issued, 30 involved economic burden that caused a hardship and required swift TAS action.[107] Specific examples of hardships encountered by these taxpayers, and worsened by IRS delays, include:

- Taxpayer being evicted;
- Taxpayer needed to pay rent and utilities; and
- Taxpayer behind on bills and needed to repair auto to get to work.

TAS Issues TAOs Where IRS Inaction Exacerbates Return Preparer Misconduct

Earlier in this report, we outline the issues surrounding the IRS's current policy with respect to assisting victims of tax return preparer misconduct.[108] Taxpayers seek TAS assistance when they become aware of preparer misconduct, which generally only happens after the IRS:

- Reviews or audits the return;
- Disallows the incorrect deductions, withholding, or credits;
- Holds the taxpayer liable for the resulting increased tax assessment; or
- Prevents the taxpayer from obtaining the portion of the refund he or she was entitled to and did not actually receive.

As a result, TAS continued to raise the problem, issuing 100 TAOs due to return preparer misconduct in FY 2013.[109] Sixty-nine TAOs for this issue were elevated to the National Taxpayer Advocate and 25 were elevated to the Acting Commissioner.[110]

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102 See Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers, supra*.

103 See National Taxpayer Advocate FY 2014 Objectives Report to Congress 85 (*TAOs Resolving Account Issues*).

104 IRM 21.9.2.2.1 (May 29, 2013).

105 Under the Service Level Agreements between TAS and the operating divisions of the IRS, the TAS employee will contact the assigned IRS employee to negotiate or renegotiate the earliest possible requested completion date.

106 Data obtained from TAMIS (Oct. 1, 2013).

107 *Id*.

108 For a detailed discussion of the return preparer fraud problem, see Most Serious Problem: *The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Fraud, Despite Ample Guidance Allowing the Payment of Such Refunds, supra*.

109 Data obtained from TAMIS (Oct. 1, 2013).

110 See Most Serious Problem: *Return Preparer Fraud: The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct, Despite Ample Guidance Allowing the Payment of Such Refunds, supra*.

TAOs to Examination Functions

TAS issued 45 TAOs to examination units for a variety of issues, including return preparer misconduct, audit reconsiderations, and problems with the adoption tax credit. Several examples follow:

- A taxpayer was denied dependency exemptions, EITC, and head of household filing status with respect to children and grandchildren. The taxpayer repeatedly sent the verification documents to the Examination function, but received no response. The taxpayer, facing eviction and unable to meet basic living expenses, turned to TAS for help. TAS did not receive a response from the Examination function. Upon inquiry, TAS learned the examiner was on "extended leave." TAS immediately issued a TAO. The IRS promptly reviewed the documents and issued the refund to the taxpayer.
- The IRS determined the taxpayer was not engaged in a business for profit pursuant to IRC § 183, and thus denied certain business expenses and assessed additional tax. The taxpayer disagreed with the assessment and requested review by the Office of Appeals. The IRS disregarded the taxpayer's request and issued the taxpayer a Statutory Notice of Deficiency, asserting that because the amount in controversy exceeded $25,000, the taxpayer should have filed a formal appeal, as opposed to an informal one. The Local Taxpayer Advocate issued a TAO, pointing out that the correct procedure under IRM 4.10.8.11.9(9) is for the IRS to allow the taxpayer the opportunity to cure an improper protest before issuing a notice of deficiency.[111] The IRS complied by rescinding the Statutory Notice of Deficiency.
- During an audit, the Innocent Spouse Unit granted a taxpayer's request for innocent spouse relief under IRC § 6015 but the unit did not properly process a partial agreement on the claim. The taxpayer's other issues were resolved subsequently, but when the case was returned to the IRS for completion, the function refused to make the previously agreed innocent spouse adjustments. TAS issued a TAO, and the IRS agreed to make the adjustments.

TAOs to TE/GE

As the issues addressed in both the report of the Treasury Inspector General for Tax Administration and the report of the National Taxpayer Advocate demonstrate, Tax Exempt and Government Entity (TE/GE) cases present vitally important advocacy opportunities, both on substantive legal determinations and on processing issues.[112] Non-profit organizations contribute religious, educational, scientific, social welfare, and other similar positive benefits to the public good, and most of these exempt organizations are small entities serving local communities staffed by volunteers.[113] Entities pursuing tax exempt status under IRC § 501(c)(3) generally will not operate in advance of IRS exempt organization status. Therefore, the timeliness of the application approval process is crucial to the goals of the organization. Without the IRS determination on the tax exemption, the entity will struggle in its efforts to solicit funds from donors, who are motivated in part by the ability to deduct contributions to an approved IRC § 501(c)(3) tax

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111 IRC § 7811(a)(3) establishes a presumption that when the IRS fails to follow its own guidance the National Taxpayer Advocate shall view the facts in the light most favorable to the taxpayer when determining whether to issue a TAO.

112 *See* Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013); National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status*, June 30, 2013.

113 National Taxpayer Advocate 2009 Annual Report to Congress 287, addressing the need for targeted research and increased collaboration to meet the needs of tax exempt organizations; National Taxpayer Advocate 2005 Annual Report to Congress 293 discussing inadequate service to exempt organization resulting in unnecessary penalties; National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013).

exempt entity. While some exempt organizations under IRC § 501(c) may operate without the need to seek an IRS determination, it is TAS's experience with IRC § 501(c)(4) cases that many entities are reluctant to operate without IRS approval.[114] TAS is advocating for these taxpayers on both the procedural issues surrounding the application process and the substantive aspects of the determination process.

TAS's FY 2013 cases involving applications for exempt status have increased by 371 percent compared to FY 2010, 218 percent since FY 2011, and 110 percent since FY 2012.[115] Thirty percent of the FY 2013 cases met economic burden criteria, and 70 percent were congressional referrals.[116] Since May, TAS has averaged about 62 new receipts per week.[117] This increase in exempt organization cases demonstrates that the IRS's processes are creating significant hardship for both new exempt organizations and those whose exempt status was automatically revoked. In FY 2013, TAS issued 42 TAOs to the TE/GE function, compared with six in FY 2012 (four of which were rescinded), and three in FY 2011.[118] The TAOs in FY 2013 were issued primarily due to issues surrounding:

- Delays in processing Forms 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, and Form 1024, *Application for Recognition of Exemption Under Section 501(a)*; and
- Automatic revocations of exempt status pursuant to provisions of the Pension Protection Act, which requires tax-exempt organizations to file an annual return or notice with the IRS or face automatic revocation.[119]

With respect to delays in processing, TAS has encountered problems with TE/GE understanding TAS's statutory authorities, and the National Taxpayer Advocate has written about these issues.[120] TE/GE tends to work applications in a first-in/first-out basis, and the essence of TAS advocacy is ensuring that certain applications are moved to the "front of the line" based on taxpayer need.[121]

The numerous problems surrounding the automatic revocation requirement are discussed at length in a Most Serious Problem in this report.[122] TAS advocacy in the typical fact pattern for an exempt organization revocation follows.

> The exempt organization is surprised when it is informed by its donors and grant-making foundations that it is no longer on the list of Exempt Organizations authorized to receive deductible contributions, discovering the exempt status was revoked. Immediately, the organization completes the necessary paperwork, enclosing a check for the application fee. The organization then applies for grants and discovers its exempt status has not been reinstated.

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114 Some organizations are not required to be tax exempt but may obtain formal recognition of tax-exempt status by submitting IRS Form 1024. Of the 19 cases TAS received, three taxpayers withdrew their applications because of the excess burden and delays. National Taxpayer Advocate Special Report to Congress, June 30, 2013, *Political Activity and the Rights of Applicants for Tax-Exempt Status*, 3. www.taxpayeradvocate.irs.gov/2014ObjectivesReport/Special-Report.

115 Data obtained from TAMIS (Oct. 1, 2010, 2011, 2012, and 2013). See Most Serious Problem: *Exempt Organizations: The IRS Continues To Struggle With Revocation Processes and Erroneous Revocations of Exempt Status, supra*.

116 Data obtained from TAMIS (Oct. 1, 2013).

117 *Id*.

118 *Id*.

119 The Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006).

120 National Taxpayer Advocate Special Report to Congress, *Political Activity and the Rights of Applicants for Tax-Exempt Status* (June 30, 2013).

121 *Id*. at 3.

122 See Most Serious Problem: *Exempt Organizations: The IRS Continues To Struggle With Revocation Processes and Erroneous Revocations of Exempt Status, supra*.

> The IRS cashed the check for the processing fee, but the organization did not receive a determination letter. When the organization inquires of the IRS, it is informed that it will be another six to eight weeks. This has been the constant response by the IRS. Often, this response is repeated several times for the organization. TAS conducts research to determine a recommended action, secures proof of grants that are being lost, and issues an OAR to the Exempt Organization Unit, recommending the exempt status be reinstated promptly, due to the lost funding. If the function does not respond within the established timeframe, TAS issues a TAO and the unit complies by reinstating the organization's exempt status.[123]

Overall, TAS provided relief to 1,552 exempt organizations in FY 2013.[124] The average time TAS took to resolve exempt status application cases was 75 days and TAS provided some form of relief in 79.3 percent of the cases.[125]

TAOs on Collection issues

In FY 2013, levy issues were the sixth most significant source of TAS economic burden receipts.[126] If the IRS does not act quickly in these cases, the taxpayer may experience even more financial harm.[127] TAS issued 20 TAOs on levy cases in FY 2013, compared to 17 in FY 2012 and 11 in FY 2011. Of the 20 TAOs for levies, TAS issued 15 TAOs to obtain the return of levy proceeds for taxpayers experiencing economic burden. The IRS complied with 15 of these TAOs, involving cases where:[128]

- The IRS initially refused to allow TAS time to review the taxpayer's situation to determine possible alternatives to resolve the issue, effectively denying the taxpayer access to TAS's assistance.
- After an Appeals Settlement Officer determined possible resolution via an installment agreement, the Revenue Officer refused to consider the request for an installment agreement.
- A taxpayer and revenue officer (RO) disagreed on the appropriate monthly payment amount for a proposed installment agreement, so the RO issued a levy. TAS requested additional time to review the matter to reach a mutually agreeable installment agreement, pointing out that required procedures for the processing of installment agreements, which includes independent review and appeal rights, were not being followed. The RO's response was that TAS should issue a TAO if it wanted additional time, so TAS did.
- The IRS did not properly code a taxpayer's account with currently not collectible (CNC) status at the time of its original determination to place the account in CNC hardship status. The IRS subsequently levied the taxpayer's income source, leaving the taxpayer with insufficient funds for basic living expenses. The IRS refused to return the levy proceeds until TAS issued the TAO.
- The IRS wrongly refunded payments to a taxpayer after a failed offer in compromise application. The taxpayer returned the money for proper application to the debt, but the IRS lost the check. After TAS issued the TAO, the IRS found the check and correctly applied it to the taxpayer's account.

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123 Data obtained from TAMIS (Oct. 1, 2013).
124 *Id.*
125 *Id.*
126 *Id.*
127 *Id.*
128 *Id.*

TAOs to Appeals

TAS issued ten TAOs to Appeals on a variety of issues during FY 2013. TAS cases involving Appeals continue to reflect a misunderstanding on the part of many Appeals' employees about TAS's statutory authority to advocate for taxpayers.[129] Some Appeals employees attempted to limit TAS's actions on the taxpayer's behalf under the misguided notion that communicating with TAS violated the prohibition on Appeals from "*ex parte* communications" with functions, that TAOs may violate Appeals' independence or exceed the National Taxpayer Advocate's authority.[130]

However, TAS worked cooperatively with Appeals in many areas. For example, TAS worked with Appeals through a joint team to reach agreement to provide standard language on OARs that includes the SLA requirement concerning the five-day advance notification to TAS of a proposed determination. The impact of this agreement is significant as it will vastly increase TAS's advocacy opportunities, because when Appeals issues a final determination to the taxpayer without notifying TAS in advance, TAS's ability to advocate, if it does not agree with the finding, is severely hampered due to time limits. This agreement puts the SLA requirements up-front when the case is assigned to an Appeals Officer or Settlement Officer.

CONGRESSIONAL CASE TRENDS

TAS is responsible for responding to certain tax account inquiries sent to the IRS by members of Congress. As shown in Figure 4.16, entity, document processing, and refund issues made up the top three categories of congressional inquiries in FY 2013.[131]

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FIGURE 4.16, TAS Congressional Inquiries by Issue Group, FY 2012 and FY 2013[132]

Issue Category	FY 2012	FY 2013	%Change
Entity Issues	5,251	5,558	5.8%
Document Processing Issues	2,048	3,034	48.1%
Refund Issues	2,033	2,577	26.8%
Collection Issues	2,424	2,407	-0.7%
Audit Issues	2,573	2,258	-12.2%
Technical, Procedural, or Statute Issues	1,348	1,322	-1.9%
Penalty Issues	1,053	989	-6.1%
Payment or Credit Issues	359	426	18.7%
Appeals Issues	278	268	-3.6%
Interest Issues	65	44	-32.3%
Other Issues	29	37	27.6%
Criminal Investigation Issues	9	12	33.3%
Total Congressional Issues	**17,470**	**18,932**	**8.4%**

129 Data obtained from TAMIS (Oct. 1, 2013).

130 See Rev. Proc. 2012-18, 2012-10 I.R.B. 455. An "*ex parte* communication" is a communication that takes places between any Appeals employee and employees of other IRS functions without the taxpayer (or representative) being given an opportunity to participate in the communication.

131 Data obtained from TAMIS (Oct. 1, 2013; Oct. 1, 2012).

132 *Id*.

From FY 2009 through FY 2011, congressional inquiries declined, but increased in FY 2012 and 2013. As shown in Figure 4.17, issues related to the FTHBC and the adoption credit contributed significantly to TAS congressional receipts in FY 2011.

FIGURE 4.17, TAS Congressional Receipts, FY 2009–FY 2013[133]

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Congressional Receipts	17,603	15,711	14,761	17,470	18,932
Total Case Receipts	272,404	298,933	295,904	219,666	244,956
% of Total Receipts	6.5%	5.3%	5.0%	8.0%	7.7%
Congressional Receipts Related to Economic Stimulus Payment (ESP)	4,264	127	22		5
Congressional Receipts Related to FTHBC		3,243	2,018	399	197
Congressional Receipts Related to Adoption Credit			496	476	118

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133 Data obtained from TAMIS. TAS obtains the data on the first day following the end of the FY for FYs 2009 through 2013.

Top 25 Case Advocacy Issues for Fiscal Year 2013 by TAMIS* Receipts

Issue Code	Description	FY 2013 Case Receipts
425	Identity Theft	57,929
045	Pre-Refund Wage Verification Hold	26,136
315	Unpostable or Reject	17,045
63x – 640	Earned Income Tax Credit	11,980
330	Processing Amended Return	10,441
71x	Levies (Including Federal Payment Levy Program)	8,829
310	Processing Original Return	8,714
340	Injured Spouse Claim	8,021
620	Reconsideration of Audits and Substitute for Return under IRC § 6020(b)	7,527
610	Open Audit (Not EITC)	6,734
060	IRS Offset	4,992
020	Expedite Refund Request	4,584
670	Closed Automated Underreporter	3,923
75x	Installment Agreements	3,916
090	Other Refund Inquiries/Issues	3,900
040	Returned or Stopped Refunds	3,382
72x	Liens	3,147
540	Civil Penalties (Other than Trust Fund Recovery Penalties)	2,739
520	Failure to File Penalty and/or Failure to Pay	2,702
790	Other Collection Issues	2,610
460	Application for Exempt Status	2,519
010	Lost or Stolen Refunds	2,368
675	Combined Annual Wage Reporting/Federal Unemployment Tax Act (CAWR/FUTA)	2,328
660	Open Automated Underreporter	2,326
390	Other Document Processing Issues	2,232
Total Top 25 Receipts		**211,024**
Total TAS Receipts		**244,956**

* Taxpayer Advocate Management Information System

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Acronym Glossary — Annual Report to Congress 2013

Acronym	Definition
AARS	Appeals Account Resolution Specialist
ABA	American Bar Association
ACA	Affordable Care Act
ACDS	Appeals Centralized Database System
ACH	Automated Clearinghouse
ACM	Appeals Case Memoranda
ACS	Automated Collection System
ACSS	Automated Collection System Support
ACTC	Additional Child Tax Credit or Advance Child Tax Credit
ADA	Americans With Disabilities Act
ADR	Alternative Dispute Resolution or Address Research System
AEITC	Advanced Earned Income Tax Credit
AGI	Adjusted Gross Income
AIA	Anti-Injunction Act
AICPA	American Institute of Certified Public Accountants
AIS	Automated Insolvency System
AIQ	(IRS Office of) Advisory, Insolvency and Quality
AJAC	Appeals Judicial Approach and Culture
AJCA	American Jobs Creation Act of 2004
AIMS	Audit Information Management System
ALE	Allowable Living Expenses
ALS	Automated Lien System
AM	Accounts Management
AMS	Accounts Management System
AMT	Alternative Minimum Tax
AMTAP	Accounts Management Taxpayer Assurance Program
AMTI	Alternative Minimum Tax Income
ANMF	Automated Non Master File
ANPR	Advance Notice of Proposed Rulemaking
AO/SO	Appeals or Settlement Officer
AOIC	Automated Offer In Compromise
APA	American Payroll Association or Administrative Procedure Act
APO/FPO	Army Post Office/Fleet Post Office
APS	Appeals Processing Service
AQC	Automated Questionable Credits
AQMS	Appeals Quality Management System
AQR	Automated Questionable Refund

Acronym	Definition
ARAP	Accelerated Revenue Assurance Program
ARC	Annual Report to Congress
ARI	Appeals Referral Investigation
ARRA	America Recovery and Reinvestment Act
ASA	Average Speed of Answer
ASED	Assessment Statute Expiration Date
ASFR	Automated Substitute for Return
ATAO	Application for Taxpayer Assistance Order
ATFRS	Automated Trust Fund Recovery System
ATIN	Adoption Taxpayer Identification Number
ATP	Abusive Transaction Program
AUR	Automated Underreporter
AWSS	Agency Wide Shared Services
BIR	Bureau of Internal Revenue
BMF	Business Master File
BOSS	Bond and Option Sales Strategy
BNA	Bureau of National Affairs
BPR	Business Performance Review
BRTF	Business Returns Transaction File
BSA	Bank Secrecy Act
BTA	Board of Tax Appeals
CAA	Certifying Acceptance Agent
CADE2	Customer Account Data Engine 2
CAF	Centralized Authorization File
CAP	CAWR Automated Program
CARE	Customer Assistance, Relationships & Education
CAS	Customer Account Services
CAWR	Combined Annual Wage Reporting
CBO	Congressional Budget Office
CBPP	Center on Budget & Policy Priorities
CBRS	Currency & Banking Retrieval System
CC	Chief Counsel (Office of)
CCB	Check Claims Branch
CCISO	Cincinnati Centralized Innocent Spouse Operation
CCP-LU	Centralized Case Processing
CDP	Collection Due Process
CDPTS	Collection Due Process Tracking System
CDE	Compliance Data Environment
CDW	Compliance Data Warehouse
CEAP	Correspondence Examination Assessment Project

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Acronym	Definition
CEAS	Correspondence Examination Automation Support
CFf	Collection Field Function
CFIF	Check Forgery Insurance Fund
CI	Criminal Investigation (Division)
CIP	Compliance Initiative Project
CIS	Correspondence Imaging System
CJEs	Critical Job Elements
CLD	Communications, Liaison and Disclosure
CNC	Currently Not Collectible
COBRA	Consolidated Omnibus Budget Reconciliation Act
CODI	Cancellation Of Debt Income
COIC	Centralized Offer In Compromise
COTR	Contract Officer Technical Representative
CONOPS	Concept of Operations
CPAT	Compliance Post Adjustment Team
CPE	Continuing Professional Education
CPS	Collection Process Study
CQMS	Collection Quality Management System
CRIS	Compliance Research Information System
CSCO	Compliance Services Collection Operations
CSED	Collection Statute Expiration Date
CSI	Campus Specialization Initiative
CSO	Communications and Stakeholder Outreach
CSR	Customer Service Representative
CTC	Child Tax Credit
DA	Disclosure Authorization
DAC	Disability Access Credit
DART	Disaster Assistance Review Team
DATC	Doubt As To Collectibility
DATL	Doubt As To Liability
DCI	Data Collection Instrument
DD	Direct Deposit
DDb	Dependent Data Base
DDIA	Direct Deposit Installment Agreement
DDP	Daily Delinquency Penalty
DFO	Designated Federal Official
DHS	Department of Homeland Security
DI	Desktop Integration or Debt Indicator
DIF	Discriminant Income Function
DJA	Declaratory Judgment Act
DLN	Document Locator Number
DMF	Death Master File
DNS	Domain Name Server

Acronym	Definition
DOD	Department of Defense
DOJ	Department of Justice
DoMA	Defense of Marriage Act
DPC	Designated Payment Code
DSO	Designated School Official
EA	Enrolled Agent
EAC	Examination Activity Code
EAJA	Equal Access to Justice Act
EAR	Electronic Account Resolution
EBE	Employee Business Expense
EBT	Electronic Benefits Transfer
ECS	Enterprise Collections Strategy
EGTRRA	Economic Growth and Tax Relief Reconciliation Act (of 2001)
EFDS	Electronic Fraud Detection System
EFS	Enterprise Fax Storage
EFTPS	Electronic Federal Tax Payment System
EFW	Electronic Funds Withdrawal
EIC	Earned Income Credit
EIN	Employer Identification Number
EITC	Earned Income Tax Credit
ELMS	Enterprise Learning Management System
ELS	Electronic Lodgment Service
ERIS	Enforcement Revenue Information System
EO	Exempt Organization
EP	Employee Plans
EQRS	Embedded Quality Review System
ERIS	Enforcement Revenue Information System
ERO	Electronic Return Originator
ERISA	Employee Retirement Income Security Act
ERSA	Employee Retirement Savings Account
ES	Estimated Tax Payments
ESA	Economic Stimulus Act
ESC	Executive Steering Committee
ESL	English as a Second Language
ESOP	Employee Stock Ownership Plan
ESP	Economic Stimulus Payment
ETA	Effective Tax Administration
ETACC	Electronic Tax Administration Advisory Committee
ETARC	Electronic Tax Administration and Refundable Credits
ETLA	Electronic Tax Law Assistance
FA	Field Assistance

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Acronym	Definition
FAFSA	Free Application for Financial Student Aid
FATCA	Foreign Account Tax Compliance Act
FBAR	Foreign Bank Account Report
FBU	Federal Benefits Unit
FCR	Federal Case Registry
FCRA	Fair Credit Reporting Act
FDCPA	Fraud Detection Center
FDIC	Federal Deposit Insurance Corporation
FEIE	Foreign Earned Income Exclusion
FEMA	Federal Emergency Management Agency
FFI	Foreign Financial Institution
FFCD	Future Field Collection Design
FFFF	Free File Fillable Forms
FICA	Federal Insurance Contribution Act
FIFO	First In, First Out
FIRPTA	Foreign Investment in Real Property Tax Act
FMV	Fair Market Value
FMS	Financial Management Service
FOIA	Freedom Of Information Act
FPAA	Final Partnership Administrative Adjustment
FPLP	Federal Poverty Level
FPLP	Federal Payment Levy Program
FRA	Federal Records Act
FSLA	Fair Labor Standards Act
FSA	Facilitated Self-Assistance
FSRP	Facilitated Self-Assistance Research Project
FTA	First-Time Abatement or Federal Tax Application
FTC	Federal Trade Commission or Foreign Tax Credit
FTD	Federal Tax Deposit or Failure To Deposit
FTE	Full-Time Equivalent
FTF	Failure To File
FTHBC	First-Time Homebuyer Credit
FTI	Federal Tax Information
FTL	Federal Tax Lien
FTP	Failure To Pay
FTS	Fast Track Settlement
FUTA	Federal Unemployment Tax Act
FY	Fiscal Year
GCM	General Counsel Memorandum
GLD	Governmental Liaison and Disclosure
GO	Government Entities
GAO	Government Accountability Office or General Accounting Office

Acronym	Definition
HCTC	Health Coverage Tax Credit
IA	Installment Agreement
IAT	Integrated Automation Technologies
IBC	International Business Compliance
IBTF	In Business, Trust Fund
ICAS	Internet Customer Account Services
ICMM	International Compliance Management Model
ICP	Integrated Case Processing
ICS	Integrated Collection System
IDAP	IDRS Decision Assisting Program
IDM	International Data Management
IDRM	Information Reporting and Document Matching
IDFP	IRS Directory for Practitioners
IDRS	Integrated Data Retrieval System
IDS	Inventory Delivery System
IDT	Identity Theft
IFC	International Finance Corporation
IGRA	Indian Gaming Regulatory Act
IITA	International Individual Taxpayer Assistance Team
IMD	Internal Management Document
IMF	Individual Master File
IMRS	Issue Management Resolution System
IP	Internet Protocol
IPM	Integrated Production Model
IPO	ITIN Program Office
IPOC	International Planning and Operations Council
IP PIN	Identity Protection Personal Identification Number
IPSU	Identity Protection Specialized Unit
IRB	Internal Revenue Bulletin
IRC	Internal Revenue Code
IRDM	Information Reporting Document Matching
IRM	Internal Revenue Manual
IRMF	Information Returns Master File
IRP	Information Returns Processing
IRPTR	Information Returns Processing Transcript Requests
IRS	Internal Revenue Service
IRSAC	Internal Revenue Service Advisory Council
IRSN	Internal Revenue Service Number
ITA	Interactive Tax Assistance
ITAAG	Identity Theft Assessment and Action Group
ITAR	Identity Theft Assistance Request
ITG	Indian Tribal Government

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Acronym	Definition
ITIN	Individual Taxpayer Identification Number
IVO	Integrity Verification Operations
JCT	Joint Committee on Taxation
JOC	Joint Operations Center
LB&I	Large Business and International Operating Division
LCCI	Last Chance Compliance Initiative
LCTU	Large Corporation Technical Unit
LEM	Law Enforcement Manual
LEP	Limited English Proficiency
LIF	Low Income Filter
LIHTC	Low Income Housing Tax Credit
LILO	Lease-In Lease-Out
LITC	Low Income Taxpayer Clinic
LLC	Limited Liability Company
LLP	Limited Liability Partnership
LOS	Level of Service
LP	Limited Partnership
LSB	Language Services Branch
LTA	Local Taxpayer Advocate
M&P	Media and Publications
MAGI	Modified Adjusted Gross Income
MEC	Minimal Essential Health Coverage
MFDRA	Mortgage Forgiveness Debt Relief Act
MFT	Master File Transaction
MIRSA	My IRS Account Application
MITS	Modernization and Information Technology Services
MLI	Multilingual Initiative or Most Litigated Issue
MWP	Making Work Pay Credit
NAEA	National Association of Enrolled Agents
NCOA	National Change of Address
NEH	Non-Economic Hardship
NFTL	Notice of Federal Tax Lien
NMF	Non-Master File
NOD	Notice of Deficiency
NQRS	National Quality Review System
NRP	National Research Program
NTA	National Taxpayer Advocate
NTIS	National Technical Information Service
OAR	Operations Assistance Request
OD	Operating Division
OIC	Offer in Compromise

Acronym	Definition
OECD	Organisation for Economic Co-Operation and Development
OLS	(IRS Office of) Online Services
OMB	Office of Management and Budget
OMM	Operation Mass Mail
OPERA	Office of Program Evaluation, Research, & Analysis
OPI	Office of Penalty and Interest Administration or Over the Phone Interpreter
OSI	Office of Servicewide Interest
OPR	Office of Professional Responsibility
OSP	Office of Servicewide Penalties
OTA	Office of Tax Analysis
OTBR	Office of Taxpayer Burden Reduction
OTC	Office of Taxpayer Correspondence
OTP	Office of Tax Policy
OUO	Official Use Only
OVC	Office for Victims of Crime
OVCI	Offshore Voluntary Compliance Initiative
OVD	Offshore Voluntary Disclosure
OVDI	Offshore Voluntary Disclosure Initiative
OVDP	Offshore Voluntary Disclosure Program
PC	Project Code
PCA	Private Collection Agency
PCAOB	Public Company Accounting Oversight Board
PCI	Potentially Collectible Inventory
PDC	Private Debt Collection
PEO	Professional Employer Organization
PFA	Pre-Filing Agreement
PGLD	Privacy, Governmental Liaison and Disclosure (Office of)
PGP	Priority Guidance Plan
PIC	Primary Issue Code
PNI	Potential New Inventory
PLR	Private Letter Ruling
POA	Power of Attorney
POL	Period of Limitations
PPBR	Printing and Postage Budget Reduction
PPIA	Partial Payment Installment Agreement
PPS	Practitioner Priority Service
PRA	Paperwork Reduction Act
PRP	Problem Resolution Program
PSC	Philadelphia Service Center
PSP	Payroll Service Provider

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Acronym	Definition
PREA	Premature Referral and Acceptance
PTIN	Preparer Tax Identification Number
PTSD	Post Traumatic Stress Disorder
PY	Processing Year
QBU	Qualified Business Unit
QETP	Questionable Employment Tax Practices
QRP	Questionable Refund Program
RA	Revenue Agent or Reporting Agent
RCA	Reasonable Cause Assistant
RCP	Reasonable Collection Potential
RGS	Report Generating Software
RICS	Return Integrity and Correspondence Services
RO	Revenue Officer or Responsible Officer
ROFT	Record of Federal Tax Liability
ROI	Return on Investment
ROTERS	Records of Tax Enforcement Results
RPS	Revenue Protection Strategy
RPVP	Return Preparer Visitation Program
RRA 98	(Internal Revenue Service) Restructuring and Reform Act of 1998
RPC	Return Preparer Coordinator
RPO	Return Preparer Office
RPS	Revenue Protection Strategy
RPP	Return Preparer Program
RRP	Return Review Program
RSED	Refund Statute Expiration Date
RTTS	Real-Time Tax System
SA	Systemic Advocacy
SAMS	Systemic Advocacy Management System
SBA	Small Business Administration
SBDC	Small Business Development Center
SB/SE	Small Business/Self Employed Operating Division
SEC	Securities and Exchange Commission
SEP	Special Enforcement Program
SERP	Servicewide Electronic Research Program
SEVP	Student and Exchange Visitor Program
SFR	Substitute for Return
SL	Stakeholder Liaison
SLA	Service Level Agreement
SMP	Secure Messaging Portal
SMS	Secure Messaging System
SNOD	Statutory Notice of Deficiency
SO	Settlement Officer

Acronym	Definition
SOI	Statistics of Income
SP	Submission Processing
SPC	Submission Processing Center(s)
SPDER	Office of Servicewide Policy, Directives, and Electronic Research
SPEC	Stakeholder Partnerships, Education & Communication
SPOC	Single Point of Contact
SSA	Social Security Administration
SSI	Supplemental Security Income
SSMC	Services, Support and Modernization Committee
SSN	Social Security Number
STC	Student Tax Clinic
STO	Student Tuition Organization
SVC	Stored Value Card
TAB	Taxpayer Assistance Blueprint
TAC	Taxpayer Assistance Center
TACT	Taxpayer Communications Taskgroup
TAD	Taxpayer Advocate Directive
TAMIS	Taxpayer Advocate Management Information System
TAMRA	Technical and Miscellaneous Revenue Act (of 1988)
TAO	Taxpayer Assistance Order
TAP	Taxpayer Advocacy Panel
TAS	Taxpayer Advocate Service
TBOR	Taxpayer Bill of Rights
TC	Transaction Code
TCE	Tax Counseling for the Elderly
TDA	Taxpayer Delinquent Account
TDRA	Tip Rate Determination Agreement
TDI	Taxpayer Delinquent Investigation
TE	Tax Examiner or Tax Exempt
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
TEC	Taxpayer Education and Communication
TE/GE	Tax Exempt & Government Entities Operating Division
TEFRA	Tax Equity and Fiscal Responsibility Act
TFP	Tax Forms & Publications
TFRP	Trust Fund Recovery Penalty
TGR	Total Gross Receipts
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number

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Acronym	Definition
TIPRA	Tax Increase Prevention and Reconciliation Act (of 2005)
TOP	Treasury Offset Program
TOS	Terms of Service
TPE	Taxpayer Education
TPI	Total Positive Income
TPNC	Taxpayer Notice Code
TPP	Third-Party Payer or Taxpayer Protection Program
TPPA	Third Party Payroll Agent
TPU	Taxpayer Protection Unit
TRA	Tax Reform Act
TRHCA	Tax Relief and Health Care Act (of 2006)
TTB	(Alcohol and Tobacco) Tax and Trade Bureau
TY	Tax Year
UAA	Undeliverable As Addressed
UAL	Uniform Acknowledgement Letter
UCR	Uniform Call Routing
UDOC	Uniform Definition of a Child
ULC	Universal Location Code

Acronym	Definition
UOU	Universal Postal Union
URF	Unidentified Remittances File
URP	Underreporter
USPS	United States Postal Service
USPTO	United States Patent and Trademark Office
UWR	Uniform Work Request
VAT	Value Added Tax
VCP	Voluntary Compliance Program
VFTF	Virtual Face-to-Face
VITA	Volunteer Income Tax Assistance
VSD	Virtual Service Delivery
VTO	Virtual Translation Office
W3C	World Wide Web Consortium
W & I	Wage and Investment Operating Division
WFTRA	Working Families Tax Relief Act
WIRA	Wage and Investment Research & Analysis
WO	Whistleblower Office
XSF	Excess Collection File

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Table 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Abarca v. Comm'r, T.C. Memo. 2012-245	6662(b)(1) — TP acted negligently for failing to maintain adequate records to substantiate Schedule C and Schedule E deductions	Yes	IRS
Albright v. Comm'r, T.C. Memo. 2013-9	6662(b)(1) & (2) — TP substantially understated income tax by failing to include proceeds from sale of home in gross income; underpayment due to changes in capital loss carryovers and technical adjustments did not establish TP's negligence	Yes	Split
Armstrong v. Comm'r, 139 T.C. 468 (2012)	6662(b)(1) — TPs (H&W) acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Ashmore v. Comm'r, T.C. Memo. 2013-137	6662(b)(2) — TP substantially understated income tax by failing to include in gross income money earned and stated on one of three W-2s	Yes	IRS
Au v. Comm'r, 482 F. App'x 289 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-247	6662(b)(1) — TPs (H&W) acted negligently by improperly deducting gambling losses against ordinary income, rather than against gambling winnings	Yes	IRS
Bartlett v. Comm'r, T.C. Memo. 2012-254	6662(b)(2) — TP substantially understated income tax by failing to include in gross income the proper amount of taxable pension income; reliance on TurboTax did not constitute reasonable cause	Yes	IRS
Beach v. Comm'r, T.C. Summ. Op. 2012-81	6662(b)(1) — TP acted negligently by failing to include insurance proceeds in the calculation of casualty loss	Yes	IRS
Bell v. Comm'r, T.C. Summ. Op. 2013-20	6662(b)(2) — TP substantially understated income tax by failing to substantiate deduction for charitable contribution	Yes	IRS
Bernard v. Comm'r, T.C. Memo. 2012-221	6662(b)(1) — TPs (H&W) acted negligently by failing to include in gross income distributions from IRA	Yes	IRS
Bishop v. Comm'r, T.C. Memo. 2013-98	6662(b)(2) — TP substantially understated income tax by failing to substantiate an improperly claimed bad debt deduction	No	IRS
Blackwood v. Comm'r, T.C. Memo. 2012-190	6662(b)(2) — TPs (H&W) acted with reasonable cause and in good faith in reliance on competent tax preparer with respect to the disallowed exclusion of settlement payment in gross income	No	TP
Bond v. Comm'r, T.C. Memo. 2012-313	6662(b)(1) — TP acted negligently by failing to substantiate deductions and deducting personal expenses as business expenses	Yes	IRS
Brady v. Comm'r, T.C. Memo. 2013-1	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income dividend proceeds and social security benefits; penalty for failure to provide CPA with Form 1099-DIV; no penalty for understatement of social security benefits because of reasonable reliance on tax preparer	Yes	Split
Brennan v. Comm'r, T.C. Memo. 2012-209, appeal docketed, No. 13-72437 (9th Cir. July 11, 2013)	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income their distributive shares of capital gains income from LLC's sale of assets	No	IRS
Brown v. Comm'r, 693 F.3d 765 (7th Cir. 2012), *aff'g* T.C. Memo. 2011-83	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income money earned in excess of investment in life insurance upon cancellation of policy	No	IRS

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Table 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Burton v. Comm'r, T.C. Summ. Op. 2012-72	6662(b)(1) — TP acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	No	TP
Callahan v. Comm'r, T.C. Memo. 2013-131	6662(b)(1) — TPs (H&W) acted negligently by failing to include in gross income capital gains and discharge of indebtedness income from the sale of homes	No	IRS
Calloway v. Comm'r, 691 F.3d 1315 (11th Cir. 2012) *aff'g* 135 T.C. 26 (2010)	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income gains from the sale of securities	No	IRS
Carlebach v. Comm'r, 139 T.C. 1 (2012)	6662(b)(1) & (b)(2) — TPs (H&W) acted negligently by failing to make a reasonable attempt to comply with tax laws when claiming child tax credits and child care credits	No	IRS
Carr v. Comm'r, T.C. Summ. Op. 2013-3	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income payment in settlement claim against H's former employer	Yes	IRS
Cherry v. Comm'r, T.C. Memo. 2013-3	6662(b)(1) — TP acted negligently by failing to include in gross income deposits into bank account	Yes	IRS
Chiavacci v. Comm'r, T.C. Summ. Op. 2012-63	6662(b) (2) — TP substantially understated income tax by failing to make a reasonable attempt to comply with tax laws when deducting alimony payments	No	IRS
Chien v. Comm'r, T.C. Memo. 2012-277	6662(b)(1) & (2) — TP acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	No	TP
Chow v. Comm'r, 481 F. App'x 406 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-48, *cert. denied*, 133 S. Ct. 1304 (2013)	6662(b)(1) — TP acted negligently by improperly deducting gambling losses against ordinary income, rather than against gambling winnings	Yes	IRS
Cole v. Comm'r, T.C. Summ. Op. 2013-34	6662(b)(1) — TPs (H&W) acted negligently by failing to substantiate deduction for casualty loss; reliance on preparers not reasonable when TPs didn't review returns with preparers	Yes	IRS
Crispin v. Comm'r, 708 F.3d 507 (3d Cir. 2013) *aff'g* T.C. Memo. 2012-70, *petition for cert. filed*, No. 13-99 (July 23, 2013)	6662(b)(2) — TP substantially understated income tax by failing to substantiate deduction for artificial loss from a Custom Adjustable Rate Debt Structure (CARDS) transaction	No	IRS
Cung v. Comm'r, T.C. Memo. 2013-81	6662(b)(2) — TP substantially understated income tax by failing to include in gross income lawsuit settlement proceeds	Yes	IRS
Daniel-Berhe v. Comm'r, T.C. Summ. Op. 2013-33	6662(b)(1) — TP made a good faith effort to substantiate deductions for unreimbursed employee business deductions and had a genuine misunderstanding of the tax code	Yes	TP
Diaz v. Comm'r, T.C. Memo. 2012-241	6662(b)(1) — TP acted negligently by failing to include in gross income gains from the sale of real property	Yes	IRS
Diaz v. Comm'r, T.C. Memo. 2012-280	6662(b)(1) & (2) — TPs (H&W) substantially understated income tax by failing to include in gross income proceeds from an international organization; TP acted negligently by failing to file a Schedule SE or pay self-employment tax; reliance on AARP volunteer not reasonable or in good faith when TPs failed to provide necessary and accurate information	No	IRS
Doolittle v. Comm'r, T.C. Summ. Op. 2012-103	6662(b)(1) & (b)(2) — TP acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Eriksen v. Comm'r, T.C. Memo. 2012-194	6662(b)(1) — TP acted negligently by failing to substantiate deduction for unreimbursed employee expenses	No	IRS

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Table 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Figueres v. Comm'r, T.C. Memo. 2012-296	6662(b)(1) — TP acted negligently by improperly deducted gambling losses against ordinary income, rather than against gambling winnings; no penalty for improperly claimed recovery rebate credit, because it was not an amount shown on the return	Yes	Split
Flood v. Comm'r, T.C. Memo. 2012-243	6662(b)(1) & (2) — TPs (H&W) acted with reasonable cause and in good faith in believing real estate lots sold and donated were capital assets; other underpayments were the result of negligence	Yes	Split
Francis v. Comm'r, T.C. Summ. Op. 2012-79	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income proceeds from an award for wrongful denial of military promotion	Yes	IRS
Gaggero v. Comm'r, T.C. Memo. 2012-331	6662(b)(2) — TP acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Giovacchini, Estate of v. Comm'r, T.C. Memo. 2013-27	6662(b)(2) — TP acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Gluckman v. Comm'r, T.C. Memo. 2012-329, *appeal docketed*, No. 13-761 (2d Cir. Mar. 1, 2013)	6662(b) (2) — TPs (H&W) substantially understated income tax by failing to include in gross income the value of two cash value life insurance policies	No	IRS
Gould v. Comm'r, 139 T.C. 418 (2012), *appeal docketed*, No. 13-1851 (4th Cir. July 5, 2013)	6662(b)(2) — TP substantially understated income tax by failing to substantiate deductions for net operating loss and capital loss	Yes	IRS
Gray v. Comm'r, T.C. Summ. Op. 2013-30	6662(b)(1) — TP acted negligently by failing to substantiate dependency exemption deduction, child tax credit, and head of household filing status	Yes	IRS
Gunkle v. Comm'r, T.C. Memo. 2012-305, *appeal docketed*, No. 13-60245 (5th Cir. Apr. 12, 2013)	6662(b)(2) — TP substantially understated income tax by failing to substantiate deduction for charitable gift and failed to include in gross income amounts paid by purported church for personal living expenses	No	IRS
Gustashaw v. Comm'r, 696 F.3d 1124 (11th Cir. 2012), *aff'g* T.C. Memo. 2011-195	6662(b)(1) — TPs (H&W) acted negligently by failing to substantiate deduction for artificial loss from a CARDS transaction	No	IRS
Hargreaves v. Comm'r, T.C. Summ. Op. 2013-37	6662(b)(1) — TPs (H&W) acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Hassanipour v. Comm'r, T.C. Memo. 2013-88	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to substantiate deductions for losses on real estate income; calendars were insufficient to show the income was non-passive	No	IRS
Hoang v. Comm'r, T.C. Memo. 2013-127	6662(b)(1) & (2) — TPs substantially understated income tax by failing to include in gross income capital gains	Yes	IRS
Jarvis v. Comm'r, T.C. Summ. Op. 2013-11	6662(b)(1) — TP acted negligently by failing to include in gross income proceeds from life insurance policy	Yes	IRS
Kerman v. Comm'r, 713 F.3d 849 (6th Cir. 2013), *aff'g* T.C. Memo. 2011-54, *petition for cert. filed*, No. 13-387 (Sept. 23, 2013)	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to substantiate deduction for artificial loss from a CARDS transaction	No	IRS
Kramer v. Comm'r, T.C. Memo. 2012-192	6662(b)(1) — TPs (H&W) acted negligently by failing to include in gross income all wages for the tax year	Yes	IRS
Langley v. Comm'r, T.C. Memo. 2013-22	6662(b)(1) — TPs (H&W) acted negligently by failing to substantiate deduction for dependency exemption and education credit for daughter	Yes	IRS

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Table 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Martin v. Comm'r, T.C. Summ. Op. 2012-126	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to substantiate deductions for children and theft loss	Yes	IRS
Mayer v. Comm'r, T.C. Summ. Op. 2013-39	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income proceeds from a 401(k) hardship withdrawal	No	IRS
McAllister v. Comm'r, T.C. Memo. 2013-96	6662(b)(2) — TP acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Minnick v. Comm'r, T.C. Memo. 2013-345, *appeal docketed*, No. 13-73234 (9th Cir. Sept. 16, 2013)	6662(b)(1) — TPs (H&W) acted negligently in determining whether grant of a conservation easement gave rise to a charitable contribution deduction; TPs failed to solicit advice from a tax professional	No	IRS
Mogbo v. Comm'r, T.C. Summ. Op. 2013-16	6662(b)(1) — TPs (H&W) acted negligently by failing to include in gross income wages and retirement distribution; H failed to substantiate real estate expenses	Yes	IRS
Morales v. Comm'r, T.C. Memo. 2013-192	6662(b)(1) — TPs acted negligently by failing to make a reasonable attempt to comply with tax laws when claiming the first-time homebuyer credit	Yes	IRS
Mui v. Comm'r, T.C. Memo. 2013-83	6662(b) (2) — TP substantially understated income tax by failing to include in gross income certain items; TP failed to establish the tax preparer was a competent professional	No	IRS
Neff v. Comm'r, T.C. Memo. 2012-244	6662(b)(2) — TPs (H&W) acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Newell v. Comm'r, T.C. Summ. Op. 2012-57	6662(b)(2) — TPs (H&W) acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment-misstatement of deduction for moving expenses	No	TP
Noz v. Comm'r, T.C. Memo. 2012-272	6662(b)(2) — TPs (H&W) acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Patel v. Comm'r, 138 T.C. 395 (2012)	6662(b)(1) & (2) — TPs (H&W) acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Peek v. Comm'r, 140 T.C. No. 12 (2013)	6662(b)(1) & (2) — TPs (H&W) substantially understated income tax in one year and in the following year acted negligently by failing to include in gross income capital gains on sale of securities; no reasonable cause for relying on advice of the promoter	No	IRS
Pollard v. Comm'r, T.C. Memo. 2013-38, *appeal docketed*, No. 13-9001 (10th Cir. May 8, 2013)	6662(b)(2) — TP substantially understated income tax by failing to substantiate deduction for charitable contribution	No	IRS
Riether v. United States, 2012 WL 6934116 (D. N.M. 2012)	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to substantiate deduction for theft loss of medical equipment; TPs failed to provide necessary and accurate information to tax professional	No	IRS
Rogers v. Comm'r, T.C. Memo. 2013-77, *appeal docketed*, No. 13-1241 (D.C. Cir. Aug. 15, 2013)	6662(b)(1) — TPs (H&W) acted negligently by failing to include in gross income foreign earnings from W's work as flight attendant abroad	Yes	IRS
Schuller v. Comm'r, T.C. Memo. 2012-347	6662(b)(2) — TP substantially understated income tax by failing to include in gross income amounts from pension and annuity income	Yes	IRS

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Table 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Smith-Hendricks v. Comm'r, T.C. Summ. Op. 2013-22	6662(b)(1) — TP acted negligently by relying on a tax preparer who was not a competent professional and failing to review the returns before signing and filing them	Yes	IRS
Smoker v. Comm'r, T.C. Memo. 2013-56	6662(b)(1) — TP acted negligently by claiming deduction for accrued but unpaid mortgage interest	No	IRS
Snow v. Comm'r, T.C. Memo. 2013-114	6662(b)(2) — TP substantially understated income tax by failing to include in income gross receipts from performance as a musician and gain from sale of securities	Yes	IRS
Thomas v. Comm'r, T.C. Memo. 2013-60	6662(b)(2) — TPs (H&W) acted with reasonable cause and in good faith in reliance on professional advice from a competent professional	Yes	TP
Todd v. Comm'r, 486 F. App'x 423 (5th Cir. 2012) *aff'g* T.C. Memo. 2011-123	6662(b) (2) — TPs (H&W) failed to include in gross income a purported loan from his employee benefit fund; TPs failed to establish reasonable reliance on competent tax professional who prepared their return, absent any evidence they had validly relied on CPA's advice	No	IRS
Tsai v. Comm'r, T.C. Summ. Op. 2013-26	6662(b)(1) — TP acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Ung v. Comm'r, T.C. Memo. 2013-126	6662(b)(2) — TP substantially understated income tax and failed to provide tax preparer with all required documents and failed to review tax return before submission	Yes	IRS
Van Der Lee v. Comm'r, 501 F. App'x 30 (2d Cir. 2012), *aff'g* T.C. Memo. 2011-234	6662(b)(1) — TPs (H&W) acted negligently by failing to provide necessary and accurate information to tax professional for claimed charitable contributions; TPs failed to substantiate deductions	No	IRS
Weaver v. Comm'r, T.C. Summ. Op. 2012-52	6662(b)(2) — TPs (H&W) substantially understated income tax and did not provide tax preparer with all required documents	Yes	IRS
Yates v. Comm'r, T.C. Memo. 2013-28, *appeal docketed*, No. 13-1833 (4th Cir. July 2, 2013)	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to substantiate deduction for sale of like kind property	Yes	IRS
Zdunek v. Comm'r, T.C. Summ. Op. 2013-13	6662(b)(1) — TP acted negligently by failing to properly compute mortgage interest deduction	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, & Sole Proprietorships — Schedules C, E, F)			
ACM Environmental Services, Inc. v. Comm'r, T.C. Memo. 2012-335	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income qualified dividends from corporation	Yes	IRS
Adams v. Comm'r, T.C. Memo. 2013-92	6662(b) (2) — TP substantially understated income tax by failing to substantiate deductions for business expenses and travel and meals expenses on Schedule C	Yes	IRS
Antonious v. Comm'r, T.C. Summ. Op. 2012-98	6662(b)(1) — TP acted negligently by failing to substantiate deduction for rental expense on Schedule E	Yes	IRS
Aries Communications Inc. v. Comm'r, T.C. Memo. 2013-97	6662(b) (2) — TP substantially understated income tax by failing to substantiate deduction for compensation expense and failed to show reasonable reliance on a tax professional	No	IRS
Barnes v. Comm'r, 712 F.3d 581 (D.C. Cir. 2013)	6662(b)(2) — TPs (H&W) substantially understated income tax by failing to include in gross income the proper amount of losses for the first year of their S Corporation	No	IRS

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Table 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Barnes Group, Inc. v. Comm'r, T.C. Memo. 2013-109	6662(b) (2) — TP substantially understated income tax by failing to include in gross income proceeds from transactions with subsidiaries; TP failed to show reasonable reliance on a competent tax professional	No	IRS
Bauer v. Comm'r, T.C. Memo. 2012-156	6662(b)(1) — TP acted with reasonable cause and in good faith in underpayment of tax as evidenced through substantiation of disallowed deductions on Schedule C	No	TP
Benson v. Comm'r, T.C. Summ. Op. 2012-87	6662(b)(1) — TP acted with reasonable cause and in good faith and lacked business acumen required to understand tax code	Yes	TP
Bernstine v. Comm'r, T.C. Summ. Op. 2013-19	6662(b)(1) — TP acted negligently by failing to substantiate deductions for travel, meals, entertainment, and other expenses	Yes	IRS
Bramlett v. Comm'r, T.C. Summ. Op. 2012-73	6662(b)(1) — TP acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Carmickle v. Comm'r, T.C. Summ. Op. 2012-60	6662(b)(1) — TPs (H&W) acted negligently by failing to substantiate deductions for lost rent and expenses for home office	Yes	IRS
Castillo v. Comm'r, T.C. Memo. 2013-72	6662(b)(1) — TP acted negligently by failing to substantiate deduction for depreciable business assets and failed to provide necessary and accurate information to tax professional	No	IRS
Chambers v. Comm'r, T.C. Summ. Op. 2012-91	6662(b)(1) & (2) — TPs (H&W) acted with reasonable cause and in good faith in believing H materially participated in real estate activities	Yes	TP
Chandler v. Comm'r, 481 F. App'x 400 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-92	6662(b)(1) — TP negligent for failing to keep adequate books and records	Yes	IRS
Chemtech Royalty Assocs. v. U.S., 111 A.F.T.R.2d (RIA) 953 (M.D. La. 2013)	6662(b)(1) & (2) – TP negligent in attempt to comply with provisions of the tax code because TP's transactions and partnerships lacked economic substance; failed to establish substantial authority for position taken on tax return	No	IRS
Chrush v. Comm'r, T.C. Memo. 2012-299	6662(b)(2) — TP did not show reasonable cause or good faith	Yes	IRS
Cook v. Comm'r, T.C. Memo. 2012-167	6662(b)(1) & (2) — TP acted with reasonable cause and in good faith in relying on tax preparer for commission expense; however, not in regards to other Schedule C expenses	Yes	Split
Curcio v. Comm'r, 689 F.3d 217 (2d Cir. 2012), *aff'g* T.C. Memo. 2010-115	6662(b)(1) & (2) — TPs negligent in attempting to comply with provisions of the tax code and failed to establish good faith reliance on a competent tax professional	No	IRS
Cvancara v. Comm'r, T.C. Memo. 2013-20	6662(b)(1) & (2) — TPs (H&W) negligent for failing to keep adequate books and records and substantially understated income	Yes	IRS
Deutsch v. Comm'r, T.C. Memo. 2012-318	6662(b)(2) — TP substantially understated income and failed to establish tax preparer was a competent professional	No	IRS
DiDonato v. Comm'r, T.C. Memo. 2013-11	6662(b)(2) — TPs (H&W) substantially understated income and failed to establish substantial authority for position taken on tax return; adequate disclosure of facts not supported by the record; failed to establish good faith reliance on the advice of tax professional	No	IRS
Dodds v. Comm'r, T.C. Memo. 2013-76	6662(b)(2) — TP substantially understated income and failed to establish reasonable cause and good faith effort to comply with tax code	No	IRS

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Table 1: Accuracy-Related Penalty Under IRC § 6662(b)(1) and (2)

Case Citation	Issue(s)	*Pro Se*	Decision
Dyer v. Comm'r, T.C. Memo. 2012-224	6662(b)(2) — TP substantially understated income and failed to establish good faith reliance on the advice of tax professional	No	IRS
Evans v. Comm'r, T.C. Summ. Op. 2012-125	6662(b)(1) — TP substantially understated income and did not argue that reasonable cause applies	Yes	IRS
Fein v. Comm'r, 504 F. App'x 41 (2d Cir. 2012), *aff'g* T.C. Memo. 2011-142	6662(b)(1) — TPs (H&W) negligent for failing to keep adequate books and records; failed to establish reasonable cause	No	IRS
Fitch v. Comm'r, T.C. Memo. 2012-358	6662(b)(1) — TPs (H&W) failed to act with reasonable cause and in good faith as H's brain aneurysm did not support finding of reasonable cause	No	IRS
Foster v. Comm'r, T.C. Memo. 2012-207	6662(b)(2) — TPs (H&W) failed to establish reasonable cause and failed to seek professional tax advice	No	IRS
G.D. Parker, Inc. v. Comm'r, T.C. Memo. 2012-327	6662(b)(1) & (2) — TP negligent for failing to keep adequate books and records to substantiate business deductions; however, TP relied in good faith on competent tax professional with respect to disallowed capital loss	No	Split
Gail Vento, LLC v. U.S., 111 A.F.T.R.2d (RIA) 1505 (D.V.I. 2013)	6662(b)(1) — TP failed to provide necessary and accurate information to tax professional	No	IRS
Garcia v. Comm'r, T.C. Summ. Op. 2012-107	6662(b)(1) & (2) — TP substantially understated income and failed to provide accurate and necessary information to tax professional	Yes	IRS
Garcia v. Comm'r, T.C. Summ. Op. 2013-28	6662(b)(1) & (2) — TP acted with reasonable cause and in good faith; honest misunderstanding of the tax code led to underpayment	Yes	TP
Gassaway v. Comm'r, T.C. Memo. 2013-13, *appeal docketed*, No. 13-60289 (5th Cir. May 1, 2013)	6662(b)(2) — TP substantially understated income and did not argue that reasonable cause or good faith applies	Yes	IRS
Gerdau Macsteel, Inc. v. Comm'r, 139 T.C. 67 (2012), *appeal docketed*, No. 13-60132 (5th Cir. Mar. 4, 2013)	6662(b)(1) & (2) — TP negligent in attempt to comply with provisions of the tax code and substantially understated income	No	IRS
Ghilardi v. Comm'r, T.C. Summ. Op. 2013-15	6662(b)(1) & (2) — TPs (H&W) substantially understated income and failed to show reasonable effort to determine the proper tax treatment of rental real estate losses	Yes	IRS
Gigliobianco v. Comm'r, T.C. Memo. 2012-276	6662(b)(1) & (2) — TPs (H&W) failed to substantiate deductions and failed to establish reasonable cause or good faith	No	IRS
Gomar v. Comm'r, T.C. Memo. 2013-95	6662(b)(2) — TP substantially understated income and did not show reasonable cause or good faith	No	IRS
Gorokhovsky v. Comm'r, T.C. Memo. 2012-206, *appeal docketed*, No. 13-1110 (7th Cir. Jan. 16, 2013)	6662(b)(1) & (2) — TP negligent for failing to keep adequate books and records and substantially understated income	Yes	IRS
Gorokhovsky v. Comm'r, T.C. Memo. 2013-65	6662(b)(1) & (2) — TP offered no reasonable cause and failed to establish good faith reliance on the advice of tax professional	Yes	IRS
Griggs v. Comm'r, T.C. Memo. 2013-2	6662(b)(1) — TP negligent for failing to keep adequate books and records; TP offered no reasonable cause or good faith	Yes	IRS
Guy v. Comm'r, T.C. Memo. 2013-103	6662(b)(1) — TPs (H&W) acted negligently in deducting certain business expenses, while not negligent in deducting others; no substantial underpayment of tax existed in some of the tax years where court allowed deductions	No	Split

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Case Citation	Issue(s)	*Pro Se*	Decision
H & M, Inc. v. Comm'r, T.C. Memo. 2012-290	6662(b)(1) & (2) — TP negligent in attempt to comply with provisions of the tax code; negligent for failing to keep adequate books and records; no penalty for substantial understatement of income because understatement of income tax will not exceed $10,000	No	Split
Heinbockel v. Comm'r, T.C. Memo. 2013-125	6662(b)(1) — TPs (H&W) negligent for failing to keep adequate books and records; failed to establish reasonable reliance on a competent tax professional	No	IRS
Holmes v. Comm'r, T.C. Memo. 2012-251, *appeal docketed*, No. 13-71034 (9th Cir. Mar. 25, 2013)	6662(b)(2) — TP failed to establish reasonable cause or good faith; failed to establish reasonable reliance on a competent tax professional	No	IRS
Hoskins v. Comm'r, T.C. Memo. 2013-36	6662(b)(2) — TPs (H&W) offered no reasonable cause or good faith argument	No	IRS
Hudzik v. Comm'r, T.C. Summ. Op. 2013-4	6662(b)(2) — TPs (H&W) failed to establish reasonable cause and good faith attempt to comply with tax code; substantially understated income	No	IRS
Humphrey, Farrington & McClain, P.C. v. Comm'r, T.C. Memo. 2013-23	6662(b)(2) — TP acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Johnson v. Comm'r, T.C. Memo. 2012-231	6662(b)(2) — TPs (H&W) offered no reasonable cause or good faith argument	No	IRS
Johnson v. Comm'r, T.C. Memo. 2013-90	6662(b)(2) — TP offered no reasonable cause or good faith argument	Yes	IRS
Kaufman v. Comm'r, T.C. Summ. Op. 2012-100	6662(b)(1) — TPs (H&W) negligent in attempting to comply with provisions of the tax code; failed to establish reasonable cause or good faith	Yes	IRS
Kazhukauskas v. Comm'r, T.C. Memo. 2012-191	6662(b)(2) — TPs (H&W) substantially understated income and failed to show a reasonable attempt to determine accurate tax liability	Yes	IRS
Kerstetter v. Comm'r, T.C. Memo. 2012-239	6662(b)(1) & (2) — TPs (H&W) negligent for failing to keep adequate books and records and substantially understated income	Yes	IRS
Kim v. Comm'r, T.C. Memo. 2013-5, *appeal docketed*, No. 13-3452 (3d Cir. Aug. 14, 2013)	6662(b)(2) — TPs (H&W) substantially understated income and failed to establish reasonable reliance on a competent tax professional	No	IRS
Kohn v. Comm'r, T.C. Summ. Op. 2012-86	6662(b)(1) — TP negligent for failing to keep adequate books and records; failed to establish reasonable cause	Yes	IRS
Kutney v. Comm'r, T.C. Summ. Op. 2012-120	6662(b)(1) & (2) — TPs (H&W) offered no reasonable cause or good faith argument	Yes	IRS
Lee v. Comm'r, T.C. Summ. Op. 2012-51	6662(b)(2) — TPs (H&W) substantially understated income and failed to establish reasonable reliance on a competent tax professional; failed to provide necessary and accurate information to tax professional	Yes	IRS
Longino v. Comm'r, T.C. Memo. 2013-80	6662(b)(1) — TP negligent in preparing return, maintaining records and distinguishing personal expenses from business expenses; offered no reasonable cause argument	Yes	IRS
Maguire v. Comm'r, T.C. Memo. 2012-160	6662(b)(1) — TPs (H&W) negligent for failing to keep adequate books and records	No	IRS
Martell v. Comm'r, T.C. Memo. 2013-115	6662(b)(1) & (2) — TPs (H&W) substantially understated income and did not argue that reasonable cause applies	No	IRS
Martin v. Comm'r, T.C. Summ. Op. 2013-1	6662(b)(1) — TPs (H&W) negligent for failing to keep adequate books and records	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Mawji v. Comm'r, T.C. Memo. 2013-108, *appeal docketed*, No. 13-13194 (11th Cir. July 15, 2013)	6662(b)(1) — TPs (H&W) offered no reasonable cause or good faith arguments	No	IRS
McCormack v. Comm'r, T.C. Summ. Op. 2013-9	6662(b)(1) & (2) — TPs (H&W) failed to establish reasonable reliance on a competent tax professional; failed to provide necessary and accurate information to tax professional	Yes	IRS
McMillan v. Comm'r, T.C. Memo. 2013-40, *appeal docketed*, No. 13-73139 (9th Cir. Sept. 9, 2013)	6662(b)(1) & (2) — TP acted reasonably and in good faith in attempting to ascertain the fair market value	Yes	TP
McPartland v. Comm'r, T.C. Summ. Op. 2012-88	6662(b)(2) — TP provided all documentation to tax preparer, acted in good faith and reasonably relied on the advice of tax preparer	Yes	TP
Mears v. Comm'r, T.C. Memo. 2013-52	6662(b)(1) & (2) — TP negligent in failing to seek professional tax advice	Yes	IRS
Meinhardt v. Comm'r, T.C. Memo. 2013-85, *appeal docketed*, No. 13-2924 (8th Cir. Aug. 29, 2013)	6662(b)(2) – TPs (H&W) acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Mills v. Comm'r, T.C. Memo. 2013-4	6662(b)(2) — TPs (H&W) failed to establish the tax preparer was a competent professional	Yes	IRS
Mistlebauer v. Comm'r, T.C. Memo. 2012-186	6662(b)(1) & (2) — TP substantially understated income and was negligent for failing to keep adequate books and records	Yes	IRS
Morris v. Comm'r, T.C. Summ. Op. 2012-96	6662(b)(1) & (2) — TP substantially understated income and failed to provide substantial authority or reasonable basis for the position taken on tax returns	Yes	IRS
Moses v. Comm'r, T.C. Summ. Op. 2012-118	6662(b)(2) — TPs (H&W) substantially understated income and failed to establish good faith reliance on advice of tax professional	Yes	IRS
Murray v. Comm'r, T.C. Summ. Op. 2012-66	6662(b)(1) — TPs (H&W) negligent for failing to keep adequate books and records; negligent in distinguishing personal expenses from business expenses	Yes	IRS
Niv v. Comm'r, T.C. Memo. 2013-82	6662(b)(2) — TP failed to establish reasonable cause by arguing that a learning disability affects TP's ability to recognize his responsibilities; TP provided no verification to self-diagnosis	Yes	IRS
Olekanma v. Comm'r, T.C. Memo. 2013-31	6662(b)(2) — TP failed to provide necessary and accurate information to tax professional	Yes	IRS
Olive v. Comm'r, 139 T.C. 19 (2012), *appeal docketed*, No. 13-70510 (9th Cir. Feb. 11, 2013)	6662(b)(1) & (2) — TP negligent for failing to keep adequate books and records and substantially understated income; however, no accuracy penalties apply to portion of underpayments that would not have resulted if TP been allowed to deduct expenses for a medical marijuana dispensary, which was unsettled law at the time TP filed his returns	No	Split
Padilla v. Comm'r, T.C. Summ. Op. 2012-70	6662(b)(1) & (2) — TPs (H&W) offered no reasonable cause or good faith arguments	No	IRS
Parker v. Comm'r, T.C. Memo. 2012-357	6662(b)(1) & (2) — TPs (H&W) failed to establish good faith reliance on the advice of tax professional	No	IRS
Pederson v. Comm'r, T.C. Memo. 2013-54	6662(b)(2) — TPs (H&W) failed to provide substantial authority or reasonable basis for the position taken on tax returns; failed to establish reasonable reliance on the advice of tax professionals or opinion letter	No	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Peries v. Comm'r, T.C. Summ. Op. 2012-84	6662(b)(1) — TPs (H&W) failed to offer reasonable cause or good faith arguments	Yes	IRS
Perry v. Comm'r, T.C. Memo. 2012-237	6662(b)(2) — TP, a CPA and former IRS revenue agent, showed no care in preparation of tax return and offered no reasonable cause or good faith arguments	No	IRS
Posluns v. Comm'r, T.C. Memo. 2012-332	6662(b)(1) — TP failed to seek professional tax advice; negligent for failing to keep adequate books and records	Yes	IRS
Powers v. Comm'r, T.C. Memo. 2013-134	6662(b)(1) & (2) — TPs (H&W) alleged 44 years of tax compliance is insufficient standing alone to overcome accuracy penalties; TPs offered no reasonable cause; negligent in keeping adequate books and records	Yes	IRS
Rasmussen v. Comm'r, T.C. Memo. 2012-353, *appeal docketed*, No. 13-2787 (8th Cir. Aug. 13, 2013)	6662(b)(1) & (2) — TPs (H&W) negligent in attempt to comply with provisions of the tax code	Yes	IRS
Rawls Trading, L.P. v. Comm'r, T.C. Memo. 2012-340	6662(b)(2) — TP acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Reiff v. Comm'r, T.C. Summ. Op. 2013-40	6662(b)(1) — TPs (H&W) negligent for failure to keep adequate books and records; failed to seek professional tax advice	Yes	IRS
Robinson v. Comm'r, 487 F. App'x 751 (3d Cir. 2012), *aff'g* T.C. Memo. 2011-99	6662(b)(2) — TPs (H&W) substantially understated income and failed to establish reasonable cause	Yes	IRS
Rodriguez v. Comm'r, T.C. Memo. 2012-286, *appeal docketed*, No. 13-1966 (4th Cir. Aug. 1, 2013)	6662(b)(2) — TPs (H&W) substantially understated income and failed to provide substantial authority or reasonable basis for the position taken on tax return; adequate disclosure of facts not supported by the record	Yes	IRS
Romanowski v. Comm'r, T.C. Memo. 2013-55	6662(b)(2) — TPs (H&W) acted with reasonable cause and in good faith in relying on a competent tax professional	No	TP
Sa'd v. Comm'r, T.C. Memo. 2012-348	6662(b) (2) — TP substantially understated income tax by failing to substantiate deduction for payments made from bank account of wholly-owned S corporation	No	IRS
SAS Inv. Partners v. Comm'r, T.C. Memo. 2012-159	6662(b)(1) & (2) — TP failed to establish reasonable reliance on the advice of tax professionals or opinion letter	No	IRS
Specks v. Comm'r, T.C. Memo. 2012-343	6662(b)(1) & (2) — TPs (H&W) substantially understated income and failed to establish tax preparer was a competent professional	Yes	IRS
Striefel v. Comm'r, T.C. Memo. 2013-102	6662(b)(1) — TP negligent for intentionally destroying business records because he had been told he would die soon and did not think the records were needed anymore	No	IRS
Thomas v. Comm'r, T.C. Summ. Op. 2013-5	6662(b)(2) — TP acted with reasonable cause and in good faith in stating casualty loss on rental property damaged by Hurricane Katrina	Yes	TP
Thousand Oaks Residential Care Home I, Inc. v. Comm'r, T.C. Memo. 2013-10	6662(b)(1) & (2) — TPs failed to establish reasonable reliance on advice from tax professional in regards to unreasonable compensation paid to purported employee; however, TPs did reasonably rely on advice from a competent tax professional with respect to employment plan contributions	No	Split
Tinney v. Comm'r, T.C. Memo. 2013-91	6662(b)(1) & (2) — TPs (H&W) negligent for failing to keep adequate books and records	Yes	IRS
Ugwuala v. Comm'r, T.C. Memo. 2013-105	6662(b)(2) — TPs (H&W) failed to establish tax preparer was a competent professional; TPs found to be well educated with business experience	No	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Verrett v. Comm'r, T.C. Memo. 2012-223	6662(b)(1) & (2) — TPs (H&W) substantially understated income and failed to establish reasonable cause and good faith attempt to comply with tax code	Yes	IRS
Vlach v. Comm'r, T.C. Memo. 2013-116	6662(b)(1) & (2) — TPs (H&W) did not make a reasonable attempt to comply with tax laws for business trusts; however, TPs acted with reasonable cause and in good faith with respect to alternative medicine income and expenses	No	Split
Wade v. Comm'r, T.C. Summ. Op. 2012-85	6662(b)(2) — TP substantially understated income and did not argue that reasonable cause applies	Yes	IRS
Wagoner v. Comm'r, T.C. Summ. Op. 2013-14	6662(b)(1) — TP negligent in failing to keep adequate books and records; negligent in attempt to comply with provisions of the tax code	Yes	IRS
Wallach v. Comm'r, T.C. Summ. Op. 2012-94	6662(b)(1) — TPs (H&W) negligent in failing to keep adequate books and records; offered no reasonable cause or good faith arguments	Yes	IRS
Welch v. Comm'r, T.C. Memo. 2012-179	6662(b)(1) & (2) — TPs (H&W) negligent in failing to keep adequate books and records; failed to provide necessary and accurate information to tax professional; failed to establish reasonable reliance on a competent tax professional	No	IRS
Westrich v. Comm'r, T.C. Summ. Op. 2013-35	6662(b)(1) & (2) — TP substantially understated income and did not argue that reasonable cause applies; negligent for failing to keep adequate books and records	Yes	IRS
Winnett v. Comm'r, T.C. Summ. Op. 2013-25	6662(b)(1) & (2) — TPs (H&W) substantially understated income and did not argue that reasonable cause applies; negligent for failing to keep adequate books and records	Yes	IRS

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Table 2: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Barnett v. Comm'r, T.C. Summ. Op. 2012-109	Deduction denied for failure to substantiate unreimbursed employee vehicle expenses	Yes	IRS
Brown v. Comm'r, T.C. Summ. Op. 2013-21	Deduction denied for failure to substantiate unreimbursed employee vehicle expenses	Yes	IRS
Burke v. Comm'r, T.C. Summ. Op. 2012-123	Deduction denied for failure to substantiate vehicle expenses, meals and entertainment expenses; deduction denied for gambling losses for failure to substantiate	Yes	IRS
Daniel-Berhe v. Comm'r, T.C. Summ. Op. 2013-33	Deduction denied for failure to substantiate unreimbursed employee vehicle expenses; deduction denied for parking expenses and overnight travel because expenses were personal	Yes	IRS
Harris v. Comm'r, T.C. Memo. 2012-312	Deduction denied for failure to substantiate unreimbursed employee expenses for lodging, meals and vehicle mileage	Yes	IRS
Newell v. Comm'r, T.C. Summ. Op. 2012-57	Deduction denied for expenses related to moving because the expenses were personal	No	IRS
Noz v. Comm'r, T.C. Memo. 2012-272	Deduction denied for failure to meet § 274 substantiation guidelines for travel, meals and entertainment expenses; deduction denied for computer-related equipment; deduction for internet service denied for failure to substantiate and insufficient evidence to use Cohan; travel denied because expense was personal	No	IRS
Posluns v. Comm'r, T.C. Memo. 2012-332	Deduction denied for failure to substantiate unreimbursed employee vehicle expenses	Yes	IRS
Saunders v. Comm'r, T.C. Memo. 2012-200	Deduction denied for unreimbursed employee expenses because commuting was a personal expense	Yes	IRS
Smith-Hendricks v. Comm'r, T.C. Summ. Op. 2013-22	Deduction denied for failure to meet § 274 substantiation guidelines for unreimbursed employee expenses; deduction denied for failure to substantiate and insufficient evidence to use Cohan	Yes	IRS
Stidham v. Comm'r, T.C. Summ. Op. 2012-61	Deduction allowed to the extent substantiated for vehicle expenses; deduction denied for travel, meals and entertainment expenses for failure to show eligibility for employer reimbursement	Yes	Split
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships — Schedule C, E, F)			
Abarca v. Comm'r, T.C. Memo. 2012-245	Deduction denied for vehicle rental expenses for failure to prove ordinary and necessary in business	Yes	IRS
Adams v. Comm'r, T.C. Memo. 2013-7	Deduction allowed for licensure expense since it was necessary and ordinary; deduction denied for failure to meet § 274 substantiation guidelines for travel, meals and entertainment expenses; deduction denied for failure to substantiate utility expenses	No	Split
Adams v. Comm'r, T.C. Memo. 2013-92	Deduction denied for failure to meet § 274 substantiation requirements for vehicle, meals and entertainment expenses; deduction denied for legal expenses because they were personal; deduction denied for insurance expenses for failure to prove ordinary and necessary in business	Yes	IRS
Arguello v. Comm'r, T.C. Summ. Op. 2012-99	Deduction denied for bad debt expense for failure to prove ordinary and necessary in business	Yes	IRS

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Table 2: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Aries Commc'ns, Inc. v. Comm'r, T.C. Memo. 2013-97	Deduction allowed to the extent substantiated for claimed compensation expense	No	Split
Ash Grove Cement Co. v. U.S., 111 A.F.T.R.2d (RIA) 767 (D. Kan. 2013), *appeal docketed*, No. 13-3058 (10th Cir. Mar. 7, 2013)	Deduction denied for litigation expenses for failure to prove ordinary and necessary in business; deduction denied for non-deductible capital expenses under § 263	No	IRS
Barocas v. Comm'r, T.C. Memo. 2013-106	Deduction denied for vehicle expense for failure to meet § 274 substantiation requirements	Yes	IRS
Bauer v. Comm'r, T.C. Memo. 2012-156	Deduction allowed under Cohan for contract labor expense	No	TP
Beirne v. Comm'r, T.C. Summ. Op. 2013-2	Deduction denied for failure to demonstrate carrying on a business under § 183	Yes	IRS
Benson v. Comm'r, T.C. Summ. Op. 2012-87	Deduction denied for failure to demonstrate engaged in business for profit under § 183	Yes	IRS
Bentley v. Comm'r, T.C. Memo. 2012-294	Deduction denied for utility expenses for failure to prove ordinary and necessary in business	Yes	IRS
Bernstine v. Comm'r, T.C. Summ. Op. 2013-19	Deduction allowed to extent substantiated for business supplies; deduction denied for failure to meet § 274 substantiation requirements for travel, meals and entertainment expenses; deduction denied for books because this expense was personal	Yes	Split
Bigdeli v. Comm'r, T.C. Memo. 2013-148	Deduction denied for vehicles because these expenses were personal; deduction denied for insurance expense for failure to substantiate	Yes	IRS
Bramlett v. Comm'r, T.C. Summ. Op. 2012-73	Deduction denied for failure to prove ordinary and necessary in business; deduction denied for airport hangar business because expense was personal	Yes	IRS
Carmickle v. Comm'r, T.C. Summ. Op. 2012-60	Deduction denied for failure to substantiate expenses related to home office; TP's testimony not accepted as credible	Yes	IRS
Cavanaugh v. Comm'r, T.C. Memo. 2012-324	Deduction denied for payment of legal fees because the expense was personal	No	IRS
Cheng v. Comm'r, T.C. Summ. Op. 2012-102	Deduction denied for failure to substantiate bad debt expense; TP's testimony not accepted as credible	Yes	IRS
Christine v. Comm'r, 475 F. App'x 259 (9th Cir. 2012), *aff'g* T.C. Memo 2010-144	Deduction denied for failure to meet § 274 substantiation requirements for travel expenses; deduction denied for failure to substantiate home office expenses	Yes	IRS
Chrush v. Comm'r, T.C. Memo. 2012-299	Deduction denied for failure to substantiate business use of home; TP's testimony not accepted as credible	Yes	IRS
Consol. Edison Co. of NY, Inc., v. U.S., 703 F.3d 1367 (Fed. Cir. 2013), *rev'g* 90 Fed. Cl. 228 (2009)	Deductions denied for expenses related to leveraged lease transaction for failure to prove ordinary and necessary in business and because underlying transaction lacked economic substance	No	IRS
Cox v. Comm'r, T.C. Memo. 2013-75	Deduction denied for failure to substantiate expenses for purportedly stolen property	Yes	IRS
Cunningham v. Comm'r, T.C. Summ. Op. 2013-27	Deductions denied for failure to demonstrate carrying on a business under § 183	Yes	IRS
Curcio v. Comm'r, 689 F.3d 217 (2d Cir. 2012) *aff'g* T.C. Memo. 2010-115, *cert. denied*, 133 S.Ct. 2826 (2013)	Deduction denied for contributions to a life insurance policy for failure to prove ordinary and necessary in the course of business; deduction denied because expense was personal	No	IRS
Cvancara v. Comm'r, T.C. Memo. 2013-20	Deduction denied for failure to meet § 274 substantiation requirements for travel, meals and entertainment expenses; deduction allowed under Cohan for general business expenses	Yes	Split

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Table 2: Trade or Business Expenses Under IRC § 162 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
DeLima v. Comm'r, T.C. Memo. 2012-291	Deduction denied for failure to meet § 274 substantiation requirements for vehicle, travel, meals and entertainment expenses; deduction denied for rent because the expense was personal	Yes	IRS
DiDonato v. Comm'r, T.C. Memo. 2013-11	Deduction denied for firearm expense for failure to prove ordinary and necessary in business; deduction denied for failure to demonstrate a profit objective under § 183	No	IRS
DKD Enters. v. Comm'r, 685 F.3d 730 (8th Cir. 2012), *aff'g* T.C. Memo. 2011-29	Deduction denied because cat breeding activity not engaged in business for profit under § 183	No	IRS
Dodds v. Comm'r, T.C. Memo. 2013-76	Deduction denied because horse breeding activity not engaged in business for profit under § 183	No	IRS
Dyer v. Comm'r, T.C. Memo. 2012-224	Deduction denied for failure to meet § 274 substantiation requirements for vehicle expenses; TP's testimony not accepted as credible	No	IRS
Efron v. Comm'r, T.C. Memo. 2012-338	Deduction allowed to the extent substantiated for cellular phone expenses; deduction denied for failure to meet § 274 substantiation requirements for vehicle expenses	No	Split
Evans v. Comm'r, T.C. Summ. Op. 2012-125	Deduction denied for failure to demonstrate carrying on a business under § 183	Yes	IRS
Evans v. Comm'r, 507 F. App'x 645 (9th Cir. 2013), *aff'g* T.C. Memo 2010-199, *petition for cert. filed*, No. 13-366 (July 22, 2013)	Deduction denied for failure to substantiate entitlement to claimed business expenses	Yes	IRS
Fein v. Comm'r, 504 F. App'x 41 (2d Cir. 2012), *aff'g* T.C. Memo 2011-142, *cert. denied,* 82 U.S.L.W. 3068 (2013)	Deduction denied for failure to substantiate general business expenses; deduction denied for failure to prove ordinary and necessary in business	No	IRS
Fitch v. Comm'r, T.C. Memo. 2012-358	Deduction allowed for expense related to rental property as an ordinary and necessary business expense; deduction for meals denied for failure to meet § 274 substantiation requirement	No	Split
Foster v. Comm'r, T.C. Memo. 2012-207	Deduction allowed for rental payments as ordinary and necessary business expenses; deduction denied for failure to demonstrate a profit objective under § 183	No	Split
G.D. Parker, Inc. v. Comm'r, T.C. Memo. 2012-327	Deduction allowed for contract labor and legal fees as ordinary and necessary business expenses; deduction denied for yacht expenses because they were personal	No	Split
Garcia v. Comm'r, T.C. Summ. Op. 2012-107	Deduction denied for failure to substantiate expenses related to roofing business	Yes	IRS
Garcia v. Comm'r, T.C. Summ. Op. 2013-28	Deduction allowed for utility and repair expenses as ordinary and necessary business expenses; deduction denied for failure to meet § 274 substantiation requirements for vehicle expense; deduction denied for legal fees for failure to substantiate	Yes	Split
Gerdau Macsteel, Inc. v. Comm'r, 139 T.C. 67 (2012), *appeal docketed*, No. 13-60132 (5th Cir. Mar. 4, 2013)	Deduction denied for consulting fees, legal fees and appraisal fees for failure to prove ordinary and necessary in business	No	IRS
Gigliobianco v. Comm'r, T.C. Memo. 2012-276	Deduction denied for failure to substantiate business expenses for aircraft, fuel and meals; deduction denied for failure to prove ordinary and necessary in business	No	IRS
Gomar v. Comm'r, T.C. Memo. 2013-95	Deduction denied for failure to substantiate deduction for business expenses beyond that already allowed by IRS	No	IRS
Gorokhovsky v. Comm'r, T.C. Memo. 2012-206	Deduction denied for failure to substantiate legal and professional expenses; insufficient evidence to use Cohan	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Gorokhovsky v. Comm'r, T.C. Memo. 2013-65	Deduction allowed to extent substantiated for travel expenses; deduction denied for business use of residence for failure to substantiate; deduction denied for travel because expense was personal	Yes	Split
Guy v. Comm'r, T.C. Memo. 2013-103	Deduction allowed to the extent substantiated for legal fees; deduction denied for partial legal fees for failure to substantiate	No	Split
H & M, Inc. v. Comm'r, T.C. Memo. 2012-290	Deduction allowed for insurance premium expenses to the extent substantiated; deduction denied for failure to meet § 274 substantiation requirements for travel expenses and truck depreciation	No	Split
Heinbockel v. Comm'r, T.C. Memo. 2013-125	Deduction allowed for interest and taxes paid in relation to personal shopping business to the extent substantiated; deduction denied for failure to demonstrate a profit objective under § 183	No	Split
Herbert v. Comm'r, T.C. Summ. Op. 2012-124	Deduction denied for failure to substantiate fuel, repair and rent expenses; insufficient evidence to use Cohan	Yes	IRS
HIE Holdings, Inc. v. Comm'r, 111 A.F.T.R.2d (RIA) 1543 (9th Cir. 2013), *aff'g* T.C. Memo 2009-130	Deduction denied because legal fees were personal	No	IRS
Hoskins v. Comm'r, T.C. Memo. 2013-36	Deduction denied for failure to demonstrate carrying on a business under § 183	No	IRS
Humphrey, Farrington & McClain, P.C. v. Comm'r, T.C. Memo. 2013-23	Deduction denied for legal fees for failure to prove ordinary and necessary in business	No	IRS
Jafarpour v. Comm'r, T.C. Memo. 2012-165	Deduction denied for failure to demonstrate carrying on a business under § 183; deduction denied because not engaged in business for profit under § 183	Yes	IRS
Jenkins v. Comm'r, T.C. Memo. 2012-283	Deduction denied for failure to prove business purpose since expenses were personal	Yes	IRS
Johnson v. Comm'r, T.C. Memo. 2012-231	Deduction denied for drag racing activity because not engaged in business for profit under § 183; deduction denied because expense was personal	No	IRS
Johnson v. Comm'r, T.C. Memo. 2013-90	Deduction denied for business use of home for failure to substantiate; deduction denied for failure to meet § 274 substantiation requirements for travel, meal and entertainment expenses	Yes	IRS
Jones v. Comm'r, T.C. Memo. 2013-132	Deduction allowed for certain marketing and licensure fees; deduction denied for failure to meet § 274 substantiation requirement for vehicle, meal and entertainment expenses	Yes	Split
K & K Veterinary Supply, Inc. v. Comm'r, T.C. Memo. 2013-84	Deduction allowed for rent and compensation expenses to the extent substantiated; deduction denied for compensation expense to corporate executives for failure to show ordinary and necessary in business	No	Split
Kanofsky v. Comm'r, 111 A.F.T.R.2d (RIA) 1539 (3d Cir. 2013), *aff'g* T.C. Docket No. 3774-11 (April 30, 2012)	Deduction denied for failure to demonstrate expenses were connected to an ordinary and necessary business purpose	Yes	IRS
Kaufman v. Comm'r, T.C. Summ. Op. 2012-100	Deduction denied for legal fees for failure to establish that activity qualified as a trade or business within § 162(a)	Yes	IRS
Kazhukauskas v. Comm'r, T.C. Memo. 2012-191	Deduction denied for failure to show expenses were ordinary and necessary in business	Yes	IRS
Kerstetter v. Comm'r, T.C. Memo. 2012-239	Deduction denied for business use of home for failure to substantiate; expenses were personal in nature and TP's testimony not accepted as credible	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Kim v. Comm'r , T.C. Memo. 2013-5, *appeal docketed*, No. 13-3052 (3rd Cir. Aug. 14, 2013)	Deduction denied for failure to meet § 274 substantiation requirement for vehicle expenses	No	IRS
Kohn v. Comm'r, T.C. Summ. Op. 2012-86	Deduction denied for failure to meet § 274 substantiation requirement for travel expenses	Yes	IRS
Kutney v. Comm'r, T.C. Summ. Op. 2012-120	Deduction denied for real estate activity for failure to demonstrate a profit objective under § 183; deduction denied because expense was personal	Yes	IRS
Langley v. Comm'r, T.C. Memo. 2013-22	Deduction denied for rental real estate expense because it was personal	Yes	IRS
Longino v. Comm'r, T.C. Memo. 2013-80	Deduction allowed for utility and extermination expense in personal residence to extent substantiated and held exclusively for business purposes; deduction denied for failure to meet § 274 substantiation requirements for vehicle expenses; deduction allowed to the extent substantiated for general business expenses	Yes	Split
MacGregor v. Comm'r, 501 F. App'x 663 (9th Cir. 2012), *aff'g* T.C. Memo 2010-187	Deduction denied for marketing expenses for failure to substantiate expenses; insufficient evidence to use Cohan	Yes	IRS
Martell v. Comm'r, T.C. Memo. 2013-115	Deduction denied for unreimbursed employee business expense for failure to prove eligibility for employer reimbursement	No	IRS
Martin v. Comm'r, T.C. Summ. Op. 2013-1	Deduction allowed to extent substantiated for business use of personal residence; deduction denied for failure to meet § 274 substantiation requirements for travel expenses	Yes	Split
McCormack v. Comm'r, T.C. Summ. Op. 2013-9	Deduction denied for failure to meet § 274 substantiation requirements for vehicle expense; deduction denied because it was personal expense	Yes	IRS
McMillan v. Comm'r, T.C. Memo. 2013-40	Deduction denied for failure to demonstrate a profit objective under § 183; deduction denied for failure to substantiate legal fees	Yes	IRS
McPartland v. Comm'r, T.C. Summ. Op. 2012-88	Deduction denied for startup expenses for failure to demonstrate carrying on a business under § 183	Yes	IRS
Mears v. Comm'r, T.C. Memo. 2013-52	Deduction allowed for compensation expense to the extent substantiated; deduction denied for legal and professional expenses and depreciation expenses for failure to show ordinary and necessary in business since expense was personal	Yes	Split
Meinhardt v. Comm'r, T.C. Memo. 2013-85	Deduction denied for real estate rental activity because not engaged in business for profit under § 183	No	IRS
Morris v Comm'r, T.C. Summ. Op. 2012-96	Deduction allowed to the extent substantiated for vehicle and travel expenses; deduction denied for failure to meet § 274 substantiation requirements for meals and entertainment expenses	Yes	Split
Moses v. Comm'r, T.C. Summ. Op. 2012-118	Deduction denied for failure to substantiate unreimbursed employee expenses and other business expenses	Yes	IRS
Murray v. Comm'r, T.C. Summ. Op. 2012-66	Deduction denied for advertising and travel expenses for failure to substantiate; deduction denied because expenses were personal	Yes	IRS
NA Gen. P'ship v. Comm'r, T.C. Memo. 2012-172	Deduction allowed for interest payments from corporate TP to its parent company to the extent substantiated	No	TP
Natkunanathan v. Comm'r, 479 F. App'x 775 (9th Cir. 2012), *aff'g* T.C. Memo 2010-15	Deduction for advertising and home office expenses denied for failure to substantiate; deduction denied for failure to meet § 274 substantiation requirements for meals and entertainment expenses	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Niv v. Comm'r, T.C. Memo. 2013-82	Deduction allowed under Cohan for office expenses; deduction denied for failure to meet § 274 substantiation requirements for travel, vehicle, meals and entertainment expenses	Yes	Split
Olekanma v. Comm'r, T.C. Memo. 2013-31	Deduction denied for general business expenses for failure to substantiate; insufficient evidence to use Cohan	Yes	IRS
Olive v. Comm'r, 139 T.C. 19 (2012), *appeal docketed*, No. 13-70510 (9th Cir. Feb. 11, 2013)	Deduction denied for expenses disallowed under § 280E; insufficient evidence to use Cohan	No	IRS
Padilla v. Comm'r, T.C. Summ. Op. 2012-70	Deduction allowed for contract labor as ordinary and necessary business expense to extent substantiated; deduction denied for materials and supplies expense for failure to substantiate	No	Split
Park v. Comm'r, T.C. Memo. 2012-279	Deduction denied for failure to meet § 274 substantiation requirement for vehicle expenses	Yes	IRS
Parker v. Comm'r, T.C. Memo. 2012-357	Deduction denied for labor payments to employees and legal fees for failure to prove ordinary and necessary in business and failure to substantiate	No	IRS
Pederson v. Comm'r, T.C. Memo. 2013-54	Deduction denied because horse breeding activity not engaged in business for profit under § 183	No	IRS
Peries v. Comm'r, T.C. Summ. Op. 2012-84	Deduction denied for failure to meet § 274 substantiation requirements for travel expenses	Yes	IRS
Perry v. Comm'r, T.C. Memo. 2012-237	Deduction denied for failure to meet § 274 substantiation requirement for travel expenses; deduction denied for failure to substantiate deduction expense and insufficient evidence to use Cohan	No	IRS
Phillips v. Comm'r, T.C. Memo. 2013-42	Deduction denied for expenses incurred in connection with consulting business for failure to substantiate	Yes	IRS
Rasmussen v. Comm'r, T.C. Memo. 2012-353, *appeal docketed*, No. 13-2787 (8th Cir. Aug. 13, 2013)	Deduction denied for failure to meet § 274 substantiation requirement for vehicle expenses	Yes	IRS
Real v. Comm'r, T.C. Summ. Op. 2012-104	Deduction denied for failure to meet § 274 substantiation requirement for vehicle expenses	Yes	IRS
Rehman v. Comm'r, T.C. Memo. 2013-71	Deduction denied for commuting expenses, cost of supplies, legal services and advertising for failure to substantiate; deduction denied for meals and utilities because the expenses were personal and TP failed to prove ordinary and necessary in business	Yes	IRS
Reiff v. Comm'r, T.C. Summ. Op. 2013-40	Deduction denied for compensation expense for failure to demonstrate a profit objective under § 183	Yes	IRS
Repetto v. Comm'r, T.C. Memo. 2012-168	Deduction denied for corporate TP for failure to substantiate expenses related to facilities support agreements	No	IRS
Reynoso v. Comm'r, T.C. Memo. 2013-25	Deduction allowed under Cohan to the extent substantiated; deduction denied for remaining expenses for failure to substantiate 60% profit margin	No	Split
Roberts v. Comm'r, T.C. Memo. 2012-197	Deduction denied for failure to substantiate general business expense; insufficient evidence to use Cohan	Yes	IRS
Robinson v. Comm'r, 487 F. App'x 751 (3d Cir. 2012), *aff'g* T.C. Memo. 2011-99	Deduction denied for failure to meet § 274 substantiation requirement for vehicle and travel expenses; expense was personal	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Rodriguez v. Comm'r, T.C. Memo. 2012-286, *appeal docketed*, No. 13-1966 (4th Cir. Aug. 1, 2013)	Deduction denied for failure to meet § 274 substantiation requirement for vehicle expenses; deduction denied for other business expenses for failure to substantiate and insufficient evidence to use Cohan	Yes	IRS
Romanowski v. Comm'r, T.C. Memo. 2013-55	Deduction denied because horse breeding business not engaged in for profit under § 183	No	IRS
Santiago v. Comm'r, T.C. Summ. Op. 2013-45	Deduction denied for business expenses because they were personal; deduction denied for failure to meet § 274 substantiation requirement for vehicle expenses	Yes	IRS
Schoppe v. Comm'r, 711 F.3d 1190 (10th Cir. 2013), *aff'g* T.C. Memo 2012-153, cert. denied, 2013 WL 4598813 (2013)	Deduction denied for real estate practice expenses for failure to substantiate	Yes	IRS
Sernett v. Comm'r, T.C. Memo. 2012-334	Deduction denied because spring car racing activity not engaged in business for profit under § 183; deduction denied because expense was personal	No	IRS
Smith v. Comm'r, T.C. Summ. Op. 2012-71	Deduction allowed to the extent substantiated as ordinary and necessary in business	Yes	TP
Stirm v. Comm'r, T.C. Summ. Op. 2012-95	Deduction denied for airplane insurance and fuel for failure to substantiate; deduction denied for meals because expense was personal	Yes	IRS
Striefel v. Comm'r, T.C. Memo. 2013-102	Deduction allowed for lodging and meal expenses to the extent substantiated; deduction denied for failure to meet § 274 substantiation requirements for vehicle expenses	No	Split
Thomas v. Comm'r , T.C. Summ. Op. 2013-5	Deduction allowed for legal and professional fees to the extent substantiated as ordinary and necessary business expenses; deduction denied for failure to meet § 274 substantiation requirement for vehicle and travel expenses; deduction denied for failure to substantiate insurance, repair and utility expenses	Yes	Split
Thousand Oaks Residential Care Home I, Inc. v. Comm'r, T.C. Memo. 2013-10	Deduction allowed for compensation expense to the extent substantiated; deduction denied for compensation expense to business owner's daughter as expense was not ordinary and necessary in business	No	Split
Thrifty Oil Co. v. Comm'r, 139 T.C. 198 (2012)	Deduction denied for environmental remediation expense for no clear Congressional declaration of intent to allow double deduction of expense	No	IRS
Tinney v. Comm'r, T.C. Memo. 2013-91	Deduction denied for failure to meet § 274 substantiation requirement for travel and vehicle expenses	Yes	IRS
Trescott v. Comm'r, T.C. Memo. 2012-321	Deduction allowed for telephone expense as ordinary and necessary in business; deduction denied for business use of home because expenses were personal in nature	Yes	Split
Tsai, In re v. Comm'r, 110 A.F.T.R.2d (RIA) 5702 (D.N.J. 2012)	Deduction allowed for vehicle and wages expense as ordinary and necessary business expenses; deduction denied for gifts and other interest payments for failure to substantiate	Yes	Split
Ugwuala v. Comm'r, T.C. Memo. 2013-105	Deduction denied for rental real estate expenses because expense was personal	No	IRS
Uniband, Inc. v. Comm'r, 140 T.C. No. 13 (2013)	Deduction denied for wage and employee expenses for failure to show eligibility for business expense deduction	No	IRS
Verrett v. Comm'r, T.C. Memo. 2012-223	Deduction denied for expenses related to construction venture because not engaged in business for profit under § 183	Yes	IRS
Vlach v. Comm'r, T.C. Memo. 2013-116	Deduction denied for general business expenses for failure to prove ordinary and necessary in business	No	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Wade v. Comm'r, T.C. Summ. Op. 2012-85	Deduction allowed for vehicle expenses to the extent substantiated; deduction denied for failure to meet § 274 substantiation requirement for travel expenses; deduction denied for gifts for failure to prove ordinary and necessary in business	Yes	Split
Wagoner v. Comm'r, T.C. Summ. Op. 2013-14	Deduction denied for failure to meet § 274 substantiation requirement for vehicle expenses	Yes	IRS
Wallach v. Comm'r, T.C. Summ. Op. 2012-94	Deduction allowed for meals and entertainment expense to extent substantiated; deduction denied for travel expenses for failure to prove ordinary and necessary in business; deduction denied for office expense because personal in nature	Yes	Split
Walthall v. Comm'r, T.C. Summ. Op. 2012-65	Deduction denied because home remodeling activity not engaged in for profit under § 183	Yes	IRS
Wanat v. Comm'r, T.C. Summ. Op. 2012-92	Deduction allowed for expense to extent substantiated for dog bed business; deduction denied for failure to meet § 274 substantiation requirements for vehicle expenses	Yes	Split
Weatherley v. Comm'r, T.C. Memo. 2012-320	Deduction for legal expenses related to royalty income denied for failure to substantiate	Yes	IRS
Westrich v. Comm'r, T.C. Summ. Op. 2013-35	Deduction denied for research and writing activity because not engaged in business for profit under § 183	Yes	IRS
Winnett v. Comm'r, T.C. Summ. Op. 2013-25	Deduction denied for expense incurred in advocacy activity as not engaged in business for profit under § 183	Yes	IRS
Zaklama v. Comm'r, T.C. Memo. 2012-346	Deduction allowed under Cohan for mortgage interest expense; deduction denied for business expense of sole proprietorship for failure to substantiate and insufficient evidence to use Cohan	Yes	Split

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Table 3: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (not including sole proprietorships)			
Abarca v. Comm'r, T.C. Memo. 2012-245	Unreported cancellation of debt income	Yes	TP
Adams v. Comm'r, T.C. Memo. 2013-7	Unreported income from like-kind exchange under IRC § 1031	No	TP
Ahmed v. Comm'r, 498 F. App'x 919 (11th Cir. 2012), *aff'g* T.C. Memo. 2011-295	Settlement proceeds not excludable under IRC § 104(a)(2)	Yes	IRS
Albright v. Comm'r, T.C. Memo. 2013-9	Unreported gain on sale of residence; whether business loss and attorney's fees affected the amount of gain; TP entitled to reduction in capital gain from sale of residence for amount of attorney's fees paid	Yes	Split
Beech v. Comm'r, T.C. Summ. Op. 2012-74	Unreported proceeds from inherited retirement savings	Yes	IRS
Bernard v. Comm'r, T.C. Memo. 2012-221	Proceeds from retirement savings taxable as ordinary income, rather than as a return of capital and capital gains	Yes	IRS
Blackwood v. Comm'r, T.C. Memo. 2012-190	Settlement proceeds not excludable under IRC § 104(a)(2); emotional distress rather than physical injuries or physical sickness	No	IRS
Brady v. Comm'r, T.C. Memo. 2013-1	Unreported social security and dividend income	Yes	IRS
Bross v. Comm'r, T.C. Summ. Op. 2012-122	Unreported cancellation of debt income	No	IRS
Brown v. Comm'r, 693 F.3d 765 (7th Cir. 2012), *aff'g* T.C. Memo. 2011-83	Unreported gain on life insurance policy termination	No	IRS
Buckardt v. Comm'r, 474 F. App'x 612 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-145	Unreported pension and annuity income	Yes	IRS
Callahan v. Comm'r, T.C. Memo. 2013-131	Unreported gain from sale of property and cancellation of debt income	No	IRS
Calloway v. Comm'r, 691 F.3d 1315 (11th Cir. 2012), *aff'g* 135 T.C. 26 (2010)	Unreported gain on sale of stock	No	IRS
Campbell v. U.S., 111 A.F.T.R.2d (RIA) 946 (C.D. Cal. 2013), *appeal docketed*, No. 13-55442 (9th Cir. Mar. 14, 2013)	Unreported pension income; disability pension payments not excludable under IRC § 104(a)(1)	No	IRS
Carmickle v. Comm'r, T.C. Summ. Op. 2012-60	Unreported gain on sale of real estate not excluded under IRC § 121	Yes	IRS
Carr v. Comm'r, T.C. Summ. Op. 2013-3	Settlement proceeds not excludable under IRC § 104(a)(2)	Yes	IRS
Cherry v. Comm'r, T.C. Memo. 2013-3	Unreported gross income determined under the bank deposits method	Yes	IRS
Clanton v. Comm'r, 491 F. App'x 610 (6th Cir. 2012), *cert. denied*, 133 S.Ct. 2050 (2013)	Unreported early distribution from retirement savings	Yes	IRS
Clark v. U.S., 111 A.F.T.R.2d (RIA) 344 (N.D. Cal. 2012)	Unreported income from a sale disguised as a loan	No	IRS
Clayton v. Comm'r, T.C. Memo. 2012-188, *appeal docketed*, No. 12-73904 (9th Cir. Nov. 28, 2012)	Unreported interest, dividend, social security and pension income	Yes	IRS
Cox v. Comm'r, T.C. Memo. 2013-75	Unreported gross receipts and interest determined under the bank deposits method; IRS failed to meet burden of showing income included funds TP received as conduit	Yes	Split
Cryer v. Comm'r, T.C. Memo. 2013-69	Unreported wages determined under the bank deposits method	No	IRS
Cung v. Comm'r, T.C. Memo. 2013-81	Settlement proceeds not excludable as lost value or capital to the TP	Yes	IRS

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Table 3: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Curtis v. Comm'r, T.C. Memo. 2013-12, *appeal docketed*, No. 13-72743 (9th Cir. Aug. 7, 2013)	Unreported rental income and capital gains	Yes	IRS
Davenport v. Comm'r, T.C. Memo. 2013-41	Unreported wages	Yes	IRS
Davis v. Comm'r, 111 A.F.T.R.2d (RIA) 1979 (11th Cir. 2013), *aff'g* T.C. Memo. 2011-286	Unreported income from the exercise of stock option	No	IRS
Francis v. Comm'r, T.C. Summ. Op. 2012-79	Unreported back pay award	Yes	IRS
Gaitor v. Comm'r, T.C. Memo. 2012-297	Unreported rental income and gambling winnings	Yes	IRS
Garber v. Comm'r, 500 F. App'x 540 (7th Cir. 2013), *aff'g* T.C. Memo. 2012-47	Unreported wages	Yes	IRS
Harris v. Comm'r, T.C. Memo. 2012-333	Settlement proceeds not excludable under IRC § 104(a)(2)	No	IRS
Hartman v. U.S., 694 F.3d 96 (Fed. Cir. 2012), *aff'g* 99 Fed. Cl. 168 (2011)	Constructive receipt of stock properly included in gross income	No	IRS
Haury v. Comm'r, T.C. Memo. 2012-215, *appeal docketed*, No. 13-1780 (8th Cir. Apr. 9, 2013)	Unreported early distribution from retirement savings	Yes	IRS
Hoang v. Comm'r, T.C. Memo. 2013-127, *appeal docketed*, No. 13-14398 (11th Cir. Sept. 26, 2013)	Unreported qualified dividend, interest and other income and gain from the sale of securities	Yes	IRS
Holmes v. Comm'r, T.C. Memo. 2012-251, *appeal docketed*, No. 13-71034 (9th Cir. Mar. 25, 2013)	Unreported gain from sale of purported small business stock	No	IRS
Hyde v. Comm'r, 471 F. App'x 537 (8th Cir. 2012), *aff'g* T.C. Memo. 2011-104, *cert. denied*, 133 S. Ct. 903 (2013)	Unreported wages, interest income, dividends and IRA distributions	Yes	IRS
Jarvis v. Comm'r, T.C. Summ. Op. 2013-11	Unreported gain on life insurance policy termination	Yes	IRS
Jenkins v. Comm'r, T.C. Memo. 2012-181	Unreported nonemployee compensation, wages, and cancellation of debt income	Yes	IRS
Kramer v. Comm'r, T.C. Memo. 2012-192	Unreported wages	Yes	IRS
Leyshon v. Comm'r, T.C. Memo. 2012-248	Unreported wages and retirement plan distribution	Yes	IRS
Leyva v. Comm'r, 483 F. App'x 371 (9th Cir. 2012)	Unreported wages and capital gains	Yes	IRS
Loren-Maltese v. Comm'r, T.C. Memo. 2012-214	Unreported income from political campaign funds	No	IRS
McAllister v. Comm'r, T.C. Memo. 2013-96	Unreported cancellation of debt income limited by insolvency exception under IRC § 108(a)(1)(B)	Yes	Split
McKinnon v. Comm'r, T.C. Summ. Op. 2013-8	Unreported interest income	Yes	IRS
Moore v. Comm'r, T.C. Summ. Op. 2012-83	Unreported gain on life insurance policy termination	Yes	TP
Moore v. Comm'r, T.C. Memo. 2012-249	Unreported social security disability benefits; no offset for state worker's compensation benefits	Yes	IRS
Mui v. Comm'r, T.C. Memo. 2013-83	Unreported income under the bank deposits method	No	IRS
Murray v. Comm'r, T.C. Memo. 2012-213	Unreported proceeds from inherited retirement savings	Yes	IRS
Naylor v. Comm'r, T.C. Memo. 2013-19	Unreported gain from sale of stock	Yes	IRS
Neff v. Comm'r, T.C. Memo. 2012-244	Unreported income from termination of split dollar life insurance policies	No	IRS
Nelson v. Comm'r, T.C. Memo. 2012- 232, *aff'd*, 112 A.F.T.R.2d (RIA) 6247 (11th Cir. 2013)	Unreported wages	Yes	IRS

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Table 3: Gross Income Under IRC § 61 and Related Sections

Case Citation	Issue(s)	*Pro Se*	Decision
Nix v. Comm'r, T.C. Memo. 2012-304, *appeal docketed*, No. 13-12316 (11th Cir. May 22, 2013)	Unreported wages	Yes	IRS
O'Connor v. Comm'r, T.C. Memo. 2012-317, *appeal docketed*, No. 13-71413 (9th Cir. Apr. 22, 2013)	Payment received for participating in a medical study not excludable under IRC § 102 or IRC § 104(a)(2)	Yes	IRS
Parker v. Comm'r, T.C. Memo. 2012-357	Unreported gain from sale of real estate under the installment method	No	IRS
Phillips v. Comm'r, T.C. Memo. 2013-42	Unreported retirement savings distribution and interest income; distribution not qualified rollover	Yes	IRS
Pinn v. Comm'r, T.C. Memo. 2013-45	Unreported cancellation of debt income on defaulted life insurance loans	No	TP
Richmond v. Comm'r, 474 F. App'x 754 (10th Cir. 2012), *aff'g* T.C. Memo. 2011-251	Unreported wages, interest and trust income	Yes	IRS
Rogers v. Comm'r, T.C. Memo. 2013-77, *appeal docketed*, No. 13-1241 (D.C. Cir. Aug. 15, 2013)	Foreign earned income exclusion under IRC § 911	Yes	IRS
Sassani v. Comm'r, T.C. Summ. Op. 2012-80	Unreported distributions from IRA	Yes	IRS
Scharringhausen v. Comm'r, T.C. Memo. 2012-350	Unreported check withdrawals from off-shore bank accounts constituted taxable income	Yes	IRS
Scott v. U.S., 111 A.F.T.R.2d (RIA) 1595 (C.D. Cal. 2013), *appeal docketed*, No. 13-55712 (9th Cir. Apr. 29, 2013)	Unreported taxable pension income	No	IRS
Shepherd v. Comm'r, T.C. Memo. 2012-212	Unreported cancellation of debt income	Yes	IRS
Smallwood v. U.S., 111 A.F.T.R.2d (RIA) 377 (C.D. Cal. 2012), *appeal docketed*, No. 13-55304 (9th Cir. Feb. 22, 2013)	Refund claim denied because contingency fee paid to attorney from settlement proceeds in employment discrimination case was taxable income	Yes	IRS
Sollberger v. Comm'r, 691 F.3d 1119 (9th Cir. 2012), *aff'g* T.C. Memo. 2011-78	Unreported income from the sale of floating rate notes	No	IRS
Thibodeaux v. Comm'r, T.C. Summ. Op. 2013-7	Unreported wages	Yes	IRS
Tran v. Comm'r, T.C. Summ. Op. 2012-110	Unreported cancellation of debt income; TP allowed deduction for fees paid	Yes	Split
Worsham v. Comm'r, T.C. Memo. 2012-219, *aff'd*, 112 A.F.T.R.2d (RIA) 5035 (4th Cir. 2013)	Unreported wages, compensation for legal services, settlement proceeds from personal lawsuits, and interest income	Yes	IRS
Wyman v. U.S., 2013 U.S. Dist. LEXIS 74258 (C.D. Cal. 2013), *appeal docketed*, No. 13-55990 (9th Cir. June 7, 2013)	Unreported taxable pension income	No	IRS
Yarish v. Comm'r, 139 T.C. 290 (2012)	Unreported income from vested accrued benefit	No	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships)			
Bennett v. Comm'r, T.C. Memo. 2012-193	Unreported fees from services determined under the specific income based method; loan proceeds not taxable	No	Split
Cadwell v. Comm'r, 483 F. App'x 847 (4th Cir. 2012), *aff'g* 136 T.C. 38 (2011)	Unreported income from "substantially vested" employer contributions made to a nonexempt employee trust	No	IRS
Cvancara v. Comm'r, T.C. Memo. 2013-20	Unreported advanced payments under accrual method; unreported partnership receipts characterized as capital contributions	Yes	TP
Barnes Group, Inc. v. Comm'r, T.C. Memo. 2013-109	Unreported income from funds transferred from foreign entities	No	IRS
Didonato v. Comm'r, T.C. Memo. 2013-11	Unreported funds transferred between subchapter S corporations	No	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Dyer v. Comm'r, T.C. Memo. 2012-224	Unreported gross receipts on Schedule C determined under the bank deposits method and specific items method	No	IRS
Flood v. Comm'r, T.C. Memo. 2012-243	Unreported gain from sale of real estate	Yes	IRS
Foxworthy, Inc. v. Comm'r, 494 F. App'x. 964 (11th Cir. 2012), *aff'g* T.C. Memo. 2009-203	Unreported income from alter ego corporation	No	IRS
Gaggero v. Comm'r, T.C. Memo. 2012-331	Unreported excess funds received in an IRC § 1034 transaction	No	IRS
Garcia v. Comm'r, T.C. Summ. Op. 2012-107	TP alleged he overstated gross receipts on Schedule C	Yes	IRS
Gardner v. Comm'r, T.C. Memo. 2013-67	Unreported gross receipts on Schedule C determined under the bank deposits method	No	IRS
Gassaway v. Comm'r, T.C. Memo. 2013-13, *appeal docketed*, No. 13-60289 (5th Cir. May 1, 2013)	Unreported fees received from client	Yes	IRS
Gluckman v. Comm'r, T.C. Memo. 2012-329, *appeal docketed*, No. 13-761 (2d Cir. Mar. 1, 2013)	Unreported income from the cash value of life insurance policies withdrawn	No	IRS
Good v. Comm'r, T.C. Memo. 2012-323	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Gorokhovsky v. Comm'r, T.C. Memo. 2013-65	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Grandy v. Comm'r, T.C. Memo. 2012-196	Unreported wages, distributions from trust fund and self-employment income	Yes	IRS
Gunkle v. Comm'r, T.C. Memo. 2012-305, *appeal docketed*, No. 13-60245 (5th Cir. Apr. 12, 2013)	Unreported income from transferred corporate funds	No	IRS
Herbert v. Comm'r, T.C. Summ. Op. 2012-124	Unreported wages; wages correctly characterized by TP	Yes	Split
Hewlett-Packard Co. v. Comm'r, 139 T.C. 255 (2012)	Unreported nonsales income	No	IRS
Hovind v. Comm'r, T.C. Memo. 2012-281	Unreported income from unincorporated entity determined under the bank deposits method	No	IRS
Jenkins v. Comm'r, T.C. Memo. 2012-283	Unreported gross receipts on schedule C determined under the bank deposits method	Yes	IRS
Kazhukauskas v. Comm'r, T.C. Memo. 2012-191	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Kim v. Comm'r, T.C. Memo. 2013-5, *appeal docketed*, No. 13-3452 (3d Cir. Aug. 14, 2013)	Unreported pass-through income from subchapter S corporation	No	IRS
Laciny v. Comm'r, T.C. Memo. 2013-107	Unreported constructive dividends from a corporation	No	IRS
MacGregor v. Comm'r, 501 F. App'x 663 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-187	Unreported gross receipts on Schedule C determined under the bank deposits method; Unreported settlement proceeds in gross income; TP properly excluded certain deposits from gross income	Yes	Split
Martell v. Comm'r, T.C. Memo. 2013-115	TP properly excluded from gross income nontaxable reimbursements and certain deposits determined under the bank deposits method; however, other deposits were determined to be taxable income	No	Split
Mawji v. Comm'r, T.C. Memo. 2013-108, *appeal docketed*, No. 13-13194 (11th Cir. July 15, 2013)	Unreported gross receipts on Schedule C determined under the bank deposits method	No	IRS
Mears v. Comm'r, T.C. Memo. 2013-52	Unreported rental income	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Mich. Mem'l Park, Inc. v. U.S., 111 A.F.T.R.2d (RIA) 475 (E.D. Mich. 2013)	Unreported distributions received from a perpetual care trust	No	IRS
Mistlebauer v. Comm'r, T.C. Memo. 2012-186	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Olekanma v. Comm'r, T.C. Memo. 2013-31	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Olive v. Comm'r, 139 T.C. 19 (2012), *appeal docketed*, No. 13-70510 (9th Cir. Feb. 11, 2013)	Unreported gross receipts on Schedule C	No	IRS
Omozee v. Comm'r, T.C. Memo. 2013-89	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Perry v. Comm'r, T.C. Memo. 2012-237	Unreported executive compensation mischaracterized as office rental income	No	IRS
Plotkin v. Comm'r, 498 F. App'x 954 (11th Cir. 2012), *aff'g* T.C. Memo. 2011-260, *cert. denied*, 133 S. Ct. 1829 (2013)	TP properly excluded from gross income funds transferred between corporations; Unreported pass-through income	Yes	Split
Powers v. Comm'r, T.C. Memo. 2013-134	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Reading, U.S. v., 110 A.F.T.R.2d (RIA) 5965 (D. Ariz. 2012)	TP granted leniency on certain unreported income; Unreported capital gains	No	Split
Real v. Comm'r, T.C. Summ. Op. 2012-104	Unreported gross receipts on Schedule C determined under the bank deposits method; however, some deposits were nontaxable reimbursements and loan repayments	Yes	Split
Reynoso v. Comm'r, T.C. Memo. 2013-25	Unreported gross receipts on Schedule C determined under the bank deposits method	No	IRS
Roye v. Comm'r, T.C. Memo. 2012-246	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Snow v. Comm'r, T.C. Memo. 2013-114	Unreported wages and gross receipts	Yes	IRS
Stephens v. Comm'r, T.C. Memo. 2013-47, *appeal docketed*, No. 13-14235 (11th Cir. Sept. 18, 2013)	Unreported income from transferred corporate funds	Yes	IRS
Tinney v. Comm'r, T.C. Memo. 2013-91	Unreported gross receipts on Schedule C determined under the bank deposits method	Yes	IRS
Todd v. Comm'r, 486 F. App'x 423 (5th Cir. 2012), *aff'g* T.C. Memo. 2011-123	Unreported distributions from employee benefit fund	No	IRS
Trescott v. Comm'r, T.C. Memo. 2012-321	Unreported gross receipts determined under the bank deposits method	Yes	IRS
Vlach v. Comm'r, T.C. Memo. 2013-116	Unreported payments from a sham trust	No	IRS
Ward v. Comm'r, T.C. Memo. 2013-133	Unreported pass-through income from subchapter S corporation determined under the bank deposits method	Yes	IRS
Williams v. Comm'r, 498 F. App'x 284 (4th Cir. 2012), *aff'g* T.C. Memo. 2011-89	Unreported income from consulting fees deposited into foreign bank accounts	No	IRS
Zaklama v. Comm'r, T.C. Memo. 2012-346	Unreported self-employment income and some distributions from IRA were nontaxable	Yes	Split

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Table 4: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Agisim, U.S. v., 2013 U.S. Dist. LEXIS 72549 (D.N.H. 2013), *adopting* 2013 U.S. Dist. LEXIS 72547 (D.N.H. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Ahlquist, U.S. v., 2012 U.S. Dist. LEXIS 104668 (D. Minn. 2012), *adopting* 2012 U.S. Dist. LEXIS 105084 (D. Minn. 2012)	Enforcement of summons ordered	No	IRS
Amabile, U.S. v., 110 A.F.T.R.2d (RIA) 5017 (E.D. Pa. 2012), *adopting* 109 A.F.T.R.2d (RIA) 2392 (E.D. Pa. 2012)	TP's blanket Fifth Amendment objection invalid; civil contempt ordered	Yes	IRS
Anderson v. U.S., 111 A.F.T.R.2d (RIA) 2047 (D. Mont. 2013)	Powell requirements satisfied; TP's untimely motion to quash third-party summons dismissed for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted; TP received adequate notice; TP failed to demonstrate that case has been referred to DOJ; TP's privacy objections lacked merit; TP's bad faith argument rejected	Yes	IRS
Bacon, U.S. v., 110 A.F.T.R.2d (RIA) 7071 (E.D. Cal. 2012)	Civil contempt ordered	Yes	IRS
Barringer, U.S. v., 111 A.F.T.R.2d (RIA) 583 (C.D. Ill. 2013)	Powell requirements satisfied; TP's assertion that United States lacks authority to issue and proceed with summons enforcement rejected	Yes	IRS
Bates, U.S. v., 110 A.F.T.R.2d (RIA) 5552 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5349 (E.D. Cal. 2012)	Powell requirements satisfied; TP failed to demonstrate that case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Bates, U.S. v., 2013 U.S. Dist. LEXIS 35650 (E.D. Cal. 2013)	Civil contempt ordered	Yes	IRS
Beck, U.S. v., 110 A.F.T.R.2d (RIA) 6279 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 6019 (E.D. Cal. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Boyd, U.S. v., 110 A.F.T.R.2d (RIA) 5772 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5434 (E.D. Cal. 2012)	Powell requirements satisfied; TP failed to demonstrate that case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Bybee v. U.S., 110 A.F.T.R.2d (RIA) 6215 (D. Utah 2012), *adopting* 110 A.F.T.R.2d (RIA) 6212 (D. Utah 2012)	Motion to quash third-party summons dismissed; movants are not third-party record-keepers.	No	IRS
Canatella v. U.S., 2013-1 U.S.T.C. (CCH) ¶ 50,332 (9th Cir. 2013), aff'g 108 A.F.T.R.2d (RIA) 5256 (N.D. Cal. 2011)	TP assertion that district court abused its discretion in denying evidentiary hearing rejected; order dismissing motion to quash third-party summons affirmed	No	IRS
Chavira v. U.S., 111 A.F.T.R.2d (RIA) 1931 (C.D. Cal. 2013)	TP's motion to quash third-party summons dismissed because it was untimely	Yes	IRS
Chow, U.S. v., 2012 U.S. Dist. LEXIS 120055 (C.D. Cal. 2012), *later proceeding to amend order*, 2012 U.S. Dist. LEXIS 135029 (C.D. Cal. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Chuhlantseff, U.S. v., 110 A.F.T.R.2d (RIA) 7024 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 6700 (E.D. Cal. 2012)	Powell requirements satisfied; TP failed to demonstrate that case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Collins, U.S. v., 111 A.F.T.R.2d (RIA) 309 (S.D. Ohio 2012), *adopting* 110 A.F.T.R.2d (RIA) 6638 (S.D. Ohio 2012)	Civil contempt ordered	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Coots, U.S. v., 110 A.F.T.R.2d (RIA) 6761 (E.D. Pa. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Cutshall, U.S. v., 110 A.F.T.R.2d (RIA) 5173 (D. Utah 2012), *adopting* 110 A.F.T.R.2d (RIA) 5172 (D. Utah 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
De La PeÑa v. U.S., 2013 U.S. Dist. LEXIS 7258 (E.D.N.Y. 2013)	Motion to quash summons dismissed because it was late and sent to wrong office	Yes	IRS
Dunnell, U.S. v., 2013 U.S. Dist. LEXIS 14606 (D.N.H. 2013), *approving* 2013 U.S. Dist. LEXIS 14607 (D.N.H. 2013)	Powell requirements satisfied; government awarded costs; enforcement of summons ordered	Yes	IRS
Elgaen, U.S. v., 2012 U.S. Dist. LEXIS 102086 (W.D. Wash. 2012), *adopting* 2012 U.S. Dist. LEXIS 102084 (W.D. Wash. 2012)	Government's motion to withdraw petition to enforce summons granted	Yes	IRS
Ellison, U.S. v., 111 A.F.T.R.2d (RIA) 1705 (E.D. Mich. 2013)	TP's motion to dismiss for lack of subject matter jurisdiction denied	Yes	IRS
Ellison, U.S. v., 111 A.F.T.R.2d (RIA) 1310 (E.D. Mich. 2013)	TP's motion to dismiss for lack of subject matter jurisdiction denied	Yes	IRS
Erickson, U.S. v., 2013 U.S. Dist. LEXIS 2065 (M.D. Fla. 2013), *adopting* 2012 U.S. Dist. LEXIS 183697 (M.D. Fla. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Erickson, U.S. v., 2013 U.S. Dist. LEXIS 2065 (M.D. Fla. 2013), *adopting* 2012 U.S. Dist. LEXIS 183697 (M.D. Fla. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Gillies, U.S. v., 111 A.F.T.R.2d (RIA) 1188 (N.D. Cal. 2013), *adopting* 2013 U.S. Dist. LEXIS 34318 (N.D. Cal. 2013)	Civil contempt ordered	Yes	IRS
Grant v. U.S., 2012 U.S. Dist. LEXIS 164861 (S.D. Ohio 2012), adopting 2012 U.S. Dist. LEXIS 152864 (S.D. Ohio 2012)	TP's motion to quash summons dismissed for failure to prosecute	Yes	IRS
Green v. U.S., 2012 U.S. Dist. LEXIS 141858 (E.D. Pa. 2012)	TP's motion to quash third-party summons denied	Yes	IRS
Grisel, U.S. v., 2013 U.S. Dist. LEXIS 11286 (N.D. Cal. 2013)	Government's motion for show cause hearing granted	Yes	IRS
Guglielmi v. U.S., 2013 U.S. Dist. LEXIS 55044 (S.D.N.Y. 2013)	Powell requirements satisfied; TP's motion to quash third-party summons denied	No	IRS
Guy, U.S. v., 110 A.F.T.R.2d (RIA) 7023 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 6719 (E.D. Cal. 2012)	Powell requirements satisfied; TP failed to demonstrate that case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Hampton, U.S. v., 110 A.F.T.R.2d (RIA) 5200 (W.D. Mo. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5198 (W.D. Mo. 2012),*vacated and dismissed as moot*, No. 12-2861 (8th Cir. Nov. 28, 2012) *(period of limitations on collection expired and summons no longer enforceable)*	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Harrington, U.S. v., 2013 U.S. Dist. LEXIS 53711 (C.D. Cal. 2013)	Powell requirements satisfied; government's motion for show cause hearing granted	Yes	IRS
Hawk, U.S. v., 2012 U.S. Dist. LEXIS 140110 (N.D. Ohio 2012), *adopting* 2012 U.S. Dist. LEXIS 140109 (N.D. Ohio 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Hezi, U.S. v., 2012 U.S. Dist. LEXIS 159193 (C.D. Cal. 2012)	Powell requirements satisfied; government's motion for show cause hearing granted	Yes	IRS

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Table 4: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Holland, U.S. v., 2012 U.S. Dist. LEXIS 90414 (D.N.H. 2012), *adopting* 2012 U.S. Dist. LEXIS 90411 (D.N.H. 2012)	Powell requirements satisfied; enforcement of summons ordered; costs awarded to government	Yes	IRS
Howard, U.S. v., 2012 U.S. Dist. LEXIS 79021 (D.N.H. 2012), *adopting* 109 A.F.T.R.2d (RIA) 2504 (D.N.H. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Hunkler v. U.S., 111 A.F.T.R.2d (RIA) 1593 (N.D. Ohio 2013), *adopting* 111 A.F.T.R.2d (RIA) 764 (N.D. Ohio 2013)	TP's motion to quash third-party summons found to be timely; United States ordered to respond to petition	Yes	TP
Joyce, U.S. v., 2013 U.S. Dist. LEXIS 65883 (C.D. Cal. 2013)	Powell requirements satisfied; government's motion for show cause hearing granted	Yes	IRS
Kahler, U.S. v., 110 A.F.T.R.2d (RIA) 5350 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5313 (E.D. Cal. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Kalra v. U.S., 111 A.F.T.R.2d (RIA) 1760 (N.D. Ill. 2013)	TP's motion to quash third-party summons granted for lack of proper notice and failure to satisfy Powell requirements	No	TP
Kibler, U.S. v., 111 A.F.T.R.2d (RIA) 2213 (M.D. Fla. 2013), *adopting* 111 A.F.T.R.2d (RIA) 2211 (M.D. Fla. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Kurtz, U.S. v., 2012 U.S. Dist. LEXIS 130907 (M.D. Fla. 2012), *adopting* 2012 U.S. Dist. LEXIS 130677 (M.D. Fla. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
LaBrecque v. U.S., 110 A.F.T.R.2d (RIA) 7064 (D. Colo. 2012), adopting 110 A.F.T.R.2d (RIA) 7061 (D. Colo. 2012)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction; TP not entitled to notice because third-party summons issued in aid of collection efforts	Yes	IRS
Lee v. Harris, 110 A.F.T.R.2d (RIA) 5038 (D. Nev. 2012)	TP's motion to quash third-party summons dismissed for lack of standing; TP not entitled to notice because third-party summons issued in aid of collection efforts	Yes	IRS
Maxwell v. U.S., 110 A.F.T.R.2d (RIA) 5105 (D.D.C. 2012), *aff'd*, 2013 U.S. App. LEXIS 13969 (D.C. Cir. 2013)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS
Maya, U.S. v., 110 A.F.T.R.2d (RIA) 5770 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5437 (E.D. Cal. 2012)	Powell requirements satisfied; TP failed to demonstrate that case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
McCollum, U.S. v., 2012 U.S. Dist. LEXIS 108913 (E.D. Tex. 2012), *adopting* 2012 U.S. Dist. LEXIS 108928 (E.D. Tex. 2012)	Powell requirements satisfied; TP failed to demonstrate that case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Melick, U.S. v., 110 A.F.T.R.2d (RIA) 7031 (1st Cir. 2012), *aff'g* 108 A.F.T.R.2d (RIA) 6031 (D.N.H. 2011) *(granting motion to strike defendant's motion to dismiss summons order) and dismissing* 108 A.F.T.R.2d (RIA) 6780 (D.N.H. 2011)	Affirming government's motion to strike TP's motion to dismiss summons order; TP's appeal of the civil contempt order dismissed for lack of jurisdiction	Yes	IRS
Meloy, U.S. v., 110 A.F.T.R.2d (RIA) 5239 (W.D. Mo. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5237 (W.D. Mo. 2012)	Powell requirement satisfied; enforcement of summons ordered	Yes	IRS
Munson v. U.S., 110 A.F.T.R.2d (RIA) 5795 (N.D. Ohio 2012)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS
Munson v. U.S., 111 A.F.T.R.2d (RIA) 2065 (N.D. Ohio 2013)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS

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Table 4: Summons Enforcement Under IRC §§ 7602, 7604, and 7609

Case Citation	Issue(s)	*Pro Se*	Decision
Olvany, U.S. v., 109 A.F.T.R.2d (RIA) 2720 (M.D. Pa. 2012), *adopting* 109 A.F.T.R.2d (RIA) 2717 (M.D. Pa. 2012)	Powell requirements satisfied; TP's frivolous argument lacked merit; enforcement of summons ordered	Yes	IRS
Peterson v. U.S., 110 A.F.T.R.2d (RIA) 6562 (D. Neb. 2012)	TP's motion to quash third-party summons denied; TP received adequate notice; TP failed to demonstrate that the case has been referred to DOJ; TP's bad faith argument rejected; TP's Fourth Amendment objection lacked merit; TPs state and federal privacy law objections lacked merit	Yes	IRS
Petty, U.S. v., 110 A.F.T.R.2d (RIA) 6772 (S.D. Cal. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Phuc Le, U.S. v., 110 A.F.T.R.2d (RIA) 5544 (N.D. Cal. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Plum, U.S. v., 2012 U.S. Dist. LEXIS 95791 (E.D. Tex. 2012), *adopting* 2012 U.S. Dist. LEXIS 79842 (E.D. Tex. 2012)	Powell requirements satisfied; TP failed to demonstrate that case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Porter, U.S. v., 2013-1 U.S.T.C. (CCH) ¶ 50,163 (E.D. Mich. 2013), *order entered at* 2013-1 U.S.T.C. (CCH) ¶ 50,163 (E.D. Mich. 2013)	Powell requirements satisfied; enforcement of summonses ordered	Yes	IRS
Ruiz, U.S. v., 110 A.F.T.R.2d (RIA) 5770 (E.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5435 (E.D. Cal. 2012)	Powell requirements satisfied; TP failed to demonstrate that the case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Ruiz, U.S. v., 2013 U.S. Dist. LEXIS 35660 (E.D. Cal. 2013)	Civil contempt ordered	Yes	IRS
Salter, U.S. v., 2012 U.S. Dist. LEXIS 122174 (S.D. Ala. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Sancen, U.S. v., 2013 U.S. Dist. LEXIS 36368 (N.D. Cal. 2013)	Show cause hearing for civil contempt order granted	Yes	IRS
Sanders, U.S. v., 110 A.F.T.R.2d (RIA) 5913 (S.D. Ill. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5910 (S.D. Ill. 2011)	Powell requirements satisfied; TP's assertion that IRS lacks authority to issue summonses rejected; enforcement of summons ordered	No	IRS
Sato, U.S. v., 111 A.F.T.R.2d (RIA) 664 (N.D. Cal. 2013), *adopting* 111 A.F.T.R.2d (RIA) 662 (N.D. Cal. 2012), order entered at 2013 U.S. Dist. LEXIS 13539 (N.D. Cal. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Schwartz v. U.S., 110 A.F.T.R.2d (RIA) 6003 (D. Neb. 2012)	Powell requirements satisfied; TP's motion to quash third-party summons dismissed; TP's frivolous arguments lacked merit	Yes	IRS
Sessions, U.S. v., 2012 U.S. Dist. LEXIS 139766 (W.D. Wash. 2012), *adopting in part and modifying in part* 2012 U.S. Dist. LEXIS 139775 (W.D. Wash. 2012), *appeal docketed*, No. 12-35929 (9th Cir. Nov. 9, 2012)	TP's Fourth Amendment and over breadth arguments rejected; TP's Fifth Amendment objection lacked merit; enforcement of summons ordered	No	IRS
Shaw v. U.S., 111 A.F.T.R.2d (RIA) 1754 (11th Cir. 2013), aff'g 109 A.F.T.R.2d (RIA) 2364 (M.D. Fla. 2012)	TP's motion to quash third-party summons denied for lack of subject matter jurisdiction; TP not entitled to notice because third-party summons issued in aid of collection efforts	Yes	IRS
Smit, U.S. v., 110 A.F.T.R.2d (RIA) 5325 (D.N.M. 2012)	TP's motion to quash summons denied; Powell requirements satisfied; TP failed to demonstrate case has been referred to DOJ; TP's frivolous arguments lacked merit; enforcement of summons ordered	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Snell, U.S. v., 110 A.F.T.R.2d (RIA) 7075 (D. Ariz. 2012)	Powell requirements satisfied; enforcement of summons ordered; government's motion for show cause hearing ordered	Yes	IRS
Snider, U.S. v., 111 A.F.T.R.2d (RIA) 483 (N.D. Cal. 2013), *amending* 111 A.F.T.R.2d (RIA) 482 (N.D. Cal. 2013), adopting 111 A.F.T.R.2d (RIA) 480 (N.D. Cal. 2012)	Powell requirements satisfied; TP's bad faith argument rejected; enforcement of summons ordered	Yes	IRS
St. John, U.S. v., 111 A.F.T.R.2d (RIA) 1653 (M.D. Fla. 2013), *adopting* A.F.T.R.2d (RIA) 1328 (M.D. Fla. 2013)	TP's motion to quash third-party summons rejected; TP's Fifth Amendment arguments rejected; civil contempt ordered	No	IRS
St. John, U.S. v., 111 A.F.T.R.2d (RIA) 723 (M.D. Fla. 2013), *adopting in part* 111 A.F.T.R.2d (RIA) 719 (M.D. Fla. 2012)	TP did not waive Fifth Amendment privilege by waiting until contempt proceeding to invoke it; show cause hearing for civil contempt ordered	No	Split
Stanley, U.S. v., 2012 U.S. Dist. LEXIS 182744 (D.N.H. 2012), *adopting* 2012 U.S. Dist. LEXIS 181793 (D.N.H. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Strauss, U.S. v., 110 A.F.T.R.2d (RIA) 6487 (S.D. Cal. 2012)	Powell requirements satisfied; enforcement of summons granted;	Yes	IRS
Tech v. U.S., 111 A.F.T.R.2d (RIA) 1423 (M.D. Pa. 2013), aff'g 109 A.F.T.R.2d (RIA) 2655 (M.D. Pa. 2012)	TP's assertion that IRS can be compelled to issue summonses for civil discovery purposes lacked merit	No	IRS
Thompson, U.S. v., 110 A.F.T.R.2d (RIA) 5169 (W.D. Mo. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5167 (W.D. Mo. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Thurkins, U.S. v., 2012 U.S. Dist. LEXIS 156775 (D.N.H. 2012), *adopting* 2012 U.S. Dist. LEXIS 156776 (D.N.H. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Trescott v. Dep't of the Treas., 2012 U.S. Dist. Lexis 127903 (N.D. Fla. 2012), *adopting* 2012 U.S. Dist. LEXIS 127906 (N.D. Fla. 2012)	TP's petition to quash third-party summons for lack of subject matter jurisdiction; TP not entitled to notice because third-party summons issued in aid of collection efforts	Yes	IRS
Valencia, U.S. v., 2013 U.S. Dist. LEXIS 15049 (C.D. Cal. 2013)	Powell requirements satisfied; government's motion for show cause hearing granted	Yes	IRS
Vanarsdal, U.S. v., 2012 U.S. Dist. LEXIS 161803 (W.D. Mich. 2012), *adopting* 2012 U.S. Dist. LEXIS 162725 (W.D. Mich. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Vanarsdal, U.S. v., 2012 U.S. Dist. LEXIS 161801 (W.D. Mich. 2012), *adopting* 2012 U.S. Dist. LEXIS 165006 (W.D. Mich. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Van Liew, U.S. v., 111 A.F.T.R.2d (RIA) 1275 (N.D. Tex. 2013), *adopting* 111 A.F.T.R.2d (RIA) 1273 (N.D. Tex. 2013).	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Waller v. U.S., 111 A.F.T.R.2d (RIA) 1876 (D. Nev. 2013)	TP's untimely motion to quash third-party summons dismissed for lack of subject matter jurisdiction	Yes	IRS
Williams v. U.S., 111 A.F.T.R.2d (RIA) 853 (D. Or. 2013), *adopting* 111 A.F.T.R.2d (RIA) 850 (D. Or. 2013)	Powell requirements satisfied; TP's motion to quash third-party summons denied; TP received adequate notice; TP failed to demonstrate case has been referred to DOJ; TP's bad faith argument rejected; TP's Fourth and Fourteenth Amendment objections lacked merit; TP's federal privacy law objection lacked merit	Yes	IRS
Williams, U.S. v., 110 A.F.T.R.2d (RIA) 5491 (S.D. Miss. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5488 (S.D. Miss. 2012)	Civil contempt ordered	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Williams, U.S. v., 2012 U.S. Dist. LEXIS 155043 (M.D.N.C. 2012), *adopting* 2012 U.S. Dist. LEXIS 156261 (M.D.N.C. 2012)	Powell requirements satisfied; TP failed to demonstrate case has been referred to DOJ; enforcement of summons ordered	Yes	IRS
Zane, U.S. v., 110 A.F.T.R.2d (RIA) 5266 (W.D. Mo. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5264 (W.D. Mo. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Zurek v. U.S., 111 A.F.T.R.2d (RIA) 1594 (D. Ariz. 2013)	TP's motions to quash third-party summonses dismissed for lack of subject matter jurisdiction	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, & Sole Proprietorships — Schedules C, E, F)			
AS Holdings Grp., LLC, U.S. v., 521 Fed. App'x 405 (6th Cir. 2013), *aff'g by an equally divided court U.S. v. Omega Solutions, LLC*, 873 F. Supp. 2d 887 (E.D. Mich. 2012)	Powell requirements satisfied; TP not entitled to notice because third-party summons issued in aid of collection efforts; order enforcing third-party summons affirmed	No	IRS
Asselin, U.S. v., 110 A.F.T.R.2d (RIA) 6459 (D.N.H. 2012), *adopting* 110 A.F.T.R.2d (RIA) 6458 (D.N.H. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Butler, U.S. v., 2012 U.S. Dist. LEXIS 175761 (D. Mass. 2012), *adopting* 2012 U.S. Dist. Lexis 182696 (D. Mass. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Christensen, U.S. v., 110 A.F.T.R.2d (RIA) 5421 (D. Ariz. 2012)	TP may assert Fifth Amendment privilege against self-incrimination on behalf of himself, but not for corporation; enforcement of summons ordered	No	IRS
Christensen, U.S. v., 111 A.F.T.R.2d (RIA) 307 (D. Ariz. 2012)	Hearing on purgation of contempt order ordered	No	IRS
Clarke, U.S. v., 2013-1 U.S.T.C. (CCH) ¶ 50,287 (11th Cir. 2013), *vacating* 2012 U.S. Dist. LEXIS 188084 (S.D. Fla. 2012), *petition for cert. filed*, No. 13-301 (Sept. 6, 2013)	TP entitled to limited adversary hearing to investigate summons allegedly issued for improper purpose	No	TP
Discount Plumbing Co., U.S. v., 110 A.F.T.R.2d (RIA) 6726 (E.D. Tex. 2012), *adopting* 110 A.F.T.R.2d (RIA) 6724 (E.D. Tex. 2012)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Don Mon Chin, U.S. v., 2013 U.S. Dist. LEXIS 12635 (D.N.H. 2013), *adopting* 2013 U.S. Dist. LEXIS 11679 (D.N.H. 2013)	Powell requirements satisfied; enforcement of summons ordered	Yes	IRS
Eaton Corp., U.S. v., 110 A.F.T.R.2d (RIA) 5638 (N.D. Ohio 2012)	Enforcement of summonses ordered in part and denied in part; privileged documentation for which written privileges logs provided protected; IRS cannot summons irrelevant information from TP	No	Split
Fisher v. U.S., 110 A.F.T.R.2d (RIA) 5324 (D. Minn. 2012)	TP's untimely motion to quash third-party summons dismissed for lack of subject matter jurisdiction and failure to state a claim upon which relief can be granted	Yes	IRS
Flight Vehicles Consulting, Inc. v. U.S., 110 A.F.T.R.2d (RIA) 5487 (N.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5484 (N.D. Cal. 2012)	Powell requirements satisfied; TPs' motion to quash third-party summonses dismissed; TPs' bad faith argument rejected	Yes	IRS
Gehrisch, U.S. v., 110 A.F.T.R.2d (RIA) 6597 (S.D. Cal. 2012)	Powell requirements satisfied; state service of process requirements satisfied; enforcement of summons ordered	Yes	IRS
Gjerde v. U.S., 110 A.F.T.R.2d (RIA) 5581 (E.D. Cal. 2012)	Powell requirements satisfied; TP's motion to quash third-party summons dismissed; documents ordered are not privileged; summons does not seek information beyond statute of limitations for the assessment period	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Ideal Products LLC v. U.S., 110 A.F.T.R.2d (RIA) 6964 (N.D. Ohio 2012)	TP's motion to quash third-party summons denied for lack of standing and subject matter jurisdiction	Yes	IRS
Jewell v. U.S., 111 A.F.T.R.2d (RIA) 1129 (E.D. Okla. 2013), *appeal docketed*, No. 13-7038 (10th Cir. May 3, 2013)	TP's motion to quash third-party summons granted for lack of proper notice	No	TP
Jewell v. U.S., 111 A.F.T.R.2d (RIA) 1005 (W.D. Okla. 2013), *appeal docketed*, No. 13-6069 (10th Cir. Mar. 21, 2013)	Powell requirements satisfied; TP's motion to quash third-party summons denied	No	IRS
Lano Equip., Inc., U.S. v., 2012 U.S. Dist. LEXIS 77392 (D. Minn. 2012), *adopting* 2012 U.S. Dist. LEXIS 77900 (D. Minn. 2012)	Powell requirements satisfied; TP's over breadth argument lacked merit; enforcement of summons ordered	No	IRS
M & M Hal Agency, Inc., U.S. v., 110 A.F.T.R.2d (RIA) 6253 (S.D. Ohio 2012), *adopting* 110 A.F.T.R.2d (RIA) 5814 (S.D. Ohio 2012)	Civil contempt ordered	Yes	IRS
Miccosukee Tribe of Indians of Fla. v. U.S., 110 A.F.T.R.2d (RIA) 6342 (11th Cir. 2012), aff'g 110 A.F.T.R.2d (RIA) 5212 (S.D. Fla. 2012)	Powell requirements satisfied; denial of TP's motion to quash third-party summonses affirmed; TP's claim of tribal sovereign immunity inapplicable to case; Rejection of TP's over breadth argument for lack of standing affirmed	No	IRS
Moore DMD PA, U.S. v., 110 A.F.T.R.2d (RIA) 6619 (D.N.J. 2012), *adopting Moore, U.S. v.*, 110 A.F.T.R.2d (RIA) 6619 (D.N.J. 2012)	Enforcement of summons ordered	Yes	IRS
Net Promotion, Inc. v. U.S., 110 A.F.T.R.2d (RIA) 6951 (D. Minn. 2012), *adopting* 110 A.F.T.R.2d (RIA) 6949 (D. Minn. 2012)	Powell requirements satisfied; TP's motion to quash third-party summons denied	No	IRS
Omega Solutions, LLC, 873 F. Supp. 2d 887 (E.D. Mich. 2012), *aff'd sub nom., U.S. v. AS Holdings Grp., LLC*, 521 Fed. App'x 405 (6th Cir. 2013)	Powell requirements satisfied; TP received adequate notice; TP's motion to intervene and to dismiss denied	No	IRS
Shiozawa v. U.S., 111 A.F.T.R.2d (RIA) 369 (N.D. Cal. 2012)	Powell requirements satisfied; TP's motion to quash third-party summons dismissed; TP not entitled to notice because third-party summons issued in aid of collection efforts; enforcement of summons ordered	Yes	IRS
Sideman & Bancroft, LLP U.S. v., 111 A.F.T.R.2d (RIA) 460 (9th Cir. 2013), *aff'g* 107 A.F.T.R.2d (RIA) 1780 (N.D. Cal. 2011)	TP may not assert Fifth Amendment privilege against self-incrimination where foregone conclusion exception applies; enforcement of summons ordered	No	IRS
Spitzer v. U.S. Dept. of Treas., 110 A.F.T.R.2d (RIA) 6942 (D. Ariz. 2012)	TP's amended motion to quash third-party summons dismissed	No	IRS
Stevens v. LL Bradford, Inc., 2012 U.S. Dist. LEXIS 138043 (D. Nev. 2012)	TP's motion to quash third-party summons dismissed for lack of subject matter jurisdiction	No	IRS
Veritas Inst. v. U.S., 111 A.F.T.R.2d (RIA) 1027 (D. Nev. 2013)	TP's motion to quash third-party summons dismissed; business entities cannot proceed pro se/without licensed counsel	Yes	IRS
Villarreal v. U.S., 110 A.F.T.R.2d (RIA) 6777 (D. Colo. 2012)	Powell requirements satisfied; TP's motion to quash third-party summons denied; TP's bad faith argument rejected; enforcement of summons ordered	No	IRS
Villarreal v. U.S., 111 A.F.T.R.2d (RIA) 1713 (10th Cir. 2013), *aff'g* 109 A.F.T.R.2d (RIA) 1522 (D. Colo. 2012)	Powell requirements satisfied; order denying TP's motion to quash third-party summons affirmed; TP's bad faith argument rejected	No	IRS

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Table 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)				
Adams v. Comm'r, T.C. Summ. Op. 2012-76	Levy	Denial of Interest abatement upheld; TPs (H&W) entitled to challenge underlying liability; liability upheld; no abuse of discretion	Yes	IRS
Anderson v. Comm'r, T.C. Summ. Op. 2013-24	Levy	TP precluded from challenging underlying liability; no abuse of discretion in rejecting collection alternatives since TP did not provide information requested	Yes	IRS
Arroyo v. Comm'r, T.C. Memo. 2013-112	Levy	TP entitled to challenge the underlying liabilities; liabilities upheld in part and denied in part	Yes	Split
Bartosovsky v. Comm'r, T.C. Summ. Op. 2012-101	Levy	TP precluded from challenging underlying liability; no abuse of discretion since TP offered no collection alternatives	Yes	IRS
Berns v. Comm'r, T.C. Summ. Op. 2013-17	Lien	No abuse of discretion since TP did not provide information requested	Yes	IRS
Boyd v. Comm'r, T.C. Memo. 2013-100	Levy/ Lien	Proceeding dismissed as to TP (H) for lack of jurisdiction; TP (W) precluded from challenging underlying liability; no abuse of discretion in denying face-to-face hearing or collection alternatives; no abuse of discretion in refusing to grant a continuance or failing to provide TP (W) with transcripts; installment agreement was no longer in effect and had properly been reverted to collection status	Yes	IRS
Brennan v. Comm'r, T.C. Memo. 2013-123	Levy	TP precluded from challenging underlying liability; no abuse of discretion	No	IRS
Buckardt v. Comm'r, T.C. Memo. 2012-170, *appeal docketed* No. 12-72119 (9th. Cir. July 3, 2012)	Levy/ Lien	TP precluded from challenging underlying liabilities since TP did not properly raise issues during hearing; no abuse of discretion in proceeding with proposed levy since TP's positions were frivolous and TP did not offer a collection alternative; motion to permit levy granted	Yes	IRS
Campbell v. Comm'r, T.C. Memo. 2013-57	Levy	TP precluded from challenging underlying liability since TP constructively refused mail deliveries; no abuse of discretion in denying face-to-face hearing since TP did not provide information requested or offer a collection alternative	Yes	IRS
Clark v. Comm'r, T.C. Memo. 2012-182	Lien	TP precluded from challenging underlying liability for civil penalties since at hearing TP only contested penalties for frivolous reasons; no abuse of discretion since TP declined to discuss collection alternatives and TP's positions were frivolous	Yes	IRS
Cohen v. Comm'r, T.C. Memo. 2013-86	Levy/ Lien	No abuse of discretion since "harmless error" doctrine applies	No	IRS
Crites v. Comm'r, T.C. Memo. 2012-267	Levy	No abuse of discretion because TP's positions were frivolous	Yes	IRS
Curran v. Comm'r, T.C. Memo. 2012-234	Levy	No abuse of discretion in rejecting installment agreement since TP had sufficient assets to pay	No	IRS
DeLon v. Comm'r, 489 F. App'x 710 (4th Cir. 2012), *aff'g* T.C. Memo. 2012-33	Levy	TP precluded from challenging underlying tax liability; no abuse of discretion since TP did not offer collection alternatives or provide requested information	Yes	IRS
Devlin v. Comm'r, T.C. Memo. 2012-145	Lien	TP entitled to challenge the underlying liabilities but liabilities sustained since TP's positions were frivolous; no abuse of discretion since TP did not offer collection alternatives or provide requested information	Yes	IRS

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Table 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Drakes v. Comm'r, T.C. Memo. 2012-189	Levy	TPs (H&W) precluded from challenging underlying liability; no abuse of discretion in rejecting offer since TPs had sufficient assets to pay	Yes	IRS
Duplicki v. Comm'r, T.C. Summ. Op. 2012-117	Lien	Determination by Appeals Office to uphold notice of lien sustained since notices of deficiency and demand for payment were properly mailed to last known address	Yes	IRS
Flint v. Comm'r, T.C. Memo. 2012-287	Lien	TP's income tax liability not discharged in bankruptcy but section 6702 penalties discharged; lien filing sustained with respect to income tax liabilities but not with respect to section 6702 penalties	Yes	Split
Friedman v. Comm'r, T.C. Memo. 2013-44	Levy	TPs (H&W) precluded from challenging underlying liability; no abuse of discretion in denying request to delay collection since TPs had sufficient assets to pay; no abuse of discretion in rejecting installment agreement since TPs failed to make estimated tax payments	Yes	IRS
Galyean v. Comm'r, T.C. Memo. 2012-242	Levy	No abuse of discretion by refusing to place the TPs' (H&W) account in "currently not collectible" status since TPs had sufficient assets to pay	Yes	IRS
Goldberg v. Comm'r, T.C. Summ. Op. 2012-62	Levy	Overpayment could not be applied to liability because it was time barred; no abuse of discretion since TP did not offer collection alternatives	Yes	IRS
Hall v. Comm'r, T.C. Memo. 2013-93	Lien	TP precluded from challenging underlying liabilities since TP previously signed a waiver agreeing to the liabilities; argument that waiver signed under duress rejected	Yes	IRS
Harper v. Comm'r, T.C. Memo. 2013-79	Levy	No abuse of discretion in denying face-to-face hearing since TP did not provide the information requested	Yes	IRS
Harris v. Comm'r, T.C. Memo. 2012-275	Levy/ Lien	TP precluded from challenging underlying liabilities; no abuse of discretion since TP's positions were frivolous	Yes	IRS
Hennessey v. Comm'r, T.C. Summ. Op. 2013-23	Lien	No abuse of discretion in rejecting TP's offer since TP had sufficient assets to pay	Yes	IRS
Hernandez v. Comm'r, T.C. Summ. Op. 2012-56	Levy	TPs (H&W) precluded from challenging underlying liability; no abuse of discretion in rejecting collection alternatives since TPs had sufficient assets to pay	Yes	IRS
Holt v. Comm'r, T.C. Memo. 2012-271	Levy/ Lien	TP precluded from challenging underlying liability; no abuse of discretion since TP did not claim or produce evidence of an abuse	Yes	IRS
Israel v. Comm'r, T.C. Memo. 2012-185	Levy	TP precluded from challenging underlying liability	Yes	IRS
Johnson v. Comm'r, 502 F. App'x 1, *aff'g* 136 T.C. 475 (2011)	Levy/ Lien	No abuse of discretion in rejecting offer since TP had sufficient assets to pay	No	IRS
Jones v. Comm'r, T.C. Memo. 2012-274	Lien	Remanded to Appeals Office to reconsider offer and to provide TPs (H&W) a meaningful opportunity to substantiate their position	Yes	TP
Kalil v. Comm'r, T.C. Summ. Op. 2013-29	Levy	TPs (H&W) precluded from challenging underlying liability; no abuse of discretion since TPs' had not arrived at a binding agreement with Settlement Officer and check payment did not constitute full payment	Yes	IRS
Kehoe v. Comm'r, T.C. Memo. 2013-63	Lien	No abuse of discretion in rejecting offer since TPs (H&W) had sufficient assets; no abuse of discretion in not withdrawing lien	Yes	IRS
Klika v. Comm'r, T.C. Memo. 2012-225	Levy/ Lien	No abuse of discretion in denying face-to-face hearing or in rejecting collection alternatives since TP did not provide information requested	Yes	IRS

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Table 5: Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Kubon v. Comm'r, 479 F. App'x 759 (9th Cir. 2012), *aff'g* T.C. Memo. 2011-41	Levy/ Lien	TPs (H&W) precluded from challenging underlying liability since notice of deficiency was mailed to last known address and TPs' positions were frivolous	Yes	IRS
Kuretski v. Comm'r, T.C. Memo. 2012-262, *appeal docketed* No. 13-1090 (D.C. Cir. Mar. 29, 2013)	Levy	No abuse of discretion in proceeding with proposed levy since Appeals Officer is not obligated to negotiate indefinitely; TPs (H&W) entitled to challenge the underlying liabilities; liabilities upheld in part and denied in part	No	Split
Kyereme v. Comm'r, T.C. Memo. 2012-174	Lien	No abuse of discretion since TP did not offer collection alternatives	Yes	IRS
Leibold v. Comm'r, T.C. Memo. 2012-210	Lien	TP not entitled to challenge underlying tax liability; no abuse of discretion in denying face-to-face hearing since TP did not provide information requested	Yes	IRS
Link v. Comm'r, T.C. Memo. 2013-53	Levy	No abuse of discretion in denying face-to-face hearing or proceeding with proposed levy since TP had sufficient assets to pay	Yes	IRS
Lipson v. Comm'r, T.C. Memo. 2012-252	Levy	No abuse of discretion in rejecting installment agreement since TP had already defaulted on 2 such agreements, was not in compliance with current payments, and had sufficient assets to pay	No	IRS
Lyons v. Comm'r, T.C. Memo. 2012-295	Levy	No abuse of discretion since TP did not provide information requested	Yes	IRS
Mattson v. Comm'r, 508 F. App'x 653 (9th Cir. 2013), *aff'g* T.C. Docket No. 19245-09 L (Jan. 19, 2011)	Levy/ Lien	TP precluded from challenging underlying liability; no abuse of discretion since TP failed to attend the face-to-face hearing or to provide information requested	Yes	IRS
Minemyer v. Comm'r, T.C. Memo. 2012-325	Levy/ Lien	No abuse of discretion since TP provided no evidence that removing the lien would facilitate collection; notice of intent to levy was invalid since it was not mailed to TP's last known address	Yes	Split
Moody v. Comm'r, 474 F. App'x 552 (9th Cir. 2012), *aff'g* T.C. Docket Nos. 1319-10 L (Apr. 14, 2011), 1060-10 L (Apr. 14, 2011)	Levy/ Lien	TP precluded from challenging underlying liabilities since notices of deficiencies were mailed to last known address	Yes	IRS
Moore v. Comm'r, T.C. Summ. Op. 2012-116	Levy	TP (H&W) satisfied their 2005 tax liability in bankruptcy proceeding; Appeals Officer abused discretion in proceeding with levy to collection income-tax liability	Yes	TP
Moser v. Comm'r, T.C. Memo. 2012-208	Lien	TP not entitled to challenge underlying tax liabilities since notice of deficiencies were mailed to last known address; no abuse of discretion since TP did not offer collection alternative or provide information requested	Yes	IRS
Nau v. Comm'r, T.C. Summ. Op. 2012-106	Lien	TP precluded from challenging underlying liability; no abuse of discretion since TP did not offer collection alternatives or provide information requested	Yes	IRS
O'Brien v. Comm'r, T.C. Memo. 2012-326	Levy	TP entitled to challenge underlying liability; liability upheld; section 6702 penalty assessment was timely	Yes	IRS
Pomeroy v. Comm'r, T.C. Memo. 2013-26	Lien	Abuse of discretion in rejecting offer since Appeals Officer did not adequately consider TP's (H) health; remanded to supplement the record	No	TP
Radeke v. Comm'r, T.C. Memo. 2012-319	Levy	No abuse discretion in denying collection alternatives since TP did not provide information requested	Yes	IRS
Raifman v. Comm'r, T.C. Memo. 2012-228	Levy/ Lien	TPs (H&W) entitled to challenge the underlying liabilities; IRS's motion for summary judgment granted in part and denied in part since material fact remained pertaining to theft loss amount	No	Split
Ramdas v. Comm'r, T.C. Memo. 2013-104	Levy	No abuse of discretion in rejecting offer since TP did not provide information requested and had sufficient assets to pay	No	IRS

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Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Sanchez v. Comm'r, T.C. Memo. 2012-216	Lien	No abuse of discretion since TP's circumstances and new information were properly considered	Yes	IRS
Satkiewicz v. Comm'r, T.C. Memo. 2013-73	Lien	No abuse of discretion since TPs' (H&W) positions were frivolous	Yes	IRS
Sawyer v. Comm'r, T.C. Memo. 2012-201	Lien	No abuse of discretion since TPs (H&W) did not provide sufficient evidence of misconduct nor did the "equitable estoppel" doctrine apply	Yes	IRS
Skidmore v. Comm'r, T.C. Memo. 2012-328	Lien	TP precluded from challenging underlying liability; no abuse of discretion since TP did not provide information requested	Yes	IRS
Starkman v. Comm'r, T.C. Memo. 2012-236	Levy/ Lien	No abuse of discretion in rejecting installment agreement since TP defaulted under a prior installment agreement and failed to make estimated tax payments	Yes	IRS
Sullivan v. Comm'r, T.C. Memo. 2012-337	Levy	No abuse of discretion in rejecting collection alternatives since TP did not provide information requested	Yes	IRS
Thompson v. Comm'r, T.C. Memo. 2013-61	Levy/ Lien	TP precluded from challenging underlying tax liability	Yes	IRS
Tucker v. Comm'r, 506 F. App'x 166 (3d Cir. 2012), *aff'g* T.C. Memo. 2012-30	Levy	No abuse of discretion since TP is not prejudiced by having received an unsigned copy of the record of assessment	Yes	IRS
Van Camp v. Comm'r, T.C. Memo. 2012-336, *appeal docketed* No. 13-70018 (9th Cir. Jan. 3, 2013)	Levy/ Lien	No abuse of discretion since TP's change in financial circumstances following the CDP hearing did not warrant remand	No	IRS
Williams v. Comm'r, 718 F.3d 89 (2d Cir. 2013), *aff'g* T.C. Memo 2007-162	Levy/ Lien	No abuse of discretion in denying face-to-face hearing since TPs' (H&W) positions were frivolous and TPs did not provide information requested	Yes	IRS
Wilson v. Comm'r, T.C. Memo. 2012-229	Levy	No abuse of discretion in rejecting offer since TP had sufficient assets to pay	No	IRS
Wilson v. Comm'r, T.C. Summ. Op. 2013-18	Levy	No abuse of discretion in rejecting TP's collection alternatives since TP had sufficient assets to pay	Yes	IRS
Winters v. Comm'r, T.C. Memo. 2012-183	Levy	No abuse of discretion in rejecting offer since TP did not provide information requested	Yes	IRS
Yoel v. Comm'r, T.C. Memo. 2012-222	Lien	No abuse of discretion in denying face-to-face hearing and collection alternatives since TP did not provide information requested	Yes	IRS
Zook v. Comm'r, T.C. Memo. 2013-128	Lien	TP precluded from challenging underlying tax liability; No abuse of discretion since TP did not offer collection alternatives	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships — Schedules C,E,F)				
A-Valey Eng'rs, Inc. v. Comm'r, T.C. Memo. 2012-199	Levy	No abuse of discretion in denying abatement of interest or in rejecting offer since TP did not provide evidence of misconduct	No	IRS
Adams v. Comm'r, T.C. Memo. 2013-92	Levy	Assessment timely; collection period open; no abuse of discretion since notice of deficiency was mailed to last known address	Yes	IRS
Alessio Azzari, Inc. v. Comm'r, T.C. Memo. 2012-310	Lien	No abuse of discretion in rejecting offer since TP failed to include the assets of its successor corporation; case remanded to the Appeals Office to allow TP to amend offer	No	Split
Antioco v. Comm'r, T.C. Memo. 2013-35	Levy	Abuse of discretion in rejecting installment agreement and in proceeding with proposed levy; Appeals Officer's findings of fraud and noncompliance were erroneous; abuse of discretion in failing to consider "special circumstances" and economic hardship	No	TP
Beeler v. Comm'r, T.C. Memo. 2013-130	Levy/ Lien	Collection action upheld; however, collection amount reduced on remand from Court of Appeals because IRS failed to meet its burden; burden of proof shifted to IRS due to IRS's gross transcript errors	No	Split

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Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Bell v. Comm'r, T.C. Summ. Op. 2012-45	Levy	TPs (H&W) precluded from challenging underlying liability; no abuse of discretion in rejecting offer since TPs did not explain change in deposits or provide all information requested	Yes	IRS
Bridgmon v. Comm'r, T.C. Memo. 2012-322	Levy	TP precluded from challenging underlying liabilities; abuse of discretion found in refusing to consider TP's installment agreement since Appeals Office did not call TP or return TP's calls	Yes	Split
Brombach v. Comm'r, T.C. Memo. 2012-265	Lien	No abuse of discretion in rejecting offer; no abuse in rejection of TP's proposed "special circumstances"	Yes	IRS
Bus. Integration Servs., Inc. v. Comm'r, T.C. Memo. 2012-342	Levy	TP precluded from challenging underlying liabilities; no abuse of discretion since TP did not provide evidence of misconduct	Yes	IRS
Cantrell v. Comm'r, T.C. Memo. 2012-257, *appeal docketed* No. 13-60007 (5th Cir. Jan, 3, 2013)	Levy/ Lien	No abuse of discretion since TP failed to schedule meeting with Revenue Agent and did not provide information requested	No	IRS
Clarke v. Comm'r, T.C. Memo. 2012-238	Levy	No abuse of discretion in rejecting collection alternatives; no abuse of discretion in rejecting argument for "special circumstances"	No	IRS
Cutler v. Comm'r, T.C. Memo. 2013-119	Levy	No abuse of discretion since 2005 liability became moot upon court granting innocent spouse relief; lack of jurisdiction for court to order IRS to return amounts levied	No	IRS
Dalton v. Comm'r, 682 F.3d 149 (1st Cir. 2012), *rev'g* 135 T.C. 393 (2010)	Levy	No abuse of discretion in rejecting TPs' (H&W) offer since TPs were the true owners of valuable real estate and determination that trust was a nominee was reasonable	No	IRS
Dreamco Dev. Corp. v. Comm'r, T.C. Summ. Op. 2012-67	Levy/ Lien	No abuse of discretion in rejecting offer since TP not compliant with its tax obligations	Yes	IRS
Ensyc Techs. v. Comm'r, T.C. Summ. Op. 2012-55	Levy	TP entitled to challenge the underlying liability and the court held TP was not liable	No	TP
Everett Assocs., Inc. v. Comm'r, T.C. Memo. 2012-143	Levy	TP precluded from challenging liabilities listed on IRS's "proof of claim" filed in the TP's bankruptcy; however, TP entitled to challenge interest and penalties that accrued during and after bankruptcy; abuse of discretion found in that IRS could not explain the interest rate it charged	Yes	Split
G.D. Parker, Inc. v. Comm'r, T.C. Memo. 2012-327	Lien	No abuse of discretion in ignoring TP's capital loss carryback for 2003 since court found TP was barred by the "step transaction" doctrine from claiming a capital loss for 2004	No	IRS
Gonzalez v. Comm'r, T.C. Memo. 2012-151	Lien	TP precluded from challenging underlying liability despite claim that he did not understand English since Revenue Officer was fluent and spoke in TP's language	Yes	IRS
Gould v. Comm'r, 139 T.C. 418 (2012), *appeal docketed* No. 13-1852 (4th Cir. July 5, 2013)	Levy/ Lien	No abuse of discretion in denying face-to-face hearing since TPs (H&W) did not offer collection alternatives	No	IRS
Hinerfeld v. Comm'r, 139 T.C. 277 (2012)	Levy	No abuse of discretion in rejecting offer; communications between Appeals Officer and Area Counsel not prohibited	No	IRS
Hirsch v. Comm'r, T.C. Summ. Op. 2012-89	Lien	TP precluded from challenging underlying liabilities; no abuse of discretion in rejecting collection alternatives since TP did not provide information requested	No	IRS
Jag Brokerage, Inc. v. Comm'r, T.C. Memo. 2012-315	N/A	TP challenged the underlying liability; IRS's summary judgment denied since material issue existed as to whether the deficiency notice was received by the corporation TP	No	TP

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Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Klingenberg v. Comm'r, T.C. Memo. 2012-292, *appeal docketed* No. 13-70506 (9th Cir. Feb. 11, 2013)	Levy/ Lien	TP precluded from challenging underlying liability; no abuse of discretion in denying face-to-face hearing or rejecting collection alternatives since TP only raised frivolous issues	Yes	IRS
La Marine Serv., L.L.C. v. Comm'r, T.C. Memo. 2012-220	Levy	No abuse of discretion in rejecting collection alternatives since TP did not provide information requested	No	IRS
Lane v. Comm'r, T.C. Memo. 2013-121	Lien	Remanded to Appeals Office to reconsider offer since there was insufficient information to establish that Appeals considered economic hardship	No	TP
Lepore v. Comm'r, T.C. Memo. 2013-135	Lien	Remanded case to Appeals Office to reconsider whether TP was liable for trust fund recovery penalties since TP did not receive notice of assessment and TP was entitled to contest underlying tax liability	No	TP
Loren G. Rice Trust v. Comm'r, T.C. Memo. 2012-301	Lien	No abuse of discretion since TP did not provide evidence of misconduct; Revenue Officer's visit to TP's workplace was permissible	Yes	IRS
Miss Laras Dominion, Inc. v. Comm'r, T.C. Memo. 2012-203	Levy	No abuse of discretion in rejecting installment agreement since TP had sufficient assets to pay	No	IRS
Morris v. Comm'r, T.C. Memo. 2012-217	Levy	No abuse of discretion since TPs (H&W) did not have authority to direct the application of overpayments from other returns and did not offer collection alternatives	Yes	IRS
Pace v. Comm'r, T.C. Memo. 2012-211	Levy	No abuse discretion in rejecting installment agreement since TP did not provided information requested	No	IRS
Precision Prosthetic v. Comm'r, T.C. Memo. 2013-110	Levy	No abuse of discretion since TP did not provide evidence of misconduct	No	IRS
Romano-Murphy v. Comm'r, T.C. Memo. 2012-330, *appeal docketed* No. 13-13186 (11th Cir. July 15, 2013)	Levy/ Lien	TP entitled to challenge the underlying liabilities and the court held TP was liable	Yes	IRS
Solucorp, Ltd. v. Comm'r, T.C. Memo. 2013-118	Levy	TP precluded from challenging underlying liabilities; no abuse of discretion since IRS is not required to attempt to collect trust fund taxes from the employer before attempting to collect against a responsible person	No	IRS
Son Gee Wine & Liquors, Inc. v. Comm'r, T.C. Memo. 2013-62	Levy/ Lien	TP precluded from challenging tax liabilities listed on IRS's "proof of claim"; however, TP entitled to challenge interest, penalties, and additions to tax that accrued and were assessed after the bankruptcy closed; court held TP was liable; no abuse of discretion since TP did not offer collection alternatives or provide information requested	No	IRS
Specialty Staff, Inc. v. Comm'r, T.C. Memo. 2012-253	Levy/ Lien	No abuse of discretion since TP not compliant with its tax obligations and TP provided no evidence that removing the lien would facilitate collection	No	IRS
Stanwyck v. Comm'r, T.C. Memo. 2012-180, *appeal docketed* No. 12-73136 (9th Cir. Oct. 1, 2013)	Levy/ Lien	No abuse of discretion since TP did not offer collection alternatives or provide information requested	Yes	IRS
Taggart v. Comm'r, T.C. Memo. 2013-113	Lien	TP precluded from challenging underlying liabilities; no abuse of discretion in rejecting offer since TP had sufficient assets to pay; filing of lien did not create an undue hardship for TP	Yes	IRS

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Case Citation	Lien or Levy	Issue(s)	*Pro Se*	Decision
Trainor v. Comm'r, T.C. Memo. 2013-14, *appeal docketed* No. 13-11797 (11th Cir. Apr. 24, 2013)	Levy	No abuse of discretion since TP failed to timely propose a collection alternative	No	IRS
Venhuizen v. Comm'r, T.C. Memo. 2012-270	Lien	TP precluded from challenging underlying tax liability; no abuse of discretion since TP did not make an offer or provide information requested	Yes	IRS

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Table 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Albright v. Comm'r, T.C. Memo. 2013-9	6651(a)(1) no evidence of reasonable cause	Yes	Split
Arroyo v. Comm'r, T.C. Memo. 2013-112	6651(a)(1) no evidence of reasonable cause; 6654 imposition proper; 6651(a)(2) IRS did not meet its burden of production	Yes	Split
Bates, Estate of v. Comm'r, T.C. Memo. 2012-314	6651(a)(1), (a)(2) reliance on advice from a non-tax professional did not establish reasonable cause	No	IRS
Bilyeu v. Comm'r, T.C. Memo. 2012-161	6651(a)(1), (a)(2) TP argued that if deduction allowed, then a refund was due and penalties should not stand; however, the deduction was not permitted	Yes	IRS
Bishop v. Comm'r, T.C. Memo. 2013-98	6651(a)(1) no evidence of reasonable cause	No	IRS
Buckardt v. Comm'r, 474 F. App'x 612 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-145	6651(a)(1), 6654 imposition proper	Yes	IRS
Calloway v. Comm'r, 691 F.3d 1315 (11th Cir. 2012), *aff'g* 135 T.C. 26 (2010)	6651(a)(1) reliance on statements from third-party did not establish reasonable cause	No	IRS
Carlebach v. Comm'r, 139 T.C. 1 (2012)	6651(a)(1) no evidence of reasonable cause	No	IRS
Cherry v. Comm'r, T.C. Memo. 2013-3	6651(a)(1) incarceration after the return due date did not establish reasonable cause	Yes	IRS
Christman v. U.S., 110 Fed. Cl. 1 (2013)	6651(a)(2) no reasonable cause; 6654 no exception	Yes	IRS
Chow v. Comm'r, 481 F. App'x 406 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-48, *cert denied*, 133 S. Ct. 1304 (2013)	6651(a)(1) Tax Court's decision to impose penalty was upheld	Yes	IRS
Cunningham v. Comm'r, T.C. Summ. Op. 2013-27	6651(a)(1), (a)(2) financial difficulties did not establish reasonable cause because TP did not act with ordinary business care; 6654 imposition proper	Yes	IRS
Ditaranto v. Comm'r, T.C. Memo. 2012-205	6651(a)(1), (a)(2) personal, professional and financial difficulties did not establish reasonable cause	Yes	IRS
Ellis v. Comm'r, T.C. Memo. 2012-250	6651(a)(1) (a)(2), 6654 no evidence that reasonable cause or exceptions applied	Yes	IRS
Foryan v. Comm'r, T.C. Memo. 2012-177	6651(a)(1), (a)(2), 6654 IRS met its burden of production	Yes	IRS
Grandy v. Comm'r, T.C. Memo. 2012-196	6651(a)(1), (a)(2) no evidence of reasonable cause	Yes	IRS
Hardin v. Comm'r, T.C. Memo. 2012-162	6651(a)(1), (a)(2), mental disorder did not establish reasonable cause and was not an exception for 6654	Yes	IRS
Harris v. Comm'r, T.C. Memo. 2012-312	6651(a)(1), (a)(2), belief that tax was not owed did not establish reasonable cause; 6654 no exception	Yes	IRS
Haury v. Comm'r, T.C. Memo. 2012-215, *appeal docketed*, No. 13-1780 (8th Cir. Apr. 9, 2013)	6651(a)(1) no reasonable cause; 6654 no exception	Yes	IRS
Hoang v. Comm'r, T.C. Memo. 2013-127	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Holmes v. Comm'r, T.C. Memo. 2012-251, *appeal docketed*, No. 13-71034 (9th Cir. Mar. 25, 2013)	6651(a)(1) no evidence of reasonable cause	No	IRS

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Table 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Hovind v. Comm'r, T.C. Memo. 2012-281	6651(a)(1) reliance on advice from non-tax professionals did not establish reasonable cause	No	IRS
Huminski v. Comm'r, T.C. Memo. 2012-302	6651(a)(2), 6654 imposition proper	No	IRS
Jenkins v. Comm'r, T.C. Memo. 2012-181	6651(a)(1) imposition proper; 6651(a)(2) IRS did not meet its burden of production; 6654 imposition not proper because TP reported no tax liability	Yes	Split
Kanofsky v. Comm'r, 111 A.F.T.R.2d (RIA) 1539 (3d Cir. 2013), *aff'g* T.C. Docket No. 3774-11	6651(a)(1), (a)(2), 6654 TP did not contest penalties in his post-trial brief, so the court sustained the determination	Yes	IRS
Kindred v. Comm'r, 2013 U.S. App. LEXIS 11028 (7th Cir. 2013), *aff'g* T.C. Memo. 2010-107	6654 no evidence that exception applied	No	IRS
Knappe v. U.S., 713 F.3d 1164 (9th Cir. 2013), *aff'g* 2013-1 U.S.T.C. (CCH) ¶ 60,662 (C.D. Cal. 2010), *cert. denied*, 80 U.S.L.W. 3031 (2013)	6651(a)(2) reliance on accountant did not establish reasonable cause	No	IRS
Kuretski v. Comm'r, T.C. Memo. 2012-262	6651(a)(2) health and financial difficulties did not create a substantial hardship and did not establish reasonable cause; 6654 IRS did not meet its burden of production	No	Split
Leyshon v. Comm'r, T.C. Memo. 2012-248	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Liftin, Estate of v. U.S., 111 Fed. Cl. 13 (2013)	6651(a)(1) IRS motion for summary judgment on the pleadings was denied, since TP provided facts that may support reasonable cause	No	TP
Murray v. Comm'r, T.C. Memo. 2012-213	6651(a)(1), (a)(2) no evidence of reasonable cause; 6654 no exception	Yes	IRS
Naylor v. Comm'r, T.C. Memo. 2013-19	6651(a)(1), (a)(2) no evidence of reasonable cause; 6654 imposition proper	Yes	IRS
Nelson v. Comm'r, T.C. Memo. 2012-232, *aff'd*, 112 A.F.T.R.2d 6247 (11th Cir. 2013)	6651(a)(1) TP did not file valid returns and provided no evidence of reasonable cause	Yes	IRS
Nix v. Comm'r, T.C. Memo. 2012-304	6651(a)(2) no evidence of reasonable cause; 6654 no exceptions	Yes	IRS
Park v. Comm'r, T.C. Memo. 2012-279	6651(a)(1) provided no evidence the return was mailed and no evidence of reasonable cause	Yes	IRS
Phillips v. Comm'r, T.C. Memo. 2013-42	6651(a)(1) litigation involvement did not establish reasonable cause; (a)(2) no evidence of reasonable cause; 6654 filing a return after a notice of deficiency was issued did not satisfy the return filed safe harbor	Yes	IRS
Richmond v. Comm'r, 474 F. App'x 754 (10th Cir. 2012), *aff'g* T.C. Memo. 2011-251	6651(a)(1), (a)(2) TP asserted frivolous arguments	Yes	IRS
Scharringhausen v. Comm'r, T.C. Memo. 2012-350	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Shafmaster v. U.S., 707 F.3d 130 (1st Cir. 2013), *aff'g* 109 A.F.T.R.2d (RIA) 2052 (D.N.H. 2012)	6651(a)(2) awaiting payment during negotiations with the IRS that the TP believed would result in abatement did not establish reasonable cause	No	IRS
Stine v. U.S., 106 Fed. Cl. 586 (2013)	6651(a)(1) disability was not severe enough to establish reasonable cause	No	IRS

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Table 6: Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown As Tax on Return Under IRC § 6651(a)(2) and Failure to Pay Estimated Tax Penalty Under IRC § 6654

Case Citation	Issue(s)	*Pro Se*	Decision
Stirm v. Comm'r, T.C. Summ. Op. 2012-95	6651(a)(1), (a)(2) insufficient time to devote to taxes did not establish reasonable cause	Yes	IRS
Tesoriero v. Comm'r, T.C. Memo. 2012-261	6651(a)(1) reliance on advisor to file extension did not establish reasonable cause	No	IRS
Thomas v. Comm'r, T.C. Summ. Op. 2013-5	6651(a)(1) imposition proper because hurricane did not extend TP's filing deadline	Yes	IRS
Thouron, Estate of v. U.S., 110 A.F.T.R.2d (RIA) 6572 (E.D. Pa. 2012)	6651(a)(1), (a)(2) no evidence of reasonable cause	No	IRS
Thurman v. Comm'r, T.C. Memo. 2013-46	6651(a)(1) imposition proper for 2006; however, (a)(2) imposition not proper for 2006 since IRS did not meet its burden of production; 6651(a)(1), (a)(2) both not proper for 2007 because TP did not have filing requirement	Yes	Split
Weatherly v. Comm'r, T.C. Memo. 2012-320	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Wilson v. Comm'r, T.C. Memo. 2012-229	6651(a)(1) imposition not proper because return was timely filed; (a)(2) imposition proper; 6654 IRS did not meet its burden of production	No	Split
Winslow v. Comm'r, 139 T.C. 270 (2012)	6651(a)(1), (a)(2) no evidence of reasonable cause	Yes	IRS
Wright v. Comm'r, T.C. Memo. 2013-129	6651(a)(1) TP's health problems established reasonable cause; 6651(a)(2) health problems did not establish reasonable cause and no evidence that payment would cause undue hardship	Yes	Split
Young, Estate of v. U.S., 110 A.F.T.R.2d (RIA) 7065 (D. Mass. 2012)	6651(a)(1) filing late because accurate property values were not available did not establish reasonable cause	No	IRS
Zaklama v. Comm'r, T.C. Memo. 2012-346	6651(a)(1) health problems did not establish reasonable cause; 6654 imposition proper	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trust, and Sole Proprietorships — Schedules C, E, F)			
Abarca v. Comm'r, T.C. Memo. 2012-245	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Adams v. Comm'r, T.C. Memo. 2013-7	6651(a)(1) lack of tax knowledge did not establish reasonable cause; (a)(2) no evidence of reasonable cause; 6654 did not qualify for exception	No	IRS
Atlantic Coast Masonry, Inc. v. Comm'r, T.C. Memo. 2012-233	6651(a)(1), (a)(2) no evidence of reasonable cause	No	IRS
Babcock Ctr., Inc. v. U.S., 111 A.F.T.R.2d (RIA) 1865 (D.S.C. 2013)	6651(a)(2) IRS motion for summary judgment for failure to pay payroll taxes for 2007 and a part of 2008 denied because genuine issue of fact existed over TP's financial hardship and ability to pay; summary judgment granted on failure to pay last quarter of 2008 payroll taxes due to willful neglect	No	Split
Brennan v. Comm'r, T.C. Memo. 2012-209, appeal docketed, No. 13-71498 (9th Cir. Apr. 26, 2013)	6651(a)(1) no evidence of reasonable cause	No	IRS
Cook v. Comm'r, T.C. Memo. 2012-167	6651(a)(1) preoccupation with unrelated, pending litigation did not establish reasonable cause	Yes	IRS
Cox v. Comm'r, T.C. Memo. 2013-75	6651(a)(1), (a)(2) lack of knowledge of the tax code or tax obligations did not establish reasonable cause; 6654 imposition proper	Yes	IRS
Cryer v. Comm'r, T.C. Memo. 2013-69	6651(a)(2) no evidence of reasonable cause; 6654 imposition proper	N/A	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Fein v. Comm'r, 504 F. App'x 41 (2d Cir. 2012), *aff'g* T.C. Memo. 2011-142, *cert. denied*, 82 U.S.L.W. 3184 (2013)	6651(a)(1) no evidence of reasonable cause	No	IRS
Efron v. Comm'r, T.C. Memo. 2012-338	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Gardner v. Comm'r, T.C. Memo. 2013-67, *appeal docketed*, No. 13-72699 (9th Cir. Aug. 1, 2013)	6651(a)(1) no evidence of reasonable cause; 6654 no exceptions; 6651(a)(2) IRS did not meet its burden of production	No	Split
Gigliobianco v. Comm'r, T.C. Memo. 2012-276	6651(a)(1) reliance on tax professional to file return does not establish reasonable cause	No	IRS
Good v. Comm'r, T.C. Memo. 2012-323	6654 imposition proper for 2003 and 2006 but not proper for 2002, because IRS did not produce evidence that TP was required to make payments; 6651(a)(2) no evidence of reasonable cause	Yes	Split
Herrera v. Comm'r, T.C. Memo. 2012-308, *appeal docketed*, No. 13-60018 (5th Cir. Jan. 7, 2013)	6651(a)(1) postal service's illegible post mark did not establish reasonable cause	No	IRS
Jenkins v. Comm'r, T.C. Memo. 2012-283	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Jones v. Comm'r, T.C. Memo. 2013-132	6651(a)(1) lack of knowledge of the tax code or tax obligations did not establish reasonable cause; (a)(2) no evidence of reasonable cause; 6654 imposition proper	Yes	IRS
Johnson v. Comm'r, T.C. Memo. 2012-231	6651(a)(1) no reasonable cause for 2003 or 2004 because returns were due prior to hurricane Katrina; reasonable cause did exist for 2005 since TP could not be expected to file a return after records had been destroyed in the hurricane	No	Split
Kerstette v. Comm'r, T.C. Memo. 2012-239	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Kohn v. Comm'r, T.C. Summ. Op. 2012-86	6651(a)(1) TP's unsupported statement that he was assisting his son with drug and gambling addiction did not establish reasonable cause	Yes	IRS
Morris v. Comm'r, T.C. Summ. Op. 2012-96	6651(a)(1) delayed filing due to work commitments did not establish reasonable cause	Yes	IRS
Niv v. Comm'r, T.C. Memo. 2013-82	6651(a)(1) TP's disability and reliance on tax professional did not establish reasonable cause	Yes	IRS
Padilla v. Comm'r, T.C. Summ. Op. 2012-70	6651(a)(1) no evidence of reasonable cause	No	IRS
Philpott v. Comm'r, T.C. Memo. 2012-307	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Rasmussen v. Comm'r, T.C. Memo. 2012-353, *appeal docketed*, No. 13-2787 (8th Cir. Aug. 13, 2013)	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Repetto v. Comm'r, T.C. Memo. 2012-168	6651(a)(1) TP failed to file required form to report excess contributions to IRA; (a)(2) reliance on tax professional did not establish reasonable cause	No	IRS
Reynoso v. Comm'r, T.C. Memo. 2013-25	6651(a)(1) reliance on another person to prepare and file return did not establish reasonable cause; (a)(2) no evidence of reasonable cause; 6654 imposition proper for 2006 but not for 2007 because TP was not required to make estimated tax payments for 2006	No	Split
Robinson v. Comm'r, 487 F. App'x 751 (3d Cir. 2012), *aff'g* T.C. Memo. 2011-99	6651(a)(1) waiting for decision from the Tax Court regarding a prior dispute did not establish reasonable cause because the decision was entered prior to the due date of the return	Yes	IRS

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Case Citation	Issue(s)	*Pro Se*	Decision
Son Gee Wine and Liquors, Inc. v. Comm'r, T.C. Memo. 2013-62	6651(a)(1), (a)(2) no evidence of reasonable cause	No	IRS
Stephens v. Comm'r, T.C. Memo. 2013-47, *appeal docketed*, No. 13-14235 (11th Cir. Sept. 18, 2013)	6651(a)(1), (a)(2), 6654 IRS did not meet its burden of production	Yes	TP
Stidham v. Comm'r, T.C. Summ. Op. 2012-61	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Thousand Oaks Residential Care Home I, Inc. v. Comm'r, T.C. Memo. 2013-10	6651(a)(1), (a)(2) TP reasonably relied on advice from tax professional	No	TP
Trescott v. Comm'r, T.C. Memo. 2012-321	6651(a)(1) belief that income was not taxable did not establish reasonable cause; (a)(2) no evidence of reasonable cause; 6654 no exception	Yes	IRS
Twin Rivers Farm, Inc. v. Comm'r, T.C. Memo. 2012-184	6651(a)(1) no evidence of reasonable cause	No	IRS
Ward v. Comm'r, T.C. Memo. 2013-133	6651(a)(1) no evidence of reasonable cause	Yes	IRS
Worsham v. Comm'r, T.C. Memo. 2012-219, *aff'd*, 112 A.F.T.R.2d (RIA) 5035 (4th Cir. 2013)	6651(a)(2) frivolous arguments did not establish reasonable cause; 6654 TP had tax liability and was required to make estimated payments	Yes	IRS

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Table 7: Charitable Deductions Under IRC § 170

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Beirne v. Comm'r, T.C. Summ. Op. 2013-2	Unsubstantiated noncash contributions; value of property donated not established	Yes	IRS
Bell v. Comm'r, T.C. Summ. Op. 2013-20	TP failed to establish delivery of the deed for the conveyance of real estate contribution; other unsubstantiated noncash contributions	Yes	IRS
Bernstine v. Comm'r, T.C. Summ. Op. 2013-19	Unsubstantiated cash contributions	Yes	IRS
Bilyeu v. Comm'r, T.C. Memo. 2012-161	Unsubstantiated cash contributions	Yes	IRS
Callahan v. Comm'r, T.C. Memo. 2013-131	Unsubstantiated cash contributions	No	IRS
Cunningham v. Comm'r, T.C. Summ. Op. 2013-27	Unsubstantiated cash contributions for 2003 through 2006; however, TP substantiated cash contributions for 2002	Yes	Split
Evenchik, Estate of v. Comm'r , T.C. Memo. 2013-34	Unsubstantiated noncash contribution of corporate stock; valuation of property not established by a qualified appraisal	No	IRS
Foster v. Comm'r, T.C. Summ. Op. 2012-90	Valuation of conservation easement	Yes	IRS
Kaufman v. Shulman, 687 F.3d 21 (1st Cir. 2012), *vacating and remanding* 136 T.C. 294 (2011), *denying reconsideration of* 134 T.C. 182 (2010)	Substantiation requirements satisfied for the contribution of a conservation easement; easement appraisal upheld by substantial compliance doctrine	No	TP
Longino v. Comm'r , T.C. Memo. 2013-80	Unsubstantiated cash contribution; TP failed to establish that donee organization qualifies as a charitable organization under § 170	Yes	IRS
Minnick v. Comm'r, T.C. Memo. 2012-345, *appeal docketed*, No. 13-73234 (9th Cir. Sept. 16, 2013)	TP mortgagor failed to satisfy subordination requirement for conservation easement contribution	No	IRS
Moses v. Comm'r, T.C. Summ. Op. 2012-118	Unsubstantiated cash contributions	Yes	IRS
Naylor v. Comm'r, T.C. Memo. 2013-19	Unsubstantiated contribution carryover disallowed	Yes	IRS
Patel v. Comm'r, 138 T.C. 395 (2012)	TPs' (H&W) charitable contribution deduction for transfer of partial interest in property disqualified under § 170(f)(3)	Yes	IRS
Peries v. Comm'r, T.C. Summ. Op. 2012-84	Unsubstantiated cash contributions	Yes	IRS
Pollard v. Comm'r, T.C. Memo. 2013-38, *appeal docketed*, No. 13-9001 (10th Cir. May 8, 2013)	TP's quid pro quo exchange lacked charitable intent; valuation	No	IRS
Quinn v. Comm'r, T.C. Memo. 2012-178	Unsubstantiated cash contributions	Yes	IRS
Rothman v. Comm'r, T.C. Memo. 2012-163, *vacated in part on reconsideration*, T.C. Memo. 2012-218	Valuation of conservation easement	No	IRS
Rothman v. Comm'r, T.C. Memo. 2012-218, *vacating in part on reconsideration* T.C. Memo. 2012-163	Valuation of conversation easement	No	Split
Scheidelman v. Comm'r, 682 F.3d 189 (2d Cir. 2012), *vacating and remanding* T.C. Memo. 2010-151, *on remand at* T.C. Memo. 2013-18	Valuation of conservation easement	No	TP

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Table 7: Charitable Deductions Under IRC § 170

Case Citation	Issue(s)	*Pro Se*	Decision
Scheidelman v. Comm'r, T.C. Memo. 2013-18, *remand ordered by* 682 F.3d 189 (2d Cir. 2012), *appeal docketed*, No. 13-2983 (2nd Cir. Aug. 8, 2013)	Valuation of conservation easement	No	IRS
Smith-Hendricks v. Comm'r, T.C. Summ. Op. 2013-22	Unsubstantiated cash contributions	Yes	IRS
Van Der Lee v. Comm'r, 501 F. App'x 30 (2d Cir. 2012), *aff'g* T.C. Memo. 2011-234	Unsubstantiated cash and noncash contributions	No	IRS
Villareale v. Comm'r, T.C. Memo. 2013-74	Unsubstantiated cash contributions	No	IRS
Wall v. Comm'r, T.C. Memo. 2012-169	Noncash contribution for donation of façade easement disallowed because conservation purpose was not protected in perpetuity	Yes	IRS
Whitehouse Hotel Ltd. P'ship v. Comm'r, 139 T.C. 304 (2012), *supplementing* 131 T.C. 112 (2008), *vacated and remanded by* 615 F.3d 321 (5th Cir. 2010), *appeal docketed*, No. 13-60131 (5th Cir. Mar. 1, 2013)	Valuation of conservation easement	No	IRS
Winnett v. Comm'r, T.C. Summ. Op. 2013-25	Unsubstantiated cash and noncash contributions; contribution carryover disallowed	Yes	IRS
Wright v. Comm'r, T.C. Memo. 2013-129	Unsubstantiated noncash contributions	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships — Schedules C, E, F)			
Averyt v. Comm'r, T.C. Memo. 2012-198	Substantiation requirements satisfied for the contribution of a conservation easement	No	TP
Belk v. Comm'r, 140 T.C. 1 (2013), *motion for reconsideration denied*, T.C. Memo. 2013-154, *appeal docketed*, No. 13-2161 (4th Cir. Sept. 19, 2013)	Contribution of a conservation easement not a qualified conservation contribution because it failed to meet the requirements of §§ 170(h)(2) and (5)	No	IRS
Boone Operations Co., L.L.C. v. Comm'r, T.C. Memo. 2013-101	Unsubstantiated noncash contribution; valuation of bargain sale not established	No	IRS
Crimi v. Comm'r, T.C. Memo. 2013-51	Substantiation requirements satisfied; valuation of bargain sale established	No	TP
Flood v. Comm'r, T.C. Memo. 2012-243	Unsubstantiated cash contributions for 2004 & 2005; noncash charitable deduction for 2005 reduced because contribution of properties was limited to cost basis	Yes	IRS
Gunkle v. Comm'r, T.C. Memo. 2012-305, *appeal docketed*, No. 13-60245 (5th Cir. Apr. 12, 2013)	TP failed to establish that donee organization qualifies as a charitable organization under § 170	No	IRS
Irby v. Comm'r, 139 T.C. 371 (2012)	Donated conservation easement made exclusively for conservation purposes; valuation of easement established; substantiation requirements satisfied	No	TP
Rehman v. Comm'r, T.C. Memo. 2013-71	Donation made to an individual in India with no evidence that individual was tied to a donee organization which qualifies as a charitable organization under § 170	Yes	IRS
Riether v. Comm'r, 919 F. Supp. 2d 1140 (D.N.M. 2012)	Unsubstantiated noncash contributions of medical equipment; also failed to establish that donee organization qualifies as a charitable organization under § 170	No	IRS
RP Golf, LLC v. Comm'r, T.C. Memo. 2012-282	Substantiation requirements satisfied for the contribution of a conservation easement; however, donated conservation easement not made pursuant to § 170(h)(4)(A)(iii)(II)	No	Split

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Table 7: Charitable Deductions Under IRC § 170

Case Citation	Issue(s)	*Pro Se*	Decision
Trout Ranch, LLC v. Comm'r, 493 F. *App'x* 944 (10th Cir. 2012), *aff'g* T.C. Memo. 2010-283	Valuation of conversation easement	No	IRS
Williams v. Comm'r, 498 F. *App'x* 284 (4th Cir. 2012), *aff'g* T.C. Memo. 2011-89	Contribution of property held for less than one year limited to basis	No	IRS

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Table 8: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
Individual Taxpayer (But Not Sole Proprietorships)				
Buckardt v. Comm'r, T.C. Memo. 2012-170, *appeal docketed*, No. 12-72119 (9th Cir. July 3, 2012)	TP petitioned for review of IRS decision to file a notice of federal tax lien and proceed with a levy action and cooperated with tax authorities	Yes	TP	
Burt v. Comm'r, T.C. Memo. 2013-58, *appeal docketed*, No. 13-1946 (6th Cir. July 7, 2013)	TP petitioned for redetermination of deficiency and penalties and asserted frivolous arguments	Yes	IRS	$20,000
Clark v. Comm'r, T.C. Memo. 2012-182	TP petitioned for review of IRS decision to file a notice of federal tax lien and claimed he was not an employee and his wages were not income as defined by the tax code	Yes	TP	
Crites v. Comm'r, T.C. Memo. 2012-267	TP petitioned for review of IRS decision to sustain levy and argued she is not a person as defined in the IRC; TP raised one nonfrivolous claim	Yes	TP	
Curtis v. Comm'r, T.C. Memo. 2013-12, *appeal docketed*, No. 13-72743 (9th Cir. Aug. 7, 2013)	TP petitioned for redetermination of deficiency and penalties, argued her income was not taxable within the meaning of the law, and unreasonably failed to pursue available administrative remedies	Yes	IRS	$25,000
Davenport v. Comm'r, T.C. Memo. 2013-41	TP petitioned for redetermination of deficiency and objected to the admission of evidence such as a W-2 as hearsay	Yes	IRS	$4,000
Flint v. Comm'r, T.C. Memo. 2012-287	TP petitioned for review of the IRS's decision to file a federal tax lien and argued he did not have income as he was not a federal employee or corporate officer; owes no tax because he is a naturalized citizen of the State of Idaho, not a U.S. citizen; did not participate in taxable activities; and Forms W-2 can only be used "against" a person engaged in business or a holder of public office	Yes	TP	
Grandy v. Comm'r, T.C. Memo. 2012-196	TP petitioned for redetermination of deficiency and argued he is not a U.S. citizen, does not reside in a "Federal area," only officers or employees of the government pay taxes, and he did not earn wages as defined in the tax code	Yes	IRS	$3,000
Huminski v. Comm'r, T.C. Memo. 2012-302	TP petitioned for redetermination of deficiency and asserted frivolous arguments	No	TP	
Klingenberg v. Comm'r, T.C. Memo. 2012-292, *appeal docketed*, No. 13-70506 (9th Cir. Feb. 11, 2013)	TP petitioned for review of IRS decision to proceed with collections and maintained proceedings solely for delay	Yes	IRS	$3,000
Leyshon v. Comm'r, T.C. Memo. 2012-248	TP petitioned for redetermination of deficiency and argued that the IRS does not have the authority to assess tax; TP also submitted voluminous, irrelevant, and incorrect documents to the court	Yes	TP	
Nelson v. Comm'r, T.C. Memo. 2012-232, *aff'd* by *Nelson v. Comm'r,* 112 A.F.T.R.2d (RIA) 6247 (11th Cir. 2013)	TP petitioned for redetermination of deficiency and claimed TP was not an employee as defined in the tax code and did not earn wages	Yes	IRS	$2,000
Nix v. Comm'r, T.C. Memo. 2012-304, *appeal docketed*, No. 13-12316 (11th Cir. May 22, 2013)	TP petitioned for redetermination of deficiency and penalties and claimed the term wages is not defined and has no force of law	Yes	TP	

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Table 8: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
Roye v. Comm'r, T.C. Memo. 2012-246	TP petitioned for redetermination of deficiency and asserted that the notice of deficiency was signed by an individual lacking the delegated authority to do so, it does not clearly state a liability of the taxpayers, the IRS lacks the authority to file substitutes for returns, and the notice impacted the taxpayer's religious freedom; TP failed to appear for trial	Yes	IRS	$15,000
Snow v. Comm'r, T.C. Memo. 2013-114	TP petitioned for redetermination of deficiency and penalties and argued his activities were not taxable because his employers were not "Subtitle C statutory employers"	Yes	IRS	$8,000
Trescott v. Comm'r, T.C. Memo. 2012-321	TP petitioned for redetermination of deficiency and penalties and asserted frivolous arguments	Yes	TP	
Weatherly v. Comm'r, T.C. Memo. 2012-320	TPs (H&W) petitioned for redetermination of deficiency and penalties and asserted frivolous claims but abandoned them on brief	Yes	TP	
Winslow v. Comm'r, 139 T.C. 270 (2012)	TP petitioned for redetermination of deficiency and penalties and argued the IRS employee who issued the notice of deficiency lacked authority to issue deficiencies	Yes	IRS	$2,500
Zook v. Comm'r, T.C. Memo. 2013-128	TP petitioned for review of IRS decision to sustain a tax lien and argued substitutes for return constitute computer fraud; notices of deficiencies are mail fraud; the IRS is overstepping the authorities granted to it; and that she received no income	Yes	IRS	$2,000
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships — Schedules C, E, F)				
Bentley v. Comm'r, T.C. Memo. 2012-294	TP petitioned for redetermination of deficiency but failed to provide evidence to support disallowed deductions	Yes	TP	
Worsham v. Comm'r, 112 A.F.T.R.2d (RIA) 5035 (4th Cir. 2013), *aff'g Worsham v. Comm'r*, T.C. Memo. 2012-219	TP petitioned for redetermination of deficiency and argued the federal income tax is unconstitutional, the IRS did not account for his basis value in his labor, and that IRS forms violate the Paperwork Reduction Act	Yes	TP	
Section 6673 Penalty Not Requested or Imposed but Taxpayer Warned to Stop Asserting Frivolous Arguments				
Good v. Comm'r, T.C. Memo. 2012-323	TP petitioned for redetermination of deficiency and penalties and claimed he is exempt from taxes because his activities were religious, anything he received belonged to God, and he had no filing requirement	Yes		
Harper v. Comm'r, T.C. Memo. 2013-79	TP petitioned for review of IRS decision to proceed with levy and maintained proceedings primarily for delay	Yes		
Jenkins v. Comm'r, T.C. Memo. 2012-181	TP petitioned for redetermination of deficiency and penalties and claimed he received zero nonemployee compensation	Yes		
Kramer v. Comm'r, T.C. Memo. 2012-192	TPs (H&W) petitioned for redetermination of deficiency and claimed their wages were not income as defined by the tax code	Yes		
Rice v. Comm'r, T.C. Memo. 2012-301	TP petitioned for review of the IRS's appeals office decision to sustain a federal tax lien and argued that the IRS is merely a debt collector and therefore not a part of the US government	Yes		
O'Brien v. Comm'r, T.C. Memo. 2012-326	TP petitioned for review of IRS decision to proceed with levy action and claimed she did earn income	Yes		
Satkiewicz v. Comm'r, T.C. Memo. 2013-73	TPs (H&W) petitioned for review of IRS decision to proceed with collection action and claimed their due process rights under the 5th Amendment were violated; TPs claimed their equal protection rights under the 14th Amendment were violated	Yes		

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Table 8: Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

Case Citation	Issue(s)	*Pro Se*	Decision	Amount
Stanwyck v. Comm'r, T.C. Memo. 2012-180, *appeal docketed*, No. 12-73136 (9th Cir. Oct. 1, 2012)	TP petitioned for review of IRS decision to deny innocent spouse relief and to proceed with collection action and maintained proceedings solely for delay	Yes		
Zaklama v. Comm'r, T.C. Memo. 2012-346	TPs (H&W) petitioned for redetermination of deficiency and penalties and maintained proceedings solely to delay	Yes		
U.S. Court of Appeals' Decisions on Appeal of § 6673 Penalties Imposed by the US Tax Court				
Garber v. Comm'r, 500 F. App'x 540 (7th Cir. 2013), *aff'g* T.C. Memo. 2012-47	TP appealed the Tax Court's decision upholding the IRS's determination of deficiencies and imposition of the frivolous issue penalty and asserted his wages are not taxable income and the tax code does not require him to file an income tax return	Yes	IRS	$1,000
Hyde v. Comm'r, 471 F. App'x 537 (8th Cir. 2012), *aff'g* T.C. Memo. 2011-104, *cert. denied*, 133 S. Ct. 903 (2013)	TP appealed the Tax Court's decision upholding the IRS's determination of a deficiency and imposition of the frivolous issue penalty and asserted the notice of deficiency was invalid because the substitute for return did not comply with the Paperwork Reduction Act; TP also asserted she is not liable because tax laws are incomprehensible	Yes	IRS	$3,000
Leyva v. Comm'r, 483 F. App'x 371 (9th Cir. 2012), *aff'g* T.C. Docket No. 25427-09 (Jan. 18, 2011)	TP appealed the Tax Court's decision upholding the IRS's determination of a deficiency and imposition of the frivolous issue penalty and asserted that the value of his labor is excluded from gross income	Yes	IRS	$5,000
Mattson v. Comm'r, 111 A.F.T.R.2d (RIA) 839 (9th Cir. 2013), *aff'g* T.C. Docket No. 19245-09L	TP appealed the Tax Court's decision regarding whether the IRS could proceed to collect his liabilities and asserted the Tax Court acted in excess of its jurisdiction	Yes	IRS	$2,000
U.S. Court of Appeals' Decisions on Sanctions Under § 7482(c)(4), FRAP Rule 38, or Other Authority				
Buckardt v. Comm'r, 474 F. App'x 612 (9th Cir. 2012), *aff'g* T.C. Memo. 2010-145	TP appealed the Tax Court's decision upholding the IRS's determination of deficiencies	Yes	TP	
Garber v. Comm'r, 500 F. App'x 540 (7th Cir. 2013), *aff'g* T.C. Memo. 2012-47	TP appealed the Tax Court's decision upholding the IRS's determination of deficiencies and imposition of the frivolous issue penalty and asserted his wages are not taxable income and the tax code does not require him to file an income tax return	Yes	IRS	$4,000
Leyva v. Comm'r, 483 F. App'x 371 (9th Cir. 2012), *aff'g* T.C. Docket No. 25427-09 (Jan. 18, 2011)	TP appealed the Tax Court's decision upholding the IRS's determination of deficiencies and imposition of the frivolous issue penalty and argued no law requires him to pay taxes assessed by the Commissioner of the IRS	Yes	TP	
Palmer v. Comm'r, 503 F. App'x 596 (10th Cir. 2012), *aff'g* T.C. Docket No. 1398-10 (Feb. 6, 2012)	TP appealed the Tax Court's redetermination of deficiency and penalties and argued that only district directors can issue notices of deficiency	Yes	IRS	$8,000

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Table 9: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Individual Taxpayers (But Not Sole Proprietorships)			
Aiello, U.S. v., 2013 U.S. Dist. LEXIS 77854 (E.D.N.Y. 2013)	Federal tax liens valid and foreclosed against TP's real property, despite transfer to wife	Yes	IRS
Barnes, U.S. v., 111 A.F.T.R.2d (RIA) 367 (11th Cir. 2012), *vacating* 110 A.F.T.R.2d (RIA) 5088 (M.D. Fla. 2012)	Record did not support attachment of federal tax liens to trust property; orders of foreclosure and sale vacated	No	TP
Benoit, U.S. v., 481 F. App'x 403 (9th Cir. 2012), *aff'g* 107 A.F.T.R.2d (RIA) 2577 (S.D. Cal. 2011)	Affirmed lower court's decision to foreclose on federal tax liens	Yes	IRS
Bishop, U.S. v., 111 A.F.T.R.2d (RIA) 1772 (E.D. Pa. 2013)	Federal tax liens valid and foreclosed on TP's property	No	IRS
Capriotti, U.S. v., 111 A.F.T.R.2d (RIA) 1624 (E.D. Cal. 2013), *judgment entered*, 111 A.F.T.R.2d (RIA) 1834 (E.D. Cal. 2013)	Federal tax liens valid and foreclosed on TPs' (H&W) property despite transfer to trust	No	IRS
Cloninger, U.S. v., 110 A.F.T.R.2d (RIA) 6914 (N.D. Cal. 2013)	Government's seeking one-half interest in TP's property did not preclude foreclosure of valid federal tax liens	Yes	IRS
Cohen, U.S. v., 930 F. Supp. 2d 962 (C.D. Ill. 2013)	Federal tax liens valid and foreclosed on TP's property despite corporation holding title under alter ego theory	Yes	IRS
Deguire, U.S. v., 111 A.F.T.R.2d (RIA) 1477 (D. Ariz. 2013)	Government's summary judgment motion to foreclose federal tax liens denied	No	TP
Dickert, U.S. v., 2012 U.S. Dist. LEXIS 187223 (N.D. Fla. 2012), *adopted by* 2013 U.S. Dist. LEXIS 43430 (N.D. Fla. 2013)	Federal tax liens valid and foreclosed on TP's real property, despite transfer to wife	Yes	IRS
Elmore, U.S. v., 110 A.F.T.R.2d (RIA) 5223 (W.D. Wash. 2012)	Federal tax liens valid and attached to TP's property, subject to a precise tabulation of TP's 1987 income from sale of property and correction of TP's 1992 assessment	No	IRS
Flaherty, U.S. v., 474 F. App'x 613 (9th Cir. 2012), *aff'g* 2010 U.S. Dist. LEXIS 125158	Affirmed lower court's decision to foreclose on federal tax liens	Yes	IRS
Goodman, U.S. v., 111 A.F.T.R.2d 2267 (10th Cir. 2013), *aff'g* 110 A.F.T.R.2d (RIA) 5447 (D. Colo. 2013)	Federal tax liens valid and foreclosed on TP's property	Yes	IRS
Hopkins, U.S. v., 927 F. Supp. 2d 1120 (D.N.M. 2013)	Federal tax liens valid and foreclosed on four properties held by TP's nominees	Yes	IRS
Johnson, U.S. v., 111 A.F.T.R.2d (RIA) 1551 (S.D. Tex. 2013)	Federal tax liens valid and attached to TP's properties despite transfer to daughter; motion to foreclose on liens denied because amount of tax owed disputed	No	Split
Marciello, U.S. v., 2013 U.S. Dist. LEXIS 43582 (D. Mass. 2013), *adopting* 2013 U.S. Dist. LEXIS 43589 (D. Mass. 2013)	Granted summary judgment and ordered foreclosure with respect to TP's one-third interest in real property but denied motion because issues of material fact existed with respect to sale of marital home	Yes	IRS
Melot, U.S. v., 2012-2 U.S.T.C. (CCH) ¶ 50,667 (D.N.M. 2012)	Federal tax liens valid and foreclosed on TP's property	No	IRS
Montesinos, U.S. v., 2012 U.S. Dist. LEXIS 134328 (S.D.N.Y. 2012)	Federal tax lien valid despite having been filed under misspelled name.	No	IRS
O'Callaghan, U.S. v., 500 F. App'x 843 (11th Cir. 2012), *aff'g* 108 A.F.T.R.2d RIA 5158 (M.D. Fla. 2011)	Affirmed lower court's decision that federal tax lien was valid and foreclosed on TP's property	Yes	IRS

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Table 9: Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax under IRC § 7403

Case Citation	Issue(s)	*Pro Se*	Decision
Porath, U.S. v., 490 F. App'x 789 (6th Cir. 2012), *aff'g* 764 F. Supp. 2d 883 (E.D. Mich. 2011)	Affirmed lower court's decision that federal tax liens valid and foreclosed on TP's one-half interest in property fraudulently transferred to TP's wife.	No	IRS
Reading, U.S. v., 110 A.F.T.R.2d (RIA) 5965 (D. Ariz. 2012)	Federal tax liens valid and foreclosed on TP's home despite transfer to trust	No	IRS
Rigler, U.S., 885 F. Supp. 2d 923 (S.D. Iowa 2012)	Federal tax liens valid and foreclosed on TP's property despite transfer to trust under alter ego theory	No	IRS
Simons, U.S. v., 476 F. App'x 171 (10th Cir. 2012), *aff'g* 108 A.F.T.R.2d (RIA) 6031 (D. Utah 2011)	Affirmed lower court's decision that federal tax liens valid and foreclosed on TP's real property	Yes	IRS
Smith, U.S. v., 109 A.F.T.R.2d (RIA) 2359 (W.D. Wash. 2012)	Federal tax liens valid and foreclosed; TP's wife not entitled to proceeds from the sale of property under community property law- until tax liens satisfied	Yes	IRS
Tingey, U.S. v., 716 F.3d 1295 (10th Cir. 2013), *aff'g Brown, U.S. v.*, 108 A.F.T.R.2d (RIA) 6755 (D. Utah 2011)	Affirmed lower court decision to foreclose on TP's property despite transfer to trust	No	IRS
Welch, U.S. v., 111 A.F.T.R.2d (RIA) 1587 (D. Colo. 2013), *adopting* 111 A.F.T.R.2d (RIA) 1573 (D. Colo. 2013)	Federal tax liens valid and foreclosed against TP's property; transfer of property to trust and then to TP's daughter disregarded as nominee transfer	Yes	IRS
Williams, U.S. v., 110 A.F.T.R.2d (RIA) 6199 (S.D. Ind. 2012)	Federal tax liens valid and foreclosed on TP's property despite fraudulent transfer to trust	Yes	IRS
Wolfers, U.S. v., 110 A.F.T.R.2d (RIA) 6481 (M.D. Fla. 2012)	Federal tax liens valid and foreclosed on TP's property	Yes	IRS
Vernon, U.S. v., 485 F. App'x 892 (9th Cir. 2012), *aff'g* 110 A.F.T.R.2d (RIA) 6084 (D. Ak. 2012)	Affirmed lower court's decision that federal tax liens were valid and foreclosed on TP's property	Yes	IRS
Youngquist, U.S. v., 2013 U.S. Dist. LEXIS 87610 (D. Or. 2013), *adopted by*, 11 A.F.T.R.2d 2467 (D. Or. 2013)	Federal tax liens valid and foreclosed on TP's property	Yes	IRS
Zaccardi, U.S. v., 110 A.F.T.R.2d (RIA) 6679 (D. Utah 2012), *appeal docketed* No. 13-4106 (10th Cir. July 18, 2013)	Federal tax liens valid and foreclosed on TP's property; transfer of property disregarded as nominee transfer	Yes	IRS
Business Taxpayers (Corporations, Partnerships, Trusts, and Sole Proprietorships — Schedules C, E, F)			
Sanford, U.S. v., 110 A.F.T.R.2d (RIA) 5440 (N.D. Miss. 2012)	Federal tax liens valid and foreclosed on TP's property	No	IRS
Sequoia Property and Equip., L.P. v. U.S., 498 F. App'x 747 (9th Cir. 2012)	Affirmed district court's order of judicial sale in government action to reduce to judgment federal income tax assessments and foreclose against TP	No	IRS
Stewart Mechanical Enters., Inc., U.S. v., 109 A.F.T.R.2d (RIA) 2652 (W.D. Ky. 2012)	Federal tax liens valid and attached to TP's property; declined to address priority of lien holders	No	IRS

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Table 10: Relief from Joint and Several Liability Under IRC § 6015

Case Citation	Issue(s)	*Pro Se*	Inter-venor	Deci-sion
Alvarado v. Comm'r, T.C. Summ. Op. 2013-41	6015(b), (c), (f) (understatement)	Yes	Yes	TP
Chaput v. Comm'r, T.C. Summ. Op. 2012-69	6015(c) (understatement)	Yes	Yes	TP
Cole v. Comm'r, T.C. Summ. Op. 2013-34	6015(b), (f) (understatement)	Yes	No	IRS
Cross v. Comm'r, 499 F. App'x 857 (11th Cir. 2012), *aff'g in part and dismissing in part* T.C. Docket No. 9480-09 (Oct. 17, 2011)	6015 request condition precedent for intervention by joint filer	No	Yes	TP*
Cutler v. Comm'r, T.C. Memo. 2013-119	6015(f) (underpayment)	No	No	TP
Deihl v. Comm'r, T.C. Memo. 2012-176, *appeal docketed*, No. 12-74169 (9th Cir. Dec. 21, 2012)	6015(b), (c), (f) (understatement)	No	No	IRS
*Elman, U.S. v.,*110 A.F.T.R.2d (RIA) 6993 (N.D. Ill. 2012)	District Court did not have jurisdiction to determine innocent spouse claim raised as a defense in a collection suit	No	No	IRS
Gallego v. Comm'r, T.C. Summ. Op. 2012-97, *reconsidering* T.C. Summ. Op. 2011-139	6015(f) (underpayment)	No	No	TP
Galvan v. Comm'r, T.C. Summ. Op. 2012-112	Dismissed for lack of jurisdiction; 6015(f) denial not invalidated by removal of two year rule	No	No	IRS
Garavaglia v. Comm'r, 111 A.F.T.R.2d (RIA) 1600 (6th Cir. 2013), *aff'g* T.C. Memo. 2011-228	6015(b), (f) (understatement)	No	No	IRS
Haag v. Shulman, 683 F.3d 26 (1st Cir. 2012), *aff'g* T.C. Memo. 2011-87	6015(g) prior proceedings bar relief	No	No	IRS
Haggerty v. Comm'r, 505 F. App'x 335 (5th Cir. 2012), *aff'g* T.C. Memo. 2011-284	6015(f) (underpayment)	No	No	IRS
Harrington v. Comm'r, T.C. Memo. 2012-285	6015(c) (understatement)	Yes	Yes	TP*
Henson v. Comm'r, T.C. Memo. 2012-288	6015(f) (underpayment)	No	Yes	IRS
Hudgins v. Comm'r, T.C. Memo. 2012-260	6015(f) (underpayment)	No	No	IRS
Jorgenson v. Comm'r, T.C. Summ. Op. 2013-10	6015(f) (underpayment)	Yes	No	IRS
Karam v. Comm'r, 504 F. App'x 416 (6th Cir. 2012), *aff'g* T.C. Memo. 2011-230	6015(f) (underpayment)	No	No	IRS
Marzullo v. Comm'r, T.C. Memo. 2013-120	6015b), (c), and (f) (understatement)	No	No	IRS
Mui v. Comm'r, T.C. Memo. 2013-83	6015 (c) (understatement)	No	No	TP
O'Neil v. Comm'r, T.C. Memo. 2012-339	6015(f) (underpayment)	No	Yes	IRS
Popowski, U.S. v., 110 A.F.T.R.2d (RIA) 6997 (D.S.C. 2012)	District Court lacked jurisdiction to determine innocent spouse claim raised as a defense in a collection suit	No	No	IRS
Reiff v. Comm'r, T.C. Summ. Op. 2013-40	6015(b), (f) (understatement)	Yes	No	IRS
Simmons Perrine Moyer Bergman, PLC v. Coleman, 111 A.F.T.R.2d (RIA) 1237 (N.D. Iowa 2013)	District Court lacked jurisdiction to determine innocent spouse claim raised in an interpleader suit	No	No	IRS
Smith v. U.S., 495 F. App'x 44 (Fed. Cir. 2012), *aff'g* 101 Fed. Cl. 474 (2011), cert. denied, 133 S. Ct. 1288 (2013)	6015(e) (understatement); because court lacked jurisdiction over refund claim, it lacked jurisdiction over innocent spouse defense	Yes	No	IRS

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Table 10: Relief from Joint and Several Liability Under IRC § 6015

Case Citation	Issue(s)	*Pro Se*	Inter-venor	Deci-sion
Stanwyck v. Comm'r, T.C. Memo. 2012-180, *appeal docketed*, No. 12-73136 (9th Cir. Oct. 1, 2012)	6015(b), (c), (f) (understatement for 1997,1998 tax years), (underpayment for 1991 tax year)	Yes	Yes	IRS
Tompkins v. Comm'r, T.C. Memo. 2013-24	6015 (b) (understatement)	Yes	No	TP
Tu Pham v. Comm'r, T. C. Memo. 2012-171	6015(b), (c), (f) (understatement) Concession that two-year rule no longer applies did not entitle tax-payer to relief on the merits	No	No	IRS
Williamson v. Comm'r, T.C. Memo. 2013-78	6015(f) (underpayment)	No	No	IRS
Wilson v. Comm'r, 705 F.3d 980 (9th Cir. 2013), *aff'g* T.C. Memo. 2010-134	6015 (f) (underpayment)	No	No	TP
Yosinski v. Comm'r, T.C. Memo. 2012-195	6015(c), (f) (understatement, underpayment)	Yes	No	Split
Young v. Comm'r, T.C. Memo. 2012-255	6015(c) (understatement)	Yes	No	TP*

*The IRS agreed that the TP was entitled to relief with respect to at least one tax year in issue; only the intervenor or other joint filer was opposed.

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Taxpayer Advocate Service Directory

HEADQUARTERS

National Taxpayer Advocate
1111 Constitution Avenue NW
Room 3031, TA
Washington DC 20224
Phone: 202-317-6100
Fax: 855-810-2126

Deputy National Taxpayer Advocate
1111 Constitution Avenue NW
Room 3039, TA
Washington DC 20224
Phone: 202-317-6100
Fax: 855-810-2128

Executive Director, Systemic Advocacy
1111 Constitution Avenue, NW
Room 3219, TA:SA
Washington, DC 20224
Phone: 202-317-4213
Fax: 855-813-7410

Executive Director, Case Advocacy
1111 Constitution Avenue NW
Room 3213, TA:CA
Washington, DC 20224
Phone: 202-927-0755
Fax: 855-810-2129

Congressional Affairs Liaison
1111 Constitution Avenue, NW
Room 3031, TA
Washington DC 20224
Phone: 202-317-3255 or
202-317-3245
Fax: 855-810-5886

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SYSTEMIC ADVOCACY DIRECTORS

Director, Advocacy Initiatives
1111 Constitution Avenue NW
Room 3219, TA:SA:AI
Washington, DC 20224
Phone: 202-317-4205
Fax: 855-813-7410

Director, Systemic Advocacy Systems
1111 Constitution Avenue NW
Room 3219, TA:SA:SAS
Washington, DC 20224
Phone: 202-317-4205
Fax: 855-813-7410

Director, Advocacy Implementation and Evaluation
1111 Constitution Avenue NW
Room 3219, TA:SA:AI/E
Washington, DC 20224
Phone: 202-317-4205
Fax: 855-813-7410

AREA OFFICES

Andover
310 Lowell St., Stop 244
Andover, MA 01812
Phone: 978-247-9207
Fax: 855-836-2839

Atlanta
401 W. Peachtree St., NE
Room 1970, Stop 101-R
Atlanta, GA 30308
Phone: 404-338-8710
Fax: 855-822-1231

Cincinnati
312 Elm Street, Suite 2250
Cincinnati, OH 45202
Phone: 859-669-5556
Fax: 855-824-6406

Dallas
4050 Alpha Road
Room 924, MS 3000 NDAL
Dallas, TX 75244
Phone: 972-308-7019
Fax: 855-829-1824

Kansas City
333 West Pershing Road
MS #P-L 3300
Kansas City, MO 64108
Phone: 816-291-9080
Fax: 855-833-6442

New York/International
290 Broadway, 14th Floor
New York, NY 10007
Phone: 212-298-2015
Fax: 855-816-9809

Oakland
1301 Clay St., Suite 1030-N
Oakland, CA 94612
Phone: 510-637-2070
Fax: 855-819-5021

Richmond
400 North 8th Street, Room 328
Richmond, VA 23219
Phone: 804-916-3510
Fax: 855-821-0237

Seattle
915 Second Avenue
Stop W-404
Seattle, WA 98174
Phone: 206-220-4356
Fax: 855-829-5331

CAMPUS OFFICES

Andover
310 Lowell St., Stop 120
Andover, MA 01810
Phone: 978-474-5549
Fax: 855-807-9700

Atlanta
4800 Buford Highway
Stop 29-A
Chamblee, GA 30341
Phone: 770-936-4500
Fax: 855-822-3420

Austin
3651 S. Interregional Highway
Stop 1005 AUSC
Austin, TX 78741
Phone: 512-460-8300
Fax: 855-204-5023

Brookhaven
1040 Waverly Ave., Stop 02
Holtsville, NY 11742
Phone: 631-654-6686
Fax: 855-818-5701

Cincinnati
201 Rivercenter Blvd.
Stop 11G
Covington, KY 41011
Phone: 859-669-5316
Fax: 855-828-2723

Fresno
5045 E Butler
Stop 1394
Fresno, CA 93888
Phone: 559-442-6400
Fax: 855-820-7112

Kansas City
333 W. Pershing Road
Stop 1005 S-2
Kansas City, MO 64108
Phone: 816-291-9000
Fax: 855-836-2835

Memphis
5333 Getwell Road
Stop 13
Memphis, TN 38118
Phone: 901-395-1900
Fax: 855-828-2727

Ogden
1973 N. Rulon White Blvd.
Stop 1005
Ogden, UT 84404
Phone: 801-620-7168
Fax: 855-832-7126

Philadelphia
2970 Market St.
Mail Stop 2-M20-300
Philadelphia, PA 19104
Phone: 267-941-2427
Fax: 855-822-1226

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LOCAL OFFICES BY STATE AND LOCATION

Alabama (Birmingham)
801 Tom Martin Drive
Room 151
Birmingham, AL 35211
Phone: 205-912-5631
Fax: 855-822-2206

Alaska (Anchorage)
949 E. 36th Ave.
Stop A-405
Anchorage, AK 99508
Phone: 907-271-6877
Fax: 855-819-5022

Arizona (Phoenix)
4041 N. Central Ave.
MS-1005 PHX
Phoenix, AZ 85012
Phone: 602-636-9500
Fax: 855-829-5330

Arkansas (Little Rock)
700 W. Capitol Avenue
MS 1005 LIT
Little Rock, AR 72201
Phone: 501-396-5978
Fax: 855-829-5325

California (Laguna Niguel)
24000 Avila Road, Room 3361
Laguna Niguel, CA 92677
Phone: 949-389-4804
Fax: 855-819-5026

California (Los Angeles)
300 N. Los Angeles St.
Room 5109, Stop 6710
Los Angeles, CA 90012
Phone: 213-576-3140
Fax: 855-820-5133

California (Oakland)
1301 Clay St., Suite 1540-S
Oakland, CA 94612
Phone: 510-637-2703
Fax: 855-820-5137

California (Sacramento)
4330 Watt Ave., Stop SA5043
Sacramento, CA 95821
Phone: 916-974-5007
Fax: 855-820-7110

California (San Jose)
(reports to Oakland LTA)
55 S. Market St., Stop 0004
San Jose, CA 95113
Phone: 408-283-1500
Fax: 855-820-7109

Colorado (Denver)
1999 Broadway
MS 1005 DEN
Denver, CO 80202
Phone: 303-603-4600
Fax: 855-829-3838

Connecticut (Hartford)
135 High St., Stop 219
Hartford, CT 06103
Phone: 860-756-4555
Fax: 855-836-9629

Delaware (Wilmington)
1352 Marrows Road, Suite 203
Newark, DE 19711
Phone: 302-286-1654
Fax: 855-822-1225

District of Columbia (Washington D.C.)
77 K Street, N.E.
Suite 1500
Washington, D.C. 20002
Phone: 202-803-9800
Fax: 855-810-2125

Florida (Ft. Lauderdale)
7850 SW 6th Court, Room 265
Plantation, FL 33324
Phone: 954-423-7677
Fax: 855-822-2208

Florida (Jacksonville)
400 West Bay St.
Room 535A, MS TAS
Jacksonville, FL 32202
Phone: 904-665-1000
Fax: 855-822-3414

Georgia (Atlanta)
401 W. Peachtree Street
Room 510, Stop 202-D
Atlanta, GA 30308
Phone: 404-338-8099
Fax: 855-822-1232

Hawaii (Honolulu)
1099 Alakea St.
Floor 22, MS H2200
Honolulu, HI 96813
Phone: 808-566-2950
Fax: 855-819-5024

Idaho (Boise)
550 W. Fort St., M/S 1005
Boise, ID 83724
Phone: 208-363-8900
Fax: 855-829-6039

Illinois (Chicago)
230 S. Dearborn St.
Room 2820, Stop-1005 CHI
Chicago, IL 60604
Phone: 312-292-3800
Fax: 855-833-6443

Illinois (Springfield)
3101 Constitution Drive
Stop 1005 SPD
Springfield, IL 62704
Phone: 217-862-6382
Fax: 855-836-2831

Indiana (Indianapolis)
575 N. Pennsylvania St.
Stop TA771
Indianapolis, IN 46204
Phone: 317-685-7840
Fax: 855-827-2637

Iowa (Des Moines)
210 Walnut St.
Stop 1005 DSM
Des Moines, IA 50309
Phone: 515-564-6888
Fax: 855-833-6445

Kansas (Wichita)
555 N. Woodlawn St., Bldg 4
Stop 1005-WIC, Suite 112
Wichita, KS 67208
Phone: 316-651-2100
Fax: 855-836-2834

Kentucky (Louisville)
600 Dr. Martin Luther King Jr. Place
Room 325
Louisville, KY 40202
Phone: 502-582-6030
Fax: 855-827-2640

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Louisiana (New Orleans)
1555 Poydras St.
Suite 220, Stop 2
New Orleans, LA 70112
Phone: 504-558-3003
Fax: 855-822-3418

Maine (Augusta)
68 Sewall St., Room 313
Augusta, ME 04330
Phone: 207-622-8528
Fax: 855-836-9623

Maryland (Baltimore)
31 Hopkins Plaza
Room 900
Baltimore, MD 21201
Phone: 443-853-6000
Fax: 855-821-0238

Massachusetts (Boston)
JFK Building
15 New Sudbury St.
Room 725
Boston, MA 02203
Phone: 617-316-2690
Fax: 855-836-9625

Michigan (Detroit)
500 Woodward
Stop 07, Suite 1000
Detroit, MI 48226
Phone: 313-628-3670
Fax: 855-827-2634

Minnesota (St. Paul)
Wells Fargo Place
30 East 7th Street
Suite 817, Stop 1005 STP
St. Paul, MN 55101
Phone: 651-312-7999
Fax: 855-833-8237

Mississippi (Jackson)
100 W. Capitol St., Stop 31
Jackson, MS 39269
Phone: 601-292-4800
Fax: 855-822-2211

Missouri (St. Louis)
1222 Spruce St.
Stop 1005 STL
St. Louis, MO 63103
Phone: 314-612-4610
Fax: 855-833-8234

Montana (Helena)
10 West 15th Street
Suite 2319
Helena, MT 59626
Phone: 406-444-8668
Fax: 855-829-6045

Nebraska (Omaha)
1616 Capitol Ave.
Suite 182, Mail Stop 1005
Omaha, NE 68102
Phone: 402-233-7272
Fax: 855-833-8232

Nevada (Las Vegas)
110 City Parkway, Stop 1005
Las Vegas, NV 89106
Phone: 702-868-5179
Fax: 855-820-5132

New Hampshire (Portsmouth)
Federal Office Building
80 Daniel St.
Portsmouth, NH 03801
Phone: 603-433-0571
Fax: 855-807-9698

New Jersey (Springfield)
955 S. Springfield Ave.
3rd Floor
Springfield, NJ 07081
Phone: 973-921-4043
Fax: 855-818-5695

New Mexico (Albuquerque)
5338 Montgomery Blvd. NE
Stop 1005 ALB
Albuquerque, NM 87109
Phone: 505-837-5505
Fax: 855-829-1825

New York (Albany)
11A Clinton Avenue
Suite 354
Albany, NY 12207
Phone: 518-427-5413
Fax: 855-818-4816

New York (Brooklyn)
2 Metro Tech Center
100 Myrtle Ave, 7th floor
Brooklyn, NY 11201
Phone: 718-834-220
Fax: 855-818-4818

New York (Buffalo)
130 South Elmwood Ave, Room 265
Buffalo, NY 14202
Phone: 716-961-5300
Fax: 855-818-4821

New York (Manhattan)
290 Broadway, 5th Floor
Manhattan, NY 10007
Phone: 212-436-1011
Fax: 855-818-4823

North Carolina (Greensboro)
Mail Stop 1
4905 Koger Boulevard, Suite 102
Greensboro, NC 27407
Phone: 336-574-6119
Fax: 855-821-0243

North Dakota (Fargo)
657 Second Avenue North
Room 244, Stop 1005 FAR
Fargo, ND 58102
Phone: 701-237-8342
Fax: 855-829-6043

Ohio (Cincinnati)
550 Main Street, Room 3530
Cincinnati, OH 45202
Phone: 513-263-3260
Fax: 855-824-6407

Ohio (Cleveland)
1240 E. 9th St.
Room 423
Cleveland, OH 44199
Phone: 216-522-7134
Fax: 855-824-6409

Oklahoma (Oklahoma City)
55 N. Robinson Ave.
Stop 1005 OKC
Oklahoma City, OK 73102
Phone: 405-297-4055
Fax: 855-829-5327

Oregon (Portland)
Mail Stop O-405
1220 SW 3rd Ave, Suite G004
Portland, OR 97204
Phone: 503-256-3591
Fax: 855-832-7118

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Pennsylvania (Philadelphia)
600 Arch St., Room 7426
Philadelphia, PA 19106
Phone: 215-861-1304
Fax: 855-821-2123

Pennsylvania (Pittsburgh)
1000 Liberty Ave.
Room 1400
Pittsburgh, PA 15222
Phone: 412-395-5987
Fax: 855-821-2125

Rhode Island (Providence)
380 Westminster St., 4th floor
Providence, RI 02903
Phone: 401-528-1921
Fax: 855-807-9696

South Carolina (Columbia)
1835 Assembly St.
Room 466, MDP-03
Columbia, SC 29201
Phone: 803-253-3029
Fax: 855-821-0241

South Dakota (Aberdeen)
115 4th Ave. SE
Suite 413
Aberdeen, SD 57401
Phone: 605-377-1600
Fax: 855-829-6038

Tennessee (Nashville)
801 Broadway, Stop 22
Nashville, TN 37203
Phone: 615-250-5000
Fax: 855-828-2719

Texas (Austin)
300 East 9th Street
Stop 1005-AUS
Austin, TX 78701
Phone: 512-499-5875
Fax: 855-829-1827

Texas (Dallas)
1114 Commerce St.
MC: 1005DAL
Dallas, TX 75242
Phone: 214-413-6500
Fax: 855-829-1829

Texas (Houston)
1919 Smith St.
MC 1005 HOU
Houston, TX 77002
Phone: 713-209-3660
Fax: 855-829-3841

Utah (Salt Lake City)
50 S. 200 E.
Stop 1005 SLC
Salt Lake City, UT 84111
Phone: 801-799-6958
Fax: 855-832-7121

Vermont (Burlington)
128 Lakeside Ave, Ste 204
Burlington, VT 05401
Phone: 802-859-1052
Fax: 855-836-9627

Virginia (Richmond)
400 North 8th Street
Room 916, Box 25
Richmond, VA 23219
Phone: 804-916-3501
Fax: 855-821-2127

Washington (Seattle)
915 Second Avenue
Stop W-405
Seattle, WA 98174
Phone: 206-220-6037
Fax: 855-832-7122

West Virginia (Parkersburg)
425 Juliana Street
Room 2019
Parkersburg, WV 26101
Phone: 304-420-8695
Fax: 855-828-2721

Wisconsin (Milwaukee)
211 W. Wisconsin Ave.
Room 507, Stop 1005 MIL
Milwaukee, WI 53203
Phone: 414-231-2390
Fax: 855-833-8231

Wyoming (Cheyenne)
5353 Yellowstone Road
Cheyenne, WY 82009
Phone: 307-633-0800
Fax: 855-829-6071

Puerto Rico (Guaynabo)
City View Plaza II
48 Carr 165, Suite 2000
Guaynabo, PR 00968
Phone: (Spanish) 787-522-8600
Phone: (English) 787-522-8601
Fax: 855-818-5697

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