

# FILING SEASON UPDATE: CURRENT IRS ISSUES

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## HEARING

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

APRIL 15, 2010



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## **FILING SEASON UPDATE: CURRENT IRS ISSUES**

**THURSDAY, APRIL 15, 2010**

U.S. SENATE,  
COMMITTEE ON FINANCE,  
*Washington, DC.*

The hearing was convened, pursuant to notice, at 10:07 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Bingaman, Wyden, Carper, Grassley, Roberts, and Enzi.

Also present: Democratic Staff: Bill Dauster, Deputy Staff Director and General Counsel; Cathy Koch, Chief Tax Advisor; and Mary Baker, Detailee. Republican Staff: Mark Prater, Deputy Chief of Staff and Chief Tax Counsel; and Theresa Pattara, Tax Counsel.

### **OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The committee will come to order.

It is the time of year when the days grow longer. It is the time of year when the daffodils are in bloom. In fact, I do not know if any of you listened to NPR this morning and you heard Wordsworth's poem "Daffodils." It is the time of the year when we Americans file our tax returns. So it is time for this committee to call in the IRS. It is time to ask the IRS for an update on the recent filing season, and it is time to discuss other matters affecting tax administration.

The Finance Committee holds the IRS to a high standard. It is appropriate to do so, not only because of the committee's responsibility to oversee the IRS, but also on behalf of the American people.

Taxpayers have a right to expect that their government applies the tax laws fairly and correctly. They have a right to expect that the IRS operates efficiently. And they have a right to know that the IRS is protecting their personal tax information.

We will have the opportunity to consider all of these matters with our witnesses today. I am pleased that we have with us today, first, Steve Miller, IRS Deputy Commissioner for Services and Enforcement, and also Ms. Nina Olson, the IRS National Taxpayer Advocate. Welcome to you both.

Today we will want to know what actions the IRS is taking during this filing season to encourage and facilitate the use of the many new tax incentives to jump-start the economy and create jobs. The IRS has reported, on average, a 10-percent increase in refunds this year following the enactment of these incentives.

For individuals, these incentives include the Making Work Pay Tax Credit, the American Opportunity Education Tax Credit, the New Homebuyer Tax Credit, the Military Homeowner Assistance Program, and the Adoption Tax Credit, just to name a few.

For businesses, these incentives include extension of bonus depreciation, extension of increased small business expensing, the 5-year carry-back of net operating losses, Build America bonds, the payroll tax exemption, and Advanced Energy Investment Credit, to name just a few.

These incentives are effective only if taxpayers use them. The IRS plays an important role, especially during filing season, in helping taxpayers understand the availability of these tax breaks and how to claim them. If the IRS can help to make these incentives work effectively, the country can grow more rapidly and create more jobs.

More generally, I look forward to learning how the 2010 filing season has unfolded. I look forward to updates on electronic filing rates and the IRS's modernization efforts to reduce filing errors and generate faster refunds.

I want to know how the IRS is working to improve its taxpayer services, including the level of service on the telephone to ensure that taxpayers who contact the IRS with a tax question are able to get through and have their questions answered timely and accurately.

I am interested to hear more about the IRS's new strategy to improve paid preparer competency, accountability, and transparency. With paid preparers doing more than 60 percent of individual tax returns, the quality of paid preparers has a direct and significant effect on voluntary compliance and the tax gap.

The committee also will take this opportunity to catch up on other matters of tax administration. One is this: I am interested to receive an update on the tax gap. How are we going? I would like to know when the \$345-billion annual figure will be updated. I would also like to hear what specific actions the IRS is taking to implement the comprehensive plan to close the tax gap that the Treasury developed at my request and that was updated last summer.

Of particular interest to me is the IRS's progress on the planning and implementation of several of my tax compliance proposals that recently have been enacted. These include the credit card information reporting, securities basis reporting, offshore loophole closures, and corporate information reporting.

These provisions are estimated to raise over \$40 billion in revenues over the next 10 years. Each of them will improve voluntary compliance and reduce the tax gap without raising one single dime of taxes on anyone, making timely and efficient IRS implementation especially critical to their effectiveness.

I also want the IRS to address the rumors and rhetoric that have been circulating about the IRS's role in administering health care reform. We have all heard the rumors alleging that the IRS will hire up to 17,000 armed U.S. agents to enforce health care, rumors that fly in the face of specific proscriptions in the law against criminal penalties for failing to buy health insurance.

We want to hear directly from the IRS to what extent it has determined the need for increased staffing and resources to conduct its role in health care reform, as well as what functions any increased staffing will perform.

Finally, I would like to extend my sincere condolences to the IRS victims of the airplane crash in the IRS building in Austin on February 18th of this year. Our thoughts especially are with the family of Vernon Hunter, a long-term IRS employee who was killed in that accident. Threats and violence against the IRS and its employees are unacceptable and intolerable.

So we have a lot to cover today. Again, I want to thank Mr. Miller and Ms. Olson for appearing. I look forward to your testimony. Senator Grassley?

**OPENING STATEMENT OF HON. CHUCK GRASSLEY,  
A U.S. SENATOR FROM IOWA**

Senator GRASSLEY. Thank you, Mr. Chairman.

As may be appropriate for tax day, we are going to be hearing a lot about numbers during this hearing. There are billions of dollars of refunds, millions of returns processed, and millions of phone calls received by the IRS. There are millions of individuals who filed for Home Buyer and Making Work Pay credits, and millions of dollars in errors with those credits. Then there is the \$12-billion IRS budget and the almost half-billion-dollar request increase for fiscal year 2011. But as the chairman has just related, we are not hearing anything about the billions of dollars and thousands of employees IRS will need to implement health care reform.

I first raised the issue in a letter 6 months ago to Secretary Geithner and Commissioner Shulman. The response back to me was that Treasury and IRS would not have estimates until legislation was enacted. Well, the House passed their bill last fall and the Senate passed its bill on Christmas Eve, over 3 months ago. While the final bill was not signed into law until last month, the provisions did not change much, so it is not clear why we still do not have estimates on the dollars and people needed by IRS to implement health reform.

Meanwhile, CBO has estimated that IRS will need between \$5 and \$10 billion over 10 years to implement health care reform alone, so that does not take into account any other legislation Congress may pass. What is troubling about this anticipated growth of IRS is that it is not all related to the IRS's mission, and that is the collection of revenue to fund the operations of the Federal Government.

What is more, we in this body, in the landmark IRS restructuring legislation of 1998, directed the IRS to revise its mission statement to "provide greater emphasis on serving the public and meeting the needs of the taxpayers."

Health care reform provisions require the IRS to make sure that every individual has health insurance. IRS employees will have to become experts in calculating a very complex subsidy for those who are eligible to receive financial assistance for purchasing that health insurance. IRS employees will also have to verify subsidy eligibility by sharing income information with Federal, State, and other entities, including the new exchanges. It is likely that IRS

will not have the necessary information, since subsidy eligibility is based upon household income, which is not taxable income.

These are just some of the provisions impacting an individual's interaction with the IRS. There are many more that impact a business's interaction with the IRS which I will not get into at this time.

The Earned Income Tax Credit is the largest social spending program administered by the IRS. This program also, unfortunately, has one of the highest fraud and abuse rates of any tax provision. While IRS has steadily reduced the fraud in this program, knowledge of and outreach to the eligible populations have been huge challenges for the IRS.

A former IRS Assistant Commissioner said it best: "These kinds of programs require social welfare expertise. IRS agents are not recruited or trained to do that well. The IRS record is mixed and sometimes abysmal with regard to effectively administering these kinds of programs."

Ms. Olson also indicates in her testimony today that the IRS is not keeping up with the needs of low-income taxpayers. Experience with the EITC teaches us that a social worker with a calculator and green eye shades should be a job description at the Department of Health and Human Services, not at the agency before us today. The IRS already struggles to stay on top of its core mission.

IRS should be training its employees to combat complex tax evasion schemes and to improve customer service instead of administering social programs at which the IRS has historically failed. Taxpayers trying to do the right thing regarding their tax responsibilities should not have to be put on hold or have to call back because the IRS is now answering questions about health insurance.

So I thank you, Mr. Chairman, for holding this hearing so we can discuss in greater length these particular issues.

The CHAIRMAN. Thank you, Senator.

Our first witness is Mr. Steven Miller. Mr. Miller is Deputy Commissioner for Services and Enforcement at the Internal Revenue Service. Our next witness is Ms. Nina Olson, National Taxpayer Advocate at the IRS.

So, thank you both very much. I think you know the drill. We will include your prepared statements, and I just urge you to summarize, each, in about 5 minutes.

Senator GRASSLEY. Can I explain to our distinguished witnesses, I am going to be in and out because of Judiciary down the hallway, so I will be back for questions later on.

The CHAIRMAN. All right.

Mr. Miller?

**STATEMENT OF STEVEN T. MILLER, DEPUTY COMMISSIONER  
FOR SERVICES AND ENFORCEMENT, INTERNAL REVENUE  
SERVICE, WASHINGTON, DC**

Mr. MILLER. Thank you, Mr. Chairman, Ranking Member Grassley, and members of the committee. Thank you for the opportunity to testify on the IRS's efforts to ensure a successful tax filing season and provide you with an overview of our proposed 2011 budget request.



The 2010 filing season has proceeded smoothly and with some noteworthy gains. For example, telephone assister level of service has improved considerably over the same period last year, and our accuracy remains very high.

With respect to returns, e-file, as a percentage of total individual returns, is up to almost 80 percent, continuing a very positive trend. And in a challenging economy, it is good news that the average refund is over \$2,900 at this point, up by 9.4 percent as compared to last year.

The IRS has taken several other additional steps this tax season to help people with financial problems. One of the most recent and most significant is new flexibility for offers in compromise. For those taxpayers facing economic troubles, including recent unemployment, IRS employees can now consider current income and potential future income when negotiating an offer.

And we are holding hundreds of special Saturday open houses to give struggling taxpayers more opportunity to resolve issues. At our most recent event just earlier in March, more than 8,000 taxpayers were helped, and, of those who had problems, more than 80 percent got them resolved that day. These events will continue, and on one Saturday we will focus on small business issues.

In addition, the IRS has begun its implementation of the Hiring Incentives to Restore Employment, or HIRE Act. We are working on revised forms, instructions, and programming so eligible employers will be able to claim the new tax incentive. We have acted quickly to get the word out. We have also put out a revised form 941 for use for the incentive and an affidavit for use by newly hired employees.

We are also spreading the word to small employers about the new health care tax credit, including sending out information about the credit on postcards to potential eligible employers.

We also have under way a major initiative to regulate paid tax return preparers, including registration, minimum competency testing, and continuing education. The goal of this strategy is to leverage the return preparer community to improve compliance.

Mr. Chairman, in recognition of the critical role that the IRS plays in the Nation's economy, the President's 2011 budget includes a judicious investment in the IRS's core service and enforcement programs. It provides the resources for the IRS to implement a strategic and balanced agenda. This investment includes improved service to taxpayers, such as continuing to raise the level of our toll-free telephone service, and providing enhanced e-products and tools.

The budget also helps us carry out our robust and targeted enforcement program, including adding staff to address offshore tax evasion and improving tax compliance for corporate and high-income taxpayers. For example, additional resources are given to our global high-wealth group to further centralize and focus IRS compliance expertise on high-wealth individuals and their complex web of related entities.

The 2011 budget will also help the IRS implement the new taxpayer account database for the 2012 filing season. Achieving this milestone will allow the migration of 140 million individual tax-

payers to a modernized, relational database that will support faster processing and result in faster refunds for individual taxpayers.

In the wake of recent events, I would like to end with a word about our employees and their commitment to public service. This February, as you mentioned, Mr. Chairman, an individual flew a plane into an IRS building in Austin, killing one of our employees.

We have no reason to believe this attack could have been prevented or that it was part of a more organized effort. However, we continue to be concerned that the IRS and our people not be demonized. The IRS is filled with dedicated public servants, reflective of the overall general public. The vast majority of Americans experience an IRS that is trying to help them by answering questions, processing returns, and issuing refunds.

Mr. Chairman, this concludes my oral testimony. I would be happy to take any questions.

The CHAIRMAN. Thank you, Mr. Miller.

[The prepared statement of Mr. Miller appears in the appendix.]

The CHAIRMAN. Ms. Olson?

**STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER  
ADVOCATE, INTERNAL REVENUE SERVICE, WASHINGTON, DC**

Ms. OLSON. Thank you, Mr. Chairman, Ranking Member Grassley, and members of the committee. Thank you for inviting me today to discuss the 2010 tax filing season.

I would like to begin by commending the IRS's response to one problem I identified in 2002, and again this year: the need to improve oversight of the return preparation industry.

Since 2002, there has been considerable congressional support for preparer regulation, including legislation passed by this committee and the full Senate. In January 2010, the IRS issued a report setting out a blueprint to do the job itself. While the devil is in the details, when fully implemented, I believe this initiative will improve tax administration significantly by helping taxpayers locate qualified preparers, establishing clear requirements of competence and ethics for preparers, and disciplining and even shutting down unqualified and unethical preparers.

With respect to the 2010 filing season, this year I designated the inability of the IRS to adequately answer taxpayer phone calls as the number-one most serious problem for taxpayers. The IRS's target for the current fiscal year is to answer only 71 percent of the calls from taxpayers seeking to reach a telephone assister. Among the calls that do get answered, the IRS projects the average wait time will be nearly 12 minutes, up from just over 4 minutes in the 2007 fiscal year.

I encourage the committee to support sufficient additional funding for the IRS toll-free lines so that the IRS can achieve an 85-percent level of service and an average wait time of 5 minutes.

Much of the impact on IRS service and program delivery over the last few years is directly attributable to the passage of special initiatives, including the economic stimulus payment, the First-Time Home Buyer Credit, and the Making Work Pay Credit. For example, because of the documentation requirements for the First-Time Home Buyer Credit, taxpayers are unable to e-file, so processing of these original or amended paper returns can take anywhere from

8 to 11 weeks in the best of circumstances, and about 5 months if audited.

As of the end of February, the IRS received more than 1.8 million original and amended returns claiming the Home Buyer Credit and selected over 260,000 for examination. Of the over 650,000 correspondence exams closed through March of this fiscal year, over 139,000 involved the Home Buyer Credit. Home Buyer Credit audits, thus, account for almost 21 percent of IRS correspondence exams closed this fiscal year. This means that the IRS has had to scale back its audits of other issues to concentrate on preventing improper Home Buyer Credit claims.

My point here is not to say that the IRS should not be administering social programs; rather, as I discuss in this year's report to Congress, I believe that social programs placed in the tax code should be designed in such a way, and the IRS should be funded sufficiently, so that the IRS can administer them effectively in addition to performing its core functions, instead of displacing those functions.

In my written testimony, I make several recommendations for improvements to the existing programs. For example, if Congress extends the Making Work Pay Credit, I recommend that it require the payer agencies like Social Security to report on their end-of-year statements the amount of credit taxpayers received. Had this procedure been in place for this filing season, the IRS would not have rejected over 1.8 million e-filed returns as of the end of February, which generated calls and re-work for the IRS and confusion and delay for taxpayers sorely needing their refunds.

More importantly, I recommend that Congress and the IRS explicitly recognize that the IRS has a dual mission of collecting Federal revenue and delivering benefits to both individuals and businesses, a trend that is common in tax administrations around the world. This recognition will enable us to better identify the resource needs for both IRS core functions and to better design and administer these programs.

One initiative that would vastly improve tax administration would be for the IRS to process information returns, such as forms W-2 and 1099, before it processes tax returns. Such an approach would enable the IRS to substantially reduce fraudulent and other erroneous refunds, largely eliminate post-filing season document-matching exams, and assist taxpayers by making this information available through pre-filled returns or by downloading into existing software programs.

This is also vitally important for effective administration of the new tax gap closers recently enacted by Congress. However, this is much easier said than done. Thus, I recommend that Congress require Treasury to study and report back within 1 year on the steps necessary to make this happen.

Finally, I note that my report designated IRS lien filing policies as the second most serious problem for taxpayers. Although perhaps counter-intuitive, more liens do not necessarily translate into more revenue. As discussed in my written testimony, when long-term damage to the taxpayers' financial viability and the costs of lien filings are taken into account, an automated or shotgun ap-

proach to lien filings may actually result in less revenue collection in many types of cases.

Thank you.

The CHAIRMAN. Thanks, Ms. Olson.

[The prepared statement of Ms. Olson appears in the appendix.]

The CHAIRMAN. I would like to begin, Mr. Miller, by asking you a question about the degree to which the IRS is informing taxpayers of recent provisions we have passed here in the Congress that helped reduce individuals' income taxes, and also helped, as you indicated, increase refunds. Those include the Making Work Pay tax credit, the New Homebuyer Tax Credit, increasing small business expensing, carry-back, and Build America bonds.

So, if you could just tell us the degree to which the Service is making taxpayers aware of these incentives and the degree to which the Service is making it easier for taxpayers to take advantage of them.

Mr. MILLER. I would be happy to do that, Mr. Chairman. We are, and continue to be, aggressive in terms of our outreach events, going out to both partners and out into the taxpayer domain and talking about these things. We have a very good relationship with a batch of partners who also, as people are working on their returns, will be informed of this. We have, obviously, web-based information out there.

As I mentioned, on the HIRE Act, in particular, we have gone one step further, and we will be issuing postcards. Not in the HIRE Act. I apologize. The Small Business Health Act credit. We will be sending out postcards to those we think may be eligible so that they can plan accordingly, because that is live right now as we speak.

The CHAIRMAN. Could you address the small business tax credit in the health legislation we passed? That is, I mentioned in my opening statement that there are some allegations that the IRS is going to have 17,000 armed agents to enforce small business compliance. As you know better than most, small businesses with 50 or fewer employees are under no obligation to provide health insurance to their employees.

Mr. MILLER. Right.

The CHAIRMAN. I just know in my State of Montana, 97 percent of businesses are small business, so virtually every business—at least 97 percent—will not have any obligation. But at the same time, as you all know, there are credits available for small businesses to provide insurance to their employees, should they choose to do so. I think there is one that is under 10 or 25, I have forgotten the exact numbers, and 35 percent, then later on 50 percent. But could you explain the degree to which the IRS has armed agents enforcing small business provisions in the health care reform legislation?

Mr. MILLER. I will do that.

The CHAIRMAN. Let me say—go ahead.

Mr. MILLER. No, please.

The CHAIRMAN. Go ahead.

Mr. MILLER. So the way we would approach the small—

The CHAIRMAN. So, do you have armed agents going out there enforcing?

Mr. MILLER. We have no armed agents. We have some criminal investigators, about 2,000 of those, who do criminal investigations.

The CHAIRMAN. Generally?

Mr. MILLER. Generally. In total, yes.

The CHAIRMAN. That is right. You have no specific new agents targeted to the small business tax credit provisions?

Mr. MILLER. Not at this point. It is very early. I recognize Senator Grassley's view that it has been a few months, but in point of fact the bill was signed incredibly recently. Until the bill was signed, we were not prepared to dig in and decide and determine exactly how we will be proceeding in terms of the entire health bill, which will include—and this is a perfect example, the Small Employer Health Credit—starting with making people aware of what they may be entitled to and what their responsibilities are, such as the postcard, such as the web, and moving from there to making sure people have the ability to reach out to us and get the information they need, whether it is call assisters or the web, and filing systems.

The CHAIRMAN. Are you taking affirmative action to make taxpayers aware of some of the other provisions I named?

Mr. MILLER. We are. We have, obviously, worked to get the word out by various news releases and the web, and in our meetings on the HIRE Act, on the jobs credit, and we have worked on Making Work Pay and First-Time Home Buyer—it is very hard to get the word out.

The CHAIRMAN. Is there any way you can determine the degree to which taxpayers have taken advantage of these provisions, sort of on a percentage basis? I know it is hard to determine, but your gut take.

Mr. MILLER. I do not have at hand any way to say that X percentage could have taken and X minus Y did. We have the numbers, X percentage did take it. I mean, Nina has raised—on First-Time Home Buyer, in total, in 2009, 1.7 million-plus folks took the First-Time Home Buyer Credit. This year, another 700,000 or something like that. We have those sorts of numbers we can make available to the committee.

The CHAIRMAN. All right. Thank you. My time has expired.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman. Thank you for holding this hearing. Mr. Chairman, I was struck this morning—apparently, many of America's restaurants and retail establishments are letting people eat for free today. You can get free coffee at Starbucks, and get free tax bites at Cinnabon just because the restaurants—

Senator BINGAMAN. What are we doing here?

The CHAIRMAN. I was going to ask! [Laughter.]

Senator WYDEN. It is because Chairman Baucus is at his post trying to assuage the pain other than by getting everybody those goodies. But my favorite, Mr. Chairman, was apparently Morton's is giving some kind of discount to the CPAs at some of their restaurants. It dawned on me that maybe the CPAs are the one group in America that gets so much income out of the tax code, that they can regularly afford Morton's.

The CHAIRMAN. Well, that may be, but I have talked to some who are quite frustrated. One is because, apparently, the Service has delayed the date on which the brokerage firms need to file their 1099s. I have talked to preparers who say that has put a huge burden on them to get their tax returns processed by April 15. That might be something we should look into. I am sorry to interrupt.

Senator WYDEN. No, no. A fair point.

So let me ask you about one idea that I have been interested in, Ms. Olson. The IRS already gets a substantial amount of information, say on an individual's wages and their interest and their investment income, the value of the mortgage deduction they are getting.

So one idea that has become popular that I have been interested in is the idea of letting the taxpayer, on a voluntary basis—in other words, this is the taxpayer's choice—if the taxpayer chose to do so, the taxpayer could ask the Internal Revenue Service to, in effect, take the information they already have and in effect send them what amounts to their judgment about what is owed, and the taxpayer could then vet it and modify it and file it and do these various things that ensure that it actually reflects what they believe is owed. It seemed to me like an attractive kind of option and something that could substantially short-circuit the more than 6 billion hours that people put into preparing these returns, the \$180 billion spent preparing these returns.

My question to start with is, if the IRS had enough time for a transition, because you obviously cannot do this overnight, and I think Chairman Baucus is right about some of the hassles already. If you had enough time to make a transition, what do you think about the idea of letting the taxpayer voluntarily request something like this?

Ms. OLSON. Well, this is something that we covered in this year's annual report, where we looked at, how could you get that information available, because we think it would minimize error and certainly be a burden reduction for the taxpayer. It is also key that the IRS have this information before returns are filed, as we have more and more programs that are relying on information reporting, such as the credit card reporting, some of the health care provisions, the basis reporting.

The problem is that the IRS right now does not start getting the data until sometime in mid-February, and we do not really start pulling it together until May. That is partly a problem in that we have pushed the filing dates back for the payers to the end of March on some of these things.

So what we recommended was that Congress require Treasury to study, what would it take to get the information quickly, in a usable form, to run against returns, but also make available to taxpayers as they want it, and report back in a year. Some of our suggestions have been, you push forward the date on which payers have to get us the information.

You figure out whether we could get the W-2 information directly. Does it need to go to Social Security first or can we scrub it and clean it up as easily as Social Security does? Then you might even want to think about, right now, taxpayers get their W-2s on January 31. You might want to say, in this day of electronic filing,

can you push that date up to January 15, and can you get us the information at the same time? So very early on, we could have that data available to taxpayers.

Senator WYDEN. Let me ask you one other one, very quickly. It looks to me like there are a fair number of abuses with these refund anticipation loans. These are the ones where the person, in effect, gets this short-term cash advance from the preparer, and it is backed by the refund. How serious a problem do you think this is, and if you think it is a serious problem, what are you all doing about it?

Ms. OLSON. Well, I think it is a very serious problem. I know that the IRS is in discussions with various Treasury and banking regulator officials about what they can do. Our recommendation has been that you do not give the debt indicator on the refund anticipation loan until you have run the entire return through all of our fraud checks and eligibility rules, and that in itself will slow up the process and increase the risk for the lenders so much that they will basically look elsewhere to make their money. That is my approach.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Bingaman?

Senator BINGAMAN. Thank you very much, Senator Baucus, for having this hearing. This is obviously the right day to be talking about the filing of tax returns and problems that need to be addressed there.

Today we are also going to introduce the Taxpayer Bill of Rights, which is legislation Senator Schumer, Senator Kerry, and various others are going to co-sponsor that contains provisions to improve services and put in law some of the protections that we think are important.

It supports representation clinics and tax preparation programs such as one we have in New Mexico that has been extremely successful, called Tax Help New Mexico. It enhances oversight of paid tax return preparers, which is what Ms. Olson just responded to Senator Wyden's question about, enhances low-income taxpayers' access to financial institutions, and does a variety of other things.

At any rate, I hope very much we can consider that legislation this year. I know it is difficult to get anything considered this year, but this ought to be some good government legislation that could be acted upon. Much of the bill, many of the provisions in the bill, were passed out of this committee in the 108th Congress but were not acted upon by the full Senate. I hope very much we can act on them this year.

Let me ask, Ms. Olson: one of the issues that you and I spoke about when you were kind enough to come by my office a few weeks ago, was this whole issue of liens and the concern that you have expressed about the IRS lien filing policies causing harm to taxpayers without necessarily increasing IRS revenue collections in the process. I guess I would just ask if you could briefly describe the concern you have there and the solution you think we should consider.

Ms. OLSON. Well, what we identified was that IRS, over the last few years, has been instituting policies where liens are essentially

filed automatically if the taxpayer meets certain requirements without really looking at the taxpayer's specific facts and circumstances. We looked further into, what is the effect of that lien filing on the taxpayer?

We learned that it caused the taxpayer's credit score to plummet 100 points immediately, and, even when the taxpayer paid off the lien or it expired after time, it sat on their credit report for years and years and years, even though it might not be enforceable. That has a huge effect on the taxpayer's financial viability and their ability to pay their future taxes.

We did a study that showed that, for the payments that we could track, very few payments and very few dollars actually came from liens, and that the vast majority of payments that taxpayers made on their past tax debts came from collection activity that needed no lien involved. So we felt that we were really doing harm to taxpayers rather than having the lien be helpful.

Senator BINGAMAN. I think that is a good suggestion. I think if there is a way we can act on that, it would be good.

Let me ask also on this issue of return preparer standards: I know that the IRS is beginning to move on that issue and trying to put in place initiatives to require certain competence by preparers and certification by preparers.

Mr. Miller, could you explain that? Perhaps you did in your comments before when I was not here. But if you could explain the status of that, that would be helpful.

Mr. MILLER. Certainly, Senator. We did a study on this issue. We came out with some proposed recommendations basically that would require preparers to actually get a preparer identifier so we would know and be able to track through the system what a particular preparer was doing in terms of returns.

We are going to require testing for those other than attorneys and CPAs and enrolled agents who have other testing. We are going to require that continuing education occur for folks who do not otherwise have a requirement. We hope to get the registration in place for the 2010 filing season, and that is our effort at this point. Over the next 3 years, probably, we will be testing people in and then we will be fully up and running.

Senator BINGAMAN. All right. You are going to exempt attorneys from the testing requirement? What is the underlying assumption that justifies doing that?

Mr. MILLER. The assumption around CPAs and attorneys is that they are otherwise bound by some other standards and testing procedures. There are also some limited legal impacts that limit us in that regard.

Senator BINGAMAN. Well, as one attorney who went to law school a long time ago, I do not know that exempting lawyers from the testing requirements is a wise course, but I will defer.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Grassley?

Senator GRASSLEY. Ms. Olson, in your 2009 annual report, you report that you issued 16 taxpayer assistance orders. The examples listed in your report seem to indicate that they are good examples of the IRS's aggressive use of liens and levies. I understand that



you may have issued three for just one taxpayer, including one to the SB/SE Commissioner, to request that a lien be withdrawn.

Further, the taxpayer lost his job because the lien impacted his credit rating, which was not tolerated by the employer. Could you describe the details surrounding this case to the extent possible, and whether you think it resulted in the best outcome for the government?

Ms. OLSON. Yes. The taxpayer has given me permission to discuss the facts of his case, so the normal confidentiality provisions do not apply.

This taxpayer had lost his job. He had actually had his first employment reduced because he was in a particular industry that did due diligence and found a lien on the books. This taxpayer was working with the IRS to pay in full the debt without the lien having been filed, and, while he was talking to the IRS over a period of 3 months and had about seven or eight phone calls with the IRS telling them he was refinancing his home, he was borrowing money from his partner's retirement account, so it was money the IRS normally could not get its hands on.

The IRS then informed him that, because the dollar amount was over a certain threshold, they were going to file the lien on him anyway, which made the taxpayer very angry, as the record noted. It would have made me angry, too. Ultimately, the taxpayer paid the face amount of the lien, and it left very little money, about \$1,700, on the past due bill.

The IRS refused to withdraw the lien so that the taxpayer could keep his employment, and ultimately the taxpayer lost his job. That is what led to the three taxpayer assistance orders issued in that case. Ultimately, we showed the IRS that their reading of the law was incorrect. They believed that they could only withdraw liens where the IRS had made a mistake. We showed them that Congress had actually passed, in 1996, a completely different provision and that it made economic sense for us to have a taxpayer earning money so that he could pay his debt.

Senator GRASSLEY. Well, so the bottom line of it is, if you are working and paying your debt, you are paying your taxes too and continue to be productive.

Ms. OLSON. Yes.

Senator GRASSLEY. Mr. Miller, Ms. Olson's testimony about the IRS's use of liens adds to what I learned personally about the IRS's use of liens from a conversation I had with Commissioner Shulman last fall. In that call, we discussed IRS's decision to file liens against taxpayers subject to the tax shelter disclosure penalty, even though the IRS had agreed not to pursue collection actions against such taxpayers until Congress had a chance to change the law.

In general, I am disappointed in the lack of judgment and discretion exercised by IRS employees, agents, lawyers, collections and appeals officers in certain of these cases. In some cases, it was an IRS regulation that prohibited the IRS from abating the penalty, such as by not allowing the filing of amended returns. In another case, IRS did not consider the negative impact to a taxpayer's credit line, which was critical to the operation of his business, before filing a lien.

Mr. Miller, everyone, including the President and Treasury Secretary, agrees that small businesses are economic engines of our recovery. The health reform bill imposes new burdens on these small businesses. So, while I appreciate the Commissioner's statements regarding a kind of policy of restraint for the individual mandate, I would like to understand what the IRS will be doing to help small businesses comply with a multitude of new laws and regulations.

Specifically, will the IRS develop a communications or outreach plan for small businesses and develop a similar policy of restraint for the employer mandate, when appropriate? If you think I am too much concerned about small businesses, before you answer that question—and that will be my last question—I will just give you the background that, when we set up the commission prior to 1998—and I think it was a couple of years before that, we reported in 1998—it was because there was a heck of a lot of lack of concern about small business and some outright harassment of small business that we do not see in regard to big corporations. So, that is where I am coming from. If you would answer the question, I would appreciate it.

Mr. MILLER. Certainly, Senator Grassley.

First, with respect to whether we will have an outreach plan for small business, as well as other important components of the economy, yes, we certainly will do that, and we are working on that as we speak.

As we approach health care, we will do what we do with any piece of legislation, which is approach it on a holistic basis, beginning with communicating to people about what they are entitled to under the bill and what their responsibilities are, making available folks to answer questions, putting in place systems that will allow the processing of returns, and obviously we will have an enforcement component as well.

On the second piece, as to whether we will utilize similar restraint with respect to small business, I do not have an answer to that. I do know that, when you talk about the individual mandate, Congress acted there to limit the number of tools in our toolbox. They did not act with respect to small businesses, but it is my assumption that we will work together to get to a place that we are comfortable.

Senator GRASSLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Let me ask you, Mr. Miller—I think this is also true in the State of Iowa. There is no permanent IRS appeals officer in the State of Montana. I think it is also true in the State of Iowa. I think it is true that there are 18 States without one. Some of our States are pretty big. It takes a long time to drive to one in another State. So what about that? Why can we not have a permanent appeals officer in Montana? It just seems to me, and in these other States too, all 18 States. I am not going to just say Montana only. If somebody wants to appeal and has to drive to Salt Lake City or Denver, that is a long drive.

Mr. MILLER. I would agree, Mr. Chairman. It is a long drive. I do not know why appeals officers are where they are. I can say two things. One is, it is about resources. Second, we are looking to try to get to the point where not all appeals work is done face to face.

I think for the most part that is the case today. But as to whether it makes sense to have somebody in Montana, to have somebody in Iowa, I do not have an answer to that today. I can come back to you on that.

The CHAIRMAN. One thing that has always struck me over the years is that some cabinets, some departments that have people out in the field, frankly, do better and there is better rapport with people and the department compared with other departments that do not have a lot of people out in the field.

I will give an example. In my State of Montana, there are a lot of USDA personnel. Of course, we are an agriculture State. There are very few Department of Housing people in the State of Montana. The opinion that Montanans have of USDA is quite high, but it is certainly much higher than it is of the Department of Housing and Urban Development, because there is nobody in Montana. But we do have a lot of issues that face that department.

I am just throwing an idea out. Given the marvels of modern technology—as you mentioned, not all appeals are face-to-face—I think it makes more sense to put people out in these States so they can then conduct not only face-to-face appeals, but also they can do some of the appeals by correspondence that might be in some other State.

At least you have people there in the State and it gives that appeals officer and his or her people a little bit of sense of that State too, and it gives access to people in a State, say Montana, for example, to an appeals officer if a taxpayer wants to appeal a decision. I just think it is good to have people out of Washington, DC. Get people outside—and I believe that very strongly—of the major cities and get them out in the country so they can better understand what is going on.

Mr. MILLER. Yes. We do have appeals officers that are outside of the Washington, DC office.

The CHAIRMAN. Well, I am sure you do. By definition, you do in 32 other States.

Mr. MILLER. Yes.

The CHAIRMAN. But you do not in 18.

Mr. MILLER. I will come back to you with a more detailed answer. I am not sure what the thought process is, except, again, we have a limited amount of resources. There are 2,000-plus appeals officers.

The CHAIRMAN. No, no, no. You did not hear my point. You could take those same resources and put them in other places because you can do a lot of work now electronically and by correspondence.

Mr. MILLER. And we circuit ride, Mr. Chairman.

The CHAIRMAN. But as we know, it takes a long time for the circuit rider to get there.

Mr. MILLER. Agreed.

The CHAIRMAN. It is pretty frustrating for a lot of people.

Another frustration in mind is the failure, frankly, of the executive branch, Treasury and IRS, to address the tax gap. The last time the tax gap was estimated by, I think, either Treasury or IRS was 2001. Back then, I think it was \$340-some billion. Why? It is unconscionable—unconscionable—that the IRS and the Treasury do not more aggressively address the tax gap. These are taxes legally

owed but not paid, and it puts the burden on the rest of the taxpayers who are paying their taxes. What is the plan? I have made this point constantly, and I get nowhere. Nowhere. Just a stone wall. I mean, it sounds like you are protecting all these folks who are not paying their taxes.

Mr. MILLER. I do not think we are trying to do that, Mr. Chairman.

The CHAIRMAN. Well, it appears that you are not doing much about it.

Mr. MILLER. Well, let me answer what we are doing with respect to the tax gap. My understanding of when we will update the chart that we have is at the end of 2011. That is the current target. What we are doing is multi-faceted. We have talked about some of the things already this morning. I split up what we are doing currently, what we will be doing, and then what I would ask for you all to help us with.

The CHAIRMAN. We will help, but we do not have a plan.

Mr. MILLER. The first is, what we are doing currently. We have talked about return preparers, which is leveraging with respect to individual taxpayers. We have talked about offshore compliance, which is work that we are doing, and we have in fact increased the number of examinations. We have increased our non-filer work considerably over the last decade.

With respect to where we are headed, Congress, and you in particular, sir, have helped us immensely in terms of the new information, streams of information we will be receiving, and we will be able to do that matching as it comes in, and that will target specifically the under-reporter portion of the program, whether it is credit card, whether it is basis reporting, these are things that are going to help in the next few years.

What I guess I would ask, finally, is the 2011 budget support which provides staffing for some of those, which provides a couple of ideas as to how we can move forward, including an employer independent contractor provision that will help us get at misclassified employees, another key component of the tax gap.

The CHAIRMAN. All right.

I asked Secretary Paulson—in fact, I do not want to restate this—when he was Secretary to set a goal for a voluntary compliance rate of 90 percent by the year 2017, compared with a rate of 84 percent, I am told, in 2007. So, that is a 6 percentage-point increase in compliance over 10 years. That was the goal. I asked Treasury and IRS to develop a plan. So I am asking you again. I would like to—what is today? This is tax day. It could not be more appropriate. Next tax day, when we meet again next year, I would like to know the degree to which you progressed. I want to hear your plan. What is the percentage progress that you have achieved?

Mr. MILLER. Understood.

The CHAIRMAN. I want numbers. I do not want just goals, I want numbers. I want data. I want metrics. I want benchmarks. I am fed up with the failure of Treasury and IRS to adequately deal with this problem. I am fed up. There is one way to change that, and that is to produce. We want to help, and we will help. But I do not get any sense from the IRS that you are really significantly ad-

brushing it in a meaningful way. It is like you are brushing it off, just brushing it off. That is how it appears.

Senator WYDEN?

Senator WYDEN. Thank you, Mr. Chairman. I share your view, Mr. Chairman, with respect to the tax gap and look forward to getting that information as well.

The CHAIRMAN. Thank you.

Senator WYDEN. I think it is absolutely pivotal.

A couple of points. One, of course, Ms. Olson, if you simplify the tax system, it will be easier to collect taxes owed. Is that not correct?

Ms. OLSON. One would hope so, yes.

Senator WYDEN. Now, the overwhelming majority of taxpayers in this country are honest, they are people who work hard, and they play by the rules. There is just no question about that. But it seems to me that taxpayers whom I am speaking about, the overwhelming majority who are honest, often make inadvertent errors, they end up overpaying their taxes, or they underpay their taxes because the system is so complicated it is not possible to get an accurate assessment of what is owed.

How prevalent is that? I am struck, when I listen to folks at home in Oregon, that this is a very, very substantial problem. Could you kind of put some numbers around it? How many people are honestly trying to comply with tax law who get snared in this bureaucratic water torture and either over-pay or under-pay?

Ms. OLSON. The only numbers that I have seen are from the 2001 National Research Program audits of individuals, where we asked auditors to identify whether an error was essentially intentional or inadvertent, and the auditors only classified 3 percent of the errors of the returns that they audited—and this was a random sample of individual taxpayers—as intentional.

Now, the IRS—

Senator WYDEN. Just to make sure—

Ms. OLSON. I just need to do a caveat here: the IRS always says that we did not give good guidance to the auditors, so they do not know what they answered.

Senator WYDEN. I understand.

Ms. OLSON. But that is the only number I have seen.

Senator WYDEN. All right. And I recognize, with your caveat, that these are not always scientific in every particular. But what you have told us is what my seat-of-the-pants assessment is—

Ms. OLSON. Right.

Senator WYDEN [continuing]. That the vast, vast, overwhelming majority of instances involve people who are anxious to comply with the rules, want to be honest, and just get ensnared in this sort of net of bureaucratic torture, and that is essentially what I think has to change.

Now, my view is—and I think you all have recommended it—we ought to have a 1-page 1040 form. It ought to be 28, 30 lines. What is striking is, this has been recommended over the years by Democrats, Republicans, all aboard. Absent legislation, I do not think we are going to get a 1-page 1040 form. Do you agree?

Ms. OLSON. I think that is correct. There have been versions of 1040 that the IRS has worked on, because we have basically run

out of room on the 1040 to add anything new, so we have had a draft version where we have a schedule where we move all sorts of provisions off the 1040. That makes it simpler to look at, but it does not get rid of all those additional provisions. It needs legislation.

Senator WYDEN. That is another area, Mr. Chairman, I would very much like to work with you on. I just, for the life of me, cannot figure out, after Republicans and Democrats for years have been calling for a 1-page 1040 form, why we cannot get one. So, I am anxious to work with you in that area as well.

One last question, if I might, Ms. Olson. Another great frustration I hear about from taxpayers is that they get different answers from the IRS on a particular problem. You hear this from preparers. You hear this from business folks. You hear this from individuals. You hear about differences between IRS regional offices, where you call one regional office and they tell you one thing, you call another regional office and you get another. This destroys, for business, the prospect of certainty and predictability. The same is true for individuals. Preparers, of course, feel very frustrated as well because they are trying to give accurate answers to their clients.

How serious is this problem of getting consistent answers from the IRS, and what ought to be done with it?

Ms. OLSON. Well, I think this is a result of the complexity of the law, and the IRS's response when their accuracy rate went down several years ago was to limit the questions that they would answer. So they have gotten a very high accuracy rate now, in the 90s, on the phone, but they get there by taking off all the difficult questions or things that many taxpayers would ask questions about, but the IRS people call it "out of scope," which does not solve the problem. The problem is that the law is very complex and it is very difficult for IRS employees to answer a particular taxpayer's questions accurately consistently.

Senator WYDEN. So they are trying to solve a problem by pretending it does not exist.

Ms. OLSON. That is my assessment.

Senator WYDEN. Mr. Chairman, thank you. Thank you for holding this very important hearing.

The CHAIRMAN. All right. Thank you very much, Senator.

Senator Enzi, you are next.

Senator ENZI. Thank you, Mr. Chairman. Earlier you asked some questions along this line. I want to delve into it just a little bit more, too. This would be a question for Mr. Miller.

The IRS Restructuring and Reform Act of 1998 says, "The Commissioner of the Internal Revenue Service shall ensure that an appeals officer is regularly available within each State," yet Wyoming and eight other States do not have such personnel physically located within their borders.

The appeals process is the last step that taxpayers get to argue the merits of their tax return before a Notice of Deficiency is recorded and the collection process begins, so I think it is critical that all taxpayers, even rural taxpayers, have unfettered access to IRS appeals officers, ones that kind of understand their area. Wyoming

is a State of high altitudes and low multitudes and lots of roads, but somebody has to understand the people who live there, too.

I realize the Act also permits the IRS to consider the use of video conferencing in rural areas, but when our Nation's founders guaranteed our rights of due process under the Constitution, I do not think they meant that the IRS ought to be able to "phone it in."

I know in some circumstances that could be handy, but video conferencing does not give you all of the body language and nuance that being there in person does. I understand that all agency budgets are strained, and I am not asking you to hire new staff. I think it is perfectly reasonable to suggest that the IRS redeploy existing resources to provide at least one full-time appeals officer and one full-time settlement agent in every State.

So, would you agree today to assess the feasibility of that redeployment so that there would be IRS resources that would guarantee a full-time appeals officer and one full-time settlement agent per State? If you do not feel they would be busy enough in the State they can always drive into the other States or phone it in to the more populous States, but we would like for them to be in there.

I would hope that you would agree to give this assessment to the committee in a timely fashion. I am sure my colleagues from Arkansas, Idaho, Montana, Kansas, and North Dakota would be very interested in the findings, since they too lack these appeals officers and settlement rights.

Mr. MILLER. Understood. We will be glad to take a look at that, Senator.

Senator ENZI. All right.

The CHAIRMAN. And I might ask, more than take a look at it. Send a letter back to this committee after you have made that assessment.

Mr. MILLER. All right.

Senator ENZI. Yes. This is of critical importance to almost a majority of this committee. So, we would like answers on that. I have had comments from our taxpayer advocate in the State about what a difference that would make. I thank the chairman, and I would yield the balance of my time.

The CHAIRMAN. Thank you, Senator, very much.

Now we are going to hear from the great Senator from Kansas, Senator Roberts.

Senator GRASSLEY. Do not encourage him! [Laughter.]

Senator ROBERTS. Well, I think that adjective is certainly apropos. [Laughter.]

I apologize for being late, and thank you, Mr. Chairman, for holding the hearing, and I thank the ranking member for his diligent work, Senator Enzi as well. Thank you folks for coming up—I know it is a very busy time for you—and taking the time to come up and try to answer our questions.

As you know, most of the questions have been about the mandate that individuals purchase health insurance, and basically the bill imposes a penalty that would be collected by you folks for those who fail to obtain and prove to the IRS they have obtained insurance.

I think our role is going to be very straightforward. It is going to be administering the tax provisions. I think that was a statement made by one of your folks. I would like to know, how will people prove to the IRS that they have health insurance? How will proof of insurance be reported to the IRS? I have read several reports in the press. There has been a lot of, I think, confusion about this. Is this going to be some form of a 1099 with an attachment from an insurance company, or what? How are they going to prove this?

Mr. MILLER. Well, Senator, I think that is basically correct. The bill itself—and we are in the beginning stages of exactly working out the systems and all of that, and we can get into that—indicates that insurance companies will be sending 1099s.

Our thought is, that is how we will match a yes/no answer as to whether you have eligibility and have taken up a plan that meets the requirements under the law, but the insurer is making that determination. We are probably, in all likelihood, not going to look behind that. We are basically going to receive a 1099 that says “yes” or “no.” If the answer is no, we will talk to the taxpayer, but we will do that by correspondence, no doubt.

Senator ROBERTS. Well, you have asked my next question: how will the IRS be able to cross-check or verify the information submitted by the taxpayer when the information is submitted by the insurance provider? There is a form in Massachusetts. They call it the 1099 HC form. That is an additional 3-page tax form and a 10-page instruction booklet. Is that what we envision for everybody here?

Mr. MILLER. I am unfamiliar with the form, Senator. I do not think so, but I will be glad to take a look at it and come back.

Senator ROBERTS. I hope not. I hope not. If it were 3 pages from the State’s standpoint and 10 pages on an instruction booklet, it would probably be 6 and 20 at least.

What will happen if an individual does not purchase insurance, and is therefore required to pay a penalty, initially as little as 95 bucks, but increasing up to \$695 per person a year? How will you collect that penalty?

Mr. MILLER. So, with respect to the individual mandate, Congress has been very clear in terms of some tools that we can use and some tools that we cannot. We cannot use liens, we cannot use levies. It is not a criminal penalty. But there are tools we can use, and we obviously will be notifying folks and letting them know that we have these questions.

Senator ROBERTS. How?

Mr. MILLER. We will do, as I mentioned, the matching program. We will be sending out a notice saying we happen to notice that we did not get a 1099 with respect to health insurance here, and we will ask for an explanation of that.

Senator ROBERTS. You have a highly mobile society here within that particular group, as well as being highly mobile everywhere. I do not know how you are going to keep up with that by mail. I guess it is by mail. Well, we will let that go.

Let me just point out that you said that you are still in the process of trying to figure this out, and I understand that, or trying to implement it, and you have plans or contingencies. Everybody does.



Everybody in the business community, every health provider is sitting down there with their lawyer, their CPA, and their actuary. This is the Lawyer, CPA, Actuary Full Employment Act, I think. They have divided it up, and they keep coming to my office and the offices of the gentleman over here to my right, asking these questions.

If an individual does not have a tax liability, does not need to file a return but is required to pay the penalty for not having insurance, how will you enforce this provision?

Mr. MILLER. You have gone a step beyond my understanding of the bill. If there is no filing requirement, I will have to come back to you as far as to what the health bill requires in that situation, Senator.

Senator ROBERTS. I am down to 14 seconds here, but the health care reform bill provides a tax credit for small business for 2 years to help them to manage the cost of providing mandated health insurance to their employees, but there is a cliff in that second year where the credit expires.

What will be the cost to small business? Have you made any kind of estimates, or guesstimates, for that matter, to provide health insurance without this tax credit? What will be the cost of compliance for small business? That is a very key question. Can you comment just generally if you do not have that specific answer on the cost of compliance for small business?

Mr. MILLER. I do not think I have any numbers in that regard from the IRS, sir.

Senator ROBERTS. When do you think you might have it?

Mr. MILLER. I am not sure the IRS would be doing the analysis on that. We are administering the provision as best we can.

Senator ROBERTS. Who would?

Mr. MILLER. I would assume it would be——

Senator ROBERTS. If we asked CBO, is that the answer, or what?

Mr. MILLER. It is possible. It is possible.

Senator ROBERTS. All right.

Mr. MILLER. Certainly, we have responsibility over administering the credit, and they are pretty active in terms of making sure folks know that it exists.

Senator ROBERTS. What would be the compliance costs for individuals and families to meet the individual mandate requirement? That is, the individuals who purchase insurance prove they have insurance to the IRS or pay a penalty to the IRS for not obtaining insurance. It gets back to that individual and that individual's cost and what they are obligated to do or not obligated to do. I think that is your repeat question, as I think upon it, but if you would like to comment on it.

The CHAIRMAN. And also, your time is more than expired.

Senator ROBERTS. Thank you, sir.

The CHAIRMAN. And I might also add that there is no mandate for any small business with 50 or fewer employees.

Senator ROBERTS. Right.

Senator GRASSLEY. Can I ask?

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Yes. I just had one question, and it is for Mr. Miller. It is in regard to Commissioner Shulman's comments at the

National Press Club on April 5th. In that speech, he indicated that the individual mandate would be enforced through a matching program of some sort based on insurance companies providing a 1099-like document to an individual who would attach it to the return. Then in a recent television interview, he stated that the IRS would not be auditing individuals to check their insurance status. This position then was reiterated today in a *Washington Post* op-ed.

So what incentives do individuals have to purchase insurance if they know the IRS will not be checking and will not be seeking to collect the individual mandate penalty?

Mr. MILLER. Well, we will be looking, Senator Grassley. We will be looking. We will have that matching program. We will be corresponding with people. Whether that triggers an examination or not is going to depend on a given case. It is not in all likelihood, I think, what my boss was saying. That is not the kind of case that we send out an agent to pursue, it is the kind of case where we correspond with the taxpayer. At the end of the day, again, Congress has limited the tools we can use, but we will be talking to the taxpayer, and we do have a refund offset mechanism in order to enforce that provision. That is in our toolbox.

Senator GRASSLEY. All right. Well then, let me give you this, some idea of something that could happen. So if you have matching, which is one of the ways of checking, if an individual does not purchase health insurance and so would not be receiving anything then from the insurance company, and also has no filing requirement with the IRS, what would the IRS be matching against?

Mr. MILLER. And again, that is Senator Roberts's question as well. I am not sure of the income levels and when that requirement triggers, and so I have to get back to the committee on that.

Senator GRASSLEY. All right. Thank you.

The CHAIRMAN. Thank you, Senator.

Mr. Miller, I would like to ask a couple of questions about offshore compliance. About how many dollars do you think are lost to offshore tax evasion each year?

Mr. MILLER. I know that numbers are thrown around a lot, Mr. Chairman. We do not have an estimate on that. We do not know what we do not know, is unfortunately the answer there.

The CHAIRMAN. Is there a way to find out?

Mr. MILLER. Ultimately, yes. We obviously have done some, I believe, very good things in the last 12 months in this area, and Congress has as well. As you are very much aware and have supported us on, the Fair and Accurate Credit Transactions Act (FACTA) bill is going to give us a much better sense of what is out there as people either come in or foreign organizations become subject to the 30-percent withholding alternative. So, that will give us a much better feel for what is out there.

The CHAIRMAN. Right. That is a provision that we put in the HIRE Act.

Mr. MILLER. Yes, sir.

The CHAIRMAN. So how much do you think you will be able to clamp down on that loophole? That is, how much will that help, that 30 percent?

Mr. MILLER. I think I started with the statement we do not know what we do not know. FACTA is going to give us much more infor-

mation to know more, and so the uncertain part should be reduced considerably within the next couple of years.

The CHAIRMAN. So what questions should I ask you next year when we have this hearing?

Mr. MILLER. By this time next year, I think we will have a much better sense of our next targets in the offshore area. I think it would be fair for this committee to be looking for, obviously, a much more robust discussion on where we are on health care and on credit card reporting, basis reporting, FACTA, the information tools that you have provided us. We should be prepared to discuss that in much more detail.

The CHAIRMAN. Well, a year is a long time from now. Some of that can be addressed earlier, do you not think?

Mr. MILLER. Certainly. And we are not waiting for the hearing to move. Some of the information reporting requirements are not yet triggered. They will not be in effect yet. Certainly in offshore we will have made significant progress, I hope.

The CHAIRMAN. Well, this is a little bit incomplete, this answer of yours. You are basically saying you just do not know. Help us figure out a way to get that information even more than you have just now said. Maybe we should meet again 6 months from now.

Mr. MILLER. I am certainly willing to do that, Senator.

The CHAIRMAN. But do you think you will know more in 6 months than you know now? That is, enough to make a progress report that is meaningful?

Mr. MILLER. On offshore?

The CHAIRMAN. Yes.

Mr. MILLER. We will certainly be much farther along in terms of the outcome on our voluntary disclosure program, on the outcome of some of our John Doe work, and in follow-up investigations as we pursue other leads through the voluntary disclosure of information and other information—

The CHAIRMAN. So when are you going to know how much is lost offshore?

Mr. MILLER. That probably does have to wait until FACTA reporting comes in, and that is not for a couple of years yet. I will know—

The CHAIRMAN. Why does that take so long?

Mr. MILLER. Again, Senator, we do not know what we do not know. We do not know who is holding assets offshore.

The CHAIRMAN. Why does it take 2 years to figure that out?

Mr. MILLER. There is no reporting right now of that, or they are not reporting accurately. The leverage points are being created by FACTA, which will come into play in a couple of years.

The CHAIRMAN. You will have to refresh my recollection of FACTA. What is FACTA?

Mr. MILLER. FACTA is requiring a new qualified intermediary program and increased reporting both on the individual side with respect to bank accounts that I might hold offshore, and also a new withholding regime whereby—

The CHAIRMAN. That is what we have just been discussing, is it not? I mean, the potential 30-percent withholding requirement for failure of foreign banks to report?

Mr. MILLER. Correct.

The CHAIRMAN. That is FACTA?

Mr. MILLER. That is FACTA, along with beneficial ownership and statute of limitations help. A whole host of excellent provisions, for which I thank you.

The CHAIRMAN. Well, you are very welcome. But I just cannot for the life of me figure out why it takes so long to know how much we are losing offshore. I am really kind of surprised that you cannot, with more diligence, answer that question more quickly. Irrespective of what the law says, why do you not come back to us and tell us what changes you need in the law to get it more quickly, if it takes additional legislation?

Mr. MILLER. Well, there are a couple of provisions in the 2011 budget along those lines, sir.

The CHAIRMAN. What are they?

Mr. MILLER. There is one about the transfer of intangibles overseas to a low-tax jurisdiction, and there is also the removal of a deduction for certain premium payments to U.S. foreign affiliates for reinsurance, so I would commend those to the committee to help us out on.

The CHAIRMAN. So, to what degree will those provisions deal with offshore loss?

Mr. MILLER. I think they will help in terms of the shifting of income overseas, and they will help in terms of, not necessarily offshore accounts obviously, but in terms of our largest business taxpayers shifting the income to a low-tax jurisdiction and escaping U.S. tax.

The CHAIRMAN. All right. Well, I appreciate your intent. I would just urge you to be a little more aggressive in trying to close this loophole.

Mr. MILLER. Yes, sir.

The CHAIRMAN. All right. Thanks very much.

Mr. MILLER. Thank you.

The CHAIRMAN. We are going to certainly meet a year from now and follow up on these questions. We may even meet earlier. I think we will meet earlier. And you are going to answer the request by Senator Enzi and myself with respect to appeals in each State?

Mr. MILLER. Yes, sir.

The CHAIRMAN. Good. Thank you. Thank you very much.

The hearing is adjourned.

[Whereupon, at 11:25 a.m., the hearing was concluded.]

# APPENDIX

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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### **Hearing Statement of Senator Max Baucus (D-Mont.) Regarding the 2010 Tax Filing Season**

It is the time of the year when the days grow longer. It is the time of the year when the daffodils are in bloom. And it is the time of the year when we Americans file our tax returns.

So, it is time for this Committee to call in the IRS. It is time to ask the IRS for an update on the recent filing season. And it is time to discuss other matters affecting tax administration.

The Finance Committee holds the IRS to a high standard. It is appropriate to do so. That's not only because of the Committee's responsibility to oversee the IRS, but also on behalf of the American people.

Taxpayers have a right to expect that their government applies the tax laws fairly and correctly. They have a right to expect the IRS to operate efficiently. And, they have a right to know that the IRS is protecting their personal tax information.

We will have the opportunity to consider all of these matters with our witnesses today.

I am pleased that with us today are Steve Miller, the IRS Deputy Commissioner for Services and Enforcement, and Nina Olson, the IRS National Taxpayer Advocate. Welcome to both of you.

Today, we will want to know what actions the IRS is taking during this filing season to encourage and facilitate the use of the many new tax incentives to jumpstart the economy and create jobs. The IRS has reported an average 10 percent increase in refunds this year, following the enactment of these incentives.

For individuals, these incentives include the Making Work Pay Tax Credit, the American Opportunity Education Tax Credit, the New Homebuyer's Tax Credit, the Military Homeowner Assistance Program, and the Adoption Tax Credit — to name just a few.

And for businesses, these incentives include Extension of Bonus Depreciation, Extension of Increased Small Business Expensing, the 5-Year Carry-back of Net Operating Losses, Build America Bonds, the Payroll Tax Exemption, and the Advanced Energy Investment Credit — to name just a few.

These incentives are effective only if taxpayers use them. The IRS plays an important role, especially during filing season, in helping taxpayers understand the availability of these tax breaks and how to claim them. If the IRS can help to make these incentives work effectively, the country can grow more rapidly and create more jobs.

And more generally, I look forward to learning how the 2010 filing season has unfolded. I look forward to updates on electronic filing rates and the IRS's modernization efforts to reduce filing errors and generate faster refunds.

I want to hear how the IRS is working to improve its taxpayer services, including the level of service on the telephones, to ensure that taxpayers who contact the IRS with a tax question are able to get through and have their questions answered accurately.

I am interested to hear more about the IRS's new strategy to improve paid preparer competency, accountability and transparency. With paid preparers doing more than 60 percent of individual tax returns, the quality of paid preparers has a direct and significant effect on voluntary compliance and the tax gap.

And the committee also will take this opportunity to catch up on other matters of tax administration.

I am interested to receive an update on the tax gap. I would like to know when the \$345 billion annual figure will be updated. I also want to hear what specific actions the IRS is taking to implement the comprehensive plan to close the tax gap that Treasury developed at my request and that was updated last summer.

Of particular interest to me is the IRS's progress on the planning and implementation of several of my tax compliance proposals that recently have been enacted.

These include Credit Card Information Reporting, Securities Basis Reporting, Offshore Loophole Closers and Corporate Information Reporting. These provisions are estimated to raise over \$40 billion in revenues over the next ten years.

Each of them will improve voluntary compliance and reduce the tax gap without raising one single dime of taxes on anyone, making timely and efficient IRS implementation especially critical to their effectiveness.

I also want the IRS to address the rumors and rhetoric that have been circulating about the IRS's role in administering health care reform. We've all heard the rumors alleging the IRS will hire up to 17,000 armed IRS agents to enforce health care — rumors that fly in the face of specific proscriptions in the law against criminal penalties for failing to buy health insurance.

I want to hear — directly from the IRS — to what extent it has determined the need for increased staffing and resources to conduct its role in health care reform, as well as what functions any increased staffing will perform.

Finally, I want to extend my sincere condolences to the IRS victims of the airplane crash into the IRS building in Austin on February 18, 2010. Our thoughts especially are with the family of Vernon Hunter, a long-time IRS employee who was killed in the incident.

Threats and violence against the IRS and its employees are unacceptable and intolerable.

So, we have a lot to cover today. Again, I want to thank Mr. Miller and Ms. Olson for appearing. We look forward to your testimony.

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*United States Senate*  
*Committee on Finance*



*Sen. Chuck Grassley · Iowa*  
*Ranking Member*

Opening Statement of Sen. Chuck Grassley  
Hearing, "Filing Season Update: Current IRS Issues"  
Thursday, April 15, 2010

As may be appropriate for tax day, we will be learning a lot of numbers during this hearing. There are the billions of dollars of refunds, millions of returns processed, and millions of phone calls received by the IRS. There are the millions of individuals who filed for the homebuyer and making work pay credits – and millions of dollars in errors with those credits. Then there is the \$12 billion IRS budget and the almost half billion dollar requested increase for fiscal year 2011.

However, what we are not hearing anything about is the billions of dollars – and thousands of employees -- IRS will need to implement health reform. I first raised this issue in a letter six months ago to Secretary Geithner and Commissioner Shulman. The response back to me was that Treasury and IRS wouldn't have estimates until legislation was enacted. Well, the House passed its bill last fall and the Senate passed its bill on Christmas Eve – over three months ago now. While the final bill wasn't signed into law until last month, the provisions did not change much so it's not clear why we still don't have estimates on the dollars and people needed by the IRS to implement health reform.

Meanwhile, CBO has estimated that IRS will need between \$5 billion and \$10 billion over ten years to implement health care reform alone. So it doesn't take into account any other legislation Congress may pass. What's troubling about this anticipated growth of the IRS is that it is not all related to the IRS' mission – the collection of revenues to fund the operations of the federal government. What's more, we in Congress, in the landmark IRS Restructuring legislation of 1998, directed the IRS to revise its mission statement to "provide greater emphasis on serving the public and meeting the needs of taxpayers." Health care reform provisions require the IRS to make sure that every individual has health insurance.

IRS employees will have to become experts in calculating a very complex subsidy for those who are eligible to receive financial assistance for purchasing health insurance. IRS employees will also have to verify subsidy eligibility by sharing income information with federal, state and other entities, including the new exchanges. And it is likely that IRS won't have the necessary information since subsidy eligibility is based on household income – which is not taxable income. These are just some of the provisions impacting an individual's interaction with the IRS – there are many more that impact a business's interaction with the IRS which I won't get into here.

The earned income tax credit (“EIC”) is the largest social spending program administered by the IRS. This program also unfortunately has one of the highest fraud and abuse rates of any tax provision out there. While IRS has steadily reduced the fraud in this program, knowledge of, and outreach to, the eligible populations have been huge challenges for the IRS. A former IRS assistant commissioner said it best – and I quote: “These kinds of programs require social welfare expertise. IRS agents are not recruited or trained to do that well. The IRS record is mixed and sometimes abysmal with regard to effectively administering these kinds of programs.” Ms. Olson also indicates in her testimony today that the IRS is not keeping up with the needs of low-income taxpayers.

Experience with the EITC teaches us that a social worker with a calculator and green eye shades should be a job description at the Department of Health and Human Services – not the IRS. The IRS already struggles to stay on top of its core mission. IRS should be training its employees to combat complex tax evasion schemes and to improve customer service instead of administering social programs – at which the IRS has historically failed. Taxpayers trying to do the right thing regarding their tax responsibilities shouldn’t have to be put on hold – or have to call back -- because the IRS is now answering questions about health insurance.

Mr. Chairman, I thank you for holding this hearing. I also would like to thank the witnesses in advance for being here. I look forward to discussing my issues and concerns with them.



**PREPARED STATEMENT OF  
STEVEN T. MILLER  
DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT  
INTERNAL REVENUE SERVICE  
BEFORE  
THE SENATE FINANCE COMMITTEE  
2010 FILING SEASON AND FY 2011 BUDGET REQUEST  
APRIL 15, 2010**

**Introduction and Summary**

Chairman Baucus, Ranking Member Grassley and Members of the Committee, thank you for this opportunity to testify on IRS' efforts to ensure a successful tax filing season this year. I would also like to thank you for allowing me to provide you with an overview of our proposed FY 2011 Budget and what we hope to accomplish with these resources. The 2010 filing season has proceeded smoothly and with few problems.

Accuracy rates for both customer tax law and accounts questions remain in the 91-plus percentile. Overall filing is down three percent, due in large part to the effects of the economic downturn. We are seeing lower than expected traditional paid practitioner e-file volume as taxpayers seek other ways to file their returns, such as on-line. However, e-file as a percentage of total individual returns is up from 76 percent to 79.6 percent – continuing a very positive trend. And in a still challenging economy, it is good news that the average refund is \$2,960 – up by 9.4 percent as compared to last year.

The IRS is also taking several additional steps this tax season to help people having difficulties meeting their tax obligations because of unemployment or other financial problems. Most recently, on March 9, 2010, the IRS announced several of these steps, the most significant being new flexibility for offers in compromise. For those taxpayers facing economic troubles, including recent unemployment, IRS employees will be allowed to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise. The standard practice has been to review offers based on income in prior years. The IRS also announced that it will hold hundreds of special Saturday open houses to give struggling taxpayers more opportunity to work directly with IRS employees to resolve issues. These steps are an expansion of efforts that began more than a year ago and also include special outreach with partner groups to unemployed taxpayers and the availability of more information on a special page of the IRS website.

Mr. Chairman, in recognition of the critical role that the IRS plays in the nation's economy, the President's FY 2011 Budget submission includes a judicious investment in the IRS' core service and enforcement programs. It also includes the funding needed to work toward timely completion of the core taxpayer account database, a key priority for the agency.

The funding in the President's Budget will be used to carry out the IRS' strategic and balanced agenda that includes: improved service to taxpayers; a robust and targeted enforcement program to address offshore tax evasion and improve tax compliance for corporate and high-income taxpayers; better use of data, such as credit card and securities basis information reporting; completion of the new taxpayer account data base and enhancements to our electronic filing platforms, as well as improved IRS website offerings and performance; and workforce development to ensure that we have a talented and capable workforce for the foreseeable future.

### **The 2010 Filing Season**

Mr. Chairman, the current filing season has proceeded smoothly and with few problems, which were quickly identified and remedied. The IRS and its volunteer partners continue to help taxpayers struggling through these difficult economic times.

The IRS is also beginning its implementation of the Hiring Incentives to Restore Employment (HIRE) Act that was signed by the President on March 18th. Under the new law, employers who hire unemployed workers this year (after February 3, 2010 and before January 1, 2011) may qualify for a 6.2 percent payroll tax incentive, in effect exempting them from their share of Social Security taxes on wages paid to these workers after the date of enactment. In addition, for each worker retained for at least a year, businesses may claim an additional general business tax credit, up to \$1,000 per worker, when they file their calendar year 2011 income tax returns. The IRS is working on revised forms, instructions, and necessary programming so eligible employers will be able to claim the new tax incentive on their employment tax form beginning with the second quarter of 2010. Information and answers to frequently asked questions will soon be available on IRS.gov.

### **General Filing Season Data**

As of April 3, 2010, the IRS received almost 90 million individual returns. Overall filing is down 2.5 percent and we are seeing lower than expected traditional paid practitioner e-file volumes as taxpayers seek other ways to file their returns, such as on-line. E-file as a percentage of total individual returns is up, however, from 76 percent to 79.6 percent – continuing a very positive trend and showing the IRS' commitment to a robust electronic tax administration program.

The number of taxpayers e-filing their returns from a home computer continued to grow this filing season. More than 25.6 million prepared their own e-file return – a 6.7 percent increase over the same time period last year. Free File, however, continued to show a decline, dropping by five percent over last year. Nevertheless, all qualifying taxpayers, including those filing for the Earned Income Tax Credit (EITC), are encouraged to use Free File to ensure a speedy refund.

Through April 3, 2010, the IRS has issued 74.1 million refunds for a total of \$219 billion, as compared to 77.7 million refunds for a total of \$210 billion over the same time period

in 2009. The average dollar refund totals \$2,960 as compared to \$2,705 for the same week last year, an increase of 9.4 percent. Over the same time period, the IRS has directly deposited 58.1 million refunds to taxpayers, as compared to 58.3 million last year. Starting this filing season, taxpayers could also purchase up to \$5,000 of Series I U.S. Savings Bonds using their federal tax refund. Through March 26, 2010, more than 15,700 taxpayers have taken advantage of this great opportunity, requesting more than 50,000 bonds totaling approximately \$6.2 million.

Working with media and its many stakeholders, the IRS publicized that taxpayers filing electronically with direct deposit can get their refunds in as few as ten days. Based on the most current Refund Timeliness data, the average time to process a refund for a paper tax return this year is six to eight weeks.

#### **Toll-Free Telephone Performance**

High quality toll-free telephone service – both assistor and automated – is an extremely important tool in answering taxpayer questions, helping them navigate an extremely complex tax code, and making voluntary compliance easier.

As of April 3, 2010, IRS telephone assistors have answered 12.6 million calls, a 15.2 percent decrease over the same period last year. The IRS also completed 23 million automated calls, a 17.9 percent increase over last year's 19.5 million, reflecting a growing taxpayer appetite for quality self-serve options.

Particularly gratifying was the strong rebound in Assistor Level of Service (LOS) which currently stands at 74.9 percent over last year's 64.3 percent – a 16.6 percent gain.

The drop in LOS in 2009 was partially due to the number of taxpayers calling to obtain their prior year adjusted gross income, which is used to satisfy the signature requirements when e-filing a current year return. More taxpayers were also calling regarding math errors and refund issues related to the Recovery rebate credit and questions generated by the economic downturn and the Recovery Act.

LOS is a measure used by the IRS for both planning and internal management of our live customer service representative (CSR) telephone assistance services. This measure is derived through a mathematical formula that essentially equates to the success rate of customers that call the IRS for live telephone assistance on our 1-800 help line at any given point in time, it does not account, however, for those calling that choose to call back later because of anticipated wait time.

This year, the IRS added an estimated wait time feature as a convenience for taxpayers. In addition, increased funding in the President's FY 2011 Budget would be used to improve the telephone LOS from a projected 71 percent in FY 2010 to a target of 75 percent in FY 2011.

Accuracy rates for both customer tax law and account questions remain in the 91-plus percentile with minimal change over last filing season's levels.

### **Website Usage and New Media**

IRS.gov has become the preferred source of information for millions of taxpayers to get answers to their tax questions and economic recovery legislation, and to prepare and file a federal tax return accurately and on time. IRS.gov/Español offers many of the same services and information in Spanish.

As of April 3, 2010, the number of visits to the website is three percent less than last year's numbers over the same time period – approximately 152 million. Visits to the "Where's My Refund" electronic tracking tool, however, are up by 14.9 percent.

When taxpayers visit the IRS.gov website, they will first see a rotating spotlight feature on the front page. The spotlights, which change every few seconds, highlight important taxpayer information, such as "Making Work Pay," "Homebuyer Credit," "Tax Law Changes Can Benefit You," "Where's My Refund" and "What If Scenarios" that deal with payment and other financial problems.

Taxpayers can also use electronic tools such as the EITC Assistant to determine if they qualify for the refundable tax credit or click on "Tax Benefits of the American Recovery and Reinvestment Act of 2009" to learn about energy, education, new vehicle, and homebuyer credits available that could help them save money.

The IRS also produced a number of podcasts this filing season that are available on IRS.gov and iTunes. In addition, the IRS created more than a dozen YouTube Videos on a variety of subjects including the "Education Tax Credit," "Making Work Pay," and the "New Homebuyer Credit." Many are available in English, American Sign Language, and Spanish. These are new ways the IRS is using to reach out to a new generation of taxpayers.

### **Walk-In Contacts**

The IRS continues to provide in-person service at its 401 Taxpayer Assistance Centers (TACs). As of April 3, 2010, approximately 1.84 million taxpayers were served – a 4.2 percent decline over the previous year, reflecting a continued weakening in the demand for such service.

Walk-in service still remains popular among elderly taxpayers, those with limited English and computer proficiency, and taxpayers without Internet access. As discussed later in my testimony, the TACs are a useful filing season resource for taxpayers resolving tax issues and needing help preparing their tax returns.

## **Helping Struggling Taxpayers**

The IRS is taking several additional steps this tax season to help people having difficulties meeting their tax obligations because of unemployment or other financial problems.

The steps build on efforts begun in the 2009 tax filing season to help taxpayers facing financial difficulties obtain the maximum refunds to which they are entitled by encouraging them to take advantage of applicable tax credits, such as the EITC and those contained in the Recovery Act, and to accelerate their refunds.

We recognize that some people are struggling to meet their tax obligations and need assistance. The IRS wants to do everything it can to help those taxpayers who have lost their job or face financial strain, especially those who have done the right thing in the past and are facing unusual hardships.

### **New Flexibility for Offers in Compromise**

For some taxpayers, an offer in compromise – an agreement between a taxpayer and the IRS that settles the taxpayer's debt for less than the full amount owed – continues to be a viable option. IRS employees will now have additional flexibility when considering offers in compromise from taxpayers facing economic troubles, including the recently unemployed.

Specifically, IRS employees will be permitted to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise. Historically, the standard practice is to judge an offer amount on a taxpayer's earnings in prior years. This new step provides greater flexibility when considering offers in compromise from the unemployed. The IRS may also require that a taxpayer entering into such an offer in compromise agree to pay more if the taxpayer's financial situation improves significantly. These immediate steps are part of an on-going effort by the IRS to ensure the availability of the offer in compromise program for taxpayers.

### **Saturday Open Houses**

Even though the IRS provides tax assistance to individuals and families every day of the year, the focus for Saturday Open Houses this year was to help those dealing with difficult economic times. The first of these was held on Saturday, February 20<sup>th</sup>, when more than 200 Taxpayer Assistance Centers went the extra mile and opened their doors for extended service hours. The IRS also held an open house on March 27 at more than 180 local offices which served 8713 taxpayers. The IRS plans to hold three more events, one in May and two in June, to give struggling taxpayers opportunities to work directly with IRS employees to resolve issues. One of those three will focus on the small business taxpayer.

During the expanded Saturday hours, taxpayers will be able to address economic hardship issues they may be facing or get help claiming any of the special tax breaks in last year's Recovery Act, including the:

- Homebuyer tax credit
- American Opportunity Credit
- Making Work Pay Credit
- Expanded Earned Income Tax Credit

In addition to these special Saturdays, taxpayers can take advantage of toll-free telephone assistance and regularly scheduled hours at local Taxpayer Assistance Centers. Taxpayers can find the location, telephone number and business hours of the nearest assistance center by visiting the Contact my Local Office page on IRS.gov.

Low-income taxpayers, people who lost their jobs, and even those with a fear of the IRS and who had not filed their taxes in years, have received help in preparing their returns and in resolving their tax issues. Local volunteer tax preparation sites, as well as many Stakeholder Partnership, Education & Communications (SPEC) employees, pitched in to help as the massive rally of tax assistance has unfolded throughout the nation.

#### **Tax Credit Helps Small Employers Provide Health Insurance Coverage**

Many small businesses and tax-exempt organizations that provide health insurance coverage to their employees now qualify for a new tax credit enacted in the Affordable Care Act, which was approved by Congress and signed by President Obama on March 23. The credit encourages small businesses and tax-exempt organizations to offer health insurance coverage for the first time, or maintain coverage they already provide. In general, the credit is available to small employers that pay at least half the cost of single coverage for their employees.

The maximum credit is 35 percent of premiums paid in 2010 by eligible small business employers and 25 percent of premiums paid by eligible employers that are tax-exempt organizations. In 2014, this maximum credit increases to 50 percent of premiums paid by eligible small business employers and 35 percent of premiums paid by eligible employers that are tax-exempt organizations.

The credit is specifically targeted to help small businesses and tax-exempt organizations that primarily employ low- and moderate-income workers. It is generally available to employers that have fewer than 25 full-time equivalent (FTE) employees paying wages averaging less than \$50,000 per employee per year. Because the eligibility formula is based in part on the number of FTEs, not the number of employees, many businesses will qualify even if they employ more than 25 individual workers.

Eligible small businesses can claim the credit as part of the general business credit starting with the 2010 income tax return they file in 2011. For tax-exempt employers, the IRS will provide further information on how to claim the credit.

The IRS will use postcards to reach out to millions of small businesses that may qualify for the credit. The postcards will encourage small business owners to take advantage of the credit if they qualify. More information about the credit, including tax tips, guides and answers to frequently asked questions, is now available on the IRS Web site, [IRS.gov](http://IRS.gov).

#### **Special Outreach Efforts to Unemployed**

The IRS is working and coordinating with state departments of revenue and state workforce agencies to help taxpayers who are having problems meeting their tax liabilities because of unemployment or other financial problems.

These coordinated efforts may include opportunities for taxpayers to make payment arrangements and resolve both federal and state tax issues at one time.

#### **Special Section of IRS.gov Created**

Taxpayers who are unemployed or struggling financially can find information on a new page on the IRS website, [IRS.gov](http://IRS.gov). This online tax center has numerous resources including links to information on tax assistance and relief to help struggling taxpayers.

#### **Other Options Available for Taxpayers**

The IRS will continue to offer other help to taxpayers, including:

- Assistance of the Taxpayer Advocate Service (TAS) for those taxpayers experiencing particular hardship navigating the IRS;
- Postponement of collection actions in certain hardship cases;
- Added flexibility for missed payments on installment agreements and offers in compromise for previously compliant individuals having difficulty making payments;
- Additional review of home values for offers in compromise in cases where real-estate valuations may not be accurate; and
- Accelerated levy releases for taxpayers facing economic hardship.

In addition, the IRS will accelerate lien relief for homeowners if a taxpayer cannot refinance or sell a home because of a tax lien. As previously announced, a taxpayer seeking to refinance or sell a home may request the IRS make a tax lien secondary to the lien by the lending institution that is refinancing or restructuring a loan. The taxpayer may also request the IRS discharge its claim under certain circumstances if the home is being sold for less than the amount of the mortgage lien.

### **Return Preparer Initiative**

The IRS recently unveiled a major initiative to regulate tax return preparers, who are a critical part of the tax system. Given the complexity of the tax code, more and more Americans now turn to a preparer to help them file their taxes. The IRS estimates that there are somewhere between 900,000 and 1.2 million paid tax return preparers. Making them an integral link to our service and compliance strategies will help the IRS to do its job.

The IRS plans to require registration, minimum competency testing, and continuing education of paid tax return preparers. In addition, once a testing process is set up and running, the IRS will create a public database of preparers, so that taxpayers can find out if they are dealing with a qualified preparer.

The IRS is also shifting enforcement resources to focus on preparers. Beginning this filing season, the IRS is expanding “knock and talk” and other programs to visit thousands of preparers to discuss their operations and ways to reduce preparer error rates.

The goals of the strategy are to leverage the return preparer community to improve service to taxpayers, increase compliance, and enhance the integrity of the overall tax system.

### **The Administration’s FY 2011 Budget Funds Key Priorities**

The total resources requested to support IRS activities for FY 2011 are \$12,971,962,000. This amount includes \$12,633,270,000 from direct appropriations, an estimated \$144,592,000 from reimbursable programs, and an estimated \$194,100,000 from user fees. The direct appropriation is a \$487,147,000 increase, or a 4.01 percent increase over the FY 2010 enacted level of \$12,146,123,000.

#### **Enforcement Program**

The FY 2011 President’s Budget Request includes an Enforcement account increase of \$293.4 million for investments in strong compliance programs, including a robust initiative to address offshore tax evasion. Additional enforcement resources will address underreporting of income associated with international activities and expand enforcement efforts on noncompliance among corporate and high-wealth taxpayers.

Increased resources for the IRS compliance programs yield direct, measurable results through high return on investment activities. The new enforcement personnel funded through a program integrity allocation adjustment in the FY 2011 President’s Budget will generate nearly \$2 billion in additional annual enforcement revenue once the new hires reach full potential in FY 2013. This alone is a return of almost \$7 for each \$1 spent. Similar to past budgets, the allocation adjustment applies to the Enforcement and Operations Support accounts, and is justified by the net positive value enforcement resources deliver. Vigorous enforcement also encourages voluntary compliance, further



increasing revenue, by generating public awareness of the consequences of not meeting one's tax responsibilities. The return on investment estimate does not include the additional revenue impact from the deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.

*Explanation of Enforcement Budget Activities*

The FY 2011 President's Budget request is \$5,797,400,000 in direct appropriations and an estimated \$61,506,000 from reimbursable programs for a total operating level of \$5,858,906,000. The direct appropriations level is an increase of 5.3 percent from the FY 2010 enacted level and includes additional tax enforcement activities funded through a program integrity allocation adjustment. This appropriation funds the following budget activities.

- **Investigations (\$651,966,000 from direct appropriations and an estimated \$50,567,000 from reimbursable programs)** This budget activity funds the criminal investigation programs that uncover criminal violations of the internal revenue laws and other financial crimes, enforce criminal statutes relating to these violations, and recommend prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. This funding provides resources for international investigations involving U.S. citizens residing abroad, non-resident aliens and expatriates, and includes investigation and prosecution of tax and money-laundering violations associated with narcotics organizations.
- **Exam and Collections (\$4,974,618,000 from direct appropriations and an estimated \$10,245,000 from reimbursable programs)** This budget activity funds programs that enforce the tax laws and increase compliance through examination and collection programs that ensure proper payment and tax reporting. It also includes programs such as specialty program examinations (employment, excise, and estate and gift tax exams), international collections, and international examinations. The budget activity also supports appeals and litigation activities associated with exam and collection.
- **Regulatory (\$170,816,000 from direct appropriations and an estimated \$694,000 from reimbursable programs)** This budget activity funds the development and printing of published IRS guidance materials; interpretation of tax laws; advice on general legal services, rulings and agreements; enforcement of regulatory rules, laws, and approved business practices; and taxpayer support in the areas of pre-filing agreements, determination letters, and advance pricing agreements. The Office of Professional Responsibility is funded within this budget activity and is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS.

### Taxpayer Service Program

The FY 2011 President's Budget includes a Taxpayer Services account increase of \$43.1 million. The increase includes \$20.9 million to improve telephone level of service, increasing the level of service performance target to 75 percent from 70 percent in FY 2009 and 71 percent in FY 2010.

Providing quality taxpayer service is especially important to help taxpayers avoid making unintentional errors. Assisting taxpayers with their questions before they file their returns prevents inadvertent noncompliance and reduces burdensome post-filing notices and other correspondence from the IRS.

#### *Explanation of Taxpayer Service Budget Activities*

The FY 2011 President's Budget is \$2,321,975,000 in direct appropriations, an estimated \$34,159,000 from reimbursable programs, and an estimated \$127,000,000 from user fees, for a total operating level of \$2,483,134,000. The direct appropriations level is an increase of 1.9 percent from the FY 2010 enacted level. This appropriation funds the following budget activities.

- **Pre-Filing Taxpayer Assistance and Education (\$693,753,000 from direct appropriations and an estimated \$1,459,000 from reimbursable programs)**  
This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication, production, and advocate services. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.
- **Filing and Account Services (\$1,628,222,000 from direct appropriations, an estimated \$32,700,000 from reimbursable programs, and an estimated \$127,000,000 from user fees)** This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically-submitted tax returns, issue refunds, and maintain taxpayer accounts. The IRS continues to make progress in decreasing paper returns and increasing the use of electronic filing and payment methods.

### Operations Support

#### *Explanation of Budget Activities*

The FY 2011 President's Budget is \$4,108,000,000 in direct appropriations, an estimated \$48,927,000 from reimbursable programs, and an estimated \$67,100,000 from user fees, for a total operating level of \$4,224,027,000. The direct appropriation level is an increase of 0.6 percent from the FY 2010 enacted level. This appropriation funds the following budget activities as well as \$25 million to improve the IRS.gov website infrastructure and

redesign the website to meet taxpayer needs and the growing demand for more electronic services.

- **Infrastructure (\$889,929,000 from direct appropriations, an estimated \$398,000 from reimbursable programs, and an estimated \$16,100,000 from user fees)** This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-IT equipment.
- **Shared Services and Support (\$1,337,776,000 from direct appropriations and an estimated \$33,110,000 from reimbursable programs)** This budget activity funds policy management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equal employment opportunity and diversity services and programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.
- **Information Services (\$1,880,295,000 from direct appropriations, an estimated \$15,419,000 from reimbursable programs, and an estimated \$51,000,000 from user fees)** This budget activity funds staffing, equipment, and related costs to manage, maintain, and operate the information systems critical to the support of tax administration programs. The IRS business programs rely on these systems to process tax and information returns, account for tax revenues collected, send bills for taxes owed, issue refunds, assist in the selection of tax returns for audit, and provide telecommunications services for all business activities, including the public's toll-free access to tax information.

#### **Business Systems Modernization (BSM)**

##### *Explanation of Budget Activities*

The FY 2011 President's Budget is \$386,908,000 in direct appropriations. This is an increase of 46.6 percent from the FY 2010 enacted level. This appropriation funds the planning and capital asset acquisition of information technology (IT) to continue the modernization of IT systems and to move toward completion of the new taxpayer account database. The completion of the core taxpayer account database is the cornerstone of modernization and is a prerequisite to the development of the next generation of IRS service and enforcement initiatives. The integration strategy includes a particular focus on enhanced information technology security practices and robust accounting and financial management controls. This activity also funds the ongoing development of the Modernized e-File platform for filing tax returns electronically. It also funds BSM labor and related contract costs.

### Health Insurance Tax Credit Administration (HITCA)

The FY 2011 President's Budget is \$18,987,000 in direct appropriations. This is an increase of 22.4 percent from the FY 2010 enacted level. This appropriation funds the administration of a refundable tax credit for health insurance to qualified individuals, which was enacted as part of the Trade Adjustment Assistance Reform Act of 2002. The additional resources will help administer the Health Coverage Tax Credit expansion found in the Recovery Act.

### FY 2011 Budget Adjustments

The IRS funding increase for FY 2011 is \$487,147,000, which includes \$219,523,000 for maintaining current levels, a temporary base adjustment of \$3,494,000 to support the Recovery Act's expansion of the Health Coverage Tax Credit (HCTC), a decrease of \$32,680,000 from non-recurring activities, a decrease of \$157,958,000 from efficiencies and savings, and a program increase of \$454,768,000 to improve taxpayer service, strengthen enforcement, and complete the new taxpayer account database. By FY 2013, the revenue-producing enforcement investments are projected to increase annual enforcement revenue by nearly \$2 billion. The Budget supports these activities by proposing the following initiatives:

- \$20,945,000 to increase the telephone level of service, which includes a \$9.0 million reallocation from the FY 2010 enacted levels for Taxpayer Service grant and advocacy programs;
- \$247,446,000 to reduce the tax gap by investing in a strong compliance program; and
- \$167,585,000 to complete development of the new taxpayer account database and continue investments in electronic filing systems.

### Building on the FY 2010 Enacted Level

The FY 2010 enacted level for the IRS is \$12,146,123,000, supporting an estimated 95,070 FTE.

### Maintaining Current Levels

- ***Adjustments Necessary to Maintain Current Levels: +\$219,523,000 / 0 FTE***  
Funds are requested for: FY 2011 cost of the January 2010 pay increase of \$47,473,000, the proposed January 2011 pay raise of \$119,537,000, the cost of the increase in Federal Employee Retirement System (FERS) agency contribution percentage of \$16,392,000, and non-labor related items such as contracts, travel, supplies, equipment, and a GSA rent adjustment of \$36,121,000.

### Base Adjustments

- **Resource Adjustment to Support Recovery Act-HCTC Program Expansion:** **+\$3,494,000/ 0 FTE** This temporary base increase will provide additional contractor funding for the continued support, sustainability, administration, and operation of the HCTC program. Taxpayer participation in the HCTC program is expected to grow because of the Recovery Act. The additional contractor support will allow HCTC to serve a significantly larger participant population.
- **Technical FTE Adjustments:** **\$0 /-318 FTE** This adjustment reflects permanent changes made to ensure FTE levels are fully funded in the base budget.

### Efficiencies and Savings

- **Non-Recur Savings:** **-\$32,680,000 / 0 FTE** This is the net of reductions of non-recurring, one-time costs associated with the IRS FY 2010 enforcement initiatives (e.g., IT equipment and training).
- **Increase e-File Savings:** **-\$22,808,000 / -472 FTE** This decrease is a result of savings from increased electronic filing (e-File), which is projected to lead to fewer returns filed on paper in FY 2011. The number of returns filed electronically is expected to increase substantially in FY 2011 with the addition of the recently enacted Worker, Homeownership, and Business Assistance Act of 2009 (Public Law 111-92), which requires electronic filing by all tax preparers filing more than ten returns in a calendar year.
- **Information Technology (IT) Infrastructure and Process Improvements:** **-\$75,000,000 / 0 FTE** The IRS will reduce infrastructure costs through process improvements in IT infrastructure. Initiatives such as the Information Technology Infrastructure Library will allow the IRS to improve the quality of IT services. In addition, the IRS is working to achieve a Capability Maturity Model Integrated certification that will yield efficiencies in software engineering.
- **Reduce Procurement/Contracting:** **-\$25,000,000 / 0 FTE** In accordance with Presidential guidance on controlling contracting costs, the IRS will generate savings by improving the effectiveness of existing acquisition practices and reduce the cost of contracts.
- **Reduce Printing, Travel, and Training:** **-\$10,000,000 / 0 FTE** The IRS will generate savings by reducing agency-wide printing of selected internal manuals, selected training materials, and other items, non-case related travel and non-technical training.
- **Reduce Tuition Assistance Program (TAP):** **-\$5,150,000 / 0 FTE** The Tuition Assistance Program provides funding to employees for courses that support both

career development and the IRS mission. In FY 2011, the IRS will generate savings by restructuring this program.

- ***Eliminate Selective Mailing of Forms and Publications: -\$20,000,000 / 0 FTE***  
The IRS will generate savings by eliminating the non-mandated notice inserts; the automatic mailing of Form 1040, U.S. Individual Tax Return, tax packages; and the automatic mailing of business tax products.

#### **Program Reinvestment**

- ***Submission Processing Consolidation (Atlanta): +\$2,792,000 / 0 FTE*** Increased use of e-File has led to consolidation of the individual return processing sites. A portion of the increased e-File savings will be reinvested to fund the one-time separation costs associated with the September 30, 2011 closure of the Atlanta submission processing site. As the Atlanta consolidation approaches, the IRS will assist employees to find employment either in or outside the organization.

#### **Program Decrease**

- ***Reduce Taxpayer Service Grant and Advocacy Programs: -\$9,000,000 / 0 FTE***  
The FY 2010 appropriation included an additional \$3,500,000 to expand Taxpayer Advocate Service case processing activities; \$500,000 to increase the Low-Income Taxpayer Clinic (LITC) grants program; \$1,000,000 to increase the Tax Counseling for the Elderly (TCE) grants program; and \$4,000,000 to increase the Volunteer Income Tax Assistance (VITA) grants program. These program decreases will realign the programs to the 2010 requested level to fund the Increase Telephone Level of Service initiative.

#### **Program Increases**

- ***Improve IRS.gov: +\$25,000,000 / 0 FTE*** This initiative, part of a multi-year plan, will initiate the migration of IRS web content and applications from the current outdated portal infrastructures to a new consolidated IRS web environment. These funds will enable the IRS to complete the first phase of the migration of the taxpayer-facing content and applications and to begin the second phase of the migration and transition of approximately 35 percent of the public and partner-facing applications to the new environment.
- ***Increase Telephone Level of Service: +\$20,945,000 / 0 FTE*** Recent legislation has led to an unprecedented demand for telephone services over the past few years. In addition, the additional complexity of – and time needed to resolve – many phone calls resulted in a decline in the telephone level of service. This initiative will improve the telephone level of service from a projected 71 percent in FY 2010 to a target of 75 percent in FY 2011 through a program increase of \$11.9 million and a \$9.0 million reallocation from TAS and the LITC, TCE and VITA grant programs.

- **Address Business and Individual International Compliance: +\$121,086,000 / +781 FTE** This initiative supports the Presidential priority to address offshore tax evasion and builds on the IRS FY 2010 international enforcement initiative. It will allow the IRS to continue its multi-year investment in international tax compliance activities. It increases coverage of the most strategically important international issues, including large enterprises with international components operated by businesses and investors through multiple interrelated financial and tax entities and high-wealth individuals and the complex business enterprises they control.

This initiative will increase examinations of additional international issues pertaining to international structures involving tiered pass-through entities, corporations, and high-wealth individuals by a projected 4,864 cases. The increase in examinations will generate \$812.2 million in additional enforcement revenue once the new hires reach full potential in FY 2013.

- **Reduce the Reporting Compliance Tax Gap: +\$77,679,000 / +700 FTE** This initiative will improve compliance by increasing examination of field and correspondence individual return audits by 61,100 annually; business return audits by 1,200; audits targeting employment, excise, and estate and gift taxes by 9,300; and Automated Underreporter (AUR) document matching individual return audits by 234,000. This request will generate \$659.6 million in additional enforcement revenue once new hires reach full potential in FY 2013.
- **Reduce the Nonfiling and Underpayment Tax Gap: +\$38,181,000 / +406 FTE** This initiative will allow the IRS to broaden its collection coverage and address the tax gap more effectively by increasing staff resources for field collection and the Automated Collection System (ACS) program. The additional staff will produce an additional 144,000 tax delinquency accounts (TDA) (i.e., balance due accounts where returns were filed, but the taxes have not been paid) and 22,500 tax delinquency investigations (TDI) (i.e., investigations of taxpayers with unfiled returns who have not responded to a notice). This request will generate \$474.4 million in additional enforcement revenue once new hires reach full potential in FY 2013.
- **Support of Increased Enforcement Activities: +\$5,000,000 / +65 FTE** Most tax enforcement actions result in downstream Accounts Management activities, including account adjustments, assisted phone calls, amended returns, and installment agreement preparation. This funding will allow the IRS to assist taxpayers to resolve issues early in the enforcement process, pay their taxes, and respond to and close out various enforcement actions. Improving the response to taxpayers who have received enforcement notices should increase revenue and reduce interest paid.
- **Maintain Recovery Act Staffing: +\$5,500,000 / +31 FTE** Among other responsibilities, the IRS is mandated by the Recovery Act to administer the new

bond provisions. The Treasury is required to issue a direct payment to the bond issuer. The unique nature of this new role requires continuous compliance reviews and verification throughout the administrative life of the bonds. This initiative will extend IRS staffing resources received in the Recovery Act to administer ongoing Recovery Act bond provisions.

- ***Business System Modernization (BSM): +\$167,585,000 / +156 FTE*** The BSM increase is a top priority for the IRS and will allow the completion of the new taxpayer account database for the 2012 filing season. The new taxpayer account database will result in faster refunds for taxpayers, improve service accuracy and timeliness, and enhance data security. Completion of the taxpayer account database is a prerequisite for other major initiatives such as significant expansion of online paperless services and next-generation enforcement technologies. The ability of the IRS to support increasingly complex taxpayer service and compliance initiatives will be severely limited until it is completed.

### **Legislative Proposals**

The FY 2011 President's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. These proposals will specifically target the tax gap and generate nearly \$26 billion over the next ten years. Among other proposals, the Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

Expand information reporting – Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would:

- Require information reporting for private separate accounts of life insurance companies;
- Require a certified Taxpayer Identification Number (TIN) from contractors;
- Require increased information reporting on certain government payments;
- Increase information return penalties; and
- Require information reporting on expense payments relating to rental property.

Improve compliance by businesses – Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would:

- Provide Treasury regulatory authority to require that information returns be filed electronically;
- Require corporations and partnerships with assets of \$10 million or more that are required to file Schedule M-3 to file their tax returns electronically;
- Provide Treasury regulatory authority to reduce the current threshold for requiring electronic filing (250 or more returns filed during a calendar year) and include certain other large taxpayers not required to file Schedule M-3 (such as exempt organizations);



- Implement standards clarifying when employee leasing companies can be held liable for their clients' federal employment taxes; and
- Increase certainty about the rules pertaining to classification of employees as independent contractors.

Strengthen tax administration – The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would:

- Expand IRS access to information in the National Directory of New Hires for tax administration purposes;
- Make repeated willful failure to file a tax return a felony;
- Facilitate tax compliance with local jurisdictions;
- Extend statutes of limitations where state tax adjustments affect federal tax liability;
- Improve the investigative disclosure statute;
- Repeal the requirement of a partial payment with an application for an offer-in-compromise; and
- Allow assessment of criminal restitution as tax; and

Expand penalties – Penalties play an important role in discouraging intentional noncompliance. A specific proposal to expand penalties would:

- Impose a penalty on failure to comply with electronic filing requirements; and
- Clarify that the bad check penalty applies to electronic checks and other forms of payment.

#### **Improve Tax Administration and Other Miscellaneous Proposals**

The Administration has put forward additional proposals relating to IRS administrative reforms. These proposals would:

- Improve the foreign trust reporting penalty;
- Apply the Federal Payment Levy Program to contractors before providing Collection Due Process; and
- Clarify that a vendor levy on “goods and services” would not exclude “property.”

#### **Conclusion**

Mr. Chairman, thank you again for this opportunity to provide testimony on the 2010 filing season and the President's FY 2011 Budget for the IRS.

The IRS continues to demonstrate improvement in key areas, including service, and the ability to react effectively and quickly to evolving situations, such as the economic downturn, and make a meaningful difference in taxpayers' lives.

We also urge passage of the President's proposed FY 2011 Budget for the IRS. It gives the IRS much needed resources to provide taxpayers with high quality customer service and bolsters IRS enforcement in critical areas, such as unlawful offshore tax evasion. It also makes wise investments for the next generation of technology and the IRS workforce. I also urge the Committee to support the enactment of the legislative proposals included in the Budget to improve compliance. That concludes my testimony. I would be happy to answer any questions.

**Senate Finance Committee Hearing**  
**“Filing Season Update: Current IRS Issues”**  
**April 15, 2010**  
**Responses to Questions for Steven T. Miller**  
**Deputy Commissioner for Services and Enforcement**  
**Internal Revenue Service**

**Questions from Senator Baucus**

1. Please provide the IRS’s legislative implementation strategy for health care reform, including goals, measures and timelines. If the implementation strategy is not complete, please provide the current status and when the implementation strategy is expected to be completed.

- To what extent has the IRS identified its staffing and other resource needs to implement and administer health care reform?

**Response:** The IRS is analyzing the tax provisions of the Affordable Care Act to determine the resources needed to effectively administer the law. The legislation includes several dozen changes to the tax law of varying degrees of size and scope. In addition, these changes come into effect in stages over the next several years. For the near-term provisions, the IRS has already started implementation and has detailed plans in place to track milestones. Other provisions that come into effect further into the future are in earlier stages of planning, but will be carefully planned in detail well in advance of the effective dates.

- Please comment on reports in the press that the IRS will hire up to 17,000 armed IRS agents to enforce health care.

**Response:** This estimate did not originate with the IRS. Any analysis that assumes the IRS would dedicate most of its resources for Affordable Care Act implementation to investigating taxpayers is fundamentally flawed.

A substantial portion of the IRS's administrative expenses for implementation will be dedicated to taxpayer service, as the IRS actively works to inform taxpayers of the new tax credits available through the Affordable Care Act. Beginning with tax year 2014, the IRS must administer more than \$400 billion in tax credits for individuals (based on Joint Committee on Taxation (JCT) estimates). This effort will require significant investment in taxpayer outreach, online self-help tools, and other taxpayer service activities. By combining this in-depth outreach with the required modifications to technology platforms, the IRS will dedicate resources to administering this law fairly and efficiently so taxpayers get quality service.

The IRS will also create balanced compliance programs for the various changes to the tax law in the Affordable Care Act to detect errors and mistakes. With respect to the provision that requires individuals who can afford health insurance to purchase it, or pay

an additional amount on the tax return, the statute precludes collection enforcement actions (e.g., liens, levies), as well as criminal sanctions. Taxpayers will report health coverage on their tax returns. The IRS will generally rely upon the information received from insurers and employers to confirm taxpayers have met the requirement. In no circumstances will IRS employees be questioning the details behind taxpayers' sensitive health choices.

The IRS is actively working to determine the resources needed to effectively administer the Affordable Care Act. This analysis is still in a relatively early stage, and for this reason, any estimate would be premature at this point. However, the premise of the estimate that you referenced – 17,000 armed agents – is a distorted view of the role of the IRS, starting with the fact that IRS revenue agents are not armed.

2. In the past year Congress passed a number of new tax incentives to encourage businesses of all sizes to invest in job creation and health care.
  - In the HIRE Act, Congress provided a payroll tax exemption for employers who hire workers that have been unemployed for at least 60 days and extended an increased level of expensing of capital expenditures for small businesses.
  - In health care reform, Congress provided a tax credit for small businesses which pay at least 50% of insurance premium costs of their employees.
  - In the Worker, Homeownership, and Business Assistance Act, Congress allowed all businesses to carry back net operating losses 5 years.

All of these provisions took effect immediately. What has the IRS done to alert the business community of these incentives and facilitate their use?

**Response:** The IRS regularly partners with thousands of national and local industry and small business organizations, tax professional and payroll associations and government agencies to leverage our overall outreach and education efforts. Through these partnerships, the IRS alerts the small business community of new tax incentives and how to facilitate their use. The IRS provides key messages and quality education on tax incentives included in the Hiring Incentives to Restore Employment (HIRE) Act, Affordable Care Act, and new Net Operating Loss (NOL) provisions.

**HIRE:**

- Issued News Release [IR-2010-33](#) – Two New Tax Benefits Aid Employers Who Hire and Retain Unemployed Workers – on March 18, 2010
- Created a page on IRS.gov dedicated to HIRE information, including FAQs, draft forms, and other information
- Created new [Form W-11](#) and posted it to IRS.gov on April 6, 2010
- Issued News Release [IR-2010-43](#) – Special Payroll Tax Exemption Form Now Available – on April 7, 2010.

Affordable Care Act:

The IRS has used a number of different communication channels to inform small employers of the new tax credit in the Affordable Care Act. Using the internet, direct mail, tax forums and practitioner meetings, and monthly calls with the payroll industry, the IRS continues to coordinate efforts to help eligible small employers take advantage of the new tax credit.

- On April 1, shortly after enactment of the Affordable Care Act, the IRS established a special section on IRS.gov to provide information on how to claim the credit. Information about the tax credit on IRS.gov is also available in Spanish.
- During the month of April, the IRS web site is among the most popular on the Web, so the IRS featured the links promoting the new small business credit prominently on the home page. In addition to publicizing general information on the tax credit and how to claim it, the IRS has also issued a news release, produced a YouTube video, issued a fact sheet on determining eligibility, and answered 22 frequently asked questions about the credit on IRS.gov.
- During the week of April 19, the IRS mailed postcards to more than 4 million small employers likely to qualify for the credit to alert them to the new benefit.
- Throughout the year, the IRS will also support more than 1,000 tax workshops, small business forums and tax practitioner meetings where employers can get information on how to claim the new credit.

Five year carry back of net operating losses:

- Issued a news release and Revenue Procedure 2009-52 for 5 year carry back of net operating loss shortly after passage.
  - Posted Frequently Asked Questions (FAQs) on IRS.gov for the 5 year carry back of net operating loss. The IRS updates these FAQs often to ensure we provide the most current information.
  - Modified Forms 1139 and 1045 to reflect the election of the extended carry back provision.
3. In light of the recent tragedy in Austin, what specific actions is the IRS taking to assess its security procedures to protect IRS employees as well as taxpayers visiting IRS facilities, and to identify necessary actions to enhance employee and taxpayer safety?

**Response:** The IRS:

- Immediately increased its use of armed guards at facilities nationwide.
- Commissioned an independent interim assessment of physical security operations to ensure consistency with standards and guidelines. Results of the review revealed the IRS exceeded federal security standards in many instances, highlighted dozens of positive accomplishments, and identified a few areas for improvement, upon which the IRS will take action.

- Initiated a full scale security readiness review of all facilities and practices
  - Completed an extensive review of the Explosive Detector Dog Program. This review resulted in streamlined management of the program and improved control.
- Describe the respective roles and responsibilities of IRS AWSS Physical Security, IRS Criminal Investigation, TIGTA and the Federal Protective Service of DHS as they relate to the security of IRS facilities and IRS personnel, including (a) building security, (b) threat assessments, security reviews, and vulnerability assessments of IRS facilities, (c) threats to IRS personnel, (d) protection of IRS employees dealing with irate, abusive or assaultive individuals in IRS offices and in the field, (e) investigation of subjects or groups that openly express or support violence occurring or directed at IRS facilities or personnel, (f) first response to attacks or violence occurring or directed at IRS facilities or personnel, and (g) continuity of operations in a national emergency or disaster. How are the respective roles and responsibilities determined? How does the IRS measure the effectiveness of the respective roles and responsibilities? How does the IRS monitor whether each function is fulfilling its roles and responsibilities? With multiple security functions, how does the IRS determine whether there are overlaps or gaps in security?

**Response:** Please see chart below. A “yes” response indicates the organization has responsibility for an action.

Organization	(a) Building Security	(b) Threat Assessments, Security Reviews, Vulnerability Assessments of Facilities	(c) Threats to IRS personnel	(d) Protection of IRS employees dealing with irate, abusive, or assaultive individuals	(e) Investigation of subjects or groups that openly express or support violence occurring or directed at IRS facilities or personnel	(f) First response to attacks or violence occurring or directed at IRS facilities or personnel	(g) Continuity of operations in a national emergency or disaster
<b>IRS AWSS Physical Security (PSEP)</b>	Yes - development of security related procedures, policies and guidance. Determine security posture of facilities in accordance with applicable standards.	Yes - conducts risk assessments at all IRS facilities	Yes - report incidents to TIGTA; add name to potentially dangerous taxpayer list; perform incident tracking	Yes - implement mitigation strategies (e.g., bldg security; risk assessments; security awareness training)	N/A - TIGTA responsibility	N/A - On-site guards, CI, FPS, local law enforcement authorities, with the exception of the Martinsburg, WVA Computing Center where Internal Revenue Police Officers (IRPOs) are employed by PSEP.	Yes - facilitate continuity of operations plan (COOP) development; perform COOP test exercises
<b>IRS Criminal Investigation (CI)</b>	Yes - first responders when present in building	Yes - investigative responsibility; consults with Joint Terrorism task force, FBI, TIGTA, local law enforcement and other agencies to advise of potential threats	N/A - TIGTA responsibility	Yes - respond and neutralize immediate threats, provide armed escorts for IRS personnel, informants & witnesses, as necessary	N/A - TIGTA responsibility	Yes - first responders when present in building; respond and neutralize threats	N/A - IRS Physical Security responsibility
<b>TIGTA</b>	N/A - IRS Physical Security and FPS	Yes - investigative responsibility; consults with Joint Terrorism task force, FBI, TIGTA, local law enforcement and other agencies to advise of potential threats	Yes - investigative responsibility	N/A - On-site guards, CI and FPS responsibility	Yes - primary investigative responsibility of threats	N/A - On-site guards, CI, FPS and local law enforcement authorities	N/A - IRS Physical Security responsibility
<b>HS Federal Protective Service (FPS)</b>	Yes - provide guard service; first responders	Yes - Perform Risk Assessments	Yes - respond and neutralize threats	Yes - first responder; respond and neutralize threats; law enforcement jurisdiction over all federal buildings	N/A - TIGTA responsibility	Yes - first responder; respond and neutralize threats; law enforcement jurisdiction over all federal buildings	N/A - IRS Physical Security responsibility

- How are the respective roles and responsibilities determined? How does the IRS measure the effectiveness of the respective roles and responsibilities? How does the IRS monitor whether each function is fulfilling its roles and responsibilities? With multiple security functions, how does the IRS determine whether there are overlaps or gaps in security?

**Response:** Statutory authority determines the respective roles of the agencies. However, the IRS has formalized procedures for ensuring that incident responses, for example, are closely coordinated, regardless of which individuals and organizational structures are involved.

The IRS conducts risk assessments to determine how well the system is working, and to identify potential gaps. In addition, the IRS reviews responses to actual incidents to determine whether unnecessary overlaps and/or gaps exist. Finally, as noted above, the IRS is conducting a review of the physical security of all facilities looking at this same issue.

- Describe IRS policies and procedures regarding screening of visitors and vehicles entering IRS facilities or areas adjacent to IRS facilities. Describe the screening that is performed. How many IRS facilities do, and do not, have security screening of visitors? How many IRS facilities do, and do not, screen vehicles by canine or other inspection? To what extent do security procedures vary among small or remote posts of duty compared to large or urban posts of duty?

**Response:** Security provided at post of duty locations is consistent with the requirements of the Interagency Security Committee standards. Security standards at these locations vary based on the established security level of the facility. Some of the security standards include, but are not limited to: intrusion detection systems and duress alarms; recording and/or monitoring Closed-Circuit TV (CCTV); entry access screening; armed security guard presence; locked doors limiting public access; and roving interior and external patrols. As noted above, the IRS is currently conducting an assessment of all building security needs.

- Compare and contrast the authorities and jurisdiction of IRS police and FPS/IRS contract security guards. How many IRS facilities are secured by IRS police? How many IRS facilities are secured by FPS/IRS contract security guards? What training do IRS police receive? What training do contract security guards receive?

**Response:** Most IRS facilities that employ guards use contract guards through FPS. Before beginning work on an FPS contract, contract guards must pass a comprehensive written exam based on the material in the FPS Security Guard Information Manual. Contract Guards must hold a valid guard card license, certification, and a handgun permit for the specific state in which they work. Contract guards have no arrest authority, nor do they have the authority to conduct investigations. Contract guards may detain persons, pending police response, not to exceed 30 minutes.



At one facility, the Martinsburg Computing Center, security is provided by Internal Revenue Police Officers (IRPOs). IRPOs are federal law enforcement officers and have full law enforcement power and authority

- How many IRS facilities have had a security review or vulnerability assessment conducted during the last three years? Describe the security review procedures. What were the conclusions and recommendations of the reviews and assessments? To what extent have the recommendations been implemented?

**Response:** The IRS has conducted formalized Risk Assessments at 579 facilities within the last three years. An IRS Physical Security Specialist performs the Risk Assessment utilizing an automated software tool customized for the IRS. The IRS conducts the assessment by completing a series of checklists, performing a physical walk through of both the interior and exterior of the facility, checking the exterior lighting, ensuring that sensitive areas are secured, and reviewing the regulatory guidance to ensure that the facility is meeting minimum standards. The Physical Security Specialist interviews building tenants and mechanical /facility representatives. The Physical Security Specialist makes note of the existing countermeasures that are in place for the protection of employees and property and also makes recommendations for corrective actions that may be needed as a result of any vulnerability identified during the review.

The IRS has implemented many recommendations to ensure protection of employees and property, such as:

- Installing duress alarms at sites that have face-to-face contact with the public.
  - Installing CCTV surveillance systems in many locations. These cameras serve as a deterrent to crime and the IRS can actively monitor and provide video footage in the event the IRS must pursue an investigation of an incident.
  - In some cases, installing access control systems to replace cipher locks.
  - Placing physical barriers both at internal and exterior locations and added security guards at many locations.
  - Implementing mail handling procedures to minimize exposure to hazardous substances.
  - Upgrading exterior lighting.
  - Creating standardized Occupant Emergency Plans.
  - Testing of duress alarms and other building alarms on a recurring basis to ensure proper function.
  - Maintaining an effective and active relationship with the FPS and other law enforcement agencies to share information and best practices.
- Please describe the training that has been conducted for employees concerning physical security awareness and procedures during the last three years.

**Response:** Physical Security utilizes a number of measures to increase employee knowledge concerning physical security. All new employees receive a security orientation within the first week following employment. The IRS holds refresher security

briefings as part of the annual Security Awareness Week activities, or as requested. The IRS developed an Employee Emergency Preparedness Guide to provide employees with guidance on actions they should take in response to a range of potential emergency events, and emphasize the importance of following building-specific plans and procedures during emergencies.

The IRS developed and distributed a suite of communications throughout the year via e-mail, flyers, and in person on various security topics. The IRS enhanced its Physical Security and Emergency Preparedness (PSEP) website to include the "AskPSEP" feature, which provides a forum for employees to submit inquiries via e-mail pertaining to physical security and emergency preparedness issues. Physical Security also publishes a quarterly physical security and emergency preparedness newsletter. Physical Security is currently developing a mandatory training module for all employees for implementation in July of this year.

The IRS has developed a suite of communications materials to address manager and employee questions, issues and concerns. The suite consists of an All Employee Mandatory Briefing; Physical Security & Emergency Preparedness Guide; A Manager's Toolkit and an enhanced Website. The Mandatory Briefing addresses issues that affect employees who have direct contact with customers, workplace violence, emergency situations and emergency preparedness. The Manager's Toolkit provides a talking paper and resources to managers to assist them in communicating Physical Security and Emergency Preparedness topics. The Physical Security and Emergency Preparedness Guide is a hardcopy book for all IRS employees that addresses the items in the Mandatory Briefing and Manager's Toolkit. The enhanced website will be providing links to Resources, Frequently Asked Questions, Informational Documents and Posters, as well as the Manager's Toolkit. In light of the Austin attack, more training and drills will occur this summer.

- How many threats or contacts of an inappropriate nature have been received by, or directed at, the IRS since the attack on the Austin IRS facility? Please provide a description of the general categories of the threats or contacts.

**Response:** Since the Austin attack, there have been approximately 523 contacts of an inappropriate nature received by, or directed at, the IRS. General categories of threats are as follows:

- Threats – any verbal or written statement that contains threatening language (includes language supportive of the Austin attacks without specifically threatening IRS personnel)
- Assaults – physical contact with an IRS employee
- Corrupt Interference/Harassment – non-forcible interference, harassment and intimidation, as well as filing false liens
- Bomb Threats – a threat made by a taxpayer to utilize explosives to cause damage to an IRS employee or an IRS facility

- Biological/Chemical – any real or fake substance that is used in a threatening manner
  - Bomb/Incendiary devices – an explosive or object that can be detonated or ignited to cause damage to an IRS employee or IRS facility
4. In most cases, a taxpayer can receive information about their tax account only by calling the IRS or visiting an IRS office. What plans, if any, does IRS have to enable taxpayers to access their individual tax account information over the Internet similar to the way taxpayers can access their bank account information?

**Response:** In recent years, the IRS has invested significantly in moving the tax filing process online. In a relatively short period of time, the individual e-file rate has increased dramatically. Since 1998, the form 1040 e-file rate has increased from 20% to approximately 70% in 2010; and that figure is expected to increase starting in 2011 due to the new practitioner mandate.

At the same time, the IRS has created a number of account-related applications that taxpayers and tax professionals can access. These include:

- Where's My Refund?
- What Was My Stimulus Payment?
- Online EIN Application
- Online Payment Agreement
- Federal Student Aid - Datashare
- Electronic Filing PIN Help

Down the road, the IRS plans to further expand the use of the core taxpayer account database being developed through CADE2 to provide additional online tools to taxpayers. The IRS will design these tools to enable taxpayers to complete transactions online that would otherwise require the assistance of a customer service agent today.

5. IRS recently posted a limited number of interactive tax assistance topics on the IRS Web site that allow taxpayers to seek out answers to complicated tax questions by responding to a chain of questions.
- What plans does the IRS have to expand the use of these types of services?

**Response:** The IRS launched the Interactive Tax Assistant (ITA) as a pilot in March 2010. It included seven of the most frequently used Tax Law Categories (TLCs). Topics include:

- Do I Need to File a Tax Return?
- Who Can I Claim as a Dependent?
- How Much Can I Deduct for Each Exemption I Claim?
- How Much is My Standard Deduction?
- What is My Filing Status?

- Am I Eligible for the Child Tax Credit?
- Am I Eligible for the Making Work Pay Credit or Government Retiree Credit?

The IRS plans to expand the number of interactive tax assistance (ITA) topics in upcoming years so taxpayers have more assistance available for their tax law questions. The IRS plans to add three to five additional TLCs in 2010 and six to 12 additional topics in 2011.

- How will the IRS know if tools like these that are designed to assist taxpayers are effective (i.e., reduce telephone calls and accurately answer questions)?

**Response:** The IRS used the pilot approach to leverage feedback and performance data to improve the application before moving into full implementation. The IRS captured and analyzed statistical data regarding visits and completions for the pilot. The IRS based success measures for the pilot on the percentage of users who began and completed a tax law category. Based on this pilot data, there was a 77.9% completion rate. After the taxpayer completed a topic using the Interactive Tax Assistant (ITA), the IRS made available a brief survey asking:

- ease of usage of the tool
- whether the taxpayer felt his/her questions were answered, and
- if additional help was needed, and if so, what channel(s) would s/he use?

Approximately 9% of the taxpayers using the tool took the survey. The IRS captured this information and is analyzing it to determine how effective the tool is in meeting taxpayer needs. The IRS will use feedback from the survey for future enhancement of the tool. While the IRS is still analyzing complete results, preliminary results from the survey show that 85.7% of the respondents found the tool easy to use and 78.0% of respondents reported the system answered their questions.

6. The IRS has a new strategy called CADE2 for its replacement of IRS's antiquated taxpayer account database.
  - Please describe the IRS's CADE2 Program's progress to-date and how it differs from previous CADE efforts.

**Response:** In recent years, the IRS has made significant progress in migrating tax account processing to a modernized database environment. CADE 2 will accelerate the data conversion of the IRS's legacy master file into a relational database structure and daily processing architecture. In essence, the IRS has prioritized the data conversion so that the benefits of a relational database can be obtained much sooner than previously anticipated.

The CADE 2 data-centric solution will leverage the work completed to-date on CADE, as well as the legacy Individual Master File (IMF) architecture and data structures. It will provide more timely access to authoritative individual taxpayer account data and enhance

the IRS's ability - beyond that of the current CADE approach - to more timely and effectively address concerns around technology security, financial material weaknesses, and long-term architectural planning and viability.

The IRS is on track to deliver the core taxpayer account database for the 2012 filing season.

- How will the CADE2 Program deliver solutions to the complex database problems that have challenged the IRS?

**Response:** Completion of IRS's CADE 2 relational taxpayer account database is a necessary prerequisite to key strategic goals of the IRS, including significant expansion of online services, and next generation compliance systems. In addition, this work will begin to address our custodial accounting material weakness and other significant deficiencies that exist in our core taxpayer account processing, which will position the IRS to address full Federal Financial Management Systems Requirements (FFMSR) compliance for core taxpayer account processing by 2014. The new database will serve as the central repository of tax account information for all individual taxpayers and it will operate in a daily processing environment. This upgrade will result in improved taxpayer service through faster disbursement of refunds, increased timeliness and accuracy of taxpayer transactions, and faster resolution of taxpayer issues. With the use of business intelligence tools to access an analytical data store, there will be additional opportunities for improvements in compliance. These opportunities could include better case selection, enhanced fraud detection for all individual taxpayer accounts, increased speed and accuracy in identifying preparer non-compliance, and expanded data analytics. Finally, the modernized environment will improve the security posture of the data and improve the efficiency of IT operations by faster integration into a single tax processing environment.

7. In recent years, the use of Free File has declined.

- What actions does the IRS take to publicize and encourage the use of Free File?

**Response:** The IRS supports a comprehensive marketing program for Free File designed to increase awareness of and access to the Free File program. The campaign utilizes a mix of paid and free media, both at the national and local level that includes: satellite media tours and press releases; public service announcements (TV, print, radio); online banner and text ads; search engine marketing; social media, such as YouTube; and, the development of other educational assets. This year, the IRS launched a new microsite to further increase public awareness through video, widgets and "shared" functions that allow easy uploads to Facebook, Twitter, and other Social Media outlets. The IRS also markets Free File on IRS.gov and through the many forms, instructions and educational materials produced for taxpayers. Many of these materials and media are available to taxpayers in English and Spanish.

- What are the IRS's future plans for the Free File program?

**Response:** The Internal Revenue Service and the Free File Alliance, LLC will enter into their 9th partnership year in 2011. The main purpose of the Traditional Free File program is to reach economically disadvantaged and underserved population and to help them comply with meeting their tax obligations by offering free online filing through a consortium of leading electronic filing providers. Based on observations, feedback from the Free File Alliance, and lessons learned from the current year's Traditional Free File program, the IRS and the Free File Alliance discuss and agree to a number of recommended improvements annually. These improvements serve to aid the individual taxpayer's needs; strengthen the partnership with the Free File Alliance and its members; and generally improve the quality of the Free File online products and services.

8. When taxpayers file electronically, they are required to provide either their prior year AGI or PIN. Through late March, the IRS rejected about 6.7 million electronically filed returns because the information provided by the taxpayer did not match IRS records. As more taxpayers file electronically, what steps can the IRS take to reduce the number of returns rejected because of incorrect AGI or PIN numbers?

**Response:** The IRS offers an alternative authentication channel for taxpayers who can not locate their prior year tax information. The IRS developed the Electronic Filing PIN web and telephone applications to reduce call volumes and wait times, and made them available during the 2010 filing season.

As of April 27, 2010, the IRS issued more than 7.6 million Electronic Filing PINs to taxpayers. The IRS will release additional enhancements to the application in January 2011. The IRS currently is receiving feedback from software companies on their customer's user experience related to the Electronic Filing PIN.

The Electronic Filing PIN-Help web application is available on IRS.gov "Online Services" section. In order to request an Electronic Filing PIN taxpayers are required to enter certain information.

In addition, the IRS recently launched a research project on returns that the IRS rejected due to authentication errors to identify the causes of these errors, determine taxpayer's subsequent filing behavior, and quantify the impact on IRS service channels.

9. Congress is expected to enact legislation to reinstate the estate tax that expired this year. There is discussion that would make the estate tax retroactive to January 1, 2010. Please identify and discuss technical, implementation and administrative issues that may arise due to a retroactive estate tax.

**Response:** As with any legislation that is enacted with a retroactive effective date, the IRS would need to swiftly assess the effects and take the appropriate actions to ensure effective tax administration. Since the IRS is aware of the proposed legislation for a retroactive estate tax, it has put a team together that will be able to act quickly upon enactment. We anticipate there may be a need to provide guidance, issue a Form 706 that

could be used to file for decedents with date of death in 2010, make systemic changes to ensure returns are processed properly, and implement a communications plan to alert the public of the need to file retroactive estate tax returns.

**Questions from Senator Bingaman**

1. In her most recent Annual Report to Congress, Ms. Olson expressed her concerns that the Service's lien filing policies are causing harm to taxpayers without necessarily increasing the IRS's revenue collection. I was surprised to learn that in the last year alone, the IRS filed nearly 5,000 liens against New Mexico taxpayers. These liens will show up on their credit reports and, in some cases, will remain there indefinitely. Accordingly, the liens will harm their financial viability – with potentially no revenue gain whatsoever to the government. Mr. Miller, I would appreciate if you would answer the following questions.

- Is it currently the IRS's practice to verify the existence or the value of a taxpayer's property before filing a notice of federal tax lien in the public record?

**Response:** The IRS does not verify the existence or value of property prior to lien filing. Though this information may be a good indicator of the immediate prospects for collection, the Notice of Federal Tax Lien (NFTL) also protects the government's interest in future income and assets of the taxpayer against the claims of other creditors. Therefore, even if the IRS could accurately determine the taxpayer's current assets, it would be highly unlikely if not impossible to determine with any certainty when a taxpayer may acquire assets during the remaining time available on the ten-year collection statute. We are currently reviewing the National Taxpayer Advocate's Annual Report to Congress.

- What factors does the IRS currently take into account in determining whether to file a lien? Should revenue officers make case-by-case determinations before filing a lien?

**Response:** All Collection employees consider taxpayer circumstances when making any significant case decision, including a determination whether to file the NFTL. Employees in the collection call sites (ACS) operate under detailed guidelines that direct them to file liens in specific situations. Factors to be considered are 1) the dollar balance of the liability, 2) the planned case resolution method, and 3) information as to whether collection is at risk. Guidance in the Internal Revenue Manual (IRM) also describes exceptions to these general rules, such as imminent reassignment of the case to a revenue officer or whether credits are available to satisfy the liability.

Revenue officers do, in fact, make case-by-case decisions when determining whether to file a lien. The IRM requires revenue officers to make the lien determination in conjunction with the initial actual contact or initial attempted contact when the IRS has not previously filed a lien. The IRM also describes several situations in which revenue officers should *not* file (e.g., doubt as to validity of the tax debt) or should defer filing, such as when it would hamper ultimate collection.

- Section 3421 of the Internal Revenue Service Restructuring, and Reform Act of 1998 directs the IRS to implement procedures under which determinations to file liens would require supervisory approval “where appropriate.” The combination of the Senate report and conference report explanations makes clear that the “where appropriate” limitation was intended to apply to “liens . . . issued by the automated collection system.” Does the IRS currently require supervisory approval of all liens other than those issued by ACS? If not, would you please explain how the IRS’s current procedures square with the direction and intent of Congress?

**Response:** Our lien filing policy and managerial review requirements recognize there are situations where additional managerial oversight is needed to ensure that employees observe legal and procedural requirements when making a decision to file a lien. This position is consistent with the statutory intent of Congress. In particular, the Conference Agreement from RRA98 section 3421 says, “The conferees *intend that the Commissioner have discretion* in promulgating the procedures required by this provision to determine the circumstances under which supervisory review of liens or levies issued by the automated collection system is or is not appropriate.” (Emphasis added.)

Nonetheless, we are always receptive to input and feedback on our programs, and we have the National Taxpayer Advocate’s recommendations under review.

- Ms. Olson has reported that the IRS generally requires collection personnel to file liens in certain categories of cases (*e.g.*, if a taxpayer owes more than \$5,000 and the account is placed into currently not collectible status) unless they are able to obtain managerial approval to refrain from filing the lien. Is this an accurate statement? Given the general congressional directive to require managerial approval where a collection employee seeks to file a lien, please explain why the IRS would flip the presumption and require managerial approval where a collection employee proposes not to file a lien.

**Response:** In order to run a balanced program that is sensitive to unique taxpayer circumstances, and at the same time protects the government’s interests, the IRS has created guidelines for collection employees.

In certain cases, managerial approval is required to file a notice of lien. These are situations where in our judgment the case deserves additional review prior to the filing.

In other cases, such as in the employment tax arena, the IRS has guidelines that require an employee to demonstrate why a lien would not be appropriate for amounts greater than \$5,000. In a July 2008 report (GAO-08-617), the GAO determined that the government was at risk because one third of unpaid payroll tax cases did not reflect lien filing. The GAO recommended the IRS “develop and implement procedures to expeditiously file a Notice of Federal Tax Lien against property as soon as possible after payroll tax debt is identified.”



These procedures demonstrate the IRS has created thoughtful guidelines and procedures to create a balanced collection program.

2. A significant number of taxpayers purchase commercial refund delivery products, such as refund anticipation loans (or RALs), to receive their refunds quickly. According to the National Consumer Law Center, RALs drained the refunds of about 8.4 million American taxpayers in 2008, costing them more than \$738 million in loan fees, plus over \$68 million in other fees. In addition, another 12 million taxpayers spent \$360 million on related financial products to receive their refunds. I have long been concerned about these products. In New Mexico, we have seen RAL providers exploit some of our most vulnerable citizens, particularly those living in Native American communities. Mr. Miller, I would appreciate if you would answer the following questions.

- In her annual report, Ms. Olson recommends that the Service process all refunds for returns through the IRS Customer Account Data Engine, or CADE, since those are released in five to seven days, instead of the 9 to 15 days for the Individual Master File (IMF). What is the Service's view of that recommendation?

**Response:** The Advocate's recommendation is in line with the IRS's current strategy. Approximately 40.1 million million taxpayers got the benefit of faster processing because of the CADE system for Filing Season 2010 (as of May 25, 2010). The IRS's CADE 2 project should substantially increase that number starting in 2012.

- Earlier this year, the IRS announced that it would create a task force to examine RALs. Can you update me on the status of that task force? What do you expect will be the ultimate outcome of its activities?

**Response:** In January of this year, the IRS issued the Return Preparer Review Final Report recommending actions to increase oversight of federal tax return preparers. One issue that came up in the context of this review is the role of refund settlement products. To address concerns associated with refund settlement products, the report recommended establishing a working group to review the industry.

In February 2010, the IRS established a cross-government working group comprised of representatives from bank regulatory agencies, Treasury tax and financial policy officials and IRS tax administrators. The working group has produced a detailed analysis of the Tax Refund Lending Industry and has held a number of meetings to begin discussions and resolution of key questions about these products. The working group has met with industry participants and consumer advocates related to these products. The industry meeting included representatives from tax software companies, tax preparation firms, and banking institutions. The consumer advocates meeting included representatives presenting the viewpoints of 10 organizations.

Additionally, on August 5, 2010, the IRS announced that it would no longer provide the debt indicator, an electronic indicator often used to facilitate the underwriting of RALs. In an environment where over 70 percent of tax returns are e-filed, and taxpayers have

the option of using direct deposit to receive refunds quickly, we no longer believe that the indicator is necessary.

- What steps, if any, is the Service already undertaking to protect vulnerable taxpayers from abusive RALs?

**Response:** The IRS is working to speed the refund process and bank the unbanked.

Direct Deposit, Paper Check, and Split Refund – The IRS offers direct deposit, paper check, and refund splitting. The direct deposit option electronically transfers refunds into a taxpayer’s checking or savings account. This option is not available to taxpayers without bank accounts. The paper check option mails a check to the taxpayer’s address of record. To encourage higher savings and more banking, the IRS allows taxpayers who use direct deposit to divide their refunds in up to three financial accounts. The split refund program gives taxpayers more control over their refund by allowing a choice of selecting one, two, or three accounts such as checking, savings and retirement account.

Stored Value Cards – In FY 2009, the IRS partnered with a financial institution to offer a stored value card refund option for low-income taxpayers using free tax return preparation VITA sites. VITA partners in eight cities at 15 sites offered approximately 1,000 cards. For taxpayers choosing this option, the financial institution created a bank account to receive the refund by direct deposit with the added benefit of permitting other federal payments such as Social Security, Supplemental Security Income or Veterans Administration benefits to be direct deposited to the account. The FY 2011 Budget requests funds for the Treasury Department’s Departmental Offices account to do an in-depth evaluation of this program, which may include reviewing expansion opportunities.

IRS Refund Processing – The IRS is improving the tax return processing cycle time with a move to an advanced system that processes returns daily instead of weekly, reducing the length of time it takes to process refunds. This advanced system with daily processing of refunds with direct deposit will take 5 to 7 days, and the IRS is currently planning to implement it for the tax filing season in 2012.

IRS Regulation – The IRS affects RALs through rules and regulations, specifically T.D. 9375 and T.D. 9478, governing providers of electronic tax filing and tax preparers who are providers of RALs.

- Disclosure rules require the provider to disclose that a RAL is a loan, that it is neither a substitute for a refund nor a faster way to receive a refund, and that the borrower may owe additional interest on the loan if the refund is not received in the expected time.
- Advertising rules require that advertisements clearly state that a RAL is a loan advanced against an anticipated refund, not the refund itself; generally prohibit deceptive or misleading advertising; and require electronic filing providers retain copies of all advertising.

- Fees rules state that electronic filing providers may charge the borrower a fee for assistance in arranging a RAL. However, the fee must be a flat fee that is identical for all customers, and it may not vary depending on the size of the loan or the amount of the refund. Providers may receive a fee from the lender and this fee may not vary depending on the size of the RAL or the amount of the refund.
- Rules prohibiting an electronic return provider from making the loan require the provider to obtain the borrower's written consent to provide tax information to the lender, and prohibit the provider from cashing a customer's refund check.

Finally, as noted above, the IRS recently decided to no longer provide the debt indicator, which is often used to facilitate refund anticipation loans.

- A report by the First Nations Development Institute found a "moderate to strong positive statistical correlation between an increase in the share of Native Americans residing in a county and the usage of RALs among EITC tax filers" and that "some of the highest rates of RAL usage among EITC filers are found in very rural reservation communities." To address these worrisome trends, the Institute recommends a series of steps, including public education campaigns in Native Communities. Can you describe what, if any, such campaigns the IRS has already undertaken? Will the IRS consider targeted education campaigns related to RALs for Native communities, including such communities that are geographically remote?

**Response:** The IRS has developed partnerships with several national Native American and Native American-serving organizations. We have approximately 180 national and local partners that provide EITC outreach, free tax preparation services and financial education to Native communities. The IRS's Native American Initiative has built alliances with partners that have extensive existing infrastructures serving Native Americans, especially in those states with the highest rate of RAL usage.

The First Nations Development Institute report identified counties in South Dakota, North Dakota, Montana and Wisconsin where 50% or more of the population is Native American as those with the highest rate of RAL usage. During the 2010 filing season, the IRS had approximately 170 Native American-serving free tax preparation sites nationwide, with 66 of those sites residing in these four states. New Mexico, which also has a large Native American population, housed fourteen sites.

During the 2010 filing season, there were approximately 35,000-plus returns prepared nationwide at sites serving Native Americans. The IRS is committed to continuing its work with organizations that serve Native Americans and growing the number of free-tax preparation locations in underserved and remote communities. Promotion of EITC, free tax help and refunds in as few as 10 days with e-file and direct deposit are key IRS messages during the filing season.

**Question from Senator Grassley**

1. In response to Chairman Baucus's question regarding the IRS's estimates on offshore tax evasion, you stated that "IRS doesn't know what it doesn't know". However, IRS should be able to quantify the amount of taxes that are lost to the U.S. Treasury through the use of offshore UBIT blockers, such as the ones created by Treasury Undersecretary for Domestic Finance Goldstein's former firm. The use of offshore UBIT blockers was discussed at length during a September 2007 Finance Committee hearing. Please provide estimates of the number of organizations utilizing UBIT blockers and the amount of taxes not collected as a result.

**Response:** Current information return reporting requirements do not specifically request information regarding use of Unrelated Business Income Tax (UBIT) blockers by an exempt organization. Accordingly, the IRS does not have a precise estimate of the number of exempt organizations using UBIT blockers. However, very preliminary data compiled from data reported on 2008 tax year Form 990 information return filings suggests that less than 5% of exempt organizations filing the return make foreign investments, including investments made through a foreign corporation commonly referred to as a UBIT blocker. This preliminary figure does not reflect a complete filing season for the 2008 tax year filings. Further, we do not yet know the extent of incomplete or inaccurate reporting of this information reported for the revised form's initial implementation year, so this figure may increase or decrease in future years as organizations become increasingly familiar with the new reporting.

**Questions from Senator Grassley and Senator Roberts**

1. Small Employer Insurance Credit

- We are aware that IRS has already mailed 4.4 million postcards to small businesses and issued 22 "Frequently Asked Questions" for the insurance tax credit available to small employers. While the information highlights that the credit increases in 2014, it does not appear that there is any mention of the cliff effect – the fact that the credit disappears after 2014. Please explain.

**Response:** The credit is available to employers after 2014, but for a maximum of two consecutive years. The IRS mailed postcards to small businesses to alert them that the tax credit is in effect this year. Our primary focus is on making sure that every eligible small business who qualifies can claim the credit. Over time, we will provide additional information to employers well in advance of any effective dates about the changes to the credit.

- Please provide the taxpayer burden estimates for this provision, including time and costs for recordkeeping, tax planning, form completion, form submission and all other activities.

**Response:** The IRS has not yet performed any burden estimates for this provision.

- What percentage of small employers does IRS expect will retain third party advisors to calculate and claim the credit?

**Response:** While the IRS does not have estimates specific to this provision, the IRS generally estimates that over 80% of small businesses use a paid tax return preparer.

2. Please describe in detail all other IRS outreach efforts to small businesses for other credits such as the Making Work Pay credit, HIRE Act payroll tax credit and other general business credits, including the research and development credit.

**Response:** The IRS embarked on an aggressive outreach campaign throughout this year to communicate various key tax provisions to small businesses and employers, including several ARRA related changes, including the Making Work Pay Credit, and net operating loss provisions. This outreach also included information about new tax law changes included in the HIRE Act, and the recently enacted Affordable Care Act including the small business tax health care credit. This effort included a variety of communication vehicles and work with outreach groups to get the information out to the affected groups, including numerous IRS news releases, fact sheets, public service announcements, videos, podcasts, outreach products, detailed and extensive web site pages and personal contacts made by IRS staff. The IRS made materials available in both English and Spanish. Additionally, the IRS made thousands of media contacts throughout the country which promoted these provisions. The IRS routinely provided key updates through outreach to the payroll community as well as numerous other outreach efforts to tax preparer groups, and hundreds of other small business partners throughout the country.

3. Employer Mandate

- Please explain why IRS decided not to explain the employer mandate penalty at this time.

**Response:** Section 1513 of the Affordable Care Act, the employer shared responsibility requirement, is effective beginning tax year 2014. The IRS is currently analyzing this provision in detail and developing implementation plans. We will provide detailed information and explanatory materials to employers well in advance of the effective date.

- Do employers currently keep the records needed to comply with this requirement?

**Response:** The employer shared responsibility requirement only applies to employers with more than 50 employees, and is not effective until 2014. The IRS has not yet completed its analysis of the provision, including recordkeeping requirements, but will attempt to align the requirements of this provision with existing requirements as much as possible to minimize the burden on businesses.

- Won't this requirement require employers to collect and retain information from employees about household income and other information that an employer doesn't have

access to? What privacy and safeguards protections will an employer have to comply with?

**Response:** The privacy of taxpayer information is of paramount importance to the IRS. The provision referenced in the question does not take effect until 2014, so it would be premature to speculate exactly how the provision will be implemented. However, it is clear that in designing the administrative processes to implement this provision, the IRS will ensure that all taxpayer information will be protected in accordance with IRC Section 6103.

#### 4. Individual Mandate & IRS Matching Programs

- Please explain the current IRS matching process for Forms W-2, 1099 and 1098, including the time between when a return is filed and matching occurs and the IRS process and procedure for resolving mismatches.

**Response:** The Automated Underreporter (AUR) Program uses data provided by a computer matching program to identify possible underreporting cases. The program compares information on a taxpayer's Form 1040 (income, deductions and credits) with documents reported by third party payers, such as Forms W-2, 1099, or 1098. The matching occurs after individual tax returns are filed.

If the program identifies a discrepancy from the matching process, a tax examiner performs an analysis. If the tax examiner's analysis is unable to resolve the discrepancy and more information from the taxpayer is needed, a notice is generated. IRS assistors work with the taxpayers over the phone or through correspondence before tax is assessed.

If the taxpayer provides an acceptable explanation for the discrepancy, the IRS closes the case with no change to the account. The IRS makes an assessment if the taxpayer agrees with all or part of the proposed change. If an agreement cannot be reached or the taxpayer does not respond to the notice, the IRS follows appropriate procedures and makes an assessment.

- In his remarks at the National Press Club, Commissioner Shulman stated that individuals would attach a 1099 like document from an insurance provider to their tax returns. What impact would this have on electronic filing?

**Response:** The use of the term "attach" was not intended to imply hard copy paper, but rather that the information would be included on the tax return. It is anticipated that most taxpayers would file electronically, just as they do today.

- It is not clear what such a 1099 like document would be matched against. Please explain. While IRS is prohibited from imposing liens, levies and criminal enforcement action to collect the individual mandate penalty, what is IRS's analysis of whether individuals who falsely claim they have insurance would be subject to perjury penalties?

**Response:** With regard to verifying health coverage information, the IRS will primarily rely on insurance company information reporting, where the information return will specify how many months of the year a plan covered the taxpayer with coverage that meets the standards determined by HHS. Individuals will be provided with a copy of the information return – just as with current W-2s and 1099s – and will use the information to complete the tax return. The individual will determine – and the IRS will confirm with insurance company reporting – whether the taxpayer has met the requirement or if an additional amount is due.

The Affordable Care Act states that criminal sanctions are not available for failure to pay amounts due under Section 5000A.

#### 5. State Information Sharing

- The Pension Protection Act of 2006 allowed IRS to share more information with state charity officials. However, they also became subject to privacy and safeguards requirements for the first time. We understand that some of these safeguards requirement may be so costly to implement for the states that many may have chosen to not participate in the additional information sharing. Please provide the number of states that are participating in information sharing regarding charities and provide the cost of compliance with safeguards requirements for those states.

**Response:** The IRS has approved eight agencies from seven different states to receive disclosures under § 6104(c). Three of these agencies are state charity officials and the remaining five agencies are state taxing agencies. We do not have data on each agency's compliance costs.

- Is it IRS's assessment that the new insurance exchanges will be subject to the safeguards requirements as well?

**Response:** Yes.

- Does IRS currently request and track household income information for any other tax provisions?

**Response:** For many households, the income levels shown on the return for the parents or other head of household reflect all of the income sources that will be used to determine household income as defined in the Affordable Care Act. There will be a number of situations – such as when a dependent child has a separate income tax filing requirement – where the tracking of household income will be new.

**Questions from Senator Hatch**

1. Mr. Miller, what problems do you expect will arise in 2013 and 2014 when the IRS will have to start enforcing the mandate requiring that every individual purchase health care insurance?

**Response:** The IRS is consistently asked to react effectively and quickly to evolving situations like the economic downturn and make a meaningful difference in taxpayers' lives. History shows we have been very successful. Legislation that significantly affects the IRS workload and affects a broad population of taxpayers requires rigorous planning, thorough testing, and significant collaboration both internally and externally. Implementation of these provisions will also require proactive and consistent communication with taxpayers affected. More specific examples include the need for proactive communication on how the individual responsibility requirement will impact the tax return filing process, and on how household income will be computed for the purposes of qualifying for the premium tax credit. These are challenges that the IRS is actively working to address in advance of the effective dates of these provisions.

2. How will the IRS determine whether or not individuals have obtained health insurance?

**Response:** The IRS will primarily rely on insurance company information reporting, where the information return will specify how many months of the year a plan covered the taxpayer with coverage that meets the standards determined by HHS. Individuals will be provided with a copy of the information return – just as with current W-2s and 1099s – and will use the information to complete the tax return. The individual will determine – and the IRS will confirm with insurance company reporting – whether the taxpayer has met the requirement or if an additional amount is due.

3. It is my understanding that a fee will be collected by the IRS if the individual does not have health insurance.

- What remedies are available to the IRS to collect such a fee? For instance, can the IRS impose a lien, garnish wages, or collect interest if the fee is not paid on time?

**Response:** The law precludes the IRS from taking certain collection enforcement actions such as liens and levies. The law also removes criminal sanctions for failure to pay amounts due under this provision. Current law allows the IRS to offset tax refunds to pay debt owed to the federal government. This new law does not change that authority.

- Can the IRS put someone in jail for not paying their taxes?

**Response:** Criminal sanctions are not applicable for failures to pay the Section 5000A penalty. More broadly, the standard for criminal sanctions is high, and requires willful behavior, intent to defraud the government, or other similar acts. Criminal sanctions are only used for very serious offenses.

4. Will the IRS take into consideration whether an individual has paid this fee when either negotiating a compromise with a delinquent taxpayer?



**Response:** The IRS will need to develop guidelines and procedures integrating this provision before the 2015 tax filing season (the provision is in effect in 2014, but individuals will not file the associated tax returns until 2015). We have not yet analyzed this specific situation.

**WRITTEN STATEMENT OF**

**NINA E. OLSON**

**NATIONAL TAXPAYER ADVOCATE**

**HEARING ON**

**TAX FILING SEASON UPDATE:**

**CURRENT IRS ISSUES**

**BEFORE THE**

**COMMITTEE ON FINANCE**

**UNITED STATES SENATE**

**APRIL 15, 2010**

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Chairman Baucus, Ranking Member Grassley, and distinguished Members of the Committee:

Thank you for inviting me to testify today about the 2010 filing season and some of the most serious problems taxpayers face in their dealings with the IRS.<sup>1</sup> To the extent relevant, I will also suggest approaches to mitigate these problems.

Before I discuss taxpayer problems, I'd like to begin by praising the IRS for undertaking what I consider a significant achievement – the initiative to improve standards in and oversight of the return preparation industry. I began calling for preparer regulation in 2002 because I saw first-hand before I joined the government how incompetent or unscrupulous preparers harmed taxpayers who trusted them and how their actions undermined tax compliance. Since that time, there has been considerable congressional support for preparer regulation. Senator Bingaman has sponsored legislation to regulate return preparers, and this Committee has twice approved the proposal without a dissenting vote.<sup>2</sup>

Commissioner Shulman announced the initiative last June, and in January 2010, the IRS issued a report setting out a blueprint of its plan.<sup>3</sup> The IRS is now working diligently to implement the plan. The IRS and the Treasury Department recently issued proposed regulations that will require all persons who are compensated for preparing, or assisting in the preparation of, all or substantially all of a tax return to obtain a unique preparer tax identification number (PTIN) in order to file tax returns, beginning next year.<sup>4</sup> Several additional regulations packages will be issued in the coming months. Although the devil is in the details and there are still some important issues that need to be resolved, I believe the IRS is headed in the right direction. I further believe this initiative, when fully implemented, will improve tax administration significantly by helping taxpayers locate qualified preparers, establishing clear requirements of competence and ethics for preparers, and disciplining and even shutting down unqualified and unethical preparers. Later in my testimony, I will provide additional detail and identify potential legislative changes to supplement the initiative.

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

<sup>2</sup> See H.R. 1528 (incorporating S. 882) (108<sup>th</sup> Cong.); S. 1321 (incorporating S. 832) (109<sup>th</sup> Cong.).

<sup>3</sup> See IRS Publication 4832, *Return Preparer Review* (Dec. 2009).

<sup>4</sup> Prop. Treas. Reg. § 1.6109-2, 75 Fed. Reg. 14539 (Mar. 26, 2010).

## I. Filing Season Issues

Overall, I believe the IRS has done a good job during the last two years as it simultaneously has delivered on its core mission of providing taxpayer services and collecting taxes while administering a number of economic stimulus programs, including the issuance of economic stimulus payments in 2008 and the processing of claims for the first-time homebuyer credit in 2009.<sup>5</sup>

Not surprisingly, however, this combination of challenges – performing its core work, administering social programs and economic stimulus provisions, and collecting taxes against the backdrop of the highest unemployment rate in nearly three decades<sup>6</sup> – has stretched the IRS too thin in certain areas.

In my testimony today, I will provide a taxpayer perspective regarding areas where I believe the tax administration process can be improved.

### A. IRS Toll-Free Telephone Service Is Inadequate to Meet Taxpayer Needs.

Each year, tens of millions of taxpayers call the IRS seeking help with a wide variety of issues, including account questions and tax-filing questions. There is no single “correct” method for measuring the IRS’s effectiveness in answering taxpayer calls, but the most common measure is the Customer Account Services Customer Service Representative Level of Service, or “LOS,” which generally measures the percentage of calls that get through to a representative among all callers seeking to do so. By this measure, the IRS answered 87 percent of its calls in FY 2004. Since that time, the LOS has been declining, plummeting to a low of 53 percent in FY 2008. In other words, IRS telephone assistors in FY 2008 were unable to answer nearly half of all calls received.

In FY 2009, the LOS rebounded somewhat to about 70 percent, and the IRS’s target for the current fiscal year is 71 percent. The IRS’s LOS for FY 2010 so far stands at 73 percent.<sup>7</sup>

While answering 72 percent of calls is a vast improvement over 53 percent, it still means the IRS is effectively failing to answer nearly three out of every ten calls it receives from taxpayers seeking assistance. Equally disturbing, the IRS projects that

<sup>5</sup> Economic Stimulus Act of 2008, Pub. L. No. 110-185, § 101, 122 Stat. 613 (2008); Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, § 3011, 122 Stat. 2654; American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, § 1006 in Division B, 123 Stat. 115.

<sup>6</sup> See Bureau of Labor Statistics, *Labor Force Statistics for the Current Population Survey* (showing the civilian unemployment rate at or over 10 percent for October, November, and December of 2009 for the first time since 1983).

<sup>7</sup> IRS Joint Operations Center (JOC), Enterprise Telephone Data, *Snapshot Reports* (Apr. 13, 2010) (statistic based on data collected through the week of Apr. 10, 2010).

among calls that do get answered, the average wait time for FY 2010 will be more than 11 minutes, up from about four-and-a-half minutes in FY 2007. For filing season 2010 to date (through April 3, 2010), the average wait time has been almost ten minutes.<sup>8</sup> This state of affairs led me to designate the level of service on the IRS toll-free lines as the number one most serious problem for taxpayers in my 2009 Annual Report to Congress.<sup>9</sup>

Although hard to quantify, the impact of the IRS's inability to answer taxpayer calls is significant and has considerable downstream consequences:

- When taxpayers call the toll-free line with tax law questions and cannot get through, some will just give up and not bother to file their tax returns. Others will file inaccurate returns that require IRS follow-up action and taxpayer response.
- When taxpayers call the IRS after receiving notices proposing additional tax and they cannot get through, some will not respond to the notices, requiring the IRS to take further steps and potentially exposing the taxpayers to enforced collection action. Others will write letters to the IRS, requiring IRS employees in the Accounts Management (AM) function to respond.

In fact, many AM employees shuttle back and forth between handling paper correspondence (including the processing of amended returns) and answering telephone calls. When IRS employees dedicated exclusively to answering taxpayer calls cannot handle the call volumes, AM employees are shifted from handling paper correspondence to help out. Not surprisingly, as call volumes have increased and AM employees have been moved to answer phone calls, paper correspondence inventories have increased as well. The paper correspondence inventory rose from approximately 480,000 at the end of FY 2007 to almost 776,000 at the end of FY 2009 – a 62 percent increase.<sup>10</sup> At the same time, the amount of overage correspondence has varied considerably from a weekly low of 54,000 to a weekly high of more than 1.1 million.

To some degree, the combination of poor telephone service and slow correspondence processing creates a vicious cycle: Taxpayers who cannot get through to the IRS by phone send letters, causing more work for employees assigned to paper correspondence and leading to correspondence backlogs and delays in processing amended returns, while taxpayers who write to the IRS and do not receive timely responses call the IRS to try to figure out what happened.

<sup>8</sup> IRS JOC, Enterprise Telephone Data, *Snapshot Reports* (Apr. 13, 2010) (statistic based on data collected through the week of Apr. 3, 2010).

<sup>9</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 4-16 (Most Serious Problem: *IRS Toll-Free Telephone Service Is Declining as Taxpayer Demand for Telephone Service Is Increasing*).

<sup>10</sup> IRS, *Joint Operations Center Accounts Management Paper Inventory Adjustments Reports FY05, FY07, FY09* (Oct. 30, 2009).

As noted above, the sharp decline in the IRS's ability to handle call demand and timely process taxpayer correspondence is due primarily to the impact of the Economic Stimulus Act of 2008 and other statutory changes that have increased the IRS's work or generated taxpayer questions. The following chart shows the level of call volumes and the IRS's success in answering calls since 2005.

#### IRS CUSTOMER ACCOUNT SERVICES (CAS) TOLL-FREE PHONE DATA<sup>11</sup>

Fiscal Year	CAS Net Attempts (in millions)	CAS Assistor Answered Calls (in millions)	Customer Service Representative Level of Service	Average Speed of Answer (in seconds)	Average Speed of Answer (in minutes)
2005	64.5	33.4	82.6%	258	4.3
2006	64.2	33.2	82.0%	242	4.0
2007	67.4	33.8	81.3%	268	4.5
2008	150.6	40.4	52.8%	626	10.4
2009	93.7	39.0	70.0%	526	8.8

As this chart shows, call volumes ran at a fairly steady level of about 64 million to 67 million in the three years before the Economic Stimulus Act was passed in February 2008. During the balance of 2008 and into 2009, the IRS was flooded with stimulus-related calls, receiving an all-time high of over 150 million calls in FY 2008. Note that the IRS actually answered 20 percent more calls in FY 2008 than it had answered in FY 2007 (40.4 million vs. 33.8 million), yet the LOS declined from 81 percent to 53 percent because the overall call volume increased by 123 percent (from 67.4 million to 150.6 million).

For these reasons, the decline in the IRS's level of service is understandable from the standpoint of resources. However, it is not an acceptable state of affairs from the standpoint of the tens of millions of taxpayers seeking help. In his book, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America*, former Commissioner Charles Rossotti addressed the importance of maintaining a high level of service on the IRS's toll-free lines:

Apart from the justifiable outrage it causes among honest taxpayers, I have never understood why anyone would think it is good business to fail to answer a phone call from someone who owed you money.<sup>12</sup>

<sup>11</sup> IRS, JOC Enterprise Telephone Data, *Snapshot & Half Hourly Adherence Reports* (Oct. 30, 2009). Some calls are handled via automation and do not require the assistance of a customer service representative. Automated calls are not shown in this chart.

<sup>12</sup> Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 285 (2005).



Let me be clear that I am not being critical of the IRS's handling of the increased telephone volume – it generally is applying its current resources appropriately and is seeking new ways to use those resources more productively. However, to meet taxpayer needs, to improve the ability of taxpayers to comply with tax law requirements and respond to IRS notices, and to reduce the aggregate burden on the IRS when taxpayers who can't get through by phone contact the IRS through multiple channels with the same question, I believe the IRS must be able to answer at least 85 percent of taxpayer calls and keep taxpayers on hold for no longer than an average of five minutes.

### **Recommendations**

- I encourage the Committee on Finance to support sufficient additional funding for the IRS toll-free lines so that the IRS will have the resources to achieve an LOS of 85 percent and an average wait time of five minutes.
- I recommend that the IRS study its call and verification requirements to try to identify opportunities to reduce the length of calls without shortchanging taxpayers. During a recent meeting of an IRS advisory committee, for example, a practitioner reported that when he calls the IRS, more than half of the call is typically spent on authenticating his identity and the identity of the taxpayer he represents and less than half is spent discussing his question. While this observation reflects just one practitioner's experience and the IRS must not compromise the effectiveness of its authentication procedures, the IRS should assess its authentication steps to determine whether the time spent on authentication can be reduced without compromising security. For example, the IRS could verify additional information via automation by asking taxpayers (or their representatives) to key in certain data before an assistor gets on the line, as many businesses ask their customers to do now. If the IRS can shave off five percent to ten percent of average call time through better screening, the resulting efficiency gain would be significant.

### **B. The First-Time Homebuyer Credit (FTHBC) Presents Challenges for the IRS and Taxpayers Alike.**

#### **1. The Statutory Complexity of the FTHBC Creates Opportunities for Taxpayer Errors.**

The First-Time Homebuyer Credit (FTHBC) presents perhaps the most significant challenge for the IRS and certain taxpayers this filing season.<sup>13</sup> The FTHBC was

<sup>13</sup> To stimulate the housing market, Congress has enacted three laws over the last two years allowing qualified first-time homebuyers to claim refundable credits on their tax returns. The laws, in order of enactment, are the Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, 122 Stat. 2654; the American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, 123 Stat. 115;

designed largely to bolster the residential real estate market during the recession and continuing economic downturn.<sup>14</sup> To claim the FTHBC, however, taxpayers must navigate a complex set of rules. The statutory and procedural complexity of the FTHBC is illustrated by the following table, which outlines the differing eligibility rules and other provisions among the enacted versions:<sup>15</sup>

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and the Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA), Pub. L. No. 111-92, 123 Stat. 2984.

<sup>14</sup> Associated Press, *Northeast Home Sales Post 13 Pct. Annual Increase*, The New York Times, available at <http://www.nytimes.com/aponline/2010/03/23/business/AP-US-Home-Sales-Northeastern-Cities.html> (Mar. 23, 2010) (last visited Apr. 7, 2010).

<sup>15</sup> Table excerpted from IRS Job Aid (Mar. 31, 2010).

	<b>Housing Economic Recovery Act of 2008</b>	<b>American Recovery Reinvestment Act</b>	<b>Worker, Homeownership and Business Assistance Act</b>
<b>Credit Amount</b>	Lesser of: <ul style="list-style-type: none"> <li>• \$7,500 (\$3,750 for MFS), or</li> <li>• 10% of purchase price</li> </ul>	Lesser of: <ul style="list-style-type: none"> <li>• \$8,000 (\$4,000 for MFS), or</li> <li>• 10% of purchase price</li> </ul>	<ul style="list-style-type: none"> <li>• First-time homebuyers – lesser of: <ul style="list-style-type: none"> <li>• \$8,000 (\$4,000 for MFS), or</li> <li>• 10% of purchase price</li> </ul> </li> <li>• Long-time resident – lesser of: <ul style="list-style-type: none"> <li>• \$6,500 (\$3,250 for MFS), or 10% of purchase price</li> </ul> </li> </ul>
<b>Eligible Time Period</b>	Home purchased between 04/09/08 – 12/31/08	Home purchased between 01/01/09 – 11/06/09	Home purchased between 11/07/09 - 04/30/2010
<b>Basic Eligibility Requirements</b>	<ul style="list-style-type: none"> <li>• First-time homebuyer</li> <li>• Purchasing principal residence</li> <li>• Cannot be acquired from a spouse or related person</li> <li>• Located in the U.S.</li> </ul>	<ul style="list-style-type: none"> <li>• First-time homebuyer</li> <li>• Purchasing principal residence</li> <li>• Cannot be acquired from a spouse or related person</li> <li>• Located in the U.S.</li> </ul>	<ul style="list-style-type: none"> <li>• First-time homebuyer or long-time resident homebuyer</li> <li>• At least 18 years of age on the date of purchase</li> <li>• Purchasing principal residence</li> <li>• Cannot be acquired from a spouse or related person</li> <li>• Located in the U.S.</li> </ul>
<b>Who is a First-Time Homebuyer or Long-Term Resident</b>	Must not have owned a principal residence during the previous 3 years, ending on the date of purchase.	Must not have owned a principal residence during the previous 3 years, ending on the date of purchase.	<ul style="list-style-type: none"> <li>• First-time homebuyer – Must not have owned a principal residence during the previous 3 years, ending on the date of purchase.</li> <li>• Long-time resident – Must have owned and used the same home as a primary residence for at least 5 consecutive years of the 8-year period ending on the date of purchase.</li> </ul>
<b>Phase Out of Credit</b>	Credit phases out between: <ul style="list-style-type: none"> <li>• \$75,000 - \$95,000</li> <li>• \$150,000 - \$170,000 (MFJ)</li> </ul>	Credit phases out between: <ul style="list-style-type: none"> <li>• \$75,000 - \$95,000</li> <li>• \$150,000 - \$170,000 (MFJ)</li> </ul>	Credit phases out between: <ul style="list-style-type: none"> <li>• \$125,000 - \$145,000</li> <li>• \$225,000 - \$245,000 (MFJ)</li> </ul>
<b>Repayment of Credit</b>	Credit must be paid back over 15 years beginning in the 2 <sup>nd</sup> year after the year in which the residence is purchased.	None required as long as home remains principal residence for 36 months after purchase date.	None required as long as home remains principal residence for 36 months after purchase date.
<b>When to Claim Credit</b>	For purchases in 2008, credit can be claimed on 2008 return.	For purchases in 2009, credit can be claimed on 2009 return or on an amended 2008 return.	For purchases in 2009, credit can be claimed on 2009 return or on an amended 2008 return. For purchases in 2010, credit can be claimed on 2009 or 2010 return.

As the above table shows, taxpayers must make numerous determinations to ascertain for which credit and what amount they are eligible. Each of these requirements creates a risk that the taxpayer will make an error.<sup>16</sup>

Even the eligibility dates are complex. For example, a taxpayer could satisfy the contract date deadline yet, for reasons outside his or her control, not meet the closing date deadline, and thus become ineligible to receive the FTHBC. I predict that the two different repayment requirements – 15 years and none – will lead to considerable frustration from affected taxpayers about the perceived arbitrariness and inconsistency of this provision, beginning in the 2011 filing season when taxpayers who received the credit under the 2008 legislation must begin paying it back. Taxpayers may direct their frustration at the IRS, even though the IRS is simply administering the law's complex requirements as enacted.

At the same time that honest taxpayers find themselves making inadvertent errors, the large dollar amount of the credit has proven an attractive target for persons seeking to perpetrate fraud on the tax system. Not surprisingly, the significant size of the FTHBC has resulted in a significant number of fraudulent claims. As of February 2010, the IRS reported that it was investigating 185 criminal schemes involving the FTHBC.<sup>17</sup>

## **2. FTHBC Procedures and Filing Requirements Cause Taxpayer Confusion and Lengthy Processing Delays.**

Taxpayers may claim the FTHBC on original or amended 2008, 2009, or 2010 returns by attaching Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit*, to the return on which the credit is claimed.<sup>18</sup> However, the specific requirements of each revision of the FTHBC involve enhanced documentation that prevents taxpayers from electronically filing their tax returns, causing administrative problems for the IRS.<sup>19</sup>

<sup>16</sup> There are three different maximum credit amounts, two different eligibility phase-outs based on adjusted gross income, two different eligible statuses (*first-time homebuyer and long-time resident*) with special rules for military personnel, and three different effective dates with separate eligibility dates for entering into a contract and for completing the sale. There are also age limits, home purchase price limits, and related-party rules.

<sup>17</sup> IRS, *FTHBC Enforcement Report FY 2009-2010* (Mar. 5, 2010).

<sup>18</sup> The year in which the FTHBC is claimed is dependent, in part, on the home purchase date. Taxpayers can elect to treat a residence purchased after December 31, 2008, and before December 1, 2009, as purchased on December 31, 2008, so that the FTHBC may be claimed on a 2008 amended return. IRC § 36(g). The FTHBC may also be claimed on 2009 or 2010 original or amended returns, but the credit may not be claimed before the closing date. IRS, *First-Time Homebuyer Credit*, <http://www.irs.gov/newsroom/article/0,,id=204671,00.html> (last visited Apr. 5, 2010).

<sup>19</sup> A properly executed settlement statement must be attached to Form 5405 for tax year 2009 and subsequent tax returns or 2009 amended returns. The IRS will treat such claims received without the properly executed settlement statement as "no consider." IRM 21.6.3.4.2.11.6 (Mar. 5, 2010). Letter 916C is used for "no consideration" or rejected claims, and must advise the taxpayer why the claim is not being considered. IRM 21.5.3.4.6.3 (July 18, 2007). Proper documentation is:

Paper return processing costs the IRS \$2.52 more per return than e-file return processing.<sup>20</sup> In addition, because paper processing of original returns takes six to eight weeks in a “normal” filing season<sup>21</sup> and the IRS has advised its employees to inform taxpayers to allow an additional two to three weeks for FTHBC refunds,<sup>22</sup> some taxpayers are e-filing original Forms 1040 without their FTHBC claims in order to get their non-FTHBC refunds quickly and are later filing paper amended returns (Form 1040X) to claim the FTHBC.<sup>23</sup> While this approach makes sense from the taxpayer’s perspective, it generates more work and additional costs for the IRS.

Taxpayers experience additional delays if their FTHBC claims are subject to further review. This requires the IRS to perform additional follow-up work, requesting the missing documentation in order to determine eligibility, thus adding time to an already lengthy process. It is taking the IRS, on average, 122 days to close an examination of

- 
- A copy of the settlement statement (typically a properly executed Form HUD-1, Settlement Statement).
  - For mobile home purchases, a copy of the properly executed retail sales contract.
  - For newly built homes, a copy of the certificate of occupancy showing the owner’s name, property address and the date of the certificate.

For a long-term resident to qualify for the FTHBC, he or she must show that he or she lived in the old home for a five-consecutive-year period during the eight-year period ending on the purchase date of the new home. IRC § 36(c)(6). Although WHBAA does not require long-time residents to submit documentation (other than the statutorily mandated settlement statement), the IRS is encouraging taxpayers to avoid refund delays by attaching documentation covering the five-consecutive-year period such as:

- Copies of Form 1098, Mortgage Interest Statements;
- Property tax records; or
- Homeowner’s insurance records.

IR-2010-6, *New Homebuyer Credit Form Released; Taxpayers Reminded to Attach Settlement Statement and Other Key Documents* (Jan. 15, 2010).

<sup>20</sup> IRS, *Summary for Weighted Averages of the Paper Form 1040, 1040A, 1040 EZ and e-File Form 1040, 1040A & 1040 EZ for Submission Processing Costs and Labor Costs* (FY 2005); IRM 3.30.10 (Dec. 1, 2007).

<sup>21</sup> IRM 21.4.1.3 (Apr. 6, 2009).

<sup>22</sup> IRS, *Service-wide Electronic Research Program (SERP) Alert 100024, Refund Inquiries for 2009 Returns Claiming First Time Homebuyer Credit/Form 5405* (Jan. 12, 2010).

<sup>23</sup> The IRS is “splitting” the refund on any return that includes a FTHBC that is selected for additional review. That is, the IRS will issue payment for the portion of the refund that is attributable to withholding or overpayment of estimated taxes, but it will “freeze” the portion of the refund attributable to the FTHBC until after the review is complete. IRS, *Talking Points: First-Time Homebuyer Credit* (Jan. 25, 2010). From the perspective of a taxpayer who needs funds as soon as possible, however, this approach is problematic because a paper return must be filed to claim the FTHBC, with the attendant slower processing times. An e-filed return claiming a refund attributable only to withholding may be processed in less than three weeks, as compared to a projected six to eight weeks for paper returns. IRM 21.4.1.3 (Apr. 6, 2009).

a return selected solely for FTHBC issues.<sup>24</sup> Moreover, the IRS estimates that it is taking an average of about 150 days to process an amended return from submission to the IRS until closing.<sup>25</sup> This means that many taxpayers have to wait up to five months (or more) to receive the FTHBC.

### **3. Administering the FTHBC May Require the IRS to Divert Resources from its Core Work.**

If a tax return as filed meets certain criteria, it is referred to the Examination function for a determination whether to select the claim for audit, accept the claim as filed, or disallow the claim on other grounds. Since the enactment of the FTHBC:

- As of February 27, 2010, taxpayers had filed more than 1.8 million original and amended returns that include FTHBC claims.
- Of those returns, more than 260,000 had been selected for examination through March 26, 2010.
- Of the FTHBC returns selected for examination, nearly 109,000 of these audits remain open.<sup>26</sup>

To place the issue in context, the IRS through March 2010 closed over 650,000 correspondence examinations in FY 2010.<sup>27</sup> Of these closed exams, 139,298 involved the FTHBC.<sup>28</sup> FTHBC exams thus account for almost 21 percent of the IRS's total correspondence audits so far in FY 2010, and these data do not include open FTHBC exams and FTHBC returns filed since February. The number of FTHBC claims that the IRS will select for examination during the remaining six months of FY 2010 (April–September) is unknown at this point, but it is likely that FTHBC examinations will displace a significant additional number of regular discretionary audits before the year is through.<sup>29</sup>

<sup>24</sup> Automated Information Management System (AIMS) Closed Case Database on the IRS Compliance Data Warehouse (including returns closed by the Examination function from January 2010 through February 2010). The data includes pre-refund returns selected for examination due solely to the FTHBC.

<sup>25</sup> IRS, *Talking Points: First-Time Homebuyer Credit* (Jan. 25, 2010).

<sup>26</sup> IRS, *FTHBC Production Report* (Apr. 6, 2010); *FTHBC Amended Return Monthly Report* (Mar. 2010); *FTHBC Compliance Activities Report* (Mar. 2010); *FTHBC Inventory Report* (Mar. 2010).

<sup>27</sup> Automated Information Management System (AIMS) Closed Case Database on the IRS Compliance Data Warehouse. Statistics are through March 2010 and include both open and closed examinations.

<sup>28</sup> FTHBC Compliance Activities Report (Mar. 2010). Statistics are through March 2010 and include both open and closed examinations.

<sup>29</sup> Regular discretionary exam work involves non-EITC and Questionable Refund Program (QRP) cases. IRS, W&I (Wage and Investment Division) Insider, *W&I Compliance Examination Program Responsibilities*. Examples of other discretionary work include innocent spouse, non-filers, alimony, charitable contributions, employee business expenses, and alternative minimum tax issues.

**4. IRS Reliance on Third-Party Data for Some FTHBC Math Error and Repayment Determinations May Lead to Incorrect Determinations That Negatively Impact Taxpayers.**

Internal Revenue Code section 6213(b) authorizes the Secretary to summarily assess a math or clerical error on a return without applying normal deficiency procedures.<sup>30</sup> Under recently enacted math error procedures, the IRS can summarily assess tax (or adjust the credit) when an FTHBC claim shows:<sup>31</sup>

- A failure to use Form 5405 and attach required documentation,<sup>32</sup>
- An omission of any increase in tax required by the recapture provisions when the taxpayer submits Form 5405 as required,<sup>33</sup>
- The taxpayer does not meet the age requirement,<sup>34</sup> or
- An income tax return for at least one of the two preceding taxable years is inconsistent with eligibility for FTHBC.<sup>35</sup>

The math error authority under IRC § 6213(g)(2)(P)(ii) – applying where “at least one of the 2 preceding taxable years is inconsistent with eligibility” – is very broad and can be problematic for the IRS and taxpayers alike. As a general matter, Congress has provided taxpayers with a meaningful opportunity to challenge IRS determinations with which they disagree, most notably through deficiency procedures. As a narrow

<sup>30</sup> Math or clerical error authority does not afford the taxpayer the opportunity to petition the tax adjustment to the United States Tax Court unless the taxpayer responds to the math error notice within 60 days and objects to the assessment within that time. If the taxpayer timely objects to the math or clerical error assessment, the IRS must reverse the assessment and use the normal deficiency procedures under IRC § 6213. IRC § 6213(b)(2)(A). For an in-depth discussion of math and clerical error procedures, see National Taxpayer Advocate 2006 Annual Report to Congress 311-332 (Most Serious Problem: *IRS Implementation of Math Error Authority Impairs Taxpayer Rights*); National Taxpayer Advocate 2003 Annual Report to Congress 113-121 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 25-31 (Most Serious Problem: *Math Error Authority*); National Taxpayer Advocate 2002 Annual Report to Congress 185-197 (Key Legislative Recommendation: *Math Error Authority*).

<sup>31</sup> This is in addition to general math error authority under IRC § 6213(b), which the IRS is using for FTHBC claims with:

- A future purchase date on Form 5405;
- A disposition of home on Form 5405, but no amount reported on Form 1040; or
- An FTHBC claim that exceeds the maximum allowed for a married-filing-separately taxpayer.

<sup>32</sup> IRC § 6213(g)(2)(P)(iii).

<sup>33</sup> IRC § 6213(g)(2)(O). This recapture begins in Tax Year 2010. Math error authority will not apply where there is an omission of any increase in tax required by the recapture provisions and the taxpayer does not submit Form 5405 as required. Deficiency procedures are required in this instance.

<sup>34</sup> IRC § 6213(g)(2)(P)(i).

<sup>35</sup> *Id.*

exception to deficiency procedures, Congress authorized the IRS to use streamlined procedures in cases where it appears clear that an underpayment of tax was due to a math or clerical error. For purposes of verifying eligibility for the FTHBC, however, the IRS uses internal and external data to determine whether there was prior qualifying home ownership, and there is no guarantee that the information is accurate or current. The use of math error authority in this instance may deprive taxpayers of a full and fair opportunity to challenge erroneous determinations.

This year, the IRS must begin administering the recapture of the FTHBC for certain taxpayers.<sup>36</sup> The IRS is planning to use third-party electronic data (Accurint) to determine whether recapture is necessary. If a taxpayer is determined to be subject to recapture, the IRS is planning to use a "soft notice" strategy under which it will reach out with an annual reminder to taxpayers of their amount of the repayment for the year. I support the notice approach the IRS is taking. However, if a taxpayer is inaccurately identified by the third-party system as needing to repay the FTHBC, the taxpayer will likely have to go through some sort of examination process to prove that he or she is not subject to the recapture. This has the potential to be burdensome for taxpayers and costly and time-consuming for the IRS.

#### **Recommendation**

- I recommend that the IRS monitor and evaluate its use of outside information for math error and credit repayment determinations to minimize incorrect determinations that will negatively impact taxpayers.

#### **C. The IRS Is Experiencing a High Rejection Rate of Returns Claiming the Making Work Pay (MWP) Credit Due to Improper Reporting of Economic Recovery Payments (ERPs).**

The American Recovery and Reinvestment Act of 2009 (ARRA)<sup>37</sup> provides for the Making Work Pay (MWP) tax credit, a refundable tax credit up to \$400 for working

<sup>36</sup> Taxpayers are required to repay the FTHBC received for 2008 purchases under HERA in 15 equal installments each year with the filing of their income tax return, beginning with the 2011 filing season. If the home is sold, however, all remaining annual installments become due in the year of sale. The repayment is limited to the amount of gain on the sale if the home is sold to an unrelated person. IR-2008-106, *Tax Credit to Aid First-Time Homebuyers; Must Be Repaid Over 15 Years* (Sept. 16, 2008). The obligation to repay the credit for home purchases in 2009 and subsequent years arises only if the home ceases to be the principal residence within 36 months from the date of purchase. The full amount of the credit received becomes due on the return for the year in which the home ceased to be the taxpayer's principal residence. See IRS, *First Time Homebuyer Credit Questions and Answers: Homes Purchased in 2009 or 2010* at <http://www.irs.gov/newsroom/article/0,,id=206293,00.html> (last visited Apr. 13, 2010).

<sup>37</sup> Pub. L. No. 111-5, Division B, 123 Stat. 115 (2009).



individuals and up to \$800 for working married taxpayers filing joint returns.<sup>38</sup> For taxpayers who receive a paycheck and are subject to withholding, the credit is typically provided through their employers as a result of mandated withholding changes that result in an increase in take-home pay. Thus, wage earners receive an advance credit through reduced payroll withholdings. The amount of the credit to which a taxpayer is entitled is ultimately computed on the taxpayer's 2009 income tax return filed in 2010 on Schedule M, *Making Work Pay and Government Retiree Benefits*. ARRA also provides for a one-time Economic Recovery Payment (ERP) of \$250 to certain individuals (potentially \$500 for married couples) who were eligible to receive Social Security, Supplemental Security Income (SSI), Railroad Retirement, and Veterans' Compensation and Pension benefits between November 2008 and January 2009.<sup>39</sup> The agencies that administer these benefit programs are the Social Security Administration, the Railroad Retirement Board, and the Department of Veterans Affairs, respectively.

When a taxpayer claims the MWP on a 2009 income tax return, Schedule M requires him or her to subtract from the amount of the MWP credit the amount of the ERP received by the taxpayer(s) in 2009. As of February 27, the IRS paid out almost \$17 billion in MWP credit funds to approximately 35.1 million taxpayers.<sup>40</sup>

**1. Schedule M Returns Are Experiencing a High E-File Reject Rate and Unnecessary Delays in Processing and Refund Delivery.**

So far this year, almost 1.9 million individual income tax returns filed electronically with a Schedule M have been rejected, and of those, more than 1.8 million were rejected because the amount of the ERP reported on Schedule M did not match IRS records.<sup>41</sup> Eventually, almost 90 percent of these returns are accepted, but at a cost to both taxpayers and the IRS.<sup>42</sup> Rejected tax returns delay refunds, increase call volumes, confuse taxpayers, and create more work for the IRS, taxpayers, and practitioners. Moreover, because about 60 percent of individual taxpayers use paid return preparers, the need to continually resubmit returns may increase return preparation fees.

Once the returns are accepted, whether filed by paper or electronically, the returns can still fall out of the processing pipeline into the Error Resolution System (ERS). As of

<sup>38</sup> This tax credit is calculated at a rate of 6.2 percent of earned income and phases out for taxpayers with modified adjusted gross income (MAGI) in excess of \$75,000, or \$150,000 for married couples filing jointly. IRC § 36A.

<sup>39</sup> The Social Security Administration, the Railroad Retirement Board, and the Department of Veterans Affairs identified nearly 55 million individuals eligible to receive \$250. W&I Response to TAS Information Request (Apr. 7, 2010).

<sup>40</sup> Individual Masterfile on IRS Compliance Data Warehouse (as of Feb. 27, 2010).

<sup>41</sup> W&I Response to TAS Information Request (Apr. 6, 2010). In some instances, taxpayers tried more than once to file the return and schedule, bringing the number of rejected occurrences to almost 2.4 million.

<sup>42</sup> W&I Response to TAS Information Request (Apr. 6, 2010).

April 2, 2010, nearly 2.7 million paper returns and almost 1.4 million e-filed returns had fallen out to ERS due to issues related to the MWP credit (but not necessarily related to an ERP mismatch).<sup>43</sup> To keep these numbers in perspective, as of April 1, 2010, the IRS had received nearly 62 million e-filed returns with Schedule Ms.<sup>44</sup>

The IRS has done a good job processing the vast majority of MWP claims, but for the over 4.1 million taxpayers whose returns are delayed in processing because of an avoidable error, the IRS's overall efficiency is small comfort.<sup>45</sup> The large majority of the returns that end up in ERS for Schedule M errors are expected to be refund returns. Of the Schedule M returns that were processed after going through ERS as of February 27, 2010, 96 percent had refunds issued.<sup>46</sup>

The failure of the agencies that administered the ERP-eligible benefit programs to adequately remind taxpayers about the amount of the ERPs they received and the need to report the payments, together with the IRS's inability to verify the amounts of the payments, is driving much of the error rate. While the IRS has identified 14 reasons why it rejects an e-filed Schedule M, the majority of taxpayers simply do not recall receiving an ERP in 2009.<sup>47</sup> In addition, practitioners complain that there is no easy way to verify whether the taxpayer received the ERP.

The Taxpayer Advocate Service's initial analysis of the issue indicates that part of the problem is lack of communication by the federal agencies administering the ERP. These agencies failed to provide adequate information about how to report the ERP and claim the MWP tax credit. We do not expect all 55 million persons who received an ERP to file returns, as some taxpayers may have no filing requirement or may not be eligible for the credit. Although the agencies advised the beneficiaries in May 2009 that they may be eligible to receive \$250 and when to expect it, they missed an opportunity to include information about the payment when sending out year-end tax information statements such as Forms SSA-1099 and RRB-1099.

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<sup>43</sup> W&I Response to TAS Information Request (Apr. 6, 2010).

<sup>44</sup> IRS, E-File Reports, Forms and Schedules, Week Ending April 1, 2010. These numbers do not include the number of e-filed 1040 EZ returns. Note that the difference between the number of returns e-filed with a Schedule M and the number of returns accepted with a Schedule M is not necessarily attributable to problems related to Schedule M issues.

<sup>45</sup> W&I Response to TAS Information Request (Apr. 6, 2010).

<sup>46</sup> Individual Masterfile on IRS Compliance Data Warehouse (as of Feb. 27, 2010).

<sup>47</sup> IRS, Error Reject Codes 1080-1241 for 2009 Individual Income Tax Returns, available at [http://www.irs.gov/taxpros/providers/article/0,,id=175117\\_00.html](http://www.irs.gov/taxpros/providers/article/0,,id=175117_00.html) (last visited Apr. 5, 2010). IRS e-file Error Reject Codes for 2009 Individual Income Tax Returns include instances where the taxpayer does not meet basic eligibility requirements, the credit claimed is too large, issues with the Government Retiree Credit exist, data on the Schedule M does not match IRS data, or issues relating to foreign residents exist.

**2. The IRS Did Not Anticipate the Need for a Method for Taxpayers and Practitioners to Verify the Receipt and Amount of ERPs.**

To compound the problem, the IRS was not positioned to deal with the volume of calls triggered by rejected returns. While the IRS has the payment data from all three agencies, which it is using to match the amount reported on Schedule M, the IRS could not initially determine which agency issued the payment and therefore could not specifically direct the taxpayer to the federal agency issuing the ERP. Our informal research found that the phone and web assistance at the three issuing agencies was less than adequate to serve taxpayers' needs on this point (*e.g.*, long waits, confusing automated prompts, no self-help tools online to determine ERP amount).<sup>48</sup>

The IRS has belatedly responded to the high Schedule M error and reject rate. In addition to launching a series of communication initiatives to address this problem, the IRS has developed two self-help tools for taxpayers encountering Schedule M problems due to an ERP mismatch. First, the IRS developed a dedicated automated phone line strictly for this issue. The line will provide, after proper authentication, the amount of the ERP and the name of the issuing agency.<sup>49</sup> In addition, the IRS designed a web-based "Did I Receive an Economic Recovery Payment?" self-help tool that allows taxpayers to verify receipt of the \$250 ERP amount and identify which agency made the payment.<sup>50</sup>

While the agencies paid out the majority of the ERPs in May and June 2009, the law provides for payments through December 31, 2010, to individuals later deemed eligible. There is also a proposal in the Treasury Department's FY 2010 Greenbook to extend the MWP and ERP provisions.<sup>51</sup> I suggest that Congress require the three issuing

<sup>48</sup> In late January 2010, a TAS Senior Analyst visited the SSA, RRB, and VA websites and contacted each agency by telephone. Practitioners and taxpayers expressed frustration about not being able to verify the ERP as they had been able to do with the economic stimulus payment. The TAS analyst also used the IRS web-based self-help tool and called the IRS automated telephone site. Between February 1, 2009, and April 6, 2010, TAS has received 15 systemic advocacy submissions related to Schedule M issues through its Systemic Advocacy Management System (SAMS).

<sup>49</sup> The telephone number is 1-866-234-2942. The phone line became available on March 8, 2010. The IRS received 486,231 calls to this line through April 6, 2010. W&I Response to TAS Information Request (Apr. 7, 2010).

<sup>50</sup> The self-help web tool became available on March 22, 2010. The IRS reports there have been approximately 2.4 million inquiries using the online tool since its launch. W&I Response to TAS Information Request (Apr. 7, 2010).

<sup>51</sup> The President's 2011 budget proposals include:

- Extending the MWP credit for one year through December 31, 2011;
- Providing a \$250 Economic Recovery Payment in 2010 to each adult eligible for Social Security benefits, Railroad Retirement benefits, veterans benefits, or Supplemental Security (SSI) benefits; and
- Providing a \$250 refundable tax credit in 2010 to federal, state, and local government retirees who are not eligible for Social Security benefits and who are not eligible to receive an ERP.

Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals 1-4* (Feb. 2010).

agencies to include notices in year-end tax information statements to inform taxpayers who receive payments in 2010 how to report the ERP and claim the MWP credit in 2011. I also recommend that Congress require payors of any ERP to include the amount of payment on year-end tax information statements and to provide that information to the IRS in a format that enables the IRS to provide that information to the taxpayer during the filing season, if necessary.

**Recommendations**

- I recommend that, when dealing with payments to taxpayers in the future, the IRS be more proactive in setting up customer service capabilities to respond to taxpayer needs.
- I recommend that Congress require payors of any ongoing or future Economic Recovery Payment or Making Work Pay credit to include the amount of the payment on year-end tax information statements furnished to beneficiaries and the IRS.

**D. Refundable Credits and Other Social Programs Run Through the Tax Code Raise Questions About the Sufficiency of IRS Resources and Suggest that the IRS's Dual Duties Should Be Reflected in Its Mission Statement.**

The Congressional Budget Office has estimated that refundable credits will increase by approximately \$500 billion over the next ten years.<sup>52</sup> As I discussed in my 2009 Annual Report to Congress, there are many valid reasons for running social programs through the IRS, including possible reduced burden of the application process (via return filing), the availability of taxpayer data where income is an eligibility factor, and the relative efficiency of the IRS as a payment processor.<sup>53</sup> However, as demonstrated by the drop in the IRS's telephone level of service, increased paper inventories, and diverted discretionary exam resources, these Code-based social programs can undermine the IRS's ability to perform its core function of collecting taxes. Moreover, the IRS is an enforcement agency, and as such, its employees are not trained in the social work skills required to effectively work with many of the populations that are usually the beneficiaries of social benefit programs.

<sup>52</sup> Doug Elmendorf, Congressional Budget Office, *Federal Budget Challenges* (Apr. 20, 2009), available at <http://www.cbo.gov/ftpdocs/100xx/doc10093/04-20-Harvard.pdf> (last visited Apr. 6, 2009).

<sup>53</sup> National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-103 (*Running Social Programs through the Tax System*).

### **Recommendation**

- In light of the increasing number of social programs the IRS is being asked to administer, I recommend that the IRS revise its mission statement to reflect its dual mission of collecting federal revenues and delivering federal benefits. While some may view a mission statement as trivial, such a revision would provide explicit recognition that the IRS is performing two roles. It would prod the IRS to develop the capability to better deliver social benefits and it would provide a justification for the additional funding that the IRS will require if it is to perform both roles effectively.

### **E. The IRS Return Preparer Initiative Is a Big Step Forward, But Several Statutory Changes Would Be Helpful.**

It is universally acknowledged that the internal revenue laws are complex, and as a result, about 60 percent of individual taxpayers and 80 percent of small business taxpayers hire preparers to help them prepare their tax returns.<sup>54</sup> Some preparers are attorneys, CPAs, or Enrolled Agents, but many – probably most – individual returns are prepared by so-called “unenrolled preparers” – people who don’t need to have any training at all and are generally not subject to oversight.

While taxpayers pay good money to preparers with the expectation that the preparers will complete their returns correctly, the reality can be very different. Within the last few years, the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) have each performed undercover visits, posing as taxpayers, to have returns prepared by unenrolled preparation businesses, and the results have been disturbing.<sup>55</sup>

<sup>54</sup> IRS Compliance Data Warehouse, Individual Returns Transaction File, Tax Year 2007 (Aug. 2009); IRS, Pacific Consulting Group, *SB/SE Customer Base Report, Covering Tax Year 2008* (Aug. 2009).

<sup>55</sup> GAO had 19 returns prepared. All 19 contained errors, and the tax liability was wrong on 17 of the 19 returns. In two cases, the errors would have caused the taxpayer to overpay his tax by more than \$1,500. In five cases, the errors would have caused the taxpayer to receive up to nearly \$2,000 in excess refunds to which he was not entitled. Where the earned income tax credit (EITC) was claimed, preparers neglected to ask required “due diligence” questions in half the cases, and where a taxpayer told the preparer he earned side income, more than half the preparers did not include that income on the return. In just over 20 percent of the cases, the preparer either did not sign the return or failed to provide an identifying number. See GAO, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (Apr. 4, 2006). TIGTA had 28 returns prepared, and its results were not much better. Sixty-one percent contained errors. None of the seven preparers working with EITC fact patterns asked required due diligence questions. Of the errors observed, TIGTA believed that about 65 percent were inadvertent, but it felt that 35 percent were willful or reckless. Notably, one of the fact patterns TIGTA used involved a small business, and none of the business returns was prepared correctly. See TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

These studies confirm what I personally witnessed throughout my own career as a return preparer, tax attorney, low income taxpayer clinic director, and National Taxpayer Advocate. Because of the availability of tax return preparation software packages and the proliferation of ancillary products and services, such as refund anticipation loans, that can be used to finance purchases of non-tax-related products, tax return preparation is viewed as a way for certain businesses to increase their profit margins rather than as a serious profession that is key to facilitating taxpayers' compliance with the tax laws. To demonstrate just how far the tax return preparation industry has degenerated, I direct you to a slideshow my office prepared this year of various return preparation sites throughout the nation at <http://www.advocatetoolkit.com/userfiles/file/TaxReturnPreparersV2.wmv>. My personal favorite – if “favorite” is the correct term – is the dog grooming parlor that also offers tax return preparation services. I also direct you to what I consider two particularly offensive advertisements by one tax return preparation chain.<sup>56</sup>

As noted above, in early January this year, the IRS published a report of its half-year study of federal return preparers and related issues. In most important respects, the IRS plan reflects the proposals I have made since 2002:

- In general, all return preparers will be required to apply to the IRS for a preparer tax identification number by the end of this year.
- Registration will be valid for three-year periods and must be renewed.
- The IRS will conduct a federal tax compliance check on all registered preparers.
- During an initial three-year phase-in process, all unenrolled preparers – meaning everyone except attorneys, CPAs, and Enrolled Agents – will be required to pass an exam designed to demonstrate their knowledge of basic return preparation concepts.
- After passing the initial exam, all unenrolled preparers will be required to meet periodic continuing professional education requirements.
- After the three-year phase-in for testing, the names of all registered preparers will be made available on a public database, so all taxpayers can verify whether their preparer is properly registered.

The National Taxpayer Advocate's 2009 Annual Report to Congress identified one significant point on which it appeared the IRS and the National Taxpayer Advocate disagreed – namely, whether tax preparers who meet with and interview clients and prepare returns, but do not sign those returns, would be subject to IRS registration, testing, and continuing education requirements. In our view, failure to include these “nonsigning”

<sup>56</sup> See <http://www.youtube.com/watch?v=DxA5gRiB-os> and <http://www.youtube.com/watch?v=uy7U5ztbqO0> (last visited Apr. 12, 2010).

preparers in the regulatory regime would have created a loophole that could be widely exploited. Such a loophole would have particular negative impact on low income taxpayers, who often do not know much about the tax laws and may not be able to detect when they are being given inaccurate and even illegal advice. In regulations issued last month, the IRS proposes to require persons to obtain a preparer tax identification number if they are “compensated for preparing, or assisting in the preparation of, all or substantially all of a tax return.”<sup>57</sup> I believe this formulation substantially closes the loophole I identified, and I look forward to working with the IRS on this and related return-preparer issues.

### **Recommendations**

The IRS plan, of course, is not self-implementing. The IRS will issue a series of regulations this year – first in proposed form to solicit public comments and then in final form – to flesh out the details and set out the requirements. Moreover, the registration and competency requirements are just one part of what must be a comprehensive strategy for improving tax return preparation and thereby increasing voluntary compliance. Such a strategy should include preparer education contacts, “shopping” visits, due diligence requirements, and enhanced penalties.

In this and previous years' Annual Reports to Congress, we have recommended that the IRS take a “responsive regulation” approach to return preparer compliance.<sup>58</sup> That is, the IRS could start with “soft” compliance touches, such as notices and education visits, and progressively ramp up enforcement treatments where a preparer’s actions become more egregious.

- I recommend that the IRS implement a large-scale program of undercover preparer visits, using scenarios carefully designed to incorporate fact patterns addressing areas of substantial noncompliance, and follow up with the appropriate compliance “touch.”
- I recommend that Congress and the IRS impose due diligence requirements on preparers that relate to identified areas of significant noncompliance, similar to the Earned Income Tax Credit due diligence provision under IRC § 6695(g) and Treas. Reg. § 1.6695-2(b). Such requirements should require preparers to sign due diligence statements and attach the statements to the taxpayers’ returns, including e-filed returns. Requiring preparers to sign and file these statements will cause preparers who follow the “IRS will never know so you don’t need to report this income” approach to have second thoughts. For the requirements to

<sup>57</sup> Prop. Treas. Reg. § 1.6109-2, 75 Fed. Reg. 14539 (Mar. 26, 2010).

<sup>58</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*).

be effective, Congress will have to authorize penalties for failure to meet these new due diligence requirements.

- I recommend that Congress enhance the monetary sanctions in existing preparer penalties under IRC §§ 6694(a) and (b) and IRC §§ 6695 (a) through (g) pertaining to preparation of tax returns for other persons and extend the penalty under IRC § 6695 for failure to sign or include certain information on tax returns or claims to include "other documents" such as offers in compromise, financial information statements, and collection due process hearing requests.

#### **F. The IRS Is Not Meeting the Needs of Low Income Taxpayers.**

Individuals with incomes below the federal poverty level make up 12.5 percent of the United States population, or 37 million people. In 2007, about 118 million individuals in the United States had incomes below 250 percent of the federal poverty level, which qualifies them for assistance and representation from low income taxpayer clinics funded by Congress through the IRS.<sup>59</sup> More to the point for tax administration, 49 percent (almost 70 million) of the approximately 140 million individual returns filed for tax year 2008 reported adjusted gross incomes at or below 250 percent of the federal poverty level.<sup>60</sup>

Notwithstanding their income levels, low income taxpayers frequently have tax problems that involve them in protracted disputes with the IRS. Specifically:

- Taxpayers who claim the EITC are more likely to be audited than other taxpayers;
- Cancellation of debt income (CODI) issues, stemming from events such as automobile repossessions and credit card collection, are more likely to arise, and taxpayers cannot receive assistance with these issues at Volunteer Income Tax Assistance (VITA) or Tax Counseling for the Elderly (TCE) sites;
- Independent contractor versus employee classification issues frequently arise, with a distinct lack of bargaining power on the part of the low income worker; and
- Liens attaching to taxpayer accounts in currently not collectible hardship status do not attach to property with significant value yet significantly impair low income taxpayers' financial viability.

Low income taxpayers, despite their diversity, share certain common characteristics. They are more likely to be elderly, disabled, Native American, or have limited English proficiency

<sup>59</sup> See IRC § 7526.

<sup>60</sup> IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File, TY 2008. For a detailed discussion of the needs of low income taxpayers, see National Taxpayer Advocate 2009 Annual Report to Congress 110-133 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).



than the general population of taxpayers handled by the IRS's Wage and Investment Division. They tend to be more transitory than the general population.<sup>61</sup> They face transportation and child care challenges that not only limit their ability to earn income but also impair their ability to comply with documentation requests in tax disputes. They live in neighborhoods with limited access to banks and thus turn to expensive check-cashing services, loan sharks, or subprime lenders. And they may not have access to assistance that requires money.

The IRS has done a commendable job on the taxpayer service side to try to understand the service needs of low income taxpayers, including conducting research under the Taxpayer Assistance Blueprint initiative, the EITC Program Office, and the Stakeholder Partnerships, Education, and Communication function. In the compliance and enforcement areas, however, the IRS takes a one-size-fits-all approach. For example, in EITC examinations, the correspondence examination procedures are the same for low income taxpayers as they are for higher income taxpayers, notwithstanding the demonstrable differences between these taxpayer populations with regard to functional and English literacy. The impact of these undifferentiated procedures is demonstrated by a recent TAS research study finding that where EITC taxpayers are represented in audits, they are nearly twice as likely to receive the EITC, and receive almost twice the amount of EITC, as unrepresented taxpayers.

The good news is that in response to concerns raised in my 2009 Annual Report to Congress, the IRS is partnering with TAS to study whether EITC examinations that are assigned to one compliance employee and conducted by correspondence or in person at IRS offices have an impact on the response rate, the agreed case rate, and the amount of EITC allowed. I believe this study will identify practices that encourage the low income taxpayer to communicate with the IRS and will result in documentation requirements that low income taxpayers can meet with minimal burden.

#### **Recommendations**

- I recommend that the IRS work with TAS to complete a post-filing needs assessment of low income taxpayers, including problems and needs in areas other than the EITC, such as worker classification disputes, collection, offers in compromise, and accessibility of the Office of Appeals. This assessment will enable the IRS to design its procedures relating to low income taxpayers so that the procedures themselves do not pose a barrier to getting the correct result.
- I recommend that the IRS collaborate with TAS and representatives of low income taxpayer clinics to develop training videos for IRS employees on working with taxpayers with special needs, especially in compliance and enforcement functions.

<sup>61</sup> 27.5 percent of those below the federal poverty level moved in 2007 compared with 15 percent of the general population. U.S. Census Bureau, *American FactFinder, 2007 American Community Survey 1-Year Estimates, Table, B07012*.

- I recommend that Congress support additional funding for the Low Income Taxpayer Clinic (LITC) program authorized by IRC § 7526. For FY 2010, Congress has provided \$10 million for the LITCs, yet largely because of job losses and the recession, LITC case inventories have skyrocketed. In 2008, the LITCs collectively worked 16,374 cases. During just the first half of 2009, LITCs worked 14,382 cases.
- I recommend that Congress amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to specific LITCs receiving funding under this section.
- I recommend that Congress authorize the IRS to promote the LITCs using paid advertising.

**G. Where a Taxpayer Who Qualifies for the Earned Income Tax Credit Owes a Past Tax Debt, the IRS Withholds Up to 100 Percent of Any Current Refund, Undermining the Purpose of the EITC and Pushing the Taxpayer Deeper Into Poverty.**

The Earned Income Tax Credit is a refundable credit that benefits low income working individuals and families. Although the EITC enables low income working families to pay for necessities, maintain homes, repair vehicles needed to commute for work, and obtain additional education or training, the tax provision is very complex. This complexity can result in inadvertent errors by honest taxpayers and provides opportunities for cheating by dishonest taxpayers. The IRS estimates that the EITC overclaim rate falls in the range of 23 percent to 28 percent.<sup>62</sup>

Characteristics of the EITC population exacerbate the problems with the statute's complex eligibility requirements. For example, approximately one-fifth of the EITC population changes each year (*i.e.*, previously eligible taxpayers become ineligible and previously ineligible taxpayers become eligible for the credit simply because of a change in life circumstances).<sup>63</sup> Thus, it is possible for a taxpayer to owe the IRS for an incorrect EITC claim in Year 1 and be eligible to receive the EITC in Year 2 due to a change in the taxpayer's circumstances.

<sup>62</sup> The IRS has estimated that EITC erroneous payments fell in the range of \$9.6 billion – \$11.4 billion (23–28 percent) for tax year 2005. See *Reporting Improper Payments: A Report Card on Agencies' Progress: Hearing Before the Subcomm. on Federal Financial Management, Governmental Information and International Security of the S. Comm. on Homeland Security and Governmental Affairs*, 109<sup>th</sup> Cong. (Mar. 6, 2006) (written statement of Mark Everson, Commissioner of Internal Revenue). To place this noncompliance rate in perspective, Schedule C (sole proprietorship) payment noncompliance is estimated at 57 percent. See IRS News Release, IR-2006-28, *IRS Updates Tax Gap Estimates* (Feb. 14, 2006) (accompanying charts).

<sup>63</sup> IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File, TY 2005–TY 2008.

Under IRC § 6402(a), the IRS may withhold current-year tax refunds in full to recover any past tax debts. As a consequence, some low income taxpayers who currently qualify for EITC assistance do not receive part or all of the EITC benefit that Congress has determined they need to provide a basic standard of living for their families.

Congress has limited the IRS's and other creditors' ability to offset or levy on Social Security and certain means-tested benefits. For example, the levy on Social Security benefits for payment of federal tax debts under the Federal Payment Levy Program (FPLP) is limited to 15 percent of the monthly benefit,<sup>64</sup> and as discussed below, the IRS has recently agreed to exempt low income individuals from such levies.

#### **Recommendation**

- I recommend that Congress amend IRC § 6402 to limit the portion of a tax refund attributable to the EITC that the IRS may withhold to 15 percent of the EITC benefit for the year.

#### **H. The Treasury Department Should Conduct a Study to Determine How to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Returns Processing.**

Each tax year, the IRS receives hundreds of millions of information returns, including Forms W-2 and 1099, and tax returns, notably Forms 1040. Right now, the IRS begins to process 1040s in January, but it does not receive and fully process W-2s and 1099s until well after the filing season ends. This sequence makes little sense for several reasons:

First: Millions of taxpayers each year make inadvertent overclaims that the IRS does not identify until it performs document-matching months later. As a result, these taxpayers not only receive notices assessing tax they did not know they owed and often did not save for, but they typically end up owing interest and penalties as well.

Second: On the criminal side, the IRS receives hundreds of thousands of false and fraudulent tax returns each year claiming billions of dollars in refunds. The Criminal Investigation Division tells us that a significant percentage of fraudulent claims involves income and withholding amounts ordinarily reported on a W-2 (e.g., the "taxpayer" will file a return showing a high withholding amount relative to tax liability, producing a large apparent refund). Because the IRS does not have W-2 data in its systems at the time it processes tax returns, the IRS has to devote significant resources to identifying and blocking fraudulent claims and it inevitably misses a fair number.

Third: Congress has given the IRS responsibility for administering an increasing number of social benefit programs through the tax code. The EITC has been around since the 1970's,

<sup>64</sup> IRC § 6331(h).

but the Making Work Pay credit,<sup>65</sup> First-Time Homebuyer Credit,<sup>66</sup> and several others are new. Earlier information reporting would help to ensure that we quickly get the right amount of benefits to eligible taxpayers while minimizing the risk of fraud.

**Fourth:** Earlier access to information reporting data would enable the IRS to make those data available to taxpayers as they prepare their returns. Taxpayers could import the information into existing programs, the IRS could create pre-populated tax returns to reduce filing burdens for millions of taxpayers who file simple returns, or both.

For these reasons, if the IRS can get to a point where it can process information returns first, it could largely eliminate the post-filing season work of the Automated Underreporter Unit, substantially reduce opportunities for fraud, make pre-populated returns a viable option, and give the IRS better tools to administer social benefit programs when Congress directs it to do so.

Despite the obvious logic of processing information returns first, it is much easier said than done. With tax returns arriving as early as January and the IRS not completing its Information Returns Master File for the year until around August, we would have to find a way to make up about six months' worth of time. Some steps could accelerate the process substantially. For example, Congress could require W-2s to be submitted directly to the IRS on January 31, when they are given to taxpayers, and might even be able to move that date up to January 15 in the future. Also with some lead time, the IRS could make systems improvements to enable it to process and match information and tax returns more quickly.

But even if these challenges are addressed, it is likely that there will still be some time gap that cannot be bridged. Put simply, if taxpayers are now entitled to submit returns in mid-January and the IRS does not even receive information returns until that time, it would be impossible to make full use of information returns unless the beginning of the filing season is somewhat delayed. Such a delay will certainly upset those early-filing taxpayers, who tend to be low income and receive large refunds. Some ways to mitigate the delay would be to more closely calibrate tax withholding to tax liability, revamp the Advance EITC, or pay out benefits ratably during the course of the year to reduce the size of refund payments. In my view, the significant benefits of real-time document-matching make it imperative that we consider such steps.

#### **Recommendation**

- I recommend that Congress direct the Treasury Department to study and report back within one year on the administrative and legislative steps that would be required to enable the IRS to receive and process information reporting documents before it processes tax returns and issues refunds. In my 2009 Annual Report to Congress, I identified key issues that would require careful

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<sup>65</sup> IRC § 36A.

<sup>66</sup> IRC § 36.

study.<sup>67</sup> I believe the benefits of getting information returns into the system first would be significant but recognize that practical challenges exist. Therefore, I suggest that Congress and the IRS aim to implement changes within five years from the time this report is completed to provide the IRS and private industry sufficient lead time to make required adjustments.

#### **I. Status Update: IRS Identity Theft Procedures**

TAS makes many recommendations in its Annual Reports to Congress, and internally to the IRS, that may take several years to implement. In some instances, it takes time and several discussions in the Annual Report to reach an agreement that the issue is, indeed, a most serious problem for taxpayers. I am pleased that I can report significant progress on the issue of identity theft.

Identity theft occurs in tax administration when an individual intentionally uses the Social Security number (SSN) of another person to file a false tax return or fraudulently gain employment. When these types of identify theft occur, the victim often begins an extremely frustrating journey through IRS processes and procedures that may take years to complete. I have included identity theft as a most serious problem encountered by taxpayers in four of my last five Annual Reports to Congress.<sup>68</sup>

The Finance Committee held a hearing two years ago titled, "Identity Theft: Who's Got Your Number?" I am pleased to report that since that time, the IRS has made several improvements in procedures to assist victims of identity theft. It is now marking the accounts of identity-theft victims with an electronic indicator, which will reduce taxpayer burden (because the IRS will not assess the perpetrator's tax against the victim) while protecting federal revenue (by not paying out refunds on suspect returns). The IRS is applying a series of filters – known as "business rules" – to distinguish valid returns from fraudulent ones. It has also developed and improved its Identity Theft Affidavit form, which taxpayers must complete to authenticate their identity.

Most significantly, the IRS has established a centralized main unit dedicated to assisting identity theft victims. Over the last year, the Taxpayer Advocate Service has worked with this unit – known as the Identity Protection Specialized Unit (IPSU) – to improve its procedures in assisting victims of identity theft. The unit is serving as a central point of contact that interacts with other parts of the IRS as appropriate. In addition, the unit conducts a global account review to identify all federal tax issues related to the identity theft

<sup>67</sup> National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

<sup>68</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 180-191; National Taxpayer Advocate 2004 Annual Report to Congress 132-136.

and ensures that the responsible IRS functions have taken the appropriate actions to resolve the victim's tax account issues.

While we are concerned that the IPSU may not have sufficient staffing to deal with the increasing numbers of identity theft cases and think the business rules can be improved, we believe that the IRS has made significant progress on this issue.<sup>69</sup>

## II. Other Issues

### A. IRS Lien Filing Policies Are Unnecessarily Harming Taxpayers Without Maximizing Tax Compliance – in Violation of the Intent of RRA '98.

#### 1. Background

When a taxpayer fails to pay a tax debt, the IRS Collection function is charged with attempting to collect it. The Collection function has powerful tools at its disposal to do this – it may file a notice of federal tax lien (NFTL) against a taxpayer's property or impose a levy against wages, bank accounts, or other income sources without obtaining prior approval from a court. However, the government has a responsibility to balance the goal of ensuring that everyone pays their fair share of taxes against the reality that millions of taxpayers lose their jobs or experience financial hardships each year, and the government generally should not be causing or exacerbating financial hardships. This is always true, but it is particularly notable when the unemployment rate is high and many taxpayers with solid compliance histories are becoming delinquent on their tax liabilities for the first time.

Properly applied, the NFTL can be an effective tool in tax collection. It gives the IRS a legal claim to the taxpayer's property, such as a home or a car, as security for the payment of the tax debt and may enable the IRS to collect all or a portion of the tax debt if the taxpayer sells or refinances the property. If improperly applied, however, NFTLs have the potential to cause needless harm to taxpayers and, not insignificantly, to undermine long-term tax collection as well. Thus, the decision whether to file an NFTL requires the IRS to balance the harm the NFTL will inflict on the taxpayer and the revenue the NFTL is likely to generate. I emphasize that, although perhaps counterintuitive, more liens do not necessarily translate into more revenue. As discussed below, when long-term damage to a taxpayer's financial viability and the costs of lien filings are taken into account, an automated or shotgun approach to lien filings may actually result in less revenue collection in certain categories of cases.

<sup>69</sup> Identity theft cases received in the Taxpayer Advocate Service have increased by 96 percent between FY 2008 and FY 2009, from 7,147 to 14,023. A significant number of those cases resulted from unintended application of the business rules.

## **2. Tax Liens Reduce a Taxpayer's Credit Score and Can Be Devastating to the Taxpayer's Financial Viability.**

Assume that the IRS files an NFTL after a taxpayer loses his job and becomes unable to pay his tax bill. The following consequences may result:

- The filing of the NFTL is quickly picked up by the three credit reporting agencies (Equifax, Experian, and TransUnion) and is included on the taxpayer's credit reports.
- The initial inclusion of a tax lien reduces the taxpayer's credit score by an average of 100 points.
- The mere notation of an NFTL on a taxpayer's credit report can destroy his financial viability. Employers increasingly review credit reports in making employment decisions, and some employers, especially in the financial services industry, will not hire or retain a person with an NFTL on a credit report. Insurance companies increasingly review credit reports and use scores in determining whom to insure and in setting rates. Landlords, retail stores, utilities, and other creditors also review credit reports. Thus, an NFTL may make someone unemployable and in virtually all cases will drive up the taxpayer's other costs.<sup>70</sup>
- For small business taxpayers, an NFTL can be a fatal blow. If an NFTL has been filed against a small business, it generally will not be able to obtain financing required to maintain business operations.
- The damage to a taxpayer is generally long-lasting. If the taxpayer settles a tax debt and the IRS releases the lien, the fact that the NFTL was filed and released will still be listed on the credit report for seven years.<sup>71</sup>
- If the taxpayer does not settle the tax debt and the lien is extinguished when the ten-year period of limitation on IRS collection action runs out, the three credit rating agencies continue to include the NFTL on the report for even longer – one continues to list it for ten years, one continues to list it for 15 years, and one continues to list it indefinitely.

## **3. The Revenue Benefits of IRS Lien Filings Appear Limited.**

The IRS has increased the number of NFTL filings significantly over the past decade. From FY 1999 to FY 2009, the number of NFTLs filed each year jumped by 475 percent (from 168,000 to nearly 966,000). It is also worth noting that the IRS has increased the number

<sup>70</sup> See *What Happened to Your Credit Score?*, Washington Post, Mar. 6, 2010, at E1.

<sup>71</sup> Fair Credit Reporting Act, § 605(a)(3), 15 U.S.C. § 1681c(a)(3).

of levies it has imposed on taxpayers' income and assets by about 600 percent from FY 1999 to FY 2009 (from 504,403 to 3,478,181).<sup>72</sup> If liens and levies were key drivers of Collection revenue, one would expect that the amount of revenue collected by the IRS Collection function since FY 1999 would have soared. That has not happened. To the contrary, Collection revenue has *fallen* since FY 1999 on an inflation-adjusted basis by 7.4 percent.

Most importantly, the government's role as a creditor is different from the role of a private creditor. The government must focus not merely on collecting a past tax debt but on maximizing future tax compliance. If the filing of an NFTL drives up the taxpayer's costs and renders him unemployed or underemployed, the taxpayer may be less able to pay his past tax debt and may earn less income (and therefore pay less tax) in the future. Moreover, unlike a private creditor, if IRS collection practices push a taxpayer into poverty, other parts of the government may be forced to make outlays in the form of unemployment benefits, food stamps, and the like. IRS collection practices do not explicitly consider that trade-off, but if the government drives a taxpayer into poverty, the taxpayer has less income and the government receives less revenue and may incur greater costs – clearly a lose-lose proposition that we should be striving harder to avoid.

#### **4. A TAS Study Shows the IRS Cannot Accurately Measure NFTL Filing Effectiveness.**

The sharp increase in NFTL filings combined with an inflation-adjusted reduction in Collection revenue prompted us to ask: What is going on here? Why is the IRS destroying the credit of so many taxpayers if doing so isn't furthering revenue collection?

Initially, I asked the IRS how much revenue is collected through NFTL filings. IRS collection personnel said they didn't know.

I found this lack of knowledge disturbing, because I do not see how the IRS can establish NFTL procedures that balance its collection goals against the desire to avoid inflicting unnecessary harm on taxpayers without knowing how much revenue NFTLs are generating. For that reason, I asked my research staff to conduct a high-level research project on collection activities that, in part, attempted to assess whether NFTLs are being filed effectively to collect revenue. To develop this assessment, TAS reviewed the collection history of all taxpayers who incurred balance-due tax liabilities for the first time during tax year 2002 – nearly 1.9 million transactions involving about 270,000 individual taxpayers – and against whom NFTLs were filed in subsequent years.<sup>73</sup> The results of our

<sup>72</sup> As noted in a prior report, the number of levies increased by about 1,600 percent when measured from FY 2000 to FY 2007. See National Taxpayer Advocate 2008 Annual Report to Congress 20.

<sup>73</sup> TAS reviewed 1,886,683 transactions from 270,399 individual taxpayers. For a more detailed discussion, see National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (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*) and vol. 2, at 4-16 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).



research suggest that the IRS's use of NFTLs may not be furthering the agency's revenue collection objective and, equally significant, that the IRS has shown very little interest in evaluating the effectiveness of NFTLs for itself. Among our findings:

- IRS procedures require employees to code the source of payments received on delinquent accounts.<sup>74</sup> Where the IRS received a payment after an NFTL was filed against a taxpayer's property, the IRS coded the source of payments as "miscellaneous" or did not code the payment at all in about 67 percent of the cases.<sup>75</sup> The IRS's failure to accurately code and track the source of payments defeats the purpose of having a coding system, because it precludes the IRS from drawing useful conclusions about the effectiveness of any of its collection actions, including NFTL filings.
- Using separate transaction codes, TAS was able to reconstruct the source of payments in 22.5 percent of the uncoded cases, with the result that TAS could identify the source of 48 percent of the payments made with respect to accounts against which an NFTL had been filed. In these cases, our analysis found that more than 95 percent of all payments and more than 80 percent of all revenue collected did not result from the NFTL filings and would have been collected anyway.<sup>76</sup> The largest source of Collection revenue and payments on these accounts was refund offsets, which occur regardless of the existence of an NFTL (*i.e.*, the taxpayer filed a return in a subsequent tax year showing a refund due and the IRS withheld the refund to satisfy the past-due tax debt). Taking into account that nearly 52 percent of payments cannot be classified, only about \$169 million out of about \$905 million collected was clearly attributable to lien filings with respect to 2002 delinquent tax liabilities.<sup>77</sup>

While the amount of revenue collected through NFTLs remains unknown, our study suggests that the total is relatively small. In FY 2009, the IRS Collection function brought in

<sup>74</sup> See IRM 5.1.2.8.1 (Aug. 15, 2008). These two-digit numeric codes are called Designated Payment Codes (DPCs). The IRS uses DPCs to help identify payments, indicate application of payment to a specific liability, and identify the event that resulted in a payment.

<sup>75</sup> IRS, Compliance Data Warehouse (CDW), Individual Masterfile (IMF) Transaction File Cycle 200913. Of the 1,886,683 total payment transactions, only 629,158 transactions had the DPC code assigned. 1,257,525 transactions were designated "miscellaneous" or "DPC indicator not present." Of the 1,257,525 transactions, 283,091 had a refund offset transaction code, leaving 974,434 payments (or 51.6 percent) as unaccountable. Thus, 912,249 payments (or 48.4 percent) had meaningful DPCs or could be identified as refund offsets. See also National Taxpayer Advocate 2009 Annual Report to Congress 22 (Chart 1.2.2, *Dollars Collected Attributable to Liens Filed Against TY 2002 Individual Taxpayer Liability and Subsequent Payments in CYs 2002-2009*). The IRS does not conduct a quality review of the payment information by DPC. IRS response to TAS research request (Oct. 6, 2009).

<sup>76</sup> See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, at 4-16 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

<sup>77</sup> IRS, Compliance Data Warehouse (CDW), IMF Transaction File Cycle 200913. The IRS collected \$168.6 million in payments attributable to NFTLs and \$736.7 million in payments not attributable to NFTLs in calendar years (CYs) 2002-2009.

\$27.2 billion. The majority of revenue raised by the Collection function comes through notices in cases where NFTLs have not been filed.<sup>78</sup> Considerable revenue also comes from refund offsets and from levies, among other sources, for which NFTLs are not required. Thus, the finding that only about \$169 million was clearly attributable to NFTL filings among cases analyzed in the TAS study may not be far off the mark.

That figure was estimated based on TAS's evaluation of the 48 percent of cases arising in 2002 for which TAS could track the payment source. If that is representative of the full population, the total revenue with respect to those cases would be about \$350 million. To be clear, we do not know the source or amount of payments that were not coded, and we do not know whether lien filings are more or less productive with respect to tax liabilities incurred in tax years other than 2002. But based on the data we have seen, there is a strong possibility that the IRS is harming hundreds of thousands of taxpayers a year to collect \$1 billion or less. What's more, the IRS incurs considerable expense to work these cases, including the salaries of Collection personnel and the costs of NFTL filing fees in local jurisdictions, so net revenue collection is considerably lower.

**5. Legislative History Shows Congress Wanted More Managerial Review of Lien Filings, But the IRS Is Now Requiring Less Managerial Review.**

When Congress passed the IRS Restructuring and Reform Act of 1998, it included a provision directing the Commissioner to develop and implement procedures under which any determination by an employee to file an NFTL would, where appropriate, be required to be reviewed by a supervisor before the action was taken.<sup>79</sup>

The provision originated in the Senate, and the Senate Finance Committee report provided the following explanation:

Supervisory approval of liens, levies or seizures is [currently] only required under certain circumstances. . . .

The Committee believes that the imposition of liens, levies, and seizures may impose significant hardships on taxpayers. Accordingly, the Committee believes that extra protection in the form of an administrative approval process is appropriate. . . .

The provision requires the IRS to implement an approval process under which any lien, levy or seizure would be approved by a supervisor, who would review the taxpayer's information, verify that a balance is due, and affirm that a lien, levy or seizure is appropriate under the circumstances. Circumstances to be considered include the amount due and the value of the asset. Failure to

<sup>78</sup> Notices accounted for 55.6 percent of the total collection yield for FY 2009. IRS, *Delinquent Accounts Receivable Yield Fiscal Year Comparison Cum thru September FY 2009*.

<sup>79</sup> Pub. L. No. 105-206, Title III, § 3421, 112 Stat. 685, 758 (1998).

follow such procedures should result in disciplinary action against the supervisor and/or revenue officer.<sup>80</sup>

The conference report generally followed the Senate amendment but provided the Commissioner with discretion "to determine the circumstances under which supervisory review of liens or levies issued by the automated collection system is or is not appropriate."<sup>81</sup> By negative implication, the conference report did not intend such discretion to apply outside the context of the automated collection system.

Through its procedures, the IRS has since turned on its head the congressional directive that managerial approval generally be obtained before an NFTL filing. The IRS has established a set of business rules under which liens are automatically filed and generally does not require employees to obtain managerial approval in order to file an NFTL. To the contrary, IRS procedures require all Automated Collection System employees to obtain managerial approval if they determine not to file an NFTL.<sup>82</sup> Any decision not to file a lien must be supported by a case history entry clearly stating the reason why filing an NFTL will hamper collection or is not proper (e.g., because of doubt as to liability).<sup>83</sup>

Similarly, the IRS in 2008 issued interim guidance requiring all Revenue Officers to obtain managerial approval to defer filing an NFTL for certain employment tax cases in which the unpaid balance is \$5,000 or more.<sup>84</sup> Thus, the IRS requires employees to take extra steps and offer additional justification to avoid filing an NFTL. What's more, it does not require employees to determine whether the filing is likely to further the IRS's revenue collection objective (e.g., verify whether the NFTL would attach to assets or undertake a review of the taxpayer's financial or personal position to determine whether the NFTL filing will be productive). In essence, IRS procedures have flipped Congress's explicit presumptions. In significant categories of cases, the IRS now imposes more rigorous managerial approval requirements when an employee determines not to file an NFTL than when an employee seeks to file one.<sup>85</sup>

<sup>80</sup> S. Rep. No. 105-174, at 78 (1998).

<sup>81</sup> H.R. Rep. No. 105-599, at 278 (1998) (Conf. Rep.). The IRS Automated Collection System (ACS) handles balance due and nonfiler cases that require telephone contact. IRS tax examiners and customer service representatives in ACS review taxpayer data and issue notices, liens, or levies to resolve delinquent tax cases.

<sup>82</sup> IRM 5.19.4.5.2(10) (Apr. 26, 2006).

<sup>83</sup> *Id.*

<sup>84</sup> Small Business/Self-Employed Division (SB/SE), *Interim Guidance for Approval of Lien Determinations*, Control No. SBSE-05-1208-069 (Dec. 22, 2008). The IRS issued this guidance in an attempt to implement a GAO recommendation to timely file NFTLs in federal employment tax cases based on an assumption that filing the NFTL will increase the likelihood of collection. See GAO-08-617, *Tax Compliance, Businesses Owe Billions in Federal Payroll Taxes* 31 (July 2008). The interim guidance expired on Dec. 22, 2009, and has now been incorporated into IRM 5.12.2.4.2 (Oct. 30, 2009).

<sup>85</sup> The IRS Office of Chief Counsel has advised the IRS that its IRM is in compliance with RRA '98. Memorandum dated Feb. 12, 2010, from Gary D. Gray, Deputy Associate Chief Counsel (Procedure and Administration) to Frederick W. Schindler, Director, Collection Policy (SB/SE). The memorandum characterizes the impact of a lien-filing on a taxpayer's financial viability as a "second-order hardship" and

Today, the IRS generates a majority of its NFTLs through the Automated Collection System (ACS). Just under two-thirds of NFTLs requested by ACS were made systemically,<sup>86</sup> which means that the IRS generates these NFTLs without determining whether the taxpayers have any assets or are likely to acquire any assets to which the NFTL would attach. As an example, the IRS automatically requests NFTLs for every taxpayer whose delinquency exceeds \$5,000 when the IRS determines that the liability is "currently not collectible" (CNC).<sup>87</sup> The CNC designation includes situations in which the IRS has determined that collection of the liability would create a hardship on taxpayers by leaving them unable to meet necessary living expenses.<sup>88</sup>

This automated approach to lien filing makes little sense not only from a common sense perspective but also from a business perspective. For example, for taxpayers with accounts in CNC/economic hardship status, TAS Research found that:

- IRS refund offsets were responsible for nearly \$6 out of every \$10 in tax payments collected from these taxpayers; and
- NFTLs were responsible for only \$2 out of every \$10 in payments collected from these taxpayers.<sup>89</sup>

One recent anecdote deeply concerns me: In a case handled by TAS, a Local Taxpayer Advocate asked a revenue officer to refrain from filing an NFTL in a sympathetic case. In response, the revenue officer said his group manager had told his work group that she would not approve any requests to defer the filing of an NFTL. The Local Taxpayer Advocate was told he would have to issue a Taxpayer Assistance Order<sup>90</sup> directing the IRS to refrain from imposing an NFTL because of the group manager's instruction.

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states rather clinically: "As an involuntary creditor not involved in the extension of credit, the Service is not in a position to evaluate these potential hardships and lacks the resources to effectively account for them in the large number of CNC hardship cases." The memorandum concludes that existing IRS procedures adhere not merely to the letter but also to the spirit of RRA '98. For the reasons discussed in the text above, we fundamentally disagree.

<sup>86</sup> ACS, *Customer Service Activity Reports (CSAR), FY 2009 BOD report*.

<sup>87</sup> IRM 5.12.2.4.1(1) (Oct. 30, 2009).

<sup>88</sup> CNC status generally suspends collection actions but the liability is still due and owing; thus, penalties and interest continue to accrue until the statutory period of collection expires. IRM 5.16.1.2.9(11) (May 5, 2009); see also IRS Policy Statement P-5-71 at IRM 1.2.14.1.14 (Nov. 19, 1980).

<sup>89</sup> National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 5 (Research Report: *The IRS's Use of Notices of Federal Tax Lien (NFTL)*).

<sup>90</sup> IRC § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order (TAO) if a taxpayer is suffering or is about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered. A TAO can direct the IRS to take a specific action, cease a specific action, or refrain from taking a specific action. A TAO can also direct the IRS to review at a higher level, expedite consideration of, or reconsider a taxpayer's case. Upon receipt of a TAO, the responsible official in the IRS operating division/function may either take the requested action or appeal. If the parties cannot resolve the matter at a lower level through the TAO appeals process, the matter will

**6. The IRS Rarely Withdraws Tax Liens Despite Explicit Statutory Authorization to Do So and Despite the Fact that a Lien “Withdrawal” Is Far Less Damaging to Taxpayers than a Lien “Release”.**

As described above, a lien that is “released” continues to be reflected on the taxpayer’s credit record for seven years from the date of the release. However, an NFTL that is “withdrawn” is treated as if it had not been filed and is removed from the taxpayer’s credit record.

In 1996, Congress authorized the IRS to withdraw an NFTL if the Secretary makes any one of four determinations:

- (A) The filing of the notice was premature or otherwise not in accordance with IRS administrative procedures;
- (B) The taxpayer has entered into an installment agreement to satisfy the tax liability for which the lien was imposed (unless the agreement provides otherwise);
- (C) The withdrawal of the notice will facilitate the collection of the tax liability; or
- (D) With the consent of the taxpayer or the National Taxpayer Advocate, the withdrawal of the notice would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.<sup>91</sup>

Congress clearly provided these four bases for withdrawal for a reason. In one TAS case, a taxpayer working in the financial services industry lost his job after the IRS filed an NFTL, because his employer had a policy to not employ individuals who have NFTLs filed against them. The taxpayer had paid the tax liability and owed only a small amount of interest and penalties. I personally became involved in the case and issued several Taxpayer Assistance Orders directing the IRS to withdraw the NFTL, but the Collection function declined to do so until after the taxpayer was fired.<sup>92</sup> In a case like that, the withdrawal of the NFTL would serve the best interests of both the taxpayer and the United States because an employed taxpayer is earning income and can pay taxes, while the IRS is much less likely to collect from an unemployed taxpayer.

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ultimately be elevated to the Commissioner or the Deputy Commissioner, who will decide whether to sustain, modify, or rescind the TAO. See IRC § 7811(c)(1); IRM 13.1.20.5 (Dec. 15, 2007).

<sup>91</sup> IRC § 6323(j)(1).

<sup>92</sup> Pursuant to IRC § 6103, the IRS generally is required to keep taxpayers’ returns and return information confidential. In this particular case, however, the taxpayer provided a written consent to the National Taxpayer Advocate to disclose the facts of his case in congressional testimony.

### **Recommendations**

On January 20, 2010, shortly after publication of the National Taxpayer Advocate's 2009 Annual Report to Congress outlining my concerns about IRS lien-filing and other collection practices, I issued two Taxpayer Advocate Directives (TADs)<sup>93</sup> to the Commissioners of the Wage and Investment (W&I) and Small Business/Self-Employed (SB/SE) Operating Divisions, ordering them, among other things, to:

- Immediately rescind the policy of automatic NFTL filing on currently not collectible hardship accounts;<sup>94</sup>
- Immediately require managerial approval for NFTL filings in all cases where the taxpayer has no assets;<sup>95</sup>
- Within 30 days of the issuance of the TAD, in consultation with the National Taxpayer Advocate, issue interim guidance requiring IRS contact employees to base a determination to file an NFTL on a thorough review of information concerning the taxpayer's assets, the taxpayer's income, and the value of the taxpayer's equity in the assets and, after weighing all the facts and circumstances, determine whether (i) the NFTL will attach to property, (ii) the benefit to the government of the NFTL filing outweighs the harm to the taxpayer, and (iii) the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future;<sup>96</sup> and
- Immediately develop and issue guidance allowing, upon the request of the taxpayer, the withdrawal of an NFTL where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released.<sup>97</sup>

In response, the IRS has established a task force to undertake a comprehensive review of IRS collection practices. I applaud this effort, in which the Taxpayer Advocate Service will participate. However, the IRS is not immediately changing any of its current guidance to collection employees. In fact, the SB/SE and W&I Commissioners appealed both of the TADs to the Deputy Commissioner for Services and Enforcement. On March 31, 2010, I supplemented and re-issued the first TAD to the Deputy Commissioner for Services and

<sup>93</sup> Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a Taxpayer Advocate Directive (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 13-3 (formerly DO-250, Rev. 1) (Jan. 17, 2001); see also IRM 13.2.1.6 (July 16, 2009). Upon receipt of a TAD, the only avenue of appeal for the IRS is to the Deputy Commissioner for Services and Enforcement. The Deputy Commissioner and the Commissioner have the authority to modify or rescind a TAD.

<sup>94</sup> Taxpayer Advocate Directive 2010-1 (Jan. 20, 2010).

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> Taxpayer Advocate Directive 2010-2 (Jan. 20, 2010).

Enforcement. To date, I have not received a response to the concerns I outlined in either of the TADs.<sup>98</sup> Therefore, in my opinion, taxpayers continue to be needlessly harmed and future tax compliance and collection continue to be undermined while the task force undertakes its year-long review. As a result of my concerns, I also issued interim guidance to TAS employees on March 31, 2010, clarifying how they can best advocate for taxpayers who are facing a lien-filing situation. A copy of this memorandum is attached as Appendix A to this testimony.<sup>99</sup>

- I recommend that the IRS institute a quality review of payment coding used to track the source of taxpayers' payments for tax liabilities. An accurate method of tracking payments is an essential first step in determining the impact of various collection tools on taxpayers and whether they are being used effectively.
- I recommend that Congress amend the Internal Revenue Code to:
  - Require that prior to filing an NFTL, the IRS review all the taxpayer's circumstances (including the existence and value of assets, the taxpayer's overall financial situation, the taxpayer's compliance history and reasons for noncompliance, and the existence and amount of non-tax debt) and make a determination, weighing all facts and circumstances, that (i) the NFTL will attach to property, (ii) the benefit to the government of the NFTL filing outweighs the harm to the taxpayer, and (iii) the NFTL filing will not jeopardize the taxpayer's ability to comply with the tax laws in the future;
  - Allow a taxpayer to appeal any NFTL filing determinations to the IRS Office of Appeals before the NFTL is filed;
  - Provide under IRC § 7432 for civil damages for improper NFTL filing or failure to make the required NFTL determination described above; and
  - Clarify that under IRC § 7433, a taxpayer may bring an action for improper lien filing or failure to make the required NFTL determination described above.
- I recommend that Congress amend section 605(a)(3) of the Fair Credit Reporting Act<sup>100</sup> to address the length of time that information about an IRS NFTL filing remains on a taxpayer's credit report after the release, withdrawal, or expiration of the NFTL or the underlying tax debt.

<sup>98</sup> Sustaining Taxpayer Advocate Directive 2010-1 (Mar. 31, 2010).

<sup>99</sup> Interim Guidance on Recommending the Non-filing of Notices of Federal Tax Lien in Certain Situations (Mar. 31, 2010).

<sup>100</sup> 15 U.S.C. § 1681c(a)(3).

**B. Despite IRS Commitments to Improve Accessibility of the Offer in Compromise Program and Assist Financially Struggling Taxpayers, the IRS Last Year Accepted the Lowest Number of Offers in a Decade.**

In the National Taxpayer Advocate's reports to Congress, I have continually expressed concern that the IRS has made offers in compromise (OICs) less and less accessible to taxpayers, creating a category of permanent tax debtors and undermining IRS collection efforts as well. The IRS has made repeated commitments to improve the accessibility of the program, but to date, tangible results are not evident.

Congress has authorized the IRS to settle a tax liability for less than the full amount owed in appropriate cases, such as where a taxpayer has lost a job or otherwise suffered a financial hardship and cannot afford to pay his or her full tax debt.<sup>101</sup> In 1998, Congress directed the IRS to make offers more accessible to appropriate taxpayers:

The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.<sup>102</sup>

Offers can be a good deal for taxpayers and an excellent deal for the government. They can be good for taxpayers because, while they require taxpayers to pay their tax obligations to the extent they are able, they give taxpayers the opportunity to make a fresh start, removing the threat of enforced IRS collection actions that otherwise hangs over their heads for the next decade. Offers can be an excellent deal for the government because they enable the government to collect as much revenue as is feasible and, most importantly, they boost the likelihood of future tax compliance. If a taxpayer is delinquent and is already facing a lien or other collection action, the taxpayer has little incentive to comply prospectively. On the other hand, offers contain a condition that requires the taxpayer to remain in full compliance with the tax laws for the following five-year period.<sup>103</sup> If the taxpayer does not comply with the contract terms, the IRS may treat the offer as in default, which will cause the original tax liability (minus any payments made) to be reinstated in full.<sup>104</sup> One study showed that about 80 percent of individual taxpayers with accepted offers remained substantially compliant for the five-year period.<sup>105</sup>

<sup>101</sup> IRC § 7122. The IRS accepts offers based on three grounds – doubt as to collectibility, doubt as to liability, and effective tax administration (including equity, public policy, and economic hardship concerns). Treas. Reg. § 301.7122-1(b).

<sup>102</sup> H.R. Rep. No. 105-599, at 289 (1998) (Conf. Rep.).

<sup>103</sup> See IRS Form 656, *Offer in Compromise*, § V(d) (Mar. 2009).

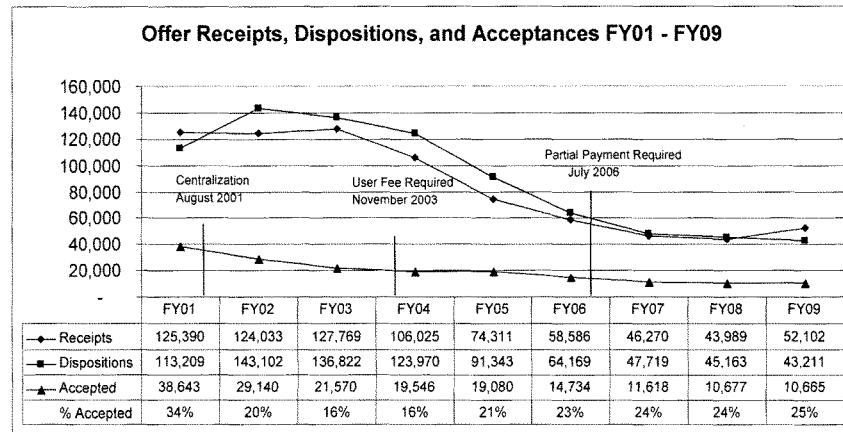
<sup>104</sup> IRM 5.19.7.3.20 (Jan. 16, 2009); IRM 8.23.3.14(3) (Aug. 28, 2009).

<sup>105</sup> IRS, *Analysis of Various Aspects of the OIC Program* (Sept. 2004). As noted, offers can also be beneficial from a revenue standpoint. In FY 2007, accepted offers generated 17 cents for every dollar



Yet the IRS has erected so many obstacles to offers in compromise that fewer and fewer taxpayers are applying for them, and fewer and fewer offers are being accepted. For example, the application form and instructions now run 50 pages,<sup>106</sup> and a consultant analyzing the offer process concluded that a taxpayer must take over 100 steps to complete an offer application.<sup>107</sup> The following chart shows the trend in offers since FY 2001:

**IRS OFFER-IN-COMPROMISE PROGRAM, FY 2001 - FY 2009<sup>108</sup>**



As this chart illustrates, the number of offers the IRS receives has declined sharply – from 125,390 in FY 2001 to 52,102 in FY 2009, a drop of 58 percent. The number of accepted offers has declined by even more – from 38,643 in FY 2001 to 10,665 in

owed. IRS, *Offer in Compromise Program, Executive Summary* (Aug. 13, 2007). By contrast, IRS research indicates the IRS has historically collected only 13 cents for every \$1 owed on debts that are two years old and virtually nothing on debts that have been outstanding for three years or more. IRS, *Automated Collection System Operating Model Team, Collectibility Curve* (Aug. 5, 2002). An IRS study of rejected offers that subsequently were deemed "currently not collectible" (CNC) found that 27 percent of the cases involving individuals and 49 percent of the cases involving businesses were already in CNC status at the time the offers were rejected. IRS, *Analysis of Various Aspects of the OIC Program* (Sept. 2004). In other words, the IRS rejected the taxpayer's offer to pay something, and often ended up with nothing.

<sup>106</sup> See IRS Form 656, *Offer in Compromise*, and accompanying instructions.

<sup>107</sup> Siegel & Gale, *Offer in Compromise, Strategic Recommendations* 10-13 (July 31, 2009).

<sup>108</sup> IRS, SBI/SE, *Collection Activity Report NO-5000-108* (FY 2001-FY 2009).

FY 2009, a decrease of 72 percent. In FY 2001, the IRS accepted 34 percent of offers, while in FY 2009, it accepted only 25 percent of offers.<sup>109</sup>

Another way to look at this situation: At the beginning of FY 2009, there were 4,001,260 taxpayers with delinquent accounts.<sup>110</sup> During FY 2009, the IRS accepted only 10,665 offers. That means, roughly speaking, that the IRS accepted one offer for every 375 taxpayers with a delinquent account. It is also worth noting that the IRS placed the accounts of 1,030,748 taxpayers into CNC status last year.<sup>111</sup> Thus, the result of the IRS's restrictive offer policy is that the IRS did not collect *any* tax on many accounts, which undermines its revenue collection goals, and it is filing NFTLs against many of these taxpayers, which will undermine their long-term financial viability and ability to pay tax. I note that, remarkably, the IRS often files NFTLs against taxpayers while reviewing their offers, which does not exactly provide an incentive for taxpayers to try to settle their tax debts and is not an appropriate way to work with taxpayers who are trying to work with the IRS.

While some taxpayers are unresponsive to the IRS out of fear, preoccupation with other problems, or in some circumstances a willful desire to flout the law, most delinquent taxpayers are delinquent because they are struggling financially. If the IRS is collecting nothing from many of these taxpayers, surely it would be better to bring more of them back into compliance by accepting what they can afford and obtaining their pledge to remain in compliance in the future. It is a major failure of IRS collection policy that its offer in compromise program works with taxpayers in such a small percentage of cases. The IRS should do far more to ensure that the offer program is open for business to these taxpayers.

In January 2009, the IRS announced several steps to assist financially struggling taxpayers.<sup>112</sup> In connection with offers, it noted that "the equity taxpayers have in real property can be a barrier to an OIC being accepted," because with the sharp drop in housing prices, "the real-estate valuations used to assess ability to pay may not be accurate." To address these cases, the IRS announced it was "creating a new second review of the information." To date, this "second review" has not resulted in acceptance of a single offer in which property valuations were adjusted. The unit assigned to perform these "second reviews" has reviewed 11 offers and accepted three – and it did not adjust real property valuations in any of the accepted cases.<sup>113</sup>

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<sup>109</sup> The percentage of accepted offers is computed by dividing the number of offers accepted by the number of offer dispositions.

<sup>110</sup> IRS, *Collection Activity Report NO-5000-2, Taxpayer Delinquent Account Cumulative Report* (Mar. 2009).

<sup>111</sup> IRS, *Collection Activity Report NO-5000-149, Recap of Currently Not Collectible Report* (Oct. 1, 2009) (covering the period 10-01-2008 to 09-30-2009).

<sup>112</sup> IRS News Release, IR-2009-2, *IRS Begins Tax Season 2009 with Steps to Help Financially Distressed Taxpayers; Promotes Credits, e-File Options* (Jan. 6, 2009).

<sup>113</sup> SB/SE, Response to TAS Information Request (as of Feb. 2010).

In February 2009, the Deputy Commissioner stated in congressional testimony that the IRS would retain a consultant to review the offer program overall and assess what can be done to make the program more accessible to taxpayers.<sup>114</sup> Since that time, the IRS has, in fact, retained two consultants to assess the offer program and identify opportunities to attract more appropriate offers. However, those commitments and the work of the consultants have not yet produced results. As noted above, the IRS actually accepted fewer offers in FY 2009 than it had accepted in FY 2008.

Last month, the IRS announced a new series of steps to assist financially struggling taxpayers. According to the IRS announcement:

IRS employees will be permitted to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise. Normally, the standard practice is to judge an offer amount on a taxpayer's earnings in prior years. This new step provides greater flexibility when considering offers in compromise from the unemployed. . . . These immediate steps are part of an on-going effort by the IRS to ensure the availability of the Offer in Compromise program for taxpayers.<sup>115</sup>

It is not clear what impact this announcement will have, because IRS employees already have the flexibility to consider a taxpayer's current income and potential for future income when negotiating an offer in compromise, including where the taxpayer is unemployed. Internal Revenue Manual guidance in effect at least since 2005 states:

Some situations may warrant placing a different value on future income than current or past income indicates:

IF [a] taxpayer is temporarily unemployed or underemployed

THEN [u]se the level of income expected if the taxpayer were fully employed and if the potential for employment is apparent. Each case should be judged on its own merit, including consideration of special circumstances or [Effective Tax Administration] issues.<sup>116</sup>

An interim guidance memorandum issued on March 10, 2010, generally retains the above language.<sup>117</sup> It differs from existing guidance in that it explicitly states a taxpayer's current

<sup>114</sup> *IRS Assistance to Taxpayers Facing Economic Difficulties: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 111<sup>th</sup> Cong. (Feb. 26, 2009) (testimony of Linda E. Stiff, IRS Deputy Commissioner for Services and Enforcement, Internal Revenue Service).

<sup>115</sup> IRS News Release, IR-2010-029, *IRS Outlines Additional Steps to Assist Unemployed Taxpayers and Others* (Mar. 9, 2010).

<sup>116</sup> IRM 5.8.5.5(5) (Sept. 1, 2005).

<sup>117</sup> SB/SE, Memorandum from Director, Collection Policy, Control No. SBSE 05-0310-01, *Interim Guidance for Calculation of Future Income in Offer in Compromise Cases* (Mar. 10, 2010).

income will be used in analyzing his or her future ability to pay and provides several new examples to illustrate the principle.

While I am pleased the IRS has issued this interim guidance and has referred in its announcement to “an on-going effort by the IRS to ensure the availability of the Offer in Compromise program for taxpayers,” I remain concerned that the IRS has been unwilling to develop a more robust offer program. I have come to believe over years of seeing the IRS truncate this program that the Collection function possesses an institutional aversion to collection of less than 100 percent of the tax the IRS believes is owed regardless of the circumstances.

### **Recommendations**

- I recommend that the IRS adopt seven administrative recommendations that I included in my 2009 Annual Report.<sup>118</sup> These include reducing the enormous substantiation and documentation requirements currently required with the initial submission of an offer, reducing the number of steps a taxpayer must take to complete an offer application, and revising internal guidance to bring about the acceptance of a much greater number of appropriate offers.
- I recommend that Congress repeal the 20 percent down payment requirement upon the submission of an offer in compromise.<sup>119</sup>

### **C. IRC Section 6707A Should Be Amended Expeditiously to Ameliorate the Unconscionable Impact It Is Having on Taxpayers.**

Section 6707A of the Internal Revenue Code imposes a penalty of \$100,000 per individual and \$200,000 per entity for each failure to make special disclosures with respect to a transaction that the Treasury Department characterizes as a “listed transaction” or “substantially similar” to a listed transaction.<sup>120</sup> Although the penalty was originally designed to encourage the disclosure of corporate tax shelters, it has had the unintended effect of subjecting to Draconian penalties – in some cases over \$1 million – small businesses that have limited assets, derived little or no tax savings, and had no knowledge that they were entering into a corporate tax shelter. Consider the following:

<sup>118</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 39-40.

<sup>119</sup> See IRC § 7122(c).

<sup>120</sup> For a more detailed discussion of this issue, see National Taxpayer Advocate 2008 Annual Report to Congress 419-422 (Legislative Recommendation: *Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact*). For the definition of a “listed transaction,” see Treas. Reg. § 1.6011-4(b)(2).

- The penalty imposes “strict liability” – it applies without regard to whether the taxpayer has knowledge that the transaction has been listed and without regard to whether the transaction is reported correctly on the taxpayer’s return.<sup>121</sup>
- The penalty applies even if the taxpayer derived no tax savings from the transaction.<sup>122</sup>
- The penalty *must* be imposed by the IRS and cannot be rescinded under any circumstances.<sup>123</sup>
- Prior to assessment, the penalty may not be appealed in any court.<sup>124</sup>
- The taxpayer’s disclosure must initially be made twice – once with the IRS Office of Tax Shelter Analysis and again with the tax return for the year in which the transaction is first required to be disclosed.<sup>125</sup> A disclosure included with the taxpayer’s filed return, no matter how detailed, will not suffice by itself to avoid the penalty. After the first year in which the transaction must be disclosed, the taxpayer must continue to make disclosures with each filed return that reflects the transaction.
- A taxpayer that discloses a transaction may be subject to the penalty if the IRS deems the disclosure to be incomplete.<sup>126</sup>
- If a transaction is not “listed” at the time the taxpayer files a return but it becomes listed years later, the taxpayer becomes responsible for filing a disclosure statement and will be liable for this penalty for failing to do so. This is true even if the taxpayer has no knowledge that the transaction has been listed.<sup>127</sup>
- The penalty applies to each tax return the taxpayer files.<sup>128</sup>

<sup>121</sup> IRC § 6707A; Joint Explanatory Statement of the Committee of Conference accompanying H.R. 4520, 108<sup>th</sup> Cong. at 373 (2004).

<sup>122</sup> *Id.*

<sup>123</sup> IRC § 6707A(a) & (d)(1)(A). Section 6707A(a) provides that “[a]ny person who fails to [make the required disclosures] shall pay [the] penalty” (emphasis added). This language seems absolute, and the IRS to date has interpreted the provision as requiring it to impose the penalty in all circumstances described in the statute.

<sup>124</sup> IRC § 6707A(d)(2); *Smith v. Comm’r*, 133 T.C. No. 18 (2009) (finding the court lacked deficiency jurisdiction to redetermine penalties for failure to report involvement in a listed transaction).

<sup>125</sup> Treas. Reg. § 1.6011-4(a) & (e).

<sup>126</sup> Treas. Reg. § 1.6011-4(d).

<sup>127</sup> Treas. Reg. § 1.6011-4(e)(2). The requirement will cease to apply after the period of limitations on assessment for the final return reflecting the transaction has expired.

<sup>128</sup> IRC § 6707A; Treas. Reg. § 1.6011-4(e)(1); Joint Explanatory Statement of the Committee of Conference accompanying H.R. 4520, 108<sup>th</sup> Cong. at 373 (2004).

- The usual three-year statute of limitations does not apply.<sup>129</sup>

Thus, an individual who does business through a wholly owned S corporation may enter into a ten-year transaction that he believes is proper and that produces little or no tax savings – only to end up owing a penalty of \$3 million (*i.e.*, a penalty of \$200,000 on the S corporation and a penalty of \$100,000 on the individual taxpayer for each of the ten years).

This harm is not merely theoretical. This penalty has been imposed against small businesses in hundreds of cases, and as noted, the minimum amount of the penalty is now \$100,000 for an individual, and in practice, most taxpayers are facing penalties running many multiples higher. All agree this effect was unintended and is unconscionable. Further, I question whether this provision is constitutional on procedural due process grounds, because the penalty constitutes a significant deprivation and does not provide for a pre- or post-deprivation hearing. It must be fixed quickly.

On June 12, 2009, the Chairman and Ranking Member of this Committee and the Chairman and Ranking Member of the House Ways and Means Subcommittee on Oversight sent a letter to the Commissioner stating their commitment to modify the law and asking that, in the interim, the IRS use the discretion provided with its effective tax administration authority to suspend collection of IRC § 6707A liabilities in cases where the tax benefits resulting from a listed transactions are less than \$100,000 for individuals and \$200,000 in other cases. In response, the Commissioner agreed to impose a temporary moratorium on collection action and has extended it twice, but faced with an operative statute that requires the IRS to assess these penalties, the IRS is unlikely to extend the moratorium indefinitely based on a stated intention to revise the statute.

Last January the full Senate passed S. 2917, the Small Business Penalty Fairness Act, which would generally limit the penalty to a percentage of the tax savings realized. The Chairman and Ranking Member of the House Ways and Means Subcommittee on Oversight have introduced similar legislation – H.R. 4068, the Small Business Penalty Relief Act. In my testimony before that Subcommittee on February 16, I urged prompt passage of the legislation to prevent untold economic calamity for hundreds of small business owners and their families across the country.

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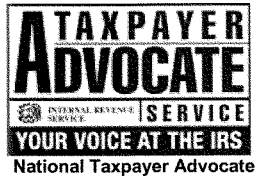
<sup>129</sup> IRC § 6501(c)(10) (providing that the statute of limitations will remain open with respect to an undisclosed listed transaction until at least one year after the earlier of (i) the date on which the taxpayer provides the required disclosure or (ii) the date on which a material advisor provides the name of the taxpayer to the Treasury Department in response to a request made under IRC § 6112(b)).

**Recommendation**

- I urge Congress to expedite final passage in both houses of S. 2917, H.R. 4068, or similar legislation as quickly as possible to address this most unfortunate and unintended situation.

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As part of our effort to reach the growing number of taxpayers who may need help from the Taxpayer Advocate Service, we have placed numerous educational products on social media sites such as Facebook (<http://www.facebook.com/YourVoiceAtIRS>) and YouTube (<http://www.YouTube.com/TASNTA>). This material includes a series of video messages that I recorded on topics such as liens, installment agreements, cancellation of debt income, offers in compromise, identity theft, and the Federal Payment Levy Program. These videos also appear on the Tax Toolkit (<http://www.taxtoolkit.irs.gov>), which contains information about basic tax responsibilities for all taxpayers, including those new to the federal tax system, taxpayers with limited English proficiency, and those with disabilities. These sites represent TAS's commitment to keeping taxpayers informed and tailoring our services to their constantly changing needs.

**Appendix A**

March 31, 2010

Control No: TAS-13.1-0310-003  
Expires: March 30, 2011**MEMORANDUM FOR TAXPAYER ADVOCATE SERVICE EMPLOYEES**

**FROM:** Nina E. Olson /s/  
National Taxpayer Advocate

**SUBJECT:** Interim Guidance on Recommending the Non-filing of Notices of Federal Tax Lien in Certain Situations

This memorandum is part of a series that consolidates and clarifies current guidance in different Internal Revenue Manual (IRM) provisions and TAS training materials.<sup>1</sup> The purpose of this memorandum is to help Case Advocates and Local Taxpayer Advocates think through, in the context of the existing guidance, how they should advocate on behalf of taxpayers with respect to the filing of a Notice of Federal Tax Lien (NFTL) in cases involving installment agreements (IAs), Currently Not Collectible (CNC) status, or offers in compromise (OICs). There are certain situations in which the IRM requires automatic NFTL filing without considering individual taxpayer facts and circumstances and without managerial review.<sup>2</sup> In these situations, TAS employees need to

<sup>1</sup> See, e.g., TAS, *Interim Guidance on Handling Collection Cases where Economic Hardship is Present but the Taxpayer has not Filed all Required Returns*, Control No. TAS-13.1-0110-001 (Feb. 28, 2010).

<sup>2</sup> For example, when the account is placed in CNC status, the IRM requires NFTL filing for any unpaid balance of \$5,000 or more, or if the IRS is unable to locate or contact the taxpayer, or the taxpayer is experiencing an economic hardship. IRM 5.12.2.4.1(1) (Oct. 30, 2009); IRM 5.19.4.5.2 (Apr. 26, 2006). The IRM requires the filing of an NFTL for non-streamlined IA accounts of more than \$5,000. IRM 5.19.1.5.5(19) (Dec. 4, 2009). Similarly, for example, an NFTL would normally be filed with OICs on unpaid balances of \$5,000 or more and the offer is being rejected or accepted with deferred payment terms. IRM 5.8.4.9 (Sept. 23, 2008).



investigate the case and apply the factors described in this memorandum to determine whether the filing of an NFTL is appropriate. TAS employees should advocate for the non-filing of an NFTL when it is appropriate based on the taxpayer's facts and circumstances. TAS employees **do not** make the actual lien determination.

### Background

Section 3421 of the IRS Restructuring and Reform Act of 1998 (RRA '98) provides that, where appropriate, a supervisor review the proposed lien filing, considering the amount due and the value of the taxpayer's assets.<sup>3</sup>

In addition, Internal Revenue Code (IRC) § 6323(j)(1) provides the IRS a **discretionary** mechanism for withdrawing the NFTL when one of the following criteria is met:

- (A) The IRS filed the NFTL prematurely or otherwise not in accordance with procedures;
- (B) The taxpayer entered into an installment agreement to satisfy the liability (unless the IA provides otherwise);
- (C) The withdrawal would facilitate collection; or
- (D) The withdrawal is in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States.<sup>4</sup>

In these situations, Case Advocates should advocate for the non-filing of a lien by arguing that the IRS should not file an NFTL because it would meet the criteria for withdrawal once filed.

### When is a Lien Determination required?

IRM 5.19.1.5.5 describes the four (4) types of installment agreements that TAS employees have the delegated authority to accept: (1) streamlined (up to \$25,000), (2) non-streamlined (up to \$100,000), (3) guaranteed (up to \$10,000), and (4) in-business trust fund express (up to \$10,000). An NFTL determination is not required for installment agreement types (1), (3), and (4), but a lien determination is required for non-streamlined installment agreements (NSIAs). A lien determination is also required when placing an account into CNC status per IRM 5.12.2.4.1(1) if the balance owed is over \$5,000. Similarly, IRM 5.8.4.9 requires a lien determination in OIC cases where the unpaid balance of assessment is \$5,000 or more and the offer is being rejected or accepted with deferred payment terms.

### Determining when to advocate for the non-filing of an NFTL

In situations where the taxpayer's individual facts and circumstances meet the criteria in IRM 5.12.2.4.2(1)-(8) for not filing or deferring an NFTL, or one of the IRC § 6323(j)(1)

<sup>3</sup> RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 685, 758 (1998).

<sup>4</sup> IRC § 6323(j); Treas. Reg. § 301.6323(j)-1.

requirements for an NFTL withdrawal, Case Advocates should advocate against the filing of an NFTL.<sup>5</sup>

When making the decision to request that the operating division refrain from filing an NFTL, you must carefully evaluate all of the facts and circumstances including the following:

- Compliance History. Has the taxpayer had prior balances due? If so, how recently? Would the NFTL filing jeopardize the taxpayer's ability to comply with the tax laws in the future? The fact that a taxpayer has never had a delinquent tax account before or has not had a delinquent account in recent years should weigh significantly in favor of refraining from filing an NFTL.
- Reasons for noncompliance. Is the taxpayer's noncompliance attributable to a one-time unusual or catastrophic event, such as a heart attack, hurricane, or a loss of job? Are there extenuating circumstances that may contribute to the noncompliance? The following situations are examples of such extenuating circumstances: after a stroke, the taxpayer fell behind in estimated tax payments, or after the loss of a job, the taxpayer incurred a ten percent penalty for early withdrawal from an IRA. In such situations, where the taxpayer has been historically compliant except for a one-time catastrophic event, filing of an NFTL will harm the taxpayer's ability to repay his or her tax liability and remain compliant in the future.
- Hamper Collection. Will the filing of an NFTL hamper the collection of tax? If not filing the NFTL will significantly impair the IRS's ability to collect the tax, this factor should weigh in favor of filing an NFTL.
- Undue Harm to the Taxpayer that Reduces Collection Potential. Consider whether the filing of the NFTL will harm the taxpayer's financial viability, thus reducing collection potential, *i.e.*, the filing prevents the taxpayer from obtaining or retaining employment or obtaining the financing necessary for a business taxpayer to remain in business. If the filing of the NFTL unduly harms the taxpayer and reduces collection potential, this factor should weigh in favor of refraining from filing an NFTL.
- Payment before the Collection Statute Expiration Date (CSED). Will the proposed Installment Agreement fully pay the taxpayer's balances owed prior to the expiration of the CSED? If the taxpayer can pay in installments before the CSED, this factor will weigh in support of a determination not to file an NFTL.

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<sup>5</sup> Under IRM 5.12.2.4.2(8) a taxpayer may also submit a faxed request for non-filing of the NFTL if the revenue officer has contacted the taxpayer by phone or in person. Such a request may include the reasons why the taxpayer wishes the NFTL not to be filed, which the RO should note in the case history.

- Existence and Value of the Assets. Are there assets, including real and personal property, to which the NFTL can attach? Is the taxpayer likely to acquire assets in the future? If so, determine the net equity in the assets. Research IRS databases and available third-party information concerning the taxpayer's assets, income, and the value of the equity in the assets. Where appropriate, request and review taxpayer financial information, including Forms 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*, or Forms 433-B, *Collection Information Statement for Businesses*. If you have access, search assets on Accurint, a web-based asset locator system. Seek ROTA assistance if necessary to assist you with equity determination. If the NFTL will not attach to property with significant value, or if the taxpayer needs the equity to cover an anticipated, necessary expense, this factor will weigh in favor of a determination to refrain from filing an NFTL.

In analyzing your case, consider all the factors and determine whether the NFTL filing is appropriate. Remember that this is not a complete list of factors, and that you should consider other relevant factors depending on the facts of your case.

**Note:** If at any time you need assistance in determining whether it is appropriate to request the non-filing of an NFTL or whether the taxpayer owns assets, please contact a ROTA to discuss the individual facts and circumstances of your case. ROTAs have access to Accurint.

#### **Example 1**

You have been assigned the case of Taxpayer A, who owes \$10,000 in income tax, penalty, and interest for 2008. The compliance history shows that Taxpayer A has been compliant in recent years and any past delinquencies were promptly resolved. A review of the taxpayer's Collection Information Statement (CIS) shows that he can afford \$150 per month. It will take the taxpayer over 60 months to pay the full balance, but the debt will be paid prior to the expiration of the CSED. The CIS also shows that Taxpayer A has no assets except his home, which has a fair market value (FMV) of \$350,000 and a first mortgage of \$347,000. Thus, there is no equity in the home. The taxpayer has requested a non-streamlined installment agreement to fully pay the tax debt; although Taxpayer A owes less than \$25,000, the liability will not be paid within 60 months.

In general, you should advocate for the non-filing of the NFTL as this taxpayer has been compliant in the past, the account will be paid prior to the expiration of the CSED, and the harm to the taxpayer would outweigh the benefit to the government because the taxpayer has no equity to which the lien could attach.

#### **Example 2**

You have been assigned the case of Taxpayer B. The facts are the same as in example 1 above, but the taxpayer has equity of \$200,000 in the house, *i.e.*, sufficient equity against which to borrow. However, the taxpayer does not want to liquidate or

borrow against the house and has requested a non-streamlined IA to fully pay the liability; although Taxpayer B owes less than \$25,000, the agreement will not be paid within 60 months.

In these circumstances, the government's interests may outweigh the harm to the taxpayer who refuses to borrow against the property to pay the tax liability. Thus, you conclude based upon an evaluation of all of the facts and circumstances that you cannot recommend that the IRS refrain from filing an NFTL. You will prepare an OAR requesting that the OD make the lien filing determination. The taxpayer will have a right to a CDP hearing if the IRS files the NFTL.

### **Example 3**

The facts are the same as in example 2, but the taxpayer has a special-needs child and must utilize the equity in the house to provide for ongoing medical and other care for the child. In these circumstances, you should advocate that the IRS refrain from filing an NFTL.

### **Example 4**

Taxpayer C, who is self-employed, owns an insurance business with an unpaid combined income and employment tax liability of \$62,500 for tax years 2008 and 2009. The taxpayer filed Form 911 stating that he just received a notice and demand for payment of the outstanding tax liabilities and is worried about the IRS filing an NFTL. The taxpayer's financial information shows a substantial decline in gross receipts and an increase in unpaid accounts receivable. The taxpayer has requested that the IRS accept an offer in compromise. If the IRS files the NFTL, the taxpayer will lose his employment because the state insurance licensing board requires insurance agents to have a clean credit history. You determine the OIC is acceptable according to the IRM guidelines. You also determine that the NFTL will not be in the best interests of the taxpayer and the United States because it will hamper collection and future tax compliance if the taxpayer cannot retain his employment.

In these circumstances, you should advocate that the IRS accept the OIC and that the IRS refrain from filing an NFTL. The filing of the NFTL will hamper collection, prevent the taxpayer from maintaining employment and staying in business, and jeopardize the taxpayer's ability to comply with the tax laws in the future.

### **Sending an Operations Assistance Request (OAR)**

If after weighing all facts and circumstances of your case, you have determined that TAS needs to advocate for the non-filing of an NFTL, elevate the case to your Local Taxpayer Advocate (LTA) and simultaneously forward the OAR to the Operating Division (OD) requesting that the IA, OIC, or CNC be accepted without filing an NFTL. In cases where you are accepting a non-streamlined installment agreement based on

delegated authority,<sup>6</sup> accept the IA and simultaneously forward the OAR requesting the non-filing of an NFTL. In all cases, the OAR should request an OD manager's review of any determination denying TAS's recommendation not to file the NFTL. If the OD does not agree with your recommendation not to file the NFTL in any of these situations, immediately notify your LTA to discuss the case with the OD manager. If the OD manager disagrees with the non-filing of an NFTL, the LTA should promptly consider issuing a Taxpayer Assistance Order (TAO).

When sending an OAR, request **expedited handling**. Including the following language in the OAR will support your recommendation and clarify the issue:

*Due to the above taxpayer's financial situation, we are recommending [insert - the account be placed into CNC status / the offer in compromise be accepted / acceptance of the IA]. Due to the amount of the liability, a Lien Determination is required.*

*Based on a thorough review of the taxpayer's information (including IRS and available third party information) concerning their assets, income, and the value of the equity in the assets [insert specific facts and circumstances regarding the taxpayer], TAS has concluded that [insert all that applies: the NFTL will not attach to property / the NFTL will hamper collection / the harm to the taxpayer will outweigh the benefit to the government/ or the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future]. Therefore, we are recommending that the IRS refrain from filing an NFTL so long as the taxpayer remains compliant.*

*If you do not agree with this recommendation, please have **your manager** immediately contact the **Local Taxpayer Advocate** (Insert name and phone #) to discuss further.*

In cases where after considering the relevant factors, TAS decides not to recommend that the OD refrain from the filing of the NFTL, forward the OAR to the OD to request that the OD make the lien filing determination.

#### **Issuing a Taxpayer Assistance Order (TAO)**

If the OD does not agree to refrain from filing the NFTL, evaluate the reasons given in support of filing the NFTL. If you still disagree, elevate the case to the LTA to consider issuing a TAO.<sup>7</sup> If the LTA decides to issue a TAO, follow the procedures in IRM 13.1.20, *TAS Taxpayer Assistance Order Process*. The TAO should order the IRS to refrain from filing the NFTL and must explain why, based on the law and the facts of the case, the filing is not appropriate.

When preparing the TAO, you should include the following language, where appropriate:

<sup>6</sup> Per Delegation Order 13-2 (Rev. 1), TAS has the authority to accept installment agreements under the procedures contained in IRM 5.19.1.5.4 (or successor provisions).

<sup>7</sup> The LTA may also consider pursuing an appeal under CAP. See IRM 5.19.4.5.2(12)(b) which provides that "if a taxpayer expresses serious objections regarding the lien filing . . . treat it as a Collection Appeal Program (CAP) before filing the lien."

*Based on a thorough review of the taxpayer's information (including IRS and available third party information), the criteria for not filing a lien found in IRM 5.12.2.4.2 have been met. [Discuss how the various criteria listed in this IRM have been established in this case.] Therefore, the NFTL should not be filed so long as the taxpayer remains compliant.*

Please contact James Book, Technical Analysis and Guidance, at (816) 291-9944, for further information.

**Senate Finance Committee Hearing**  
**“Filing Season Update: Current IRS Issues”**  
**April 15, 2010**  
**Responses to Questions for Nina E. Olson,**  
**National Taxpayer Advocate, Internal Revenue Service**

**Questions from Senator Baucus**

- 1. In a recent testimony, you stated that the IRS is not meeting the needs of low-income taxpayers. In addition, the use of the Free-File program is down by about 5 percent this year.**
  - **What additional steps can the IRS take to provide services to low-income populations?**

First, the IRS should develop a comprehensive, research-based strategy to address the needs of low income taxpayers.<sup>1</sup> The IRS should collaborate with the Taxpayer Advocate Service (TAS) to conduct this research and consult with the Low Income Taxpayer Clinics (LITCs) to develop a low income taxpayer strategy that addresses the needs of individuals and Small Business/Self-Employed (SB/SE) taxpayers as well. This strategy should extend beyond pre-filing and filing activities and encompass IRS compliance and enforcement initiatives. Absent such a strategy, the IRS cannot adequately tailor programs to meet the needs of low income taxpayers.

The IRS should make more use of its authority under the Offer in Compromise (OIC) program. At present, the IRS either does not encourage or rejects offers from low income taxpayers that would allow these taxpayers to make a fresh start, instead placing these taxpayers into “currently not collectible” status and filing liens against their property. These actions further degrade the credit ratings of these taxpayers and leave them unable to improve their economic futures. Low-dollar OICs could bring these taxpayers into compliance. They would not be weighed down by nagging tax debts that accrue penalties and interest and that they likely would never be able to pay in full.

The IRS should expand the work of the Earned Income Tax Credit (EITC) program office to take a holistic approach to the EITC. IRS compliance employees need special training in interviewing taxpayers during EITC audits. The IRS also should design its audit process to recognize the difficulty low income taxpayers face in navigating the IRS and fulfilling its demands. These taxpayers are more likely to benefit from phone calls from IRS employees explaining what is required of them than from IRS correspondence that many find incomprehensible. Additionally, the IRS should pilot a

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<sup>1</sup> See National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2, 107 (Research Report: *IRS Earned Income Credit Audits – A Challenge to Taxpayers*). More than 70 percent of taxpayers surveyed for this report prefer to communicate with the IRS through a manner other than correspondence when facing EITC audits.

face-to-face EITC audit program to determine whether low income taxpayers receive better results when they (or their representatives) can ask questions in person as the audit proceeds.<sup>2</sup>

Regarding electronic free filing, the National Taxpayer Advocate has advocated for years for the IRS to place a basic, fill-in template on its website to permit taxpayers to prepare and directly file their own returns for free.<sup>3</sup> The IRS recently implemented a version of a free "fillable form." This product is a good start, but its functionality could and should be improved with the addition of many more forms, importation of data from one form to another, and the ability to save a copy of the return to the taxpayer's own computer.

- **What additional resources, if any, does IRS need to adequately meet the needs of low-income taxpayers?**

The IRS needs more resources for LITCs, which perform a crucial service in tax administration by providing representation to those who would otherwise not be able to afford it, especially in matters including collection matters and in EITC audits. A review of all EITC audits in 2004 found that represented taxpayers fared substantially better than others without representation. Nearly twice as many audited taxpayers with representation were found eligible for the EITC as compared to unrepresented taxpayers.<sup>4</sup> Similarly, taxpayers with representation retained, on average, 45 percent of the EITC they had claimed compared with 25 percent for taxpayers without representation – nearly twice as much.<sup>5</sup> Increased funding for the LITC matching grant program would permit more clinics to be funded to help meet the needs of low income taxpayers. Additionally, increased funding would permit clinics to open in historically underserved areas where there are significant populations of low income taxpayers.

**2. You have noted that the IRS's toll-free telephone service is insufficient to meet taxpayer needs.**

- **What effect does the current level of service have on the ability of taxpayers to meet their tax responsibilities and voluntary tax compliance?**

<sup>2</sup> See, e.g., IRS Oversight Board, *Customer Service and Channel Preference Survey*, 2006; National Taxpayer Advocate 2006 Annual Report to Congress, vol. 2 (*Study of Taxpayer Needs, Preferences, and Willingness to Use IRS Services*); IRS, *Taxpayer Assistance Blueprint*, 2006.

<sup>3</sup> National Taxpayer Advocate 2009 Annual Report to Congress 92.

<sup>4</sup> See National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 (Research Report: *IRS Earned Income Credit Audits – A Challenge to Taxpayers*).

<sup>5</sup> *Id.*



As discussed in the National Taxpayer Advocate's 2009 Annual Report to Congress, the quality of service on the IRS toll-free lines has declined significantly in recent years. During the 2007 filing season, the IRS attained a Customer Service Representative Level of Service (CSR LOS) of 83 percent on its toll-free lines.<sup>6</sup> During the 2008 filing season, the CSR LOS declined to 77 percent.<sup>7</sup> During the 2009 filing season, the CSR LOS dropped further to 64 percent with a 519-second average speed of answer (ASA), which means that the average caller sat on hold for nearly nine minutes.<sup>8</sup> These figures present a substantial barrier to taxpayers who are trying to get an answer so they can file their tax returns accurately and timely. When taxpayers cannot get through on the toll-free lines, they and the IRS face significant repercussions. For example, a taxpayer's inability to get answers could cause him or her to file a return containing errors, which in turn could lead to an IRS notice, audit, or collection actions.<sup>9</sup>

- **To what extent might taxpayer access to personal tax account information through the Internet reduce call volumes?**

If designed properly, Internet access to account information may provide an effective way to communicate with some taxpayers and reduce certain types of telephone calls to the toll-free lines. Electronic taxpayer accounts may be particularly useful for tasks such as obtaining forms and publications that are relevant to a taxpayer's particular circumstance.<sup>10</sup> However, taxpayers may be less likely to use this medium to obtain answers to more complex questions, such as tax law or specific account issues. For instance, one survey showed 51 percent of taxpayers preferred to call the IRS to pose a tax law question, compared to only 21 percent who preferred the website.<sup>11</sup> In addition, a number of taxpayers lack access to or have difficulty navigating the Internet.<sup>12</sup> For these taxpayers, the toll-free lines are essential. According to research, the key to customer service is providing taxpayers with options for

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<sup>6</sup> IRS, JOC Enterprise Telephone Data, Enterprise Snapshot.

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

<sup>8</sup> Treasury Inspector General for Tax Administration, Ref. No. 2009-40-127, *Unplanned Call Demand Reduced Toll-Free Telephone Access for the 2009 Filing Season 5* (Sept. 8, 2009).

<sup>9</sup> National Taxpayer Advocate 2009 Annual Report to Congress 7.

<sup>10</sup> See IRS, Taxpayer Assistance Blueprint Phase 2 (2007) at 48.

<sup>11</sup> IRS Oversight Board, *Channels Survey* (Nov. 2006) at 15.

<sup>12</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 4-16 (Most Serious Problem: *The Needs of Low Income Taxpayers Are Not Being Adequately Met*); National Taxpayer Advocate 2006 Annual Report to Congress, vol. 2, 2, 18 (Most Serious Problem: *Study of Taxpayer Needs, Preferences, and Willingness to Use IRS Services*).

communicating with the IRS.<sup>13</sup> Therefore, the IRS should continue to explore enhancements to its e-services, while striving to improve its toll-free lines.

- **What opportunities have you identified for the IRS to expand taxpayer services through its web site and automated telephone service?**

Both the Internet and the IRS toll-free lines are essential components of customer service. Self-service Internet applications such as *Where's My Refund?* have been particularly successful. In fact, the use of this application increased from 39.2 million visits in 2007 to 54.4 million in 2009. This growth enabled skilled toll-free assistors to focus on resolving more complex customer calls.<sup>14</sup> Expansion of these self-service Internet applications may enable even more assistors to focus on the more challenging calls. The National Taxpayer Advocate offered several recommendations in her 2009 Annual Report that would enable the IRS to improve and expand its e-services. These recommendations include the following:

- Continue to enhance the design of the website to make information easier to find and manage, including accessibility options for taxpayers with disabilities and aging taxpayers;
- Conduct usability studies with a particular focus on individual taxpayer segments identified as likely to use or migrate to the electronic channel and on the use of self-assistance tools;
- Drive improvements to content design to enhance the ability of taxpayers and partners to receive requested information and services on the first try;
- Expand available electronic interactions between taxpayers, practitioners, and the IRS by providing account management and the ability to resolve account issues securely over the Internet (including receiving electronic transcripts of accounts);
- Develop an authentication strategy that enables all users to perform account-related services by logging into the website once; and
- Decrease the time burden of using multiple account-related online tools, while protecting taxpayer privacy.<sup>15</sup>

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<sup>13</sup> In almost every situation, taxpayers prefer in-person assistance to self-help options like automated phone systems or the Internet. Further, taxpayers overwhelmingly prefer in-person assistance to self-help options when it comes to account-related issues. See IRS, *Taxpayer Assistance Blueprint Phase 2* (2007) at 40. Another survey showed that the toll-free line was by far the preferred option, by a margin of almost two to one. See IRS Oversight Board, *Channels Survey* (Nov. 2006) at 15.

<sup>14</sup> IRS, JOC Internet Refund-Fact of Filing (IRFOF) file.

<sup>15</sup> National Taxpayer Advocate 2009 Report to Congress 85.

Considering and implementing these recommendations in an e-service strategy will produce Internet services that are well designed to meet the needs of taxpayers and are easy for all taxpayers to navigate and use, will expand the type of tasks that can be performed, and will increase efficiency for both taxpayers and the IRS.

At the same time, we must remember that some taxpayers will not use the Internet or will use it only for certain tasks. This is one reason why it is also essential for the IRS to improve service on the toll-free lines and in its Taxpayer Assistance Centers. The National Taxpayer Advocate's first concern regarding the lines is whether a taxpayer can reach an IRS employee within a reasonable time. As mentioned above, the rate at which taxpayers can get through has dropped precipitously in recent years, making it more difficult for millions of taxpayers to obtain answers to their tax questions. Thus, an overriding challenge the IRS faces is to answer a higher percentage of calls and reduce hold times.

**Questions from Senator Hatch****1. Ms. Olson, Can you please describe the biggest difficulties taxpayers face when dealing with the IRS?**

This year, the most serious problems encountered by taxpayers include the following:<sup>16</sup>

- IRS toll-free telephone service is inadequate to meet taxpayer needs. Recently, the quality of service on toll-free lines has declined significantly. When taxpayers cannot get through on the toll-free lines, they may file erroneous returns, which in turn could lead to audit or collection work that the IRS could have avoided through better toll-free service.
- IRS lien filing policies are unnecessarily harming taxpayers without maximizing tax compliance – in violation of the intent of applicable provisions of the IRS Restructuring and Reform Act of 1998. Generally, tax liens reduce a taxpayer's credit score and can destroy the taxpayer's financial viability, while the revenue benefits of IRS lien filings appear limited. In particular, a study conducted by the Taxpayer Advocate Service shows that the IRS cannot accurately measure the effectiveness of notices of federal tax lien filings. Moreover, legislative history shows that Congress wanted more managerial review of lien filings, yet the IRS is now requiring less managerial review. The IRS rarely withdraws tax liens despite explicit statutory authorization to do so and despite the fact that a lien "withdrawal" is far less damaging to taxpayers than a lien "release."
- Several legislative changes would strengthen the IRS's recently announced tax return preparer initiative. Specifically, Congress should consider imposing due diligence requirements that relate to identified areas of significant noncompliance and enhancing monetary sanctions under existing preparer penalties.
- The IRS Office of Appeals' efficiency initiatives have not improved taxpayer satisfaction or confidence in Appeals. While Appeals has reduced time spent resolving certain disputes between taxpayers and the IRS, customer satisfaction ratings have declined.
- The IRS lacks a servicewide e-services strategy. While the IRS has developed a significant number of online tools to assist taxpayers, proliferating online applications without an overarching strategy could become inefficient.
- The IRS is not meeting the needs of low income taxpayers, particularly in the compliance and enforcement context. During the 2010 tax filing season, a significant number of returns claiming the Making Work Pay (MWP) credit, a recently enacted provision designed especially to benefit lower income taxpayers, have been rejected due to improper reporting of Economic Recovery Payments (ERPs) and various processing problems. In particular, the IRS did

<sup>16</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 1-306.

not anticipate the need for a method for taxpayers and practitioners to verify the receipt and amount of ERPs. Regarding a long-standing provision for low income taxpayers, the earned income tax credit (EITC), if a claimant owes a past tax debt, the IRS withholds up to 100 percent of any current refund, undermining the purpose of the EITC and pushing the taxpayer deeper into poverty. More generally, such refundable credits and other social programs benefiting especially low income taxpayers, when run through the tax code, raise questions about the sufficiency of IRS resources. This situation suggests that the IRS's dual duties – collecting taxes and administering social programs -- should be reflected in a revision to its mission statement.

- U.S. taxpayers located or conducting business abroad face significant compliance challenges due to complex and interactive provisions of U.S. and foreign tax law.
- The IRS's examination strategy fails to maximize voluntary compliance through its correspondence audit program or at the local level. Generally, the IRS does not know if it is using state and local data effectively to maximize voluntary compliance and lacks a comprehensive "income" database that could help identify underreporting and improve audit efficiency. The IRS does not have a significant audit program focused on detecting the omission of gross receipts. Finally, the IRS has delayed minor tax form changes that would promote voluntary compliance and increase audit efficiency.
- Collection practices need improvements. First, despite IRS commitments to improve accessibility of the offer in compromise program that could assist financially struggling taxpayers, the IRS last year accepted the lowest number of offers in a decade. Second, IRS policies and procedures regarding expiration dates of collection statutes of limitation adversely affect taxpayers. Finally, the IRS's approach toward taxpayers during and after bankruptcy may impair their "fresh start" and future tax compliance.
- Tax administration needs improvement in various ways. First, Ponzi schemes present challenges for taxpayers and the IRS. Second, IRS power of attorney procedures often adversely affect the representation many taxpayers need. Third, the IRS mismanages joint filers' separate accounts. Fourth, the IRS should conduct targeted research about and increase collaboration with tax-exempt organizations to better meet their needs. Fifth, the IRS should develop an in-house cognitive research lab to understand taxpayer behavior and devise more effective products and programs.

## 2. What can Congress do to assist taxpayers in filing taxes?

Congress can assist taxpayers in filing returns in several ways. First, Congress can vastly simplify the Internal Revenue Code, which in turn would simplify the preparation of tax returns. While this is obviously easier said than done, something is seriously wrong with a tax system so complex that a significant majority of taxpayers lack either

the ability or the time to comply with it on their own. In my 2008 Annual Report to Congress, I identified the complexity of the tax code as the #1 most serious problem facing taxpayers.<sup>17</sup>

Second, Congress could provide additional funding for taxpayer services, particularly outreach and education, to enable the IRS to better meet taxpayer needs. After adjusting for inflation, funding for taxpayer services has declined by nine percent since FY 2004. At the same time, the IRS's resources have been stretched thinner and thinner as Congress has charged the IRS with administering an increasing number of social benefit programs, including Economic Stimulus Payments, the Making Work Pay credit, the First-time Homebuyer Credit, and a variety of provisions relating to health care reform. As a result, the IRS's ability to answer taxpayer phone calls, answer correspondence, and perform other taxpayer service functions has declined markedly.

Third, Congress could reiterate and clarify the policy within the IRS Restructuring and Reform Act of 1998 that contemplated electronic filing of tax returns through the IRS.<sup>18</sup> In particular, the IRS should develop a direct filing portal to provide a free, Government-sponsored method to file electronic tax returns as well as an on-line account management program for taxpayers to monitor their own accounts and resolve issues securely over the Internet.<sup>19</sup>

Fourth, Congress could improve upon the IRS tax return preparer initiative by legislating due diligence requirements that relate to identified areas of significant noncompliance and enhanced monetary sanctions under existing preparer penalties. Given that approximately 60 percent of individual taxpayers and 80 percent of small business taxpayers hire preparers,<sup>20</sup> these professionals should be well regulated.

Fifth, Congress could provide additional grant funding for the Volunteer Income Tax Assistance (VITA) program, Tax Counseling for the Elderly (TCE), and Low Income Taxpayer Clinics (LITCs) to better serve a low income taxpayer caseload that has expanded during the economic recession and to provide assistance in currently underserved areas with significant populations of low income taxpayers.

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<sup>17</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 3-14 (Most Serious Problem: *The Complexity of the Tax Code*).

<sup>18</sup> See H.R. Rep. No. 105-599 (1998) at 235.

<sup>19</sup> National Taxpayer Advocate 2009 Annual Report to Congress 109.

<sup>20</sup> IRS Compliance Data Warehouse, Individual Returns Transaction File, Tax Year 2007 (Aug. 2009); IRS, Pacific Consulting Group, *SB/SE Customer Base Report, Covering Tax Year 2008* (Aug. 2009).