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[Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform](#)

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Getting Correct Returns

For low income taxpayers any trip into the arena of tax controversy amounts to a loss. In general, they do not have the ability to successfully navigate the tax controversy system. This system, however well-intentioned and layered with protections, does not serve them well. If low income taxpayers end up in the controversy system after receiving a refund, the IRS also does not fare well. Even if the IRS establishes a deficiency in tax, it will struggle and generally fails to collect the tax once it goes out the door to a low income taxpayer.

Refundable credits create the greatest area of concern for low income taxpayers, the IRS and the system in general. The decision to use the tax system as a delivery mechanism for benefits places a great strain on the tax system because it was not designed for this purpose. The siren song of obtaining money from the government for the cost of submitting a return, refundable credits, used to benefit low income taxpayers, bring out identity thieves and fraudulent preparers who prey on low income taxpayers and the IRS. The actions of these thieves, bad preparers and fraudulent preparers draw low income taxpayers into the controversy system and greatly complicate their lives. Once the IRS begins the examination process, low income taxpayers must react appropriately to a host of letters and notices that bewilder them. Avoiding this situation provides a path to simplifying the system for taxpayers who generally do not have the skills to protect themselves.

To simplify the system and the interaction between low income taxpayers and the IRS, I would place great emphasis on getting it right at the return filing stage. Instead of building a system designed to issue a refund as quickly as possible and then deal with the consequences of mistakes or fraud through the tax controversy system, the system should emphasize competent tax return preparers or well-designed software programs coupled with document matching to make sure that the right amount of tax gets assessed at the outset and the right amount of refund gets issued. If the returns received by the IRS contain correct information and if the IRS processes those returns at a time when it can verify the correctness of the information reported on the returns, then identity thieves will no longer use the return process as a source of revenue. If preparers are properly regulated, particularly ones preparing returns with refundable credits, low income taxpayers will not be victimized by the preparation process and wind up in the controversy system.

In placing emphasis on the return filing point as the most critical point in the tax system, my colleague, Les Book has put forth principles that should guide decisions on how to the return process:

Does the provision promote desired behavior?

How does it relate to other provisions also intending to promote compliance?

What are the taxpayer and third party costs?

Are compliant taxpayers/preparers bearing too high a cost?

Are the “right” noncompliant parties being identified?

Is the administrative determination readily susceptible to challenge?

Does the provision allow IRS to efficiently administer its scarce resources?

Is compliance readily ascertainable?

Desired Behavior

We want taxpayers to file accurate returns. We want to stop identity thieves by making the return filing process unproductive for them. We want return preparers or return preparation software to perform in a manner that makes them the gatekeepers to the system and assists taxpayers in navigating the system with the least cost and inconvenience.

Relationship to Other Provisions Promoting Compliance

We want a filing system that stops submission of incorrect data without moving the matter downstream into the compliance system except in rare cases. With respect to identity thieves, a system of matching information prior to issuance of refunds will generally stop the theft. Once the system demonstrates that filing the return does not bring the desired reward, thieves will abandon the filing system unless and until they can identify another opening. Delaying the issuance of refunds until data matching occurs should significantly relieve downstream pressure on compliance.

Taxpayer and Third Party Costs

Costs go beyond time and must reflect characteristics of community being regulated. Low income taxpayers rely on their refunds to pay bills. Delaying the refunds will delay bill payment. While the delay to build a matching system brings a one-time delay not felt in subsequent filing seasons, the timing of the refund can have other consequences. Delaying the refund annually into the late Spring or early Summer could impact the ability to pay certain time sensitive bills such as utility bills for heat. Coordination with those providers and with other providers on time sensitive matters would need to be a part of the equation of moving the refund period.

Placing greater regulation on preparers would drive up their costs and the cost to taxpayers using their services. The additional costs may need to be considered in determining the amount of the refundable credit in order to enable and incentivize taxpayers to utilize more qualified and diligent preparers.

Compliant Taxpayer Costs

The goal is to eliminate the reward that currently exists for thieves and remove incompetent or fraudulent preparers. Return preparation costs may increase and the refund may come later in the filing season. Both changes could negatively impact compliant taxpayers who have not had difficulties with the present system. Providing some basis for offsetting the return preparation costs could take care of

the first problem. With greater savings from greater compliance, perhaps a basis for providing taxpayers with this financial cushion exists. Allowing a quicker refund to taxpayer using certain certified preparers may eliminate the delay in receipt of the refund and provide additional incentive to use qualified preparers.

Identifying the Right Noncompliant Parties

The noncompliant parties are known. Identity thieves will struggle to profit in a system that tests information on the return against third party data and returns filed by the “real” taxpayer prior to sending out a refund. These individuals should largely get blocked from refunds eliminating their incentive for filing and perhaps reducing the number of returns filed once the matching system gains full impact. Fraudulent preparers should have much greater difficulty operating in a regulated system. If the IRS has authority to police the return preparer population, it should largely eliminate the unscrupulous preparers without the need to file injunction suits that stop people after they have prepared inappropriate returns. The IRS also needs to develop a more effective system for assisting taxpayers from preparers who do get past the regulation and steal from them.

Challenging the System

A system must exist for pushing back against the determination by the IRS that has understandable legal standards—both to IRS and taxpayer. Even though a well-defined and well administered tax controversy system exists today, it places significant barriers to success for low income taxpayers because it avoids human contact and relies almost exclusively on correspondence and telephone contacts. This method of addressing the problem does not work well for many low income taxpayers who simply avoid and ignore a system not designed for their problem solving skills.

Low income taxpayers need an accessible and clear way to communicate with IRS about determination. Many times that way should involve in person contact, but such contact does not exist for low income taxpayers until they get to the Appeals Office or to Tax Court. The IRS assigns individual agents to work larger cases involving sophisticated taxpayers who could navigate the maze of phone and computer options, but sends low income taxpayers to deal with employees in phone banks who only touch the case once and cannot develop a connection with the taxpayer. The system itself of requiring the least sophisticated users to endure the most impersonal process creates many of the problems for low income taxpayers. In both the examination and collection phases of their case, low income taxpayers go from start straight through to levy without a person assigned individually to their case. They simply receive a series of letters requesting information or directing action but they never hear from a person. These letters provide little meaning or context to the problem for many low income taxpayers and end up in a drawer or in a trash can.

Low income taxpayers need a clear path to court review of administrative determination. The IRS provides them with information in the correspondence it sends but makes it very difficult for them to speak to someone who can explain the process or answer their questions. They must wait for an hour or more to get through to someone on the phone who may or may not have good skills at explaining the process and guiding them to the steps they need to take to challenge a decision and preserve their rights. The system relies on taxpayers understanding and exercising their rights yet it has, through refundable credits, picked up a populace with great difficulties in doing so. The IRS has made some accommodations to assist these taxpayers after they fail to properly exercise their rights, e.g., audit reconsideration; however, it uses the system built for more sophisticated taxpayers to serve this population. Neither Congress nor the IRS has not tried to build a system designed to meet the challenges of this population that were placed without request into the federal tax system.

Effective Use of Scarce Resources

As the IRS tries to manage more and more taxpayers and tax issues with fewer and fewer resources, it seeks to rely more and more heavily on automation and impersonal contact. This is a logical use of scarce resources except that it often fails the low income population which cannot adapt to systems and processes developed by the IRS for more sophisticated users. While marshalling its resources for effective use, the IRS and Congress must acknowledge that some taxpayers simply need a personal touch. Sending letters, citing people to internet sites and having phone lines that do not get answered for long periods does not serve a populace that cannot hire representatives to assist it with the process and does not have the knowledge to navigate the system effectively. A different system for using resources needs to emerge even if it means fewer resources to do other tasks.

Having said this, the best use of scarce resources is preventing problems in the first place by putting great emphasis on the correctness of the return and enlisting return preparers and software manufacturers to aid in the correctness through a mixture of regulation, behavioral science and matching. At the outset of the case, the IRS could rely on its computers and on outside resources to try to prevent taxpayer problems that will draw upon its limited human capital. Through this method, which may involve delaying the timing of refunds to maximize the correctness at the outset, the IRS can more effectively use its scarce resources. One model for using outside resources to help insure the correctness of returns involves some form of certification of the correctness of returns seeking refundable credits. A certification process exists in the ITIN area for taxpayers seeking an [identification number](#):

One proposal to assist the IRS that has recently emerged involves expanding the math errors procedures using the name correctible error. This proposal raises concerns because it focuses on the back end of the return process rather than the front end and it removes rather than expands rights of low income taxpayers. It does address the scarce resources concern at the IRS and seeks to truncate the audit process but it does so at a cost to taxpayers who may have a legitimate claim which may get lost in the new shorter process.

Successful Compliance Outcomes

The most successful compliance outcome for low income taxpayers results from keeping them out of the compliance process as a result of their own mistakes or the willful or mistaken conduct of others such as identity thieves or fraudulent preparers. While minor improvements to the process might exist and will receive attention below, none of these improvements will create a compliance process that will work well for low income taxpayers.

To sum up this section of operating principles, I recommend certain possibilities as a possible application of the principles as they apply to returns containing refundable credits:

- 1) Require a form of pre-certification of the returns and do this through preparers who have obtained certification from the IRS or through approved software programs;
- 2) Do not allow preparers who have not obtained the proper approvals from the IRS to prepare returns with refundable credits;
- 3) Do not issue refunds to taxpayer seeking refundable credits to those who do not use properly approved preparers or properly approved software until after the IRS has the opportunity to

load matching data and cross check the accuracy of the data on the returns (or do not allow any refundable credit refunds until the matching has occurred);

- 4) Acknowledge that accuracy and not speed is the key to the successful filing experience of a low income taxpayer seeking a refundable credit;
- 5) Provide some financial incentive to taxpayers to use the properly authorized preparers or software to compensate for the additional cost incurred

Other Provisions That Would Assist Low Income Taxpayers in Tax Compliance

Provide Authority for the IRS to Regulate Preparers

Clinicians operating low income taxpayer clinics see day in and day out the ravages that poor and unscrupulous preparers cause to our clients. The return preparation stage is the most important moment in the process for low income taxpayers who do not have the resources or savvy to engage effectively in the tax controversy process. Reverse the decisions in *Loving v. United States* and *Ridgely v. Lew* and allow the IRS and Treasury to regulate the industry that has such an important impact on agency actions and on taxpayers in general. As mentioned above concerning walk in sites, if we must bring low income taxpayers into the tax filing system in order to obtain benefits, we need to make sure we have designed a system that does not prey upon them. By creating refundable credits, the system attracts individuals motivated to get that easy money. These credits have created a paradigm shift in the return filing process that must be acknowledged. The IRS finally acknowledged the problem only to have its efforts stymied by the Courts. Congress needs to step in to protect low income taxpayers and the system in [general](#).

Provide a Workable Framework for Assisting Victims of Fraudulent Preparers

We brought low income taxpayers into the tax system to deliver benefits causing them to prepare, or have prepared, tax returns with sufficient complexity to create problems many cannot navigate without assistance. When the low income taxpayer has the misfortune to choose the wrong preparer among the many unregulated preparers, these taxpayers are being stuck not only without their refund but with the bill created by the fraudulent preparers. The IRS has the authority to abate taxes on fraudulent returns in which the taxpayer did not participate and to refund to the taxpayer the correct amount of tax the taxpayer should have received had the taxpayer not been defrauded. The IRS has significantly dragged its feet in assisting these individuals.

After being defrauded and not receiving their refund or receiving their refund and then being placed in the audit system, these victims must endure audit process and wait years seeking resolution. The adoption of a better filing system described above should eliminate many of these problems going forward, but at this time many low income taxpayer sit in victim's purgatory awaiting disposition of their cases. The IRS is not moving on their corrected returns and has placed the most vulnerable population of taxpayers in an untenable position. If a taxpayer can demonstrate that they are the victim of a fraudulent preparer, the IRS should establish a system of quickly moving to assist them to remove assessments from their account and to restore their correct refund. They should not receive bad treatment because they are poor and made an unfortunate choice in the unregulated marketplace of who to trust to prepare a return they do not know how to prepare themselves.

Provide Taxpayers Fighting Identity Theft and Fraudulent Return Preparation with Adequate Information

The IRS interprets the disclosure rules in a manner that can make it very difficult for taxpayers victimized by identity theft to obtain information about the theft of their identity and defend against the

consequences. If a taxpayer informs the IRS that a return using their identifying information did not originate from the taxpayer, the IRS declines to provide the taxpayer with that return citing the disclosure laws. The disclosure laws should allow a taxpayer access to documents using their tax identifying information. The ABA Tax Section has proposed a legislative [change](#) that would address this problem and allow individuals access to tax returns using the tax identification number of the individual. A prior [legislative proposal](#) also sought to address the problem although it placed discretion in the IRS to release the information. Taxpayers whose identities have been stolen need access to the information concerning use of their personal information. The disclosure laws came into existence to protect taxpayers and not to leave them uninformed and unprotected.

Assist Low Income Taxpayers in Meaningful Way When They Interact with IRS

The IRS budget problems drive it to close sites where individuals provide assistance to taxpayers and cause it to seek to provide more services via the [internet](#). This does not work for many low income taxpayers who do not have the access or skills to get the information they need from the internet. The IRS has not only closed or greatly curtailed its walk in sites but its phone wait times have increased to unmanageable proportions. Many low income taxpayers use track phones and do not have the minutes to wait for someone to come onto the line. If we decide to use the tax system as the delivery mechanism for certain benefits previously delivered elsewhere in the government, we must build a system that accommodates this population and not ignore the fact that we have introduced millions into the tax system that might not otherwise need to interface with the IRS. A part of using the tax system to deliver benefits must include the necessary infrastructure to service the population that does not operate as most taxpayers in the system. The IRS must receive the resources necessary to service this population in a meaningful way.

Move Slowly into Process That Reduces Taxpayer Rights

The concept of math error is rooted in a simple desire to quickly and easily correct a return where the taxpayer adds 2+2 and gets 5. That type of mistake deserves the treatment established in [6213](#) for a letter to the taxpayer explaining the problem and a short time frame for the taxpayer to point out their math was correct or allow assessment of the correctly calculated amount. From that simple concept has grown a panoply of provisions giving the IRS authority to make an assessment without giving the taxpayer the direct opportunity to go to Tax Court and contest the decision.

Recently, much discussion has centered on a further expansion of math error to allow the IRS to administratively create adjustments similar to math error now traveling under the more correct moniker of correctible error. A proposal to give the IRS authority to expand these provisions appeared in the General Explanation of the Administration's Fiscal Year 2016 Revenue Proposals at pages [245-256](#).

For the reasons discussed above, fixing problems at the return filing stage provides far better benefits to the system than fixing those problems at the back end. The correctible error proposal would allow the IRS to fix the problem at the end of the return filing stage as it would normally transition to the examination phase. It will reduce IRS resources in examining returns because it will allow the IRS to send a correctable error notice when data on the return does not match data in the IRS system.

Matching information before sending refundable credits should occur. The correctible error proposal does not seem designed to stop and correct the return prior to sending the refund. Although the IRS will freeze refunds in many instances as it does today, the correctible error proposal at its core appears to reduce exam resources for the IRS and truncate [taxpayer rights](#).

Matching before refunding should also reduce examination resources. The goal of correctible error, in that respect, operates in sync with the goal of matching before refunding. The problem with correctible error comes with the truncation of taxpayer rights. A math error notice (and presumably a correctible error notice) does not come with the same explanations and rights as a notice of deficiency and does not come with the same time frame. A taxpayer must determine what the notice says and write back to the IRS within the 60 day time period in order to avoid having the taxes assessed. If the IRS matches documents before refunding, freezes any refundable credits (and possibly and paid credits) not lining up with the documents available to the IRS, the taxpayer should have the opportunity to test the difference in Court after a full and fair opportunity to respond to the IRS concerning the correctness of the items on the return.

The abbreviated protections afforded by math error should remain the exception and not the rule. The IRS should give taxpayers the opportunity for a meeting with an individual assigned to their case who can review the information and make informed determinations. The goal should be to swiftly make a determination because the taxpayer awaits a refund which is crucial to their financial well-being, However, swiftness should not mean an abbreviation of their rights.

While Congress has expanded math error authority over the years, it has done so in a slow and deliberate manner. As it expanded the math authority provisions Congress looked to ensure the benefits of reducing taxpayer rights justified the expansion of the math error authority. The correctible error proposal would pass that decision to the IRS. Erring on the side of giving taxpayers more due process protections by allowing them a day in Tax Court when a discrepancy exists regarding data follows a path that should not harm the IRS if it holds the money. Taxpayers engaged in identity theft or refund fraud are not likely candidates to call upon the IRS or Tax Court resources to resolve their problems. Once denied the initial quick refund, these parties will run and hide seeking to avoid further identification and detection. Taxpayers with legitimate concerns should get their opportunity to explain the correctness of their return with full rights including the presumptions created in IRC 6201(d) regarding third party information. These procedures will fall disproportionately on low income taxpayers who have the most to lose.

While we should look to create systems within the IRS that work for those brought into the tax system because of its use to deliver benefits, those systems should not seek to usher taxpayers out the door without the opportunity for the full measure of their rights.